

Background paper for the
**Competitive Commercial Agriculture in Sub-Saharan Africa
(CCAA) Study**

**All-Africa Review of
Experiences with Commercial Agriculture**

**An African Success Story –
the development of a
Competitive Tea Export Industry**

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An African Success Story - the Development of a Competitive Tea Export Industry¹

A Brief History of Black Tea

The “modern” black tea industry began in the late 1830’s when British explorers found the tea bush, *camelia sinensis*, growing wild in Assam in Northern India. Until then the tea trade had been a virtual Chinese monopoly and tea was an expensive luxury.

The development of large-scale, British-owned tea plantations, first in India and then in Ceylon (Sri Lanka) transformed tea into a popular, healthy (because the water had to be boiled and it was promoted as an alternative to beer), low-cost beverage in Britain and its Empire. By the 1920’s Britain was by far the world largest importer of black tea (60% of the total), and India and Ceylon were the world’s largest exporters (supplying approximately 75% of the total). India also had a large and growing domestic market.

Following independence in the late 1940’s both India and Sri Lanka took steps to gain control over the perceived economic benefits of the largely British-owned tea sector. Export prices for tea were high during the 1950’s (along with many other agricultural commodities) and both countries imposed export taxes and increased taxes on tea company profits. In Sri Lanka the main objective was to have a source of revenue to fund an attempt to create a welfare state. India also had the objective of keeping the domestic price of tea low to protect poor consumers.

Many tea companies took the strategic decision to develop new sources of tea production in perceived “safer” countries. Kenya, Uganda, Tanzania and Malawi already had some tea estates², growing conditions were fundamentally good and they were expected to remain as British colonies and protectorates for many decades. Substantial investment began in the 1950’s. Kenya in particular had excellent growing conditions and good transport infrastructure for export via Mombassa. The Tea Board of Kenya was established in 1950 and the Tea Research Institute of East Africa³ was established in 1951 at Kericho in Kenya, financed by a cess on production.

Thus between 1947 and 1973 tea production in Kenya and in the rest of East and Central Africa grew by 9.6% p.a. and 9.5% p.a. respectively.⁴ Their combined share of world exports also increased dramatically.

¹ The author of this case study undertook a study of the international tea trade in 1975 for his MSc thesis. He worked in the Ministry of Agriculture in Malawi, 1977-79. With CDC he participated in reviews of tea estates in Sri Lanka, Zambia, Uganda, Tanzania. In 2002 he undertook a review of tea estates in Sri Lanka acquired by the James Finlay Group.

² The first tea estate in Africa was developed in Malawi in the 1880’s. The first tea was planted in Kenya in 1904.

³ It was originally Brooke-Bond’s tea research department. It was transformed into the Tea Research Foundation of Kenya in 1980. It has released over 45 new clones suitable for East African growing conditions.

⁴ Recent Developments and Future Prospects for the World Tea Economy. G Tyler (1976), Oxford Agrarian Studies

share of Africa in world tea exports:

	%
1938	2
1950	4
1960	8
1970	18
1973	21

Independence in the 1960's was followed by the partial nationalisation of the tea industries in Uganda and Tanzania. Civil war in Uganda and hostile macro-economic policies in Tanzania further contributed to the stagnation and then decline of tea production in those two countries.

However growth in Kenya and Malawi continued. The growth in Malawi was eventually constrained due to the lack of new, suitable land but in Kenya the expansion was massive, rising from 14,000 tonnes in 1960 to 90,000 tonnes by 1980 and nearly 200,000 tonnes in 1990. Moreover this growth incorporated the development of the world's largest smallholder tea production scheme – the Kenya Tea Development Authority.

From the early 1960's world tea prices began a long-term decline due to the growing export volumes outstripping rising world consumption. By 1975 the real average price of tea, adjusting for inflation, had fallen to only 52% of the average price during the 1950's. In 1969 India and Sri Lanka proposed the introduction of export quotas through an International Tea Agreement (modelled on the experience with international coffee quotas). This was effectively rejected by Kenya which saw it as an attempt to block the development of the African industry and would only agree to a quota that fully allowed for its intended expansion.

A report by the World Bank prepared in 1971⁵ clearly showed the impact that export taxes were having on the Asian industry:

U.S. cents/lb

	India	Sri Lanka	Kenya	Uganda	Tanzania	Malawi
cost of production	33.0	32.6	32.6	35.9	36.2	31.0
average export price	45.2	49.3	53.0	51.0	52.8	43.4
margin pre-tax	12.2	16.7	20.4	15.1	16.6	12.4
taxes on exports	7.2	11.6	0.3	0.3	1.5	0.3
margin post-tax	5.0	5.1	20.1	14.8	15.1	12.1

note: data is 1968 for India and Sri Lanka, 1970 for African countries

⁵ Report on the World Tea Economy, D Elz (1971)

In the mid-1970's Sri Lanka nationalised the tea industry, while in India legislation was introduced to restrict foreign ownership. Subsequently the Indian industry has thrived under private, Indian ownership⁶, but rapidly rising domestic demand has led to a decline in exportable surpluses. (India now produces 900,000 tonnes of tea, but 750,000 is consumed domestically). In Sri Lanka the industry stagnated and then went into decline due to the combination of falling world prices, an unwillingness to modernise (e.g. to produce tea suitable for tea bags), and political interference.

