CHAPTER IX: CHANGES IN MARKETING STRUCTURE AND AUCTION ANOMALIES

This chapter is devoted to the analysis of the reorganization of tea trading structure and the anomalies of the auction mechanism. Since late eighties and early nineties, Indian tea industry has experienced some important changes in trading structure. There has been greater concentration of buyers at auctions. Retail market is getting dominated by few multinational companies. Some of these companies gradually shifted from production to marketing of tea. Retail market is witnessing more transactions in branded tea than loose tea in recent times. Evidently, over the span of last twenty years, Indian tea has witnessed two important restructuring processes – that of production structure and that of tea trading structure. With respect to production structure there had been a tendency towards a shift from estate sector to BLF-smallholder sector. I have already discussed production restructuring in the previous chapter. In this chapter I will be discussing changes in the tea trading structure that have taken place since the early part of the last decade.

This chapter has three sections. Section 1 describes the changes in the tea trading structure. Section 2 is devoted to the discussion on anomalies observed in tea auctions in India and possibilities of cartelization at auctions. Section 3 summarizes the major points of the chapter.

9.1: Reorganisation of tea trade structure following global economic change

It is the organization of tea trade which influences price determination in tea auctions to a great extent (Asopa, 2004). Reorganization of tea trade was primarily manifesting itself in the form of growing buyers’ concentration at auctions (Karmakar & Banerjee, 2005) and subsequent widening of the gap between auction and retail prices. Majority of tea producers do not possess any marketing network of their own. They depend on the auction mechanism to dispose of their produce. Auction mechanism ensures that producers receive sale proceed within a stipulated period of time. Technically producers can withdraw tea from auction if they don’t find the price satisfactory but in practice withdrawals are not common even when price is depressed because reprints are allowed
after a certain period of time and tea producers need the revenue to flow back to take care of day-to-day estate expenditure (Tea Board, 2003). Further, quality of tea deteriorates if it is stored for longer periods. Deterioration in quality would result in further decline in possible price realization. Ideally, competition among the buyers of tea at auction leads to bidding in the upward direction. But growing buyers’ and brokers’ concentration at auctions since early nineties was causing lower price realization in the form of lower bids (Kumar, 2000). This resulted in widening of gap between auction and retail price.

There has been a growing concentration of buyers’ in Indian auctions since early nineties (Nayar, 1998, Kumar, 2000). A few international blenders and distributors control most of the tea auctioned in major auction centres. Moreover, the retail markets in major tea producing countries are also controlled by a few international blenders (World Bank, 1997). In 1999, in Guwahati auction (30 per cent of total Indian tea is auctioned through Guwahati) Hindustan Lever (HLL) had a share of 33 per cent and Tata Tea had a share of 13 per cent of total sales at the auction (RIS-DRIDC, 2000). In 1990, the corresponding shares were 19 per cent and 7 per cent respectively. In 2000, in southern India, according to Tea Board’s estimate, there were more than 10,000 producers but at Cochin auction the number of registered buyers was below 100 and in Coonoor it was around 70 (Tea Board, 2000). Among these buyers a small group controlled the major portion of disposal of tea (UPASI, 2001). That kind of buying concentration led to smaller number of retailers which implied less competition (Kumar, 2000). In 1998, in India, two largest tea traders controlled 29 per cent of total market share and the top six companies held 50 per cent share (Kumar, 2000). Because of greater integration along the supply chain, a few traders could dominate the entire supply network. This took place through coordination (mostly pre-financial) or vertical integration with local retailers (Karmakar & Banerjee, 2005). By becoming large corporation and by providing a homogenized retail experience with a consistent but not exceptionally good quality product, few tea chains consolidated their holding in the tea commodity chain (Nayar, 1998).

Sharp price fluctuations particularly lower price realization during late nineties and early this decade at auctions adversely affected those producers who were not operating in the retail trading chain. But buyers, who were operating all along the commodity chain,
gained from lower price realization at auctions. They bought tea at auctions as intermediaries and the tea passed through different stages of the trading chain before it reached the final consumer. Now for those buyers who had presence along the entire commodity chain, lower price at auction implied greater profit at the retail end (Asopa, 2007). During the period of sharp increase in auction prices profit of tea retailers fell and in subsequent years buyers (because they were less in numbers compared to producers) got together to depress auction prices which suited them (Karmakar & Banerjee, 2005).

