Teakoe: The Path To Growth

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Introduction

Lemon, Ginger, and Spearmint. As he held the cup close to his mouth, Paul felt the steam from his new aromatic tea rise, enveloping his nose and face. The warm mist and elegant smell brought a smile to his face as he thought about the future of his start-up company. It had only been five short years ago when Paul first approached his long time friend Cole with the idea of launching a tea company. Now their Teakoe products were being sold in over 300 establishments ranging from hotels to restaurants to health clubs.

As Paul reflected on Teakoe’s successes, he could not help but to return to a question that had been on his mind: was Teakoe growing in the best possible way? Was it best to continue to spread their efforts across an array of wholesale segments or was it spreading itself too thin? Would Teakoe be better off focusing on a particular product and/or market segment?

Teakoe Background

Paul Fry first came up with the idea for Teakoe in 2008. As a young, professional lacrosse athlete playing for the Denver based Colorado Mammoth, he was devoted to maintaining his health and pursuing an active lifestyle. With a mind towards health, he began blending his own tea as a healthy, flavorsome alternative to sugary beverages. As Paul experimented with various spices, fruits, herbs, and teas, he began to recognize the need for a tea that appealed to a younger demographic, interested in unique innovative flavored tea blends that offered the potential of healthy alternatives to commercial sugar based beverages (Teakoe, n.d.).

Paul’s vision expanded toward establishing a brick and mortar tea café. He decided to approach his long-time friend, Cole James, with his idea of launching a new company and employing creative marketing strategies to provide signature hot and iced teas geared to younger consumers interested in unique health-based products. Cole excitedly agreed. Cole’s skill base as a 6-plus year professional background with Starbucks provided the venture with a resource to understand the challenges of targeting unique wholesale markets, an understanding of value chain management, and a successful track record with product market segments. After a handshake, Paul and Cole rolled up their sleeves and started to work.
The two worked for over a year to develop signature blends that appealed to consumers. The company introduced its first product in 2009 at a local Denver farmers market with the goal of learning about consumer demand, tastes, and preferences. Laboriously seeking and incorporating feedback from potential customers, Paul and Cole worked to develop a sophisticated understanding of customer tastes and preferences. As Paul and Cole learned more about their potential customers, they continued to learn more about exotic ingredients, their flavor profiles, and health attributes. They eventually developed several bagged tea products specially designed for either hot or cold consumption and began to sell these products directly to consumers at various farmers markets and special events.

As Paul and Cole surveyed younger customers about their tastes and preferences, they recognized an increasing trend among young clientele to frequent fast casual restaurant establishments. Unlike the fast food segment—commonly referred to as the quick service segment—the fast casual restaurant segment offered higher quality, innovative menu items in a pleasing environment. While prices at fast casual establishments were typically higher than that of the quick service segment, the fast casual segment was able to offer lower prices than the table service segment due to its lower overhead and faster table turns.

While the fast casual restaurant concept first took hold in the mid-1990s, it did not become mainstream until around 2010. Three areas in the U.S. to experience the fastest growth in the number of fast casual establishments were the Denver, Fort Collins, and Boulder metropolitan areas—all in close proximity to Teakoe’s headquarters in west Denver (Brandau, 2013). Because of Teakoe’s proximity to this rising trend, Teakoe founders were uniquely positioned to recognize the nationwide trend for fast casual growth and the need for fast casual restaurants to offer innovative, high quality, small batch iced teas. The two founders felt confident that they could bring innovative, small batch, iced tea to fast casual restaurants to complement each restaurant’s unique, high quality menu items.

As a result, Teakoe broadened its strategy to also target several of the national fast casual chains headquartered in Colorado and other western states. Unlike its direct sales to consumers of single serving tea bags, the products sold to restaurants were for larger quantity brewing. A more significant difference between their retail and wholesale activities involved the various services Teakoe provided to the restaurants with which it worked. Teakoe worked closely with restaurant owners and chefs to develop signature products for individual restaurants complementing the restaurant’s unique menu. Teakoe also provided design services to develop dispenser designs and labels exclusive to each partner restaurant. By 2010, Teakoe had developed contracts with fast casual restaurants including Denver Quizno’s locations and Smashburger—a national fast casual chain.

As Teakoe worked with various fast casual restaurants, the company developed unique capabilities to serve a broader wholesale market which included hotels, spas, and health
clubs. In 2011, Teakoe brought on its first full-time employee to market exclusively to the wholesale market. Teakoe continued to make headway between 2011 and 2013, particularly in the fast casual wholesale segment, signing numerous contracts with multi-site fast casual restaurants such as Famous Daves, Mad Greens, and Larkburger. Teakoe also had success in penetrating the resort and spa wholesale segment signing contracts with companies such as the Four Seasons in Denver and several world-renowned ski resorts.