Since the late 1980's Kenya and Sri Lanka have vied with each other for the status of the world's biggest exporter.

In the 1990's the pressure of low prices forced all countries to recognise the need to modernise and improve efficiencies in order to survive. The tea industry was privatised in Sri Lanka, Tanzania and Uganda, and thereafter production substantially increased in those countries. Political uncertainties, political interference at KTDA and low prices have combined to slow down the expansion of the Kenyan tea industry. The position by 2004 was:

	Tea Exports, 2004 ⁷	
	<u>'000 tonnes</u>	<u>Value(US\$m)</u>
Sri Lanka	299	732
India	175	378
Kenya	284	464
Uganda	37	37
Malawi	33	39
Tanzania	24	30

The world demand for black tea has also evolved. Consumption has declined in the UK but increased rapidly elsewhere, especially in India, the middle east, Pakistan, the former Soviet Union and the USA, so that black tea is now a global industry rather than a peculiarity of the British Empire.

CDC Involvement

The Commonwealth Development Corporation participated in the development of the African tea industry, and appendix 1 presents a summary of its investments.

In the Cameroun, Ethiopia and Zimbabwe, tea estates were developed primarily for the local and regional markets, but in all other cases it was intended that production should be internationally competitive.

⁶ To complete the cycle, in 2000 the Indian Tata group bought one of the UK's leading tea packaging, distribution and marketing companies, Tetleys, for US\$432m.

⁷ source: FAO database

The commercial performance of these ventures has varied widely and this case study aims to analyse CDC's experience of:

- smallholder/outgrower production
- privatisation/rehabilitation
- greenfield development

The Success of the Outgrower Model

Main Principles

Black tea is traditionally a plantation crop. A heavy capital investment is needed:

- to clear land, raise tea seedlings in a nursery, plant out, weed and fertilise for several years prior to achieving the first commercial harvest;
- for transport of the green leaf, and finally
- for the tea processing factory.

The leaf deteriorates quickly once plucked, so there has to be total co-ordination between field and factory.

Nevertheless tea also offers some key advantages for smallholder production:

- it is very labour intensive, and requires labour for most of the year, which takes advantage of the smallholder's prime resource – family labour. Tea production and harvesting is not normally mechanised (but can be) and smallholders are not seriously disadvantaged by having relatively small, scattered, blocks of tea compared with large-scale, homogeneous estate production
- once established, it is a relatively robust, tolerant crop that can withstand periods of neglect, and the production of leaf is inherently less agronomically sensitive than the production of flowers, fruits or seeds
- since it is harvested and sold for most of the year (tea only stops growing if it is too dry or too cold) it generates a regular source of income (unlike the production of crops which are harvested just once a year), similar to the advantage of being a regular wage-earner
- tea is normally grown as a rainfed crop (but can be irrigated) and so there is no need to invest in and manage an irrigation system to supply scattered outgrower fields
- since the tea plant is permanent and the tea must be processed nearby (within 6 hours of plucking) it is feasible to extend credit and services to contracted outgrowers confident that the outgrower will, ultimately, have to honour his obligation to sell his green leaf to the factory.

The model was therefore developed, primarily in Kenya, of outgrower, smallholder production supplying a central factory, which could be privately owned (possibly with its own nucleus estate), co-operatively owned by the outgrowers themselves, or state-owned.

Kenyan Experience

CDC's first participation in smallholder, outgrower tea production was in Kenya. Once it was clear during the 1950's that Kenya was heading for independence, there was a desire to involve small-scale farmers more in cash crop production. Sir Roger Swynnerton was the Director of Agriculture in Kenya at the time and he was instrumental in developing several smallholder schemes, including the Special Crops Development Authority (SCDA). (He subsequently became the Head of the Natural Resources Department in CDC).

In 1960 CDC began providing loans to the SCDA (guaranteed by the Kenyan Government), which evolved in 1964 into the Kenyan Tea Development Authority. The Authority provided outgrowers with seedlings, fertiliser and other materials on credit and provided training. In return it had a legal monopoly right, and obligation, to process and market the smallholders' tea crop. KTDA was intended to be a cost recovery, rather than profit making, venture.

CDC made a series of loans over the years. CDC was never a shareholder in KTDA since it was a statutory authority. At various times CDC assisted with the development of the KTDA concept and detailed plans. CDC seconded the Chief Accountant initially and provided other technical experts. By virtue of its long-term support, the Government traditionally appointed CDC's representative in Kenya as a member of the KTDA Board of Directors.

After independence KTDA attracted loan finance from a number of international agencies including KfW, World Bank, EIB and the OPEC Fund. Once KTDA was established and successful it was able to raise loan finance from within Kenya.

The factories for processing the smallholder tea were set up as separate companies, and were intended to be profit centres. Beginning in 1963 CDC, KTDA and a number of foreign tea factory management companies provided the equity for each of these joint venture tea companies. In the mid-1970's management responsibility for the factories was successfully (but controversially at the time) taken over by KTDA itself and the factories were run as cost-recovery centres rather than profit centres, within any profits used to increase the price paid for green leaf rather than to pay attractive dividends.