According to World Bank (1997), the processing and distribution of tea in 1996 was controlled by four major companies – all were vertically integrated – Unilever, Cadbury Schweppes, Tata Tea and Twining. Along with six other big companies, these transnational companies controlled 80 per cent of the world tea market (World Bank, 1997). In 1996, 75 per cent of the tea market in New Zealand was dominated by two multinationals – the Bell Tea Company and Unilever group. In a similar manner Australian market was dominated by the Unilever and Tata Tea. The fast growth of the conglomerates was maintained by blocking potential entrants through heavy advertising, expensive marketing strategies and popularising branded products. All these made it difficult for small firms to make any headway in the retail tea business (World Bank, 1997).

In early 2000, the tea market was extremely concentrated as 90 per cent of the world trade was in the hands of seven transnational companies and 80 per cent of world production was sold by multinationals (Transfair, 2002). The larger companies had such large purchasing power that they could influence the price for particular qualities and types of tea at auctions (Asopa, 2004).

Such concentration of buying power was mainly taking place through mergers and acquisitions (Kumar, 2000). During the period of liberalization, Indian tea trading set-up witnessed a number of mergers and acquisitions leading to greater concentration in tea trade. In almost all cases of such mergers and acquisitions, multinational enterprises were involved. Mergers & acquisitions extended the scope of operation and facilitated group
consolidation (Kumar, 2000). Table 9.1 represents the numbers of mergers and acquisitions that took place during the period from 1993 to 1999.

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<td>2</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>7</td>
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</tbody>
</table>

Source: RIS-ICDRC Database

Some large firms took advantage of the liberalization and started to buy out tea companies in order to acquire an instant marketing chain (Kumar, 2000). For example, economic liberalization, through relaxing restrictions on foreign equity and by delicensing, had a significant impact on the behavior of Unilever in India. This impact was visible in the consolidation under the flag of Hindustan Lever Limited (HLL) of all of Unilever operations in India which were hitherto remained divided into several companies to escape legal requirements (Kumar, 2000). Seizing the opportunity offered by liberalization, in 1995, HLL raised the foreign equity in two of Unilever's other subsidiaries in India to 51 per cent- Brooke Bond and Lipton. There then occurred in 1996 the merger of these two subsidiaries into Brooke Bond Lipton India Limited (BBLIL). This was followed by a spree of quick acquisitions by BBLIL which absorbed several local companies making BBLIL in 1996 the largest foods and beverages Company and the market leader in retail tea business. There then took place in 1996 India's largest ever merger that of BBLIL into HLL amidst rising prices of the shares of both. This new Lever mega-corporation was a market leader in tea. Of course, both HLL and BBLIL were in any case part of the same family earlier and would have been a single entity but for India's laws. HLL's merger and acquisitions represented a significant transformation of the link between India and the global economy dominated by TNCs. In 2005, HLL was the largest tea retailer and controlled 33 per cent of total tea trade in India (Transfair, 2005).

Tata Tea's acquisition of Tetley in 2000 was the largest acquisition of a foreign company ever by an Indian company. Tata Tea's earlier bid in 1995 to acquire Tetley failed. Price paid by Tata Tea for the acquisition was US$ 435 million. The price of acquisition was almost four times the net worth of Tata Tea which stood at US$ 114 million. Tetley acquisition was executed through a financing mechanism of Leveraged Buy Out (LBO).
Tata Tea used this mechanism with the hope that cash flows from Tetley would repay the leverage over the time (Kumar, 2000). The acquisition made Tata Tea the largest tea company in the world after Unilever. Tata Tea also had a 21 per cent share of the Indian branded tea market in 2005 (Fairtrade, 2005). After acquiring Tetley, Tata Tea became a major brand in the Europe as well as the second largest tea brand worldwide (Kumar, 2000).

Unilever was the owner of the world’s largest selling tea brand Lipton and the company purchased 12 per cent of total black tea production making it world’s largest buyer of tea in 2002 (Fairtrade, 2005). Tata Tea was the world’s second largest tea company in terms market share in retail tea trade. Both of these two companies initiated restructuring from production to marketing. The restructuring process is built upon both companies’ change in orientation away from producing tea and towards being sellers of tea. They were more interested in purchasing tea at auctions worldwide rather than producing tea. Both companies realized that their level of profits could be greatly increased by selling branded and processed tea products rather than owning plantations.

