Ceylon Tea Services

A Short Case Prepared by Professor Heather Elms

Note: This case is an annotated version of “A Sri Lankan Underdog Battles Global Tea Giants.” (Bajaj, V., 2010, New York Times, January 9.)

“COLOMBO, Sri Lanka — Merrill J. Fernando’s eyes lit up one recent morning when his son Dilhan handed him a box of Twinings Pure White Tea. He quickly ripped open a teabag and spilled its contents onto a piece of paper. Then he asked for some green tea, which Dilhan delivered on another piece of paper. Mr. Fernando beamed as he put the samples side by side. They looked similar but were starkly different from the silvery white tea produced by his company, Dilmah, which is sold in supermarkets for nearly four times the price of Twinings.¹ ‘All the brands without exception sell as white tea either 99 percent black tea or green tea with one piece of white tea,’ Mr. Fernando, 79, said ruefully. ‘This is what we are up against. This is what the consumer is up against. But this is part of normal trade, and I have begun to accept it.’ Twinings said it used a Chinese white tea variety known as Bai Mudan in its tea bags and the more exclusive silver needle variety, which is similar to Dilmah’s white tea, in its loose leaf tea.

Mr. Fernando has relished his role as the underdog battling the giants of the global tea business. In the last two decades, he has built Dilmah into one of the world’s largest independent tea companies and one of the best-known Sri Lankan brands by selling tea that is critically acclaimed and more expensive than the competition. His company’s story symbolizes the path that other Sri Lankan businesses and industries have had to follow to compete with the likes of China and India, which have lower costs of production and the advantage of size.² To attract business, Sri Lankan companies have become specialists and producers of affordable yet exclusive products. In apparel, for instance, producers here have established themselves as a go-to source for lingerie and sportswear so they do not have to compete on cheaper clothes directly with low-cost mass producers like Bangladesh and China. ‘To compete with the Chinese juggernaut in particular, the Sri Lankan strategy has been to go into niches like lingerie for Victoria’s Secret,’ said Razeen Sally, an expert on the Sri Lankan economy who is co-director of the European Center for International Political Economy in Brussels. In tea, Sri Lanka was the world’s largest exporter as recently as 2004, but it lost significant market share as governments and companies in Kenya and China made a big push to produce low-cost tea, and as green tea became more popular. Today, Sri Lanka exports about $1.3 billion in tea.

Mr. Fernando spent much of his career selling tea to big companies like Lipton³ and Tetley⁴. But in the 1970s, he noticed that buyers in the United States, Europe and Australia had started to buy less Sri

¹ Note that Twinings, Britain’s oldest tea brand (Ricketts, 2006), is owned by Associated British Foods, a $15B diversified UK-HQd food company with a 2008 net profit margin of 4.3% (Hoovers, 2010a) which recently launched a $5M print campaign meant to appeal to ‘younger, affluent consumers ‘who treat tea as one of life’s little luxuries,’ said Michael Cobb, marketing director of Twinings, Clifton, N.J. “The brand had become stodgy, aloof and unapproachable.” (Reyes, 2006.)
² Note, however, that while India is the world’s largest tea producer, it is also the largest tea consumer and the vast majority of the tea it produces is consumed locally, not exported. China also consumes most of the tea it produces. (Scott, 2009). (Roman) Scott is Group Managing Director of Calamander, a private equity firm that has invested in Sri Lanka for the last 12 years.
³ Lipton is owned by Netherlands-HQd Unilever, a $56B diversified food and personal care products company with a 2008 profit margin of 13% (Hoover’s, 2010b). Unilever recently committed to produce all of its tea in a sustainable manner, and has engaged the Rainforest Alliance to certify its tea estates (Lipton, 2010).
Lankan tea, blending it with cheaper teas from other countries. Those companies’ profits jumped, but growers, producers and traders in Sri Lanka were devastated. ‘Unless I got into branding and marketing,’ he said, ‘I would have been out of the business in two or three years.’ Dilmah, named after his sons Dilhan and Malik, who now help run the company, positioned itself as a seller of pure Sri Lankan, or Ceylon, tea that was not blended with other teas. But most foreign supermarket operators and customers had never heard of Dilmah and it was hard to persuade them to take a chance on the upstart, said Jaliya Wickramasuriya, Sri Lanka’s ambassador to the United States and a former Dilmah executive. ‘It was very difficult to even get an appointment with the big chains,’ he said. Mr. Fernando’s break came in the mid-1980s when an Australian supermarket chain, Coles, gave him an order for tea that carried the store’s brand. Dilmah has since expanded across much of the globe, including recently the United States. The research firm Datamonitor estimates it is the sixth-largest tea brand in the world now. In the six months ended in September [2009], Ceylon Tea Services, Dilmah’s parent company, earned $5.2 million on $19.7 million in revenue. That was up from profits of $1.3 million, on $18.6 million in revenue the year before, when the company’s earnings were hurt by a fall in the value of the Australian dollar.