In total CDC provided an estimated £15.5m in a series of loans to KTDA and £2.7m for equity stakes in a number of tea factories. These sums would be much larger today if we took account of subsequent inflation. The loans were all serviced and repaid. The equity stakes were not a commercial success for CDC due to KTDA's policy of not paying attractive dividends.

KTDA grew into the biggest single tea growing institution in the world. By 1984 there were 145,000 registered growers producing half of Kenya's tea output from 58,000 ha of planted tea. Average yields were on a par with Kenyan estate levels, which in turn were on average the highest in the world. Moreover the quality of tea achieved (mainly due to good plucking and processing standards⁸) was high and KTDA tea generally sold for higher prices than estate teas. In the same year it was estimated that 7% of Kenya's population was dependent upon KTDA for their livelihood, after taking account of ancillary industries such as transport and commerce.

This success was in part due to the supportive environment created by the Kenyan Government during the 1960's and 1970's, e.g.

- secure individual land-titles
- reasonably sound macro-economic management, so (unlike in Tanzania or Uganda) Shillings earned could be used to buy foodstuffs and other consumer goods at reasonable prices
- generally low taxes, and no significant export taxes on tea

KTDA also benefited from being part of a wider, successful industry with all the advantages of industry-wide economies of scale in terms of input services, packaging, transport, auction costs, shipping etc that that entails.

It is perhaps noteworthy that many Kenyan leaders (whether political or civil service) participated in one aspect or other of the tea industry (and other agro-industries) and thus had a personal stake in its success, i.e. Government policy was to increase private Kenyan participation in its agricultural export industries rather than to nationalise them.

KTDA's early success was also due to its high level of integrity, which gave confidence to smallholders that they could deliver their leaf to KTDA and then would be paid a fair price without excessive deductions or KTDA overheads. As KTDA grew into one of the biggest enterprises in Kenya this reputation slipped. Politicians and individuals recognised that there was money and patronage to be squeezed out of KTDA. At the same time the role played by external bodies such as CDC who could have provided some checks and balances diminished as KTDA became less dependent on external finance.

KTDA had become a politicised institution by the 1990's, eventually losing its monopoly rights and being privatised as the Kenya Tea Development Agency Limited in 2000, through the issue of shares to its smallholder growers. By this time KTDA had 54 tea factories supplied by 312,000 licensed tea smallholdings, collectively producing 62% of Kenya's tea.⁹

⁸ KTDA expansion was so fast that there was often a shortage of factory processing capacity. KTDA was therefore able to insist on high plucking standards as a way of limiting deliveries of green leaf to its factories.

⁹ Value Chains: Lessons from the Kenya Tea Sector. Natural Resources Institute

The ability of Kenya smallholders to respond to an attractive, cash crop opportunity has therefore been amply demonstrated by the KTDA experience.

There have nevertheless been some serious social criticisms of KTDA, e.g.

- farmers were meant to grow tea and subsistence food crops, but some stopped producing food crops and concentrated entirely on tea
- encouraging farmers to grow cash crops for export exposed them to excessive price risk
- women participated in the work but the sales revenue was paid by KTDA to the male household head leading to allegations of increased alcohol abuse by the men and increased poverty and poor nutrition for the women and children
- use of family labour includes young children, which by some is seen as exploitation and by others as a way of keeping families together and contributing an essential component to household income (especially households affected by AIDS)
- many smallholders make use of casual, hired labour who qualify for none of the benefits available to tea estate workers
- fuel wood needed for the tea factories has led to deforestation

In addition CDC and the World Bank were criticised by India and Sri Lanka for supporting the development and expansion of the tea industry in East and Central Africa, arguing that the effect of this “aid” would be to increase production and push down prices. They saw it as unfair competition for their own tea industries.

Experience Elsewhere

CDC tried to repeat the success of KTDA by supporting the establishment of state-owned tea factories in Uganda in 1964 and the creation of the state-owned Uganda Tea Growers Corporation in 1965, and via the establishment of the Smallholder Tea Authority in Malawi in 1967.

The UTGC collapsed during the Amin regime and the tea was abandoned. I understand however that it had struggled from the beginning. Ugandan society was more polarised politically than in Kenya and it was difficult to manage a state-controlled enterprise with independence and integrity.

The STA was fundamentally successful, with CDC initially providing management services. However it suffered from the relatively low price of Malawi’s “plain” teas, the small area of suitable land available in Malawi (most of Malawi is too dry), and high population pressure leading to relatively small plot sizes. The Authority therefore had relatively high overheads in relation to the tea produced, and no possibility to achieve the economies of scale of KTDA. In addition during the 1970’s and 1980’s the industry suffered from the wars in Mozambique which closed off the direct route (via rail to Nacala) for Malawi’s exports. In 2005 the STA was merged with a state-owned tea company (MATECO) to create the Smallholder Tea Company which it was intended to

privatise by issuing shares to staff and smallholders, once financial viability had been demonstrated.

Both Uganda and Malawi suffer from being land-locked and distant from export ports, which means that the factory gate prices of tea will always be less than that achievable by Kenyan producers.