In April 2005, HLL announced that 6100 permanent workers, 3100 hectares of plantations and three processing factories in Assam would be parceled off into a demerged company called Doom Dooma Tea Company. By December 2005, HLL announced the transfer and sale of Doom Dooma Tea Company to Mcleod Russel India. In the same year HLL parceled together its holdings in Tamil Nadu encompassing 6300 permanent workers, 3700 hectares of plantations and six processing factories into a demerged company called ‘Tea Estates India Limited’. On March 1, 2006, HLL announced the completion of the sale and transfer of Tea estates India Limited to the Woodbriar Group. Thus between 2005 and 2006, HLL managed to divest itself of the responsibility of more than 12000 permanent workers. In practice, total number of workers affected by this decision was much higher as the number did not include temporary workers or dependents of permanent workers. In 2006, HLL showed an increase of 32 per cent in profits compared to 2005 (Asian Food Worker, 2007).
Tata Tea also followed a similar restructuring process away from manufacturing to marketing. In 2005, Tata Tea management transferred 17 plantations to the company ‘Kannan Devan Hills Plantation Limited’ of which it retained 19 per cent share. Tata Tea kept the brand name ‘Kannan Devan’. Through this restructuring Tata Tea transferred 75 per cent ownership of the company to workers and local management. In West Bengal and Assam, Tata Tea initiated plans to demerge its 24 plantations into ‘Amalgamated Plantations Private Ltd.’ This affected more than 30,000 workers (Asian Food Worker, 2007).

Between 2001 and 2006, Tata Tea experienced substantial reduction in cost related to labour. In 2001, 21 per cent of total expenditure was incurred on workers’ payment. In 2006, the corresponding figure was 15 per cent. Volume of permanent labour declined from 58,888 in 2001 to 34,596 in 2006. During the same period, share of wage payment, provident fund payment and welfare payment out of total labour share declined by 12.5 per cent, 43 per cent and 40 per cent respectively (Asian Food Worker, 2007).

The liberalization of industrial and trade policies was accompanied by an increasingly receptive attitude towards Foreign Direct Investment (FDI) and foreign licensing collaborations. Policy guidelines were issued to streamline the foreign licensing collaborations. The rules concerning payments of royalties and lump-sum technical fees were also relaxed. Tax rates on royalties were reduced from 40 per cent to 30 per cent in 1986 (Kumar, 1995). FDI in tea plantations in 1990 constituted only 4.1 per cent of total FDIs in India. After the adoption of liberalizing policies in 1991 this FDI component of tea plantation was on the increase and in 1999 it constituted 9.5 per cent of total FDI in India (RBI, 2000).

Also there had been a change in the profile of tea as a commodity in the last two decades. Gradually tea is being positioned as a branded product and has shifted away from its generic version (Karmakar & Banerjee, 2005). Since mid eighties, sale of branded tea had increased whereas sale of generic version had declined. Table 9.2 corroborates this shifting trend of tea from a generic to a branded product.
Table 9.2: Changing composition of disposal of tea in internal market during 1986-2006

<table>
<thead>
<tr>
<th>Year</th>
<th>Packet tea (in m kg)</th>
<th>% out of total</th>
<th>Loose tea (in m kg)</th>
<th>% out of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>113</td>
<td>26</td>
<td>318</td>
<td>74</td>
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<tr>
<td>1988</td>
<td>118</td>
<td>26</td>
<td>328</td>
<td>74</td>
</tr>
<tr>
<td>1990</td>
<td>129</td>
<td>28</td>
<td>333</td>
<td>72</td>
</tr>
<tr>
<td>1992</td>
<td>145</td>
<td>30</td>
<td>335</td>
<td>70</td>
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<tr>
<td>1994</td>
<td>160</td>
<td>32</td>
<td>340</td>
<td>68</td>
</tr>
<tr>
<td>1996</td>
<td>176</td>
<td>34</td>
<td>335</td>
<td>66</td>
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<tr>
<td>1998</td>
<td>184</td>
<td>35</td>
<td>340</td>
<td>65</td>
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<tr>
<td>2000</td>
<td>192</td>
<td>36</td>
<td>345</td>
<td>64</td>
</tr>
<tr>
<td>2002</td>
<td>200</td>
<td>36</td>
<td>350</td>
<td>64</td>
</tr>
<tr>
<td>2004</td>
<td>214</td>
<td>35</td>
<td>355</td>
<td>65</td>
</tr>
<tr>
<td>2006</td>
<td>224</td>
<td>36</td>
<td>366</td>
<td>64</td>
</tr>
</tbody>
</table>