Dilmah has also expanded into tourism, by turning four old tea plantation bungalows in central Sri Lanka into five-star guest houses known as Ceylon Tea Trails. The company plans to add two more bungalows and build 10 timeshare villas nearby. The company has opened ‘tea bars’ where it offers tastings and classes about how to make, drink and appreciate tea, much as wineries do. These efforts are aimed at showing consumers that its tea is worth the extra cost. Dilmah’s white tea, for instance, cost $11 for a box of 10 bags while a box of Twinings costs about $3. (White tea costs more than black or green tea because it is made from a smaller part of the plant and has more antioxidants.)

The Sri Lankan tea industry has been slow to change in some important ways. Many of its tea bushes, for instance, have low yields because they are decades past their prime and need to be replanted, which is expensive, said Hasitha de Alwis, director of promotion for the Sri Lanka Tea Board. The country has also shunned automation to preserve the quality of its tea. While most producers in Kenya and India make black tea using a speedy manufacturing process known as cut, turn and curl, Sri Lanka favors a traditional approach that takes longer to produce more varieties.  

Most tea here is also hand-plucked by small teams of Tamil women who are descendants of Indians who were brought to the island 150 years ago by the British. After years of struggle for higher wages and better working conditions, Sri Lankan estate workers are now better paid than laborers in India and elsewhere, though many often still live in small, rundown houses. A recent labor agreement increased wages by about 40 percent; most workers earn $3.50 to $5 a day. That increase and an estimated 15

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4 Tetley is owned by Tata Tea, a $208M India-HQd company with a 2008 profit margin of 12% (Tata Tea, 2010), which is in turn owned by Tata Group, a $71B India-HQd, diversified company with a 2009 profit margin of 2% (Hoovers, 2010c). Tetley is a member of the Ethical Tea Partnership, which assures living and working conditions on tea estates (Tetley, 2010).

5 Ceylon Tea Services is traded on Sri Lanka’s Colombo Exchange. It reported an 11% profit margin on revenues of $39M for the year ending March, 2009 (Ceylon Tea Services, 2008/9: 2). ‘The principal activities on the company are to manufacture, export and market tea bags and packets under the brand name ‘Dilmah.’’ (Ceylon Tea Services, 2008/9: 22).

6 Scott (2009) notes that the machinery is 50-100 years old.

7 Scott (2009) notes that by Western standards, the tea is also essentially organic.

8 The Tamil Tigers, a radical separatist group formally identified as a terrorist organization by multiple states, was finally overwhelmed by the Sri Lankan government in May, 2009—following a war that began in 1983 and has taken more than 60,000 lives and displaced possibly a million people in the meantime (New York Times, 2009). Scott (2009) notes that for the last 6 years, Sri Lankan economic growth averaged 6.5%, making it one of the strongest performing economies in the world, and estimates 1.5-2% additional growth associated with the end of hostilities.
percent drop in production because of inadequate rainfall have helped drive up prices at Colombo’s tea auctions by 100 percent in the last 12 months. Plantation companies that manage estates and a foundation funded by Mr. Fernando say they have spent millions to improve the quality of education, housing and health for plantation workers. Still, industry and labor officials expect a severe labor shortage in the coming years because many children of plantation workers are not interested in working in tea fields even at the increased wages. On a recent December afternoon, K. Tilgouthey and about 15 other women were plucking tea leaves from a hillside in central Sri Lanka as the rain came down. They worked quickly and quietly, the only sounds coming from the snapping of tea leaves and the rustle of the plastic bags that covered their heads and torsos. Many of the women wore no shoes; some wore flip-flops. Mrs. Tilgouthey, 31, said she started working on the Holyrood Estate, which is partly owned by Dilmah, 10 years ago when she married a man who worked and lived here. The couple have two daughters and a son. Asked whether she would like them to work with her on the plantation, she was quick to say no.

‘It’s hard work,’ she said. ‘So, I hope my children get educated.’”

References