Smallholder tea production was also promoted in Tanzania, although CDC was not involved.¹⁰ A Tanzania Tea Authority was established in 1968 modelled on the KTDA. It had substantial initial success. Eight tea factories were built with World Bank financial support and smallholder production reached a peak of nearly 5,000 tonnes in the mid-1980's. Thereafter production collapsed due to a combination of low prices, weak and possibly corrupt management, a failure to maintain the factories and feeder roads, lack of working capital and delays in paying smallholders for their tea. In contrast with the KTDA, smallholder tea yields and quality were always much lower than on private estates.

The TTA factories were privatised in 2001/2, with CDC acquiring two as part of its development of an integrated tea business in Tanzania.

The Challenges of Privatisation and Rehabilitation

Background

During the 1980's and 1990's CDC was keen to participate in the privatisation and rehabilitation of agricultural ventures in Africa believing that this was both developmentally important and that it would offer better financial returns than starting from scratch, i.e. greenfield developments.

In some situations Government's themselves were not wholly convinced of the benefits or political acceptability of privatisation and saw CDC participation as a kind of safer half-way house. In other cases CDC had to compete head on with fully private businesses to secure development opportunities. EUTCO in Tanzania is an example of a negotiated privatisation and Rwenzori in Uganda is an example of a competitive process. This section analyses and then compares the two cases.

East Usambara Tea Company (EUTCO)

In the mid-1980's, CDC was looking generally in Africa to resolve sovereign debt service problems by agreement to accept payments in local currency for re-investment into high priority ventures that were labour intensive (and so could utilise large amounts of local currency) and which ideally would produce goods for export to earn foreign exchange.

¹⁰ see Tanzania Tea Sector, Constraints and Challenges. John Baffles (2004) World Bank

CDC reached such an agreement with the Tanzanian Government and one of the projects that was identified, in 1987, to utilise the supply of Shillings was the merger and rehabilitation of two run-down tea estates and factories (Bulwa and Kwamkoro) in the East Usambaras. They had been nationalised in 1971 and were owned by the Tanzania Tea Authority (TTA) and the Tanzania Sisal Authority. CDC did not expect to achieve a high financial return – the expected FIRR was in less than 10% - but believed EUTCO was a sound opportunity to use Tanzanian Shillings to produce tea that could be exported and sold for US Dollars.

The project was developed as a joint venture, with TTA allocated shares in return for the existing assets and CDC providing cash and management. There was no open advertising of the opportunity and no actual purchase of state assets by CDC.

There was not much international interest in investing in Tanzania at the time, because Government believed in state ownership and price control. The negotiation of a joint venture with CDC holding a majority of the shares (60:40) was seen as a great concession by the Government which had previously nationalised EUTCO to take it out of foreign ownership. Formally the Government of Tanzania was still opposed to privatisation per se in the mid-1980's. CDC was seen as a pioneer in this respect.

Subsequently, CDC raised its percentage shareholding by further investment which diluted TTA's holding. CDC also made substantial loans which further increased its "beneficial interest" in the business to the point where all free cash-flow was in practice assigned to CDC.

CDC initially committed £4.2m to the venture. CDC planned and implemented the rehabilitation project which encompassed social infrastructure as well as the tea estate and factories. Half of the 1350 ha of tea on the two estates had been abandoned. Tea production had been more than 1,800 tonnes prior to nationalisation and had fallen to 300 tonnes prior to the take-over by CDC.

The physical rehabilitation targets, in terms of areas of tea restored to production, yields of tea produced and factory throughput were broadly achieved, but the process cost approximately twice as much as CDC had expected and took five years to complete. CDC had to refinance the business several times, each time arguing that it would be better to complete the project rather than pull out and write off the investment to-date (i.e. the phenomenon known as "creeping commitment").

Higher costs were in part because of a need to employ more expatriates, for longer periods, than had been anticipated. There had been a major decline in standards and disciplines under state ownership.

There was also a substantial expenditure on social infrastructure, especially housing. As tea production volumes increased there was a shortage of labour for tea plucking. The 1980's had seen a collapse of the monetary economy and people were reluctant to become entirely dependent on cash wages when there was so little available to buy in the

shops. In addition tea plucking was seen as having low social status. Management therefore substantially increased wages and invested to improve living conditions on the estates to make EUTCO a more attractive place to live.

One innovation, modelled on experience in Zimbabwe, which attracted both praise and criticism was to build and run a secondary school, with students paying for their tuition by working part-time on the estate. Was this “exploitation” of people’s poverty by the estate or a practical way by which young men and women from poor families could obtain an education? The answer is that it was both.

In addition (after a rally in the mid-1980’s) by the late-1980’s tea prices were back on their downward trend and prices achieved were approximately half the level that had been assumed (based on the World Bank forecasts) at the time of CDC’s appraisal of the project. As a result there were little, if any, “self-generated funds” to help meet the cost of the development.

CDC came to realise that although EUTCO had been profitable in the 1950’s when tea prices were much higher (about three times higher in real terms), it was now struggling to compete in modern world markets. It was a smallish, relatively remote estate. Transport costs to the Mombassa auctions were high. Moreover because of its location it suffered from periodic droughts and was only capable of producing average yields of rather ordinary quality tea¹¹, i.e. it was not a “world-class” production unit and moreover the site did not have world-class potential.