Source: Tea Digest 2005-06, Tea Board, India

Before liberalization, India specialized in bulk tea (Tea Board, 1984). Since the mid 80s there was a major shift towards branded tea business. In 2000, of the total Indian tea market, branded packaged teas accounted for 36 per cent in terms of volume. HLL, owned by Unilever, was the market leader with around 33 per cent market share followed by Tata Tea with 21 per cent market share (Kumar, 2000).

As discussed earlier, the gap between auction prices and retail prices increased over the years and those who had retail marketing network gained from the situation. In early nineties Tata Tea was basically a plantation company whose major strengths were managing estates, dealing with a huge work force and manufacturing teas. On the other hand, Tetley was strong in marketing quality tea all over the world. Acquisition of Tetley by Tata Tea helped the latter to inherit the trading chain all over the world especially in the European markets (Kumar, 2000). Both companies were already involved in a joint-venture created in 1992 called Tata-Tetley limited. The joint venture company was a 50 per cent holding by each joint venture partner (Kumar, 2000). Acquisition of Tetley by Tata took place in 2000. Table 9.3 represents the increase in the market share of Tata-Tetley in two time periods - (2002 and 2006).
In 2006, Tata Tea achieved good financial results, notably it earned highest profit before and after tax in nominal terms (Tata Tea, 2007). Tata Tea’s market share of branded tea business has steadily increased over the years as 85 percent of earning came from branded tea whereas rest 15 per cent came from bulk tea. Tata Tea experienced comfortable debt-equity ratio of 0.21 in 2006 and on a consolidated basis the debt-equity ratio was 1:1 (Tata Tea, 2007). Consequently, the level of debt showed a significant reduction from the level of debt at the time of Tetley acquisition.

9.2: Anomalies in auction mechanism and possibilities of cartelisation

Prior to the Second World War, London was the major international market for tea and tea prices registered in London auctions could be looked upon as the world price. In the post-war period, London auction started to lose its importance gradually as volume of transactions in Calcutta and Colombo auctions kept on increasing. Shares of Calcutta and Colombo auctions out of the total world auction transaction were 12 per cent and 6 per cent respectively in 1936-37 and in 1960-61 the corresponding figure for the two auctions became 24 per cent and 15 per cent respectively. Share of transaction declined from 32 per cent to 16 per cent over the same period in London auction centre (ITC, 1962). Prices in London in the post-war period did not reflect world demand-supply situation as in the pre-war period. Because of declining quantities, the London tea auction stopped operations in 1998.

In India, auction system got strengthened in 1984 with the implementation of Tea Marketing Control Order (TMCO) issued by the Tea Board, India upon the instruction of Ministry of Commerce, Government of India, which stipulated that 75 per cent of the production (except plantation packed tea and bulk export) must be routed through the auction process. As a result, volume of tea transacted at Indian auctions increased
substantially. In 1980, 53.93 per cent of total production was sold in auctions. The corresponding figure for the year 1990 was 65.80 per cent (Tea Board, 2002). Thus, the volume of tea sold at Indian auctions was increasing following the TMCO 1984. But since early 1990s, when India initiated the liberalization process, volume of tea sold at auctions started declining. In 1995, volume of tea sold at auctions was 56.66 per cent of total production and fell to 52.89 per cent in 2000 (Tea Board, 2002). TMCO 2001 relaxed the auction norms completely and producers were no longer bound to send tea to auctions. The declining trend continued and in 2006, volume of tea sold in auctions was 50.83 per cent of total tea production. Between 1990 and 2006, volume sold through auctions declined from 65.80 per cent to 50.83 per cent of total production (Tea Board, 2007). Table 9.4 depicts the proportion of tea sold in Indian auction since 1900.