By the end of 2013, Teakoe was selling hot and iced teas to five major customer segments. In the wholesale market, Teakoe sold to restaurants and cafes, spas and health clubs, hotels and resorts, and specialty retail stores such as specialty grocers and boutiques. Teakoe also sold direct to customers through their website.

Teakoe’s Strategy

Teakoe took advantage of industry dynamics that allowed small firms to avoid direct competition with large established firms by providing highly differentiated, highly tailored products to unique market niches. Specifically, Teakoe’s strategy was to target restaurants, hotels, spas, and specialty grocery and boutique stores by providing them with high quality, innovative tea blends using a variety of exotic ingredients. While Teakoe’s blends could be used to brew hot or iced tea, its niche was providing the hospitality industry with tea blends specifically designed for fresh iced tea consumption. Accordingly, many of the tea blends were developed with a focus on creating flavor profiles desirable in iced tea. While Teakoe’s primary focus was on the wholesale market, the company also sold products directly to consumers through their website.

Raw Materials Sourcing

To help ensure ingredients met their stringent quality standards, Teakoe developed a long-term purchasing relationship with one of the industry’s largest processed tea wholesalers with a broad and expansive supplier network. Because of the scale of operations, the supplier also sold a variety of high quality, exotic herbs, spices, and fruits from various parts of the world. Teakoe’s longstanding relationship with a reliable supplier helped the firm by decreasing the likelihood of unplanned supply shortages and reducing excessive supply cost volatility.

Teakoe’s raw ingredients were sourced from various countries including Argentina, Brazil, Chile, Peru, Indonesia, India, Egypt, and South Africa. Founders leveraged their extensive knowledge concerning differences in agricultural standards, optimum climate conditions, and regional farming specialties to guide purchasing decisions to attain the highest quality and most complex flavor profiles achievable.

Production and Operations
In 2010, Teakoe began leasing a 2,000 square foot facility in the heart of the industrial district of Lakewood, Colorado, a part of the Denver metropolitan area. The facility housed the firm’s entire operations including marketing, sales, production, and product development. Two-thirds of the facility was devoted to production, warehousing, and product development. As a young start-up, Teakoe managers conducted operations as lean as possible, opting to blend and bag tea by hand rather than investing in expensive production equipment.

With an emphasis on quality, Teakoe had strict quality controls in place storing ingredients in vacuum-sealed containers and continuously monitoring and regulating the facility’s temperature and humidity to provide the ideal storage conditions. Tea was blended as orders were placed to guarantee freshness and quality. Blending as the tea was ordered also allowed the company to take advantage of unforeseen and rare opportunities to purchase particularly exotic and/or high quality ingredients when those supplies became available. Flexible operations also allowed Teakoe the ability to instantly tailor a product to a particular customer’s unique tastes and quickly respond to industry trends.

Because each product was hand blended, each product was individually tested for quality and freshness allowing Teakoe to consistently deliver fresh, high quality products. Flexibility in production also allowed the Teakoe workforce the opportunity to casually experiment with new flavor profiles frequently resulting in new product introductions.

Because of differences in the brewing techniques for hot and iced tea and differences in tea properties, the size of grind and the tea bag used was different based on whether the user’s intent was to serve the tea hot or over ice. Tea was packaged and labeled according to whether it was intended for hot or iced tea consumption.

As orders were filled, the product was shipped to the buyer via FedEx, UPS, or USPS.

**Product Development**

Between 2009 and 2014, Teakoe had developed 28 teas—16 of which were controlled solely by Teakoe and 12 of which were developed for a specific client. Signature blends were made using exotic ingredients, such as Rooibos and Bergamot, that were sourced from 8 different countries. The original founder, Paul, was primarily responsible for product development. Even as the company grew, Paul continued to be involved in farmers market sales and other sales events to collect firsthand feedback from customers. In addition to carefully following nationwide beverage trends, Paul learned about culinary practices and constantly examined culinary trends to find unique flavors and combinations.

In addition to new blend introductions, Teakoe founders had developed two distinctive bag designs. As opposed to selling their tea blends in a standardized ingredient and bag format that could be used for either hot or iced tea consumption, Teakoe developed two
distinctive bags and specific tea blends based on whether the tea was to be consumed hot or cold. These innovations were designed to account for the inherent differences in the hot and cold tea brewing processes and differences in desired product attributes between hot and iced tea.