CDC’s strategic response was to expand to achieve economies of scale. Expansion was to be both at EUTCO itself and by creating an East African Tea Group by acquiring or developing plantations elsewhere within the region.

In the mid-1990’s plans were prepared for an outgrower project at EUTCO. Ultimately it was not implemented as it was believed that tea prices were too low to justify the investment and to provide outgrowers with attractive incomes.

There were also environmental concerns. The East Usambaras are an ecologically special and fragile mountainous area of Tanzania. There is a desire amongst conservationist to restrict further development in the area and to prevent encroachment into the forest reserves. There was a concern that the rehabilitation of EUTCO and the possible support for smallholder tea production would stimulate an influx of settlers and encroachment.

Rather than planting new areas with tea, CDC tried to spread overhead costs by taking on the management of a neighbouring tea estate (KAL). When KAL’s parent company went into liquidation, CDC acquired the tea estate from the liquidator and merged it with EUTCO.

¹¹ Tanzanian tea sells at an average discount of 25% to Kenyan teas at the Mombassa auctions

The merged estates were able to generate a small operating cash surplus, they provided employment for some 3,500 workers and produced around 3,600 tonnes of tea, but could not service the loans that had been advanced by CDC.

In 2001, CDC sold EUTCO by tender (along with its tea and other farming interests in Malawi) to Global Tea and Commodities Ltd, a UK based tea packer and distributor which saw the opportunity to create a fully integrated business. The overall price received for the assets in Tanzania and Malawi was a fraction of the investment cost to CDC.

CDC had financed part of the £10m cost of rehabilitating EUTCO with receipts in local currency from Government debt that probably would not have been paid without the EUTCO reinvestment opportunity. Nevertheless CDC came to realise that it had not “benchmarked” the cost of rehabilitating EUTCO against the potential of using the same sum of money elsewhere, i.e. for £10m could CDC have created a better tea estate on an ideal greenfield site? Could it have bought better quality, existing tea estates elsewhere, e.g. in Kenya? Instead CDC had relied on forecast financial returns from the specific EUTCO investment opportunity examined in isolation. Return forecasts are notoriously unreliable and prone to manipulation through over optimism. FIRR’s can also be made to appear high by assuming high levels of self-generated funds during the rehabilitation phase of a project which, on paper, appear to off-set some of the necessary capital costs.

Rwenzori Highlands Tea Company (Rwenzori)

CDC had been involved in Uganda’s tea sector after independence, but this came to an end following Amin’s take-over.

In 1984, after Amin’s downfall, CDC provided loan finance to assist the rehabilitation of 2,200 ha of tea and 3 factories belonging to the Toro and Mityana Tea Company (Tamteco), that had been abandoned during the civil war,

CDC was invited by the Ugandan Government to review five nationalised tea estates that had been grouped into a single company – Agricultural Enterprises Ltd (AEL) to see if it would participate in their rehabilitation.

However the two appraisals by CDC teams that took place in the 1980’s¹² concluded that financial returns would be low while the security risks were high¹³. Not surprisingly management quality had suffered under civil war and state ownership and the appraisal teams also believed that the industry needed to be privatised, which was not Government policy at the time. Meanwhile, substantial funds were allocated by the World Bank to rehabilitate the tea factories but it was difficult to implement the project successfully in the context of continuing public ownership.

¹² The author participated in the second appraisal in 1987

¹³ Tamteco had its vehicles requisitioned by rival armed-factions. The 1987 appraisal team was “rescued” by an SAS unit from the British Embassy when the house in which they were staying in Kampala was besieged by an armed-gang intent on stealing the team’s land-rover.

In the early 1990's the Government decided to privatise the tea estates through a formal tender process. Following CDC's management of tea in Malawi and the rehabilitation of EUTCO in Tanzania, CDC was keen to create a regional tea business, and decided to participate in the tender process and submitted the highest credible offer alongside a commitment to invest substantially in rehabilitation of the estates and factories.

The Government in the form of the Uganda Development Corporation, stayed on as a minority shareholder.

James Finlay plc had also bid (they had major tea interests in Kenya, as well as Bangladesh and Sri Lanka) and after CDC's success, Finlays decided to join forces, with CDC holding a slight majority of the equity, providing long-term loans and providing corporate management. It was always Finlays' aspiration to buy-out CDC, once it was ready to sell. They were happy for CDC to take on the responsibility of providing management during what proved to be a difficult rehabilitation phase. However Finlays did provide regular technical and commercial comment through their directors and there were also advisory visits by Finlays' experts.

CDC and Finlays held a 51:49 interest in Rwenzori Tea Investments Ltd that in turn held 90% of RHTC with UDC holding the remaining 10% (subsequently diluted).

CDC planned and implemented the rehabilitation and development projects. As at EUTCO, much of the tea had been abandoned and reverted to bush. The level of skills and morale amongst local staff was low and a large expatriate team was needed to turn the situation around. The first general manager seconded by CDC, Simon Hill, had previously been general manager of EUTCO.¹⁴

It was decided to rehabilitate four of the five estates and to abandon tea growing at one which was close to Kampala and was fundamentally unsuitable for high yielding tea production.