Table 9.4: Production and auction sale of Indian tea

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (million kg)</th>
<th>% of tea sold in auctions</th>
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<tbody>
<tr>
<td>1900</td>
<td>89.6</td>
<td>27.45</td>
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<tr>
<td>1910</td>
<td>119.6</td>
<td>28.85</td>
</tr>
<tr>
<td>1920</td>
<td>156.6</td>
<td>23.96</td>
</tr>
<tr>
<td>1930</td>
<td>177.4</td>
<td>23.67</td>
</tr>
<tr>
<td>1940</td>
<td>210.4</td>
<td>21.48</td>
</tr>
<tr>
<td>1950</td>
<td>275.5</td>
<td>41.23</td>
</tr>
<tr>
<td>1960</td>
<td>321.1</td>
<td>54.13</td>
</tr>
<tr>
<td>1970</td>
<td>418.5</td>
<td>57.66</td>
</tr>
<tr>
<td>1980</td>
<td>569.2</td>
<td>53.93</td>
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<tr>
<td>1990</td>
<td>702.3</td>
<td>65.80</td>
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<tr>
<td>1995</td>
<td>756.9</td>
<td>56.66</td>
</tr>
<tr>
<td>2000</td>
<td>900.2</td>
<td>52.89</td>
</tr>
<tr>
<td>2006</td>
<td>981.8</td>
<td>50.83</td>
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Source: Various issues of Tea Statistics, Tea Board, India

Period of decline in volume of tea sold in auctions coincided with the period of liberalization in India. Liberalization process facilitated buyers' concentration and subsequently they could exploit certain anomalies in the auction process. The loss in auction volumes was compensated by the corresponding increase in private sales. Indeed, since 2001 producers especially in north-eastern India had actively explored and pursued private sales as an alternative channel for the primary marketing of tea partly because of permitted liberalization but also in search for better price realizations at a time when price
realization at auction was poor. Private sales were clearly emerging as an alternative primary marketing channel for tea. In keeping with the liberalization scenario and subsequent to the clause 17 relaxation of TMCO in early 2001, auction volumes as a per cent of total production declined in both north-eastern and southern India. In north-eastern India, the reduction has been fairly significant from 49 per cent to 42 per cent between 1995-96 and 2004-05 whereas in southern India this impact was less severe (from 83 per cent to 80 per cent) (Tea Board, 2005).

There are certain loopholes in the auction process in India which may result in formation of cartel among the few major auction buyers (Tea Board, 2003). There was in the past some evidence of collusion among brokers to influence prices (Tea Board, 2003). United Nations Committee on Trade and Development (UNCTD) pointed to the danger arising from links between brokers and big buyers (Kitous & Christelle, 2007). In 2001, J Thomas & Co. Ltd. was the largest tea brokers in the world and participated in 33 per cent of all the tea auctioned in India (155 million kg). Carrit Moran & Co. Ltd., world’s second largest tea broker, handled 24 per cent of auctioned tea in India. There were only four registered brokers at Calcutta (Transfair, 2003). The concentration of buyers in most auction centres and presence of few brokers at auctions might create an unhealthy collusion between the two (Asopa, 2007). Auction anomalies further complemented such a trend. A review of the auction system in India can be attempted here.

Activities in tea auctions are a complex interplay of the various stakeholders namely producers, buyers, brokers, warehouse-keepers and the Tea Trade Associations (the auction organizers). These stakeholders participate in the auctions adhering to a set of auction rules that have been laid down (and modified from time to time) by the Ministry of Commerce, Government of India, through the Tea Board, India. Though there is plethora of auction rules across auction centres, broadly the auction rules can be divided into two categories- rules related to auction principles and rules related to the auction process. Rules relating to auction principles mainly involve lot size, divisibility and bidding for others. Rules relating to auction process mainly involve pre-sale (like catalogue closing, sampling, withdrawals etc.), sale (advancement of bids, reopening of bids etc.) and post-sale (reprints, prompts etc.) conditions.
9.2.1 Rules related to auction principles

Lot size\(^1\): The rules are largely similar across north-eastern and southern India where minimum lot sizes are stipulated by tea category as well as size of the estate (Tea Board, 2003). Unlike in India, lot sizes in Colombo and Mombassa have to be in multiples of 10 presumably given the bulk, export-oriented nature of the tea auctions in those two countries. It should be noted that in India lot sizes are defined in terms of number of chests/bags rather than in terms of weights of lot. This effectively means that even with the minimum lot size rules in place, the actual quantity of tea sold per lot can vary widely depending on the actual average weight of a lot for a particular tea category at a particular auction centre. Thus effectively, though the minimum lot size rules exists, in practice significantly varying quantities of tea are sold per lot across auction centres which somewhat neutralizes the basic objective of the rule (Tea Board, 2003).