Sales And Marketing

To service the various wholesale markets, Teakoe hired its first full-time employee in 2011 to act as a business development manager. The new business development manager, with an extensive background in marketing and sales, brought new sales and networking capabilities to the firm. The business development manager was responsible for developing new relationships with restaurants, hotels, spas, and grocery stores, but all three members of the Teakoe team were involved in managing relationships with clients. Teakoe founders gave the new business development manager autonomy to make decisions about customer relationships and sales strategies and worked to create an environment in which each team member was regarded as an equal.

With a small staff of three, each of the Teakoe team members worked closely with wholesale buyers. After working with a large restaurant chain that launched a new beverage strategy working alongside Teakoe, and after much success brought beverage development in-house, Teakoe founders placed tremendous emphasis on developing close, collaborative relationships with their customers and providing customers with a clear, identifiable value proposition that included not only product development, but also in-store marketing expertise. Teakoe devoted a significant amount of attention to establishing close ties with customers and to working with customers to develop bright, creative displays that reflected not only the restaurant’s image but also the Teakoe image. All the dispenser labels prominently displayed the restaurant’s name and logo and in about half of the restaurants, the dispenser label also included the Teakoe name and logo.

Teakoe’s geographic proximity to three of the fastest growing metropolitan markets for fast casual dining with the highest number of fast casual restaurants per capita provided the company with more than enough business development opportunities to keep the three occupied. Consequently, the majority of sales efforts were directed towards the Denver, Boulder, and Fort Collins metropolitan areas. The three Teakoe team members also collaborated to develop a list of nationwide sales prospects which included individuals in their professional network who were involved in the restaurant, hotel, or spa industries. By the end of 2013, although the majority of Teakoe’s restaurant revenue was generated in Colorado, the company reported restaurant sales in numerous other states including California, Utah, Wyoming, Arizona, Nevada, Kansas, Missouri, Texas, Maryland, and New Jersey. Furthermore, the vast majority of revenue generated with restaurants was from the sale of iced tea blends.

Teakoe restaurant sales were distributed across various types of restaurant structures which included single establishment restaurants, multi-establishment non-franchised establishments, and franchises. Restaurant needs tended to vary based on the ownership
structure. Single and multi-establishment restaurants that were not associated with a franchise found great value in Teakoe’s up-to-date knowledge concerning beverage trends, unique product innovations, and efforts to stay at the forefront of new beverage trends. By collaborating with Teakoe to develop signature blends that complemented the restaurant’s unique menu selection, restaurant owners were able to focus on their food menu while continuing to offer fresh and innovative beverages. Also, iced tea generated about twice the margin as soda for the restaurants.

A significant part of Teakoe’s value proposition to restaurant owners involved designing attractive and creative iced tea dispenser displays to lure customers to select the higher margin iced tea products over other beverages. Although the displays took up a significant amount of restaurant space, restaurant owners found that as a result of the display and product offerings, they experienced a higher volume of customers during the off-peak hours who purchased a single, iced tea beverage. Consequently, some of Teakoe’s clients began to recognize the opportunity to pad revenue during off-peak hours by attracting customers who would otherwise buy a beverage from a different seller such as a convenience store or coffee shop.

With one full time sales manager on staff, the majority of Teakoe’s sales resources were devoted to developing new restaurant clients and servicing existing restaurant clients. Most of Teakoe’s remaining resources were directed towards increasing their presence in hotels and spas where Teakoe had also successfully gained market share.

Although Teakoe had long-term ambitions of eventually supplying products to large, supermarket chains, the company had primarily focused on selling to smaller, privately owned, upscale gourmet markets. To generate supermarket demand, Teakoe worked with a handful of stores, such as Fresh Market in an upscale Denver community, conducting in-store promotions. Consistent with its founding tradition, Teakoe’s managers were extensively involved in in-store promotions and sought detailed feedback from customers. From these events, the founders learned that the Teakoe packaging was not distinctive enough to draw customer’s attention given the massive variety of boxed teas on store shelves. Additionally, Teakoe owners recognized inconsistencies in their branding whether on packaging, restaurant labeling, or promotional events. As a result, Teakoe owners worked to develop a consistent branding message that asserted Teakoe as a young, fresh, innovative tea product. Consequently, Teakoe engaged in a significant packaging redesign project that combined bright colors and eye-catching retro graphics to reflect Teakoe’s energetic and playful feel.