Eventually CDC and Finlays achieved a substantial increase in tea yields, production and quality. Production reached 9,000 tonnes p.a. by the early 2000's (up from 1,000 tonnes at the time of take-over) involving nearly 7,000 permanent employees.

Rwenzori benchmarked its operating performance against the Finlay Group's tea estates in Kenya. By the late 1990's Rwenzori was achieving similar unit costs up to factory gate. Average returns per kilo of tea produced were however less than in Kenya because Rwenzori's tea is inherently of medium rather than high quality and so attracts a lower price at auction¹⁵, in addition there are inevitably higher transport costs to get the tea to Mombassa.

¹⁴ the author would like to thank Simon for reviewing an earlier version of this case study and for his helpful comments and suggestions

¹⁵ the typical discount is 25-30% compared with Kenyan teas

However, although development costs were broadly in line with plan, the endeavour took longer than CDC had expected. As at EUTCO there was a greater than expected need for sustained input by expatriate, specialist staff. In most cases it proved better to focus on recruiting and training a new cadre of Ugandan managers than to “re-educate” the existing managers who’s morale, commitment and integrity had collapsed during the era of civil war and state-ownership.¹⁶

The trend in tea prices continued to decline during most of the 1990’s and cash generation from operations was substantially less than expected. Ultimately CDC invested approximately £12m in a mixture of equity and long-term loans.

Throughout the rehabilitation James Finlay plc contributed its 49% share of all equity calls (there were several beyond the initial capitalisation of the venture). Finlays were confident that Uganda was a prime tea growing area (although tea quality is only “medium”, very high yields are possible and wage rates are lower than Kenya) and was not discouraged by short-term losses or forecasts of low FIRR. In their view Rwenzori was a “world-class” asset and they wanted to be the major player in a revitalised Ugandan tea industry.

Indeed Finlays complained that CDC spent too much time and money on agonising over long term financial planning instead of just getting on with what had to be done. CDC undertook a review of the project in 1995¹⁷, which concluded that CDC was unlikely ever to see any financial return on its investment, but the confidence of Finlays in the venture persuaded CDC management to persevere.

In 1998 the strategic decision was taken to embark on an expansion programme, planting previously uncultivated land on the estates and acquiring adjacent suitable land, with a view to reducing unit costs. Since average quality was always going to be medium, it was essential that unit costs of production should be less than the average of the Kenya industry which would always be able to obtain better average prices at auction.

There have been social and environmental issues, but Rwenzori’s overall impact has been beneficial. As noted earlier there was an issue in gradually regaining control over all of the estate lands due to the unofficial “outgrower scheme” and also general squatters.

There was also an issue in attracting sufficient plucking labour. Prior to Amin much of the labour had come from Rwanda. This had stopped, but local people still saw plucking as inferior work. While wages remained low by international standards, Rwenzori made substantial improvements in terms of wages, conditions and health and safety compared to operations while under state control.

¹⁶ Prior to privatisation, parts of the estates had been allocated to senior employees and associates in the guise of an outgrower scheme. Generally the workforce had lost confidence in the long-term future of the industry and were looking to make short-term gains by any means possible.

¹⁷ supervised by the author of this case study

There have been periodic insecurity problems with rebel groups from within Uganda and from DRC active in border areas and I believe there have been murders of local employees. There were also continuing disputes and revenge attacks amongst the workforce arising out of the dark years of the Amin regime and subsequent civil wars.

Securing adequate supplies of fuel wood for tea drying is a major challenge with a risk of local deforestation. Rwenzori made great strides in developing fuel wood plantations to provide the power for the tea factories, instead of relying on cutting down the natural forest, which had been the previous practice.

CDC sold its equity stake in Rwenzori to James Finlay plc in 2001. The price negotiated I understand, was similar to the costs that CDC had incurred, and was sufficiently attractive to dissuade CDC from seeking offers from third parties. All CDC loans to Rwenzori had been serviced on schedule and were ultimately repaid.

Assessment

The privatisations and rehabilitations of both EUTCO and Rwenzori were ultimately technical and operational successes although both took longer and cost more than anticipated. Both enterprises suffered from very low tea prices during critical periods of their rehabilitation.

In the case of Rwenzori CDC achieved a small positive financial return on its total investment whereas at EUTCO it made a substantial loss.

The main factor is that Rwenzori represents an investment made by CDC in the 1990's when it had become more focussed on the long term, international competitiveness of the agricultural commodity businesses in which it invested, whereas EUTCO is an example of CDC promoting a project in the 1980's in order to utilise Government debt service payments made in local currency and to support the principle of privatisation, without adequately assessing whether the venture itself had the potential to be a "world class" producer of a commodity which must compete on international markets.

An important indicator of this difference was the enthusiastic participation of a major, private sector player in the international tea business, James Finlay, in the Rwenzori privatisation, rehabilitation and expansion. They saw Rwenzori as a strategic, "world class" tea asset and were determined to acquire it. In contrast, they apparently had no interest in acquiring EUTCO when CDC put it up for sale.

The Financial Folly of Starting from Scratch

In 1988 CDC decided to establish a tea estate and factory from scratch on land it controlled at Tanwat in Tanzania, which it called Kibena.

For many years Tanwat had been searching for an alternative, high value, export crop to compensate for the slow decline in the market for wattle extract, its principal product.

Tea was identified as a crop suitable to Njombe's high altitude and relatively wet climate, but tea would have to be irrigated to achieve good yields. The costs of land clearing and development, dam construction, water distribution and infield irrigation would all be high, but it was believed that these costs could be justified by the high yields and good quality expected.

A tea estate of 600ha was developed and tea yields (over 4 tonnes/ha) and quality, (as reflected in a premium over average Tanzanian prices obtained at the auction), were both excellent as forecast. Tea production reached 2,778 tonnes in 2000. Thanks to the high standards of both tea and employment practices, Kibena has been a supplier of "fair trade" tea for the "TeaDirect" label in the UK since 1998. Tanwat has also been self sufficient in energy, since it is able to use residues from its wattle and pine operations to provide fuel wood for the tea factory and to run a dendro-thermal power station.

Unfortunately the cost of development, especially the factory, proved to be much higher than forecast. This was in part due to Tanwat's remote location and also due to a tendency of CDC to build to the best engineering standards and not necessarily to the most appropriate commercial standard, e.g. ruling out the option of using second hand equipment. As with the rehabilitation projects, CDC came to realise that for the amount it had spent, per hectare, at Kibena it could probably have purchased top quality, profitable, tea estates in Kenya.

As with EUTCO and Rwenzori, production came on stream at a time of particularly low tea prices. I believe that the Kibena tea operation was able to generate an operational profit, but this was not sufficient to service the loans that had been obtained from CDC to finance the development. The debt had to be written down by CDC.

In 2002 Kibena was separated from Tanwat and merged with a successful Tanzanian tea processing, packaging and distribution business (TATEPA), also controlled by CDC, to create a strong, integrated tea business which is listed on the Dar es Salaam Stock Exchange.

The Kibena tea estate is important for the region and, with CDC loans written down, it became a financially viable and sustainable enterprise. It created continuity of employment in a remote part of Tanzania where the traditional enterprise, wattle extract, was in inevitable decline. The social case for the development of Kibena was therefore strong.

Financially however it was costly for CDC, and represents another example of focussing on forecast financial rates of return rather than on benchmarking the capital cost of the development against opportunities to buy similar quality tea estates elsewhere in Tanzania or in Africa generally. Thus CDC, at the time, was not looking to make the best possible investment in tea, it was looking to make the best possible use of the land

available at Tanwat, irrespective of opportunities to make better use of its capital elsewhere.

Some Key Lessons from the Tea Experience

Perhaps the most important lesson from the long-term history of tea is the reality of global competition. Neither China in the nineteenth century nor India and Sri Lanka in the twentieth century were able to halt the spread of tea production to other well suited, low-cost locations. Standing still, for the producers of any commodity, is not an option. Not only are new production locations being identified but also technology and markets are constantly evolving and changing¹⁸. The policy in India and Sri Lanka of levying substantial taxes on tea exports only accelerated the growth of competition elsewhere while starving their own industries of the resources needed for continuous modernisation.

A second major lesson derives from the positive experience of outgrower, smallholder tea in Kenya. This demonstrates that smallholders have the capacity:

- to respond to economic incentives
- to perform competitively when the fundamental characteristics of the enterprise are in their favour
- to specialise when the overall market economy is functioning well.

Tea production is well adapted to the needs of smallholders (a regular income from regular work) and the outgrower model is also well suited to tea factory owners (it reduces the need to take on permanent labour with its costly “add-ons” such as housing and pensions, and factory owners can be reasonably confident that support provided to contracted outgrowers will lead to extra tea delivered to their factory). Thus for future projects, whatever the commodity, the question to ask should not be, “are smallholders capable of farming commercially?” (since they clearly are) but rather “is this particular crop/technology well suited to giving smallholders a competitive advantage over larger commercial farmers and estates?”

A third major lesson is the importance of asset prices when making investment decisions. Private companies, when seeking to develop a business, normally ask the question “buy or build?”. They will examine the likely comparative cost of developing a business through acquisitions or by starting afresh. If existing businesses can be bought for less than the cost of building up from scratch, then they will acquire, i.e. when existing assets trade at a discount to the cost of new assets.

In the case of agricultural ventures, when commodity prices are low, it is not unusual to find high quality agricultural businesses available for sale at a large discount to their replacement cost. This is the way the market place says that it does not need any more capacity in the sector. In these circumstances it is financially irrational to start new projects. In the late 1980’s/early 1990’s CDC undertook two major tea rehabilitation

¹⁸ The latest “threat” has been a major expansion of production in Vietnam which by 2004 was producing around 100,000 tonnes of tea, compared with 20,000 tonnes in 1980.

projects (which were so run down that they were closer to “build” than to “buy” situations) and one brand new project at a time when existing, prime tea estates could probably have been bought for less than the “build” cost incurred by CDC. At the time, being a development organisation, rather than a private financial institution, CDC did not consider the “buy” option. However, in order to avoid contributing to world-wide over capacity, even development organisations should do so.