Divisibility of lots\(^2\): Divisibility rules in India are far more liberal than in Colombo and Mombassa (Tea Board, 2003). In fact divisibility norms in southern India are perhaps the most liberal in the world with lots of 35 packets and above being allowed to be shared by upto four buyers. Also since divisibility rules do not take into consideration the variable lot weights across different centres, effectively, vastly different quantities of tea are being divided even though divisibility rules are similar. Divisibility issue should be viewed from the fundamental auction principle standpoint namely that all buyers must put the winning bid in any auction system for them to buy the tea. Divisibility of any kind contradicts this basic auction principle since it permits some buyers to buy tea without putting the winning bid. When a knocked down lot is divided among three buyers, effectively two buyers out of three buyers purchase tea through the auction system without bidding. In the Indian context, this assumes significance since it has been observed that across auction centres whenever a lot is permitted to be divided it is in fact almost always divided and that too to the fullest extent possible (Tea Board, 2003). This effectively means that significant quantities of tea are sold through the auction system to buyers who have not put the winning bid for the tea. It can be argued that both Colombo and Mombassa too permit

\(^{1}\) Minimum number of lots (packets) to be purchased by a buyer

\(^{2}\) Rules related to sharing of lots purchased by a buyer with others who did not participate in auction
divisibility but it should be noted that the rules apply essentially for extremely large lots. In the Indian context, the divisibility rules have resulted in another system weakness from a control standpoint namely that it technically permits some buyers to buy their entire requirement of tea without making a single winning bid. Thus particularly in Indian context, divisibility weakens the fundamental spirit of the auction system. Further, as observed in actual situation, divisibility rules encourage the small buyer to become a sharing buyer rather than the winning buyer since the small buyer is always worried about the risk of being stuck with a large lot. Thus, existing divisibility rules encourage big buyers to participate actively in the auction whereas small buyers function as sharing buyers who do not participate in the bidding process. As a result, number of buyers participating in the bidding process remains relatively low and the auction process get dominated by few big buyers (Tea Board, 2003).

Bidding for others (proxy bidding): Proxy bidding is permitted at all Indian auction centres though the number of other buyers a particular bidder is allowed to represent varies. For example, in southern India, a buyer is allowed to bid for two other buyers whereas in Guwahati a buyer can bid for four other buyers (Tea Board, 2003). A fundamental auction principle is that a buyer must be present in the auction room to make his bid so that effectively there is more competition in the auction room Viewed in this context proxy bidding is a distortion of this rule and for this reason it is not permitted in certain international auction centres (Colombo auction for example). However, in Indian context, as there are six auction centres which sometimes operate simultaneously and given the fact that same buyer may operate through multiple sister companies, withdrawal of proxy bidding facility is perhaps may not be feasible. There is however, a discrepancy that proxy bidding has created. Currently, buyers have to participate in a minimum 25 per cent of the sales (minimum 13 sales) as one of the conditions to be eligible for trade samples (Tea Board, 2003). However, as per existing rules this minimum participation norm is satisfied irrespective of whether the buyer is actually present or not. This has effectively created a lacuna in the system since it technically permits a buyer to purchase its entire requirement of tea without ever physically participating in the auctions. Further, big buyers

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3 A buyer who is present at the auction room is allowed to bid on behalf of others who are not present
can take advantage of proxy bidding provision by taking part in at multiple auctions simultaneously through sister concerns. This facilitates big buyers’ concentration and subsequent cartelization at auctions.

9.2.2 Rules related to the auction process

Pre-sale activities: The main rules related to pre-sale activities are those pertaining to catalogue closing time, sampling and withdrawal of lots.

Catalogue closing has a direct bearing on the transaction time and cost (higher warehousing and holding cost) and also provides buyers with advance information on teas to be offered in subsequent auctions. In north-eastern India catalogue closing time is 20 days whereas in southern India this varies from 11 to 13 days (Tea Board, 2003). Further in north-eastern India, because of the seasonality of production, auction committees have historically regulated the quantities to be auctioned in each sale so that tea is available the whole year round (i.e. 8 months production is sold through auction over 12 months). However, in the post-liberalization period, the regulation of tea by north-eastern Indian auction centres has a negative implication. As the season progresses to an end, stock of tea that enters the auction system has to face a prolonged wait till those are catalogued and sold. The situation worsens further if such tea has to be subsequently reprinted. Southern India does not face this issue at all as tea is a perennial crop there and is available all year round. Also catalogue closing time in southern India is lower than that in Colombo and Mombassa (Tea Board, 2003).