Lastly, Teakoe sold its product directly to consumers through their website. This sales channel generated a relatively insignificant amount of revenue but Teakoe management felt it was important to provide easy access to end consumers to support overall consumer demand for the product.

Target Markets
Restaurants. Restaurants were a significant target market for Teakoe. Tea sales to the food services industry were estimated at $1.2 billion in 2013 (Tea Association, 2014a). The number of tea beverages included as menu items grew by 11.2 percent from 2008 to 2010 making tea the third most-available type of non-alcoholic beverage (Wolf, 2011).

Growth in the fast casual market segment provided additional opportunities because of similarities between the value proposition offered at fast casual restaurants and that offered by Teakoe. Fast casual grew by 13% in 2014 compared to overall restaurant industry that grew by 3.8% (Techtronic, 2015). Teakoe and the fast casual restaurant segment also targeted similar consumers. Fast casual restaurants were particularly popular among Millennials (QSR Insights 2014). Surveys of customers found that 81% of customers believed that beverage quality was an important factor in their decision to go to a particular fast casual restaurant. Among fast casual consumers, 20% visited a fast casual restaurant just for a beverage only, yet 90% of individuals who purchased a meal also purchased a beverage (Techtronic, 2014).

The nature of contracting with franchised restaurants varied depending on the franchise. In general, franchisors developed corporate contracts with suppliers and required franchisees purchase from contracted suppliers. Whether or not beverage suppliers were contracted at the national franchisor level or by individual franchisees depended on the individual franchise. Accordingly, for some franchises, distributors worked directly with a centralized purchasing group for the franchisor, but for other franchises, distributors worked with individual franchisees. Typically, franchisees owned more than one of the franchised establishments and located their network of establishments within a given geographical area. As a result, working with a franchisee typically resulted in multi-establishment contracts.

Working with franchisees and franchisors presented significant opportunities but also some unique challenges. Corporate contracts with a national franchise provided access to a much wider geographic region and allowed Teakoe to expand its reach, but national franchisors typically wanted to private label the tea which limited Teakoe’s ability to further grow its brand. National franchisors were also more likely to be able to move beverage development in-house if supplier costs were not in their favor. Rigid contract requirements and high pressure for lower prices posed significant challenges to servicing national franchisors. Alternatively, franchisees tended to be more willing to co-brand dispensers with but required greater support with managing inventory and dispenser equipment.

Hotels and Resorts. The high concentration of hotels and resorts in Colorado and the western area of the U.S. presented Teakoe with additional opportunities. Hotels and Resorts were projected to increase revenues by 3% between 2014 and 2019 as the economy rebounded (Brennan, 2014). High quality beverages were important to some high-end hotels and resorts as a way to enhance the customer experience. Bar and restaurant sales accounted for 12% for revenues in the hotel and resort industry. Hotels were also increasingly improving the quality of their restaurants and bars to lure in
customers that would stay elsewhere were it not for the hotel’s restaurant and bar amenities.

A challenge of selling to this segment was obtaining access to large hotel and resort chains that had significant product demands but rigid purchasing procedures. Concentration in the hotel and resort industry was forecasted to increase over the next several years with future hotel buyouts and mergers. Hotels and resorts also varied tremendously in terms of their focus on cost containment versus creating a quality customer experience. Often within a single hotel, decision makers held very different positions on these issues depending on their role in the organization.

**Spas and Health Clubs.** The spa and health club segment was a $14.7 billion dollar industry in 2013 and was projected to grow by 4.5% annually between 2013 and 2018 (Moldvay, 2013). The western portion of the U.S. had the third highest share of spa and health clubs in the nation. The industry was highly fragmented with an estimated 20,774 spas in the U.S. in 2013. Baby Boomers were a significant area for growth in the spa and health club segment primarily because of their increasing focus on health and their relatively high disposable income.

Teakoe had experienced some success selling to high-end spas, but the small quantities purchased and the fragmented nature of the industry had limited Teakoe’s growth in this sector. Spas were increasingly working to differentiate their firms by their unique sections of skincare and haircare products and placed far less emphasis on trying to differentiate their spas by their food and beverage options.

**Specialty Grocery and Boutique Stores.** Specialty grocers and boutiques accounted for 15% of tea revenues in 2014. Consumers of specialty grocers tended to be more health conscious and possessed higher levels of disposable income. Promotional opportunities common among specialty grocers also allowed Teakoe to leverage the store’s existing customer base to build brand recognition.