A further, if rather obvious, lesson is that production systems involve more than physical assets. Much of the “technology” needed to operate a business is tied up in “human capital”. If the human capital of an industry is destroyed through war, corruption, mismanagement and/or demoralisation, rebuilding can be slow and expensive. A functioning enterprise or industry is thus a valuable resource and caution should be exercised before tampering with it, even if motives are well intentioned. The contrast in the fortunes of the tea industry in Kenya and in Uganda could not be more dramatic. Between 1970 and 1980 Kenya’s production rose from 41,000 tonnes to 90,000 tonnes, while Uganda’s collapsed from 18,000 tonnes to 2,000 tonnes.

Similarly, in order to be willing to work for cash wages, employees need to be sure that the monetary economy is working, and that food and other essentials will be available and can be bought with cash. The monetary economy effectively collapsed in Uganda and Tanzania and made it more difficult and costly for CDC to recruit sufficient labour for its tea rehabilitation projects. A functioning economy and general food security are important (if obvious) requisites for a thriving cash crop sector.

Appendix 1

CDC'S INVESTMENTS IN TEA IN AFRICA 1948-2001					
first invest	Country	Description	Invest (£m)	public /private	Outcome
1958	Tanzania	Bird & Co <i>finance for expansion of tea & sisal production</i>	0.45	pvte then govt	loan nationalised in 1967; loan repaid
1959	Kenya	Nyambeni Tea Co <i>nucleus estate and outgrower scheme. Eastern Produce as managers</i>	0.14	pvte/JV	50/50JV
1959	Cameroun	Cameroun Development Corp <i>rehabilitation of statutory corporation – rubber, bananas, oil palm, tea. Intended to convert to Ltd Co with CDC 50% stake but not done. Co-financing with World Bank.</i>	12.00	govt, CDC mgd	technical OK; commercially weak; loan arrears transferred to DFID
1960	Kenya	Special Crops Development Auth. Promotion of smallholder tea. Concept developed by Sir Roger Swynnerton of Min of Agric with CDC support. Evolved into Kenya Tea Development Authority	15.50	public	series of loans guaranteed by govt. a success. Over 130,000 growers.
1963	Kenya	Smallholder Tea Factories to process smallholder tea. private managers, CDC minority stake.	2.68	govt/JV	technical and commercial success; investment modest
1964	Uganda	Bugamba and Mwenge Tea <i>finance for new tea factories</i>	0.46	govt	CDC provided loans Collapsed due to coup and war.
1965	Uganda	Uganda Tea Growers Corp <i>development of smallholder tea. Co-financed with IDA.</i>	1.26	govt	CDC provided loans. Collapsed due to coup and war.
1967	Malawi	Smallholder Tea Authority CDC initiative	2.47	govt	CDC loan with govt guarantee
1974	Ethiopia	Gumaro Tea Plantation CDC Managed	0.35	CDC	Abandoned due to revolution
1983	Uganda	Tamteco <i>Tea Estate rehabilitation</i>	0.82	private	loan. moderate success. Difficult security.
1984	Malawi	Kawalazi/Kavuzi Estates <i>Tea and Macadamia Part financed with debt roll-over (merged with Sable Farming)</i>	5.16	CDC/ govt JV	technical difficulties sustainable business; investment failure. Sold in 2001.
1986	Zimbabwe	Southdown Holdings <i>Tea estate and factory expansion.</i>	2.71	pvte	CDC loan, converted to equity; moderate success; merged with Ariston
1987	Tanzania	East Usumbara Tea Co <i>privatisation and rehabilitation of tea estates. Part financed with debt roll-over</i>	10.00	CDC/ govt JV	technical success; sustainable business; investment failure; sold in 2001
1950	Tanzania	T. Wattle Estates <i>33,000 acres of wattle. Diversified into arable, pines, dairy.</i>	13.55	CDC	technical success but wattle market weak; sustainable business;

		<i>Kibena Tea and power generation projects developed in the late 1980's.</i>			investment failure. Kibena tea separated and merged with TATEPA in 2002
1992	Tanzania	Karimjee Agriculture Ltd <i>rehabilitation of tea (managed by CDC) and sisal estates.</i>	3.50	CDC/ pvte JV	equity and loan; poor technical and financial results. Placed into receivership. CDC purchased the tea assets
1993	Uganda	Rwenzori Highlands Tea <i>tea estates and factories privatisation and rehabilitation. James Finlay minority partner</i>	11.83	CDC/ pvte JV	technical success; sustainable business; sold in 2001 to Finlays, "at cost"
1999	Tanzania	Southern Highlands Tea <i>Privatisation of 2 smallholder tea factories- Wakulima</i>	2.0	CDC	equity. Subsequently merged with TATEPA and Kibena Tea and listed on stock exchange

note: Not shown above is CDC's initial investment of £0.3m, via a local venture capital fund, in the Tanzania Tea Packing Company (TATEPA). TATEPA subsequently became the vehicle to create an integrated tea company through mergers with Kibena Tea and Southern Highlands Tea.