In the auction system, sampling is the major promotional tool of the seller where tea sample is sent to all eligible buyers through the broker so that buyers can taste the tea and place their bid accordingly. Sampling is a promotional tool and it has an attached sampling cost which is borne by the producer. Across tea categories, Mombassa auction has lowest sampling percentage in the world (0.14%) while Darjeeling tea auction at Kolkata centre has highest (1.51%). Overall with the exceptions of Kolkata (1.51%) and Siliguri (1.31%)

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4 The time between receipt of tea and finalization of sale catalogue
5 Unsold tea put in the auction process again
6 Sample is drawn from the tea received at the warehouse for auctioning and sent to listed buyers for evaluation of quality
sampling percentage across Indian auctions is below 1 per cent. In southern India, sampling percentage is relatively modest (between 0.3 to 0.4 %) (Tea Board, 2003). Big buyers and their sister concerns receive a sizable amount of tea free because of sampling provision and the respective cost is borne by producers particularly in north-eastern auction centres (Tea Board, 2003).

Withdrawal of lots once catalogued for sale is not allowed at all in southern Indian auction centres as well as Mombassa and Colombo auctions. North-eastern Indian auction centres are the only exceptions in this regard. Cataloguing time is highest in north-eastern India because of the seasonality of crop and consequent auction supply regulation. Hence a seller is provided with some options and is allowed to withdraw a lot at least 10 days before the date of sale (Tea Board, 2003).

Sale related rules: The main rules related to the sale procedures are rate of advancement of bidding and re-opening of bids.

Rate of advancement of bidding and the related slabs varies widely across auction centres in India and in practice ranges from 20 p to Rs 1. Low rate of advance reduces auction speed. Also rate of advance such as 30 p (as at Cochin auction centre for example) is administratively odd to handle especially as presently all auctions operate on an ‘open outcry’ manual system with no electronic support whatsoever in the auction room (Tea Board, 2003).

Re-opening of bids is allowed in all auction centres in India till five subsequent lots are allowed for sale (the only exception is Cochin where it is three subsequent lots) (Tea Board, 2003). In Colombo and Mombassa auctions, re-opening of bids is not allowed. Re-opening of bids slows down the auction process and also encourages trend based bidding which runs contrary to the spirit of auctions.

Post-sale rules: The main rules related to post-sale activities are those related to reprints/unsold lots, prompt period and brokers’ remuneration.

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7 Withdrawing tea from auction process after finalization of catalogue
8 Movement from lower bid to higher bid
9 Renewal of bidding process for tea not sold earlier in the same date
In north-eastern auction centres in India, reprints\textsuperscript{10} are allowed in the 3\textsuperscript{rd} week from the date of original sale with fresh sampling. In southern India, reprints are allowed in supplement catalogue in the next week without sampling or in the main catalogue in the 2\textsuperscript{nd} week from the date of original sale with fresh sampling. In both north-eastern and southern India there is no limit on the number of times the same lot of tea can be reprinted. Incidentally, both at Colombo and Mombassa auctions reprints are permitted via a separate reprint catalogue. Reprints put a significant burden on the auction system both in terms of time and cost and in terms of wasted effort in selling a lot by the broker. On an average at least 15-20 per cent of the lots across catalogues are reprint lots of which a few are multiple reprints (Tea Board, 2003).

Sale of unsold lots is permitted across all auction centres in India (as well as internationally) and such sales are treated as private sales and recorded as such in the auction statistics.

Prompt date\textsuperscript{11} has a direct bearing on the competitiveness of the auction system in terms of transaction time and cost. The rules regarding prompt varies across auction centres. Colombo auction with a ‘6\textsuperscript{th} working day’ prompt is the fastest while Indian centres with a ‘12\textsuperscript{th} -15\textsuperscript{th} day’ perhaps the slowest. Prompt is technically not a credit period but in north-eastern India it is treated as a credit period for selective buyers. This makes north-eastern India auction system vulnerable to the potential risk of default. In general for buyers who buy for themselves in the auction, longer prompt does not have much significance because in practice they usually pay well ahead of the prompt date. But for agents longer prompt period has significance since they often wait to get paid by their principals (Tea Board, 2003).