Despite the increase in consumer demand for healthy products and increase in disposable incomes, growth in this segment was only predicted to be 1.3% annually between 2013 and 2018 (Lerman, 2013). Small growth was projected because of increasing competitive pressures from large, traditional grocers.

**Online Sales.** The total revenue associated with e-commerce reached $297 billion in 2014. Growth in e-commerce was expected to outpace growth in GDP between 2014 and 2019 (Lerman, 2014). The increase in online sales was largely driven by increased availability of high speed Internet, consumers’ desire for convenience, capabilities in mobile payments, and growing acceptance of online retail sales as a standard outlet for purchases.

A key success factor for firms conducting online sales was its ability to continually direct traffic to their website. Brand awareness and brand loyalty helped firms attract repeat
buyers and ensure continued traffic to the firm’s website. Teakoe’s online sales were relatively small compared to other market segments and customers buying from the website often reached out to the website after having Teakoe tea in one of the hospitality establishments previously discussed.

**Future Growth**

Between 2009 and 2014 Teakoe had grown revenue and was being sold in over 300 establishments. Despite this growth, Teakoe founders questioned whether the strategy they were pursuing was the best method for growth. Eager to get their product into the hands of consumers, Teakoe owners did not want to close any doors that would allow them to reach consumers, but the owners felt that perhaps the company needed greater focus.

Was Teakoe growing in the best possible way? Was it better for Teakoe to spread its efforts over numerous wholesale segments and product segments or should it narrow its focus on particular wholesale and/or product segments?
Appendix: Industry Data

Tea Industry Overview

Teakoe was able to take advantage of growth in the overall tea industry. Between 2010 and 2013, the overall tea industry had grown by approximately 4% annually into an estimated $7 billion dollar industry (Mintel, 2013b). The overall tea industry was comprised of four industry market segments—(1) the canned and bottled shelf stable ready to drink (RTD) tea segment; (2) the ready to brew (RTB) bagged, loose leaf, or single cup bagged tea segment; (3) the refrigerated RTD tea segment; and (4) the instant tea segment. Over the past several years, the U.S. tea industry had changed significantly as firms rapidly introduced new product innovations and consumer demand shifted from traditionally strong industry segments towards traditionally smaller industry segments. While the shelf stable RTD industry segment had traditionally dominated the U.S. tea industry, accounting for approximately 59% of the market in 2010, the industry segment began to lose some of its market share to the RTB and refrigerated RTD industry segments.

Between 2010 and 2013, the RTB and refrigerated RTD industry segments were responsible for a disproportionate amount of growth in U.S. tea sales. Mintel (2013b) research found that in 2010 the RTB and refrigerated RTD tea industry segments made up approximately 23% and 10% of the U.S. tea market, respectively, compared to the shelf stable RTD industry segment that made up approximately 59% of the market. However, from 2010 to 2013, RTB and refrigerated RTD sales growth accounted for approximately 68% of total tea sales growth compared to shelf stable RTD sales growth that accounted for approximately 36% of industry growth. Additionally, the instant tea industry segment which accounted for approximately 8% of the total U.S. tea market in 2010 continued its decline, experiencing a 7% decline in sales between 2010 and 2013.

Among the teas consumed in 2012 approximately 85% of tea consumed in U.S. was served as iced tea (Tea Association, 2014). Black tea accounted for about 84% of all tea consumed, green tea accounted for 15% of consumption, and oolong and white tea made up the remainder of tea consumption.

Major Trends In The U.S. Tea Industry

While tea was consumed in approximately 80% of U.S. households, U.S. consumption of tea fell behind that of coffee, bottled water, soft drinks, milk and juice. Despite this ranking, the tea industry benefited from greater consumer interest in foods and beverages consumers believed were healthier or provided health-enhancing benefits. As more consumers became health conscious, tea consumption continued to grow while carbonated soft drink consumption declined by 3% between 2012 and 2013 (Beverage Marketing, 2014).

Increasing Concerns Over Sugar Intake
The increase in consumer awareness and concerns about the impact of sugar on health had significant effects on beverage consumption. Research linking sugar to a range of health conditions such as obesity, diabetes, heart disease, hypertension, and cancer, and negative publicity for sugary drinks led consumers to increasingly turn to water, tea, and coffee as alternatives to sodas and juices high in sugar (Mintel, 2013b). Research published in 2013 in the American Journal of Clinical Nutrition revealed children and adults were consuming fewer sugar-sweetened beverages than in the previous decade (Kit et al., 2013). Even as consumers were turning to low sugar beverages, diet soda sales suffered a decline between 2010 and 2013 as consumer concerns about artificial sweeteners increased (Mintel, 2013a).

Among the various industry segments, the refrigerated RTD tea segment and the RTB tea segment benefited the most from increasing consumer concerns about sugar and artificial sweeteners. Products in these segments generally contained less sugar and fewer artificial sweeteners than shelf stable RTD products. Researchers also found widespread belief among consumers that tea was a healthy alternative to other beverages. In a consumer survey conducted by Mintel, approximately 59% of respondents agreed that refrigerated RTD teas were healthier than soft drinks and 56% of the respondents agreed RTB tea was healthier than coffee (Mintel, 2013b).

In an effort to respond to consumers’ health concerns, manufacturers of sodas, juices, and energy beverages aggressively invested in new product development and the introduction of products with health attributes. Rapid new product development among firms in these industries would likely place increasing pressure on the RTB tea industry (Mintel, 2013b).

**Awareness of the Health Benefits from Tea**

Increased consumer awareness about the health benefits of tea further supported growth in the tea industry. Researchers linked tea consumption to a variety of health benefits such as improvements in bone health, mood, weight loss, attention, and problem solving abilities. The aggressive marketing campaigns of major tea producers, such as Unilever and Hain Celestial Group, touting tea’s health attributes, benefited all tea manufacturers as consumers’ awareness and beliefs about the tea’s health benefits strengthened (Coughlin 2014).

The increased appeal of tea for its anti-aging and health attributes were particularly notable among the aging Baby Boomers as their health concerns grew. Consequently, growth in the number of individuals age 65 plus was expected to drive growth among RTB herbal and green tea products. Alternatively, individuals ages 18-34 who had generally held the highest regard for the health attributes of tea, were expected to drive growth in the refrigerated RTD industry segment. Demand among individuals ages 18-34 for RTD teas was largely attributed to this population’s desire for convenience (Mintel, 2013b).
Social Dynamics of Tea Consumption

Marketing campaigns promoting the experience of tea drinking, the emergence of specialty tearooms, and the common inclusion of tea on coffee house menus reinforced the sociological aspects of tea drinking, further stimulating the demand for tea. While the overall tea industry was particularly susceptible to economic downturns, refrigerated RTD and specialty RTB teas were relatively isolated from downturns in the economy (Coughlin, 2014). Consumers’ perceptions of refrigerated RTD and specialty RTB teas as affordable luxury goods allowed firms in those industry segments to fare much better than other industry segments such as shelf stable RTD, instant, and traditional RTB tea segments. Ambitious product and packaging innovations in the refrigerated RTD and specialty RTB tea segments further helped to differentiate products and establish brand loyalty. Research in the food and beverage industry found that during economic downturns, consumers were much less likely to switch to low cost, private label options for refrigerated RTD teas and specialty RTB teas than they were for other food and beverage items (AC Nielsen, 2006).

RisingDisposable Incomes in the U.S. and Abroad

As the economy began to rebound from the Great Recession, sales in higher-priced and healthier categories such as refrigerated RTD teas and specialty RTB teas continued to outperform the overall beverage industry. It was predicted that between 2014-2019 an increase in personal disposable income in the U.S. would further fuel tea industry growth. As such, the U.S. tea industry was forecasted to grow by approximately 3.3% annually between 2014-2019 (Coughlin 2014).

Rising consumer spending in emerging markets and increased global interest in healthy lifestyles were also expected to fuel industry growth. By 2014, U.S. tea exports had grown to account for 28.6% of total tea revenue compared to 14.7% five years prior (Coughlin, 2014). Canada, the largest market for U.S. tea exports, accounted for 57.9% of U.S. tea exports, followed by Russia, Japan, and Mexico. Forecasts for 2014-2019 demand suggested that while demand for U.S. tea exports in Canada and Mexico would remain stable, demand from markets such as China, Singapore, and Germany would increase significantly making these markets an important source of industry growth. Consequently, U.S. tea exports were expected to grow by approximately 14.9% annually over the next five years and grow to account for 49.5% of total U.S. tea revenues.

How the RTB Tea Segment Operated

The RTB tea industry segment was highly concentrated with the three biggest manufacturers—Unilever, R.C. Bigelow Inc., and Hain Celestial—accounting for 72.8% of sales in 2013. The remainder of sales was distributed among approximately ninety-six other firms. Despite its relatively high concentration, the RTB tea industry segment had experienced a high number of new entrants in the recent past as new entrants were drawn to the segment by high growth in