The main remuneration specified in the auction system is brokers’ commission which is currently 1 per cent of the selling price and payable by the seller across all Indian auction centres. Buyers pay no brokerage in India unlike in Mombassa where there is a buyer brokerage of 0.5 per cent in addition to a seller brokerage of 1 per cent. As brokers are few

\textsuperscript{10} Unsold tea in a particular auction entering the auction process again in subsequent weeks

\textsuperscript{11} The maximum time that is allowed between sale of tea and date of receipt of money by the producers
in numbers and are in a position to influence buying pattern, broker-buyer collusion is quite eminent and often observed in Indian auctions (Tea board, 2003, Asopa, 2007).

One of the most primary objectives of the auction system is price discovery. As regards the price discovery process all Indian auction centres have an ‘open outcry’ bidding system and all the auction room activities are handled manually. Some of the major drawbacks of a manual auction room are

1. The ‘open outcry’ process provides shorter time for price discovery (roughly 20 to 30 seconds per lot) (Tea Board, 2003). Also there is always a pressure on the participants to complete the catalogue for the day which dilutes the quality of the price discovery process.

2. The ‘open outcry’ system can not ensure anonymity of bids

3. The current manual system necessarily has to have a serial bidding sequence. Next lot comes up for sale only after the previous one is completed. This puts a pressure on ‘completing’ the catalogue and also makes the system vulnerable to trend based bidding since the market trend of the sale is soon known.

4. In a manual system there is no record of bid history. Records exist only for the sale made.

5. A manual system requires enormous back office operation and does not facilitate real time information dissemination. It takes a longer time to compile sale data and there is wasteful duplication of paper works by many agencies.

All the above drawbacks of the current manual system can be overcome by the introduction of an electronic auction room.

From the above review of auction principle and process, it can be said that divisibility of lots and proxy bidding are the two most important factors which impede the basic auction principle that all buyer must be present at the auction room and that the product goes to the highest bidder. Scope for proxy bidding and divisibility of lots leave enough room for buyers to form cartel. Greater flexibility in sale related rules like higher catalogue closing time, sampling obligation and provision for withdrawal of lots allow the big buyers to
consolidate their hold on auction process. Low rate of advancement of booking and reopening of bids slow down the auction process and big buyers often take advantage of this lacuna. Post sale auction rule like longer prompt date further undermines the competitiveness of the auction process. Moreover continuation of the practice of manual auction room (open out-cry bidding process) prevents democratization of auction buyers. In order to universalize auction process manual system should be replaced by electronic system. Overall the present auction mechanism does provide some opportunities for formation of cartels among the big buyers (Tea Board, 2003).

9.3 Concluding remarks

There had been a growing concentration of buyers' in Indian auctions since early nineties. Few international blenders and distributors controlled most of the tea auctioned in major auction centres. Large companies had such sizable purchasing power that they could influence the price for particular qualities and types of tea at auctions. Buyers, who had presence along the entire commodity chain, benefited from lower price realization at auctions during late nineties and early this decade. Buyers' concentration at auctions further led to a smaller number of retailers which implied less competition at the retail level. Moreover, the retail tea markets in major tea producing countries were also controlled by few international blenders and distributors. From the marketing perspective, because of greater integration along the supply chain, few traders could dominate the entire supply network. This took place through financial coordination, vertical integration with local retailers and through mergers and acquisitions.

Also there had been a change in the profile of tea as a commodity in the last two decades. Gradually, in the retail market, tea is being positioned as a branded product. Such development was related to the tendency towards a shift from manufacturing to marketing. Both Hindustan Lever Limited and Tata Tea, presently the two major tea sellers of the world, initiated restructuring from production to marketing since early nineties. Such restructuring is based upon both companies change in orientation away from producing tea and towards being sellers of tea. Both companies realized that their
level of profit could be greatly increased by selling branded and processed tea rather than owning plantations.

Also, auction process, as an instrument of primary marketing of tea, was loosing some of its vitality over the last one decade as percentage of tea sold through auctions was showing a declining trend. Certain inherent flaws (like proxy bidding, divisibility of lots, manual auction system, long drawn auction procedure) in auction mechanism were exploited by the big buyers. They were forming cartels among themselves and also with brokers and in the process exploited the existing anomalies of the auction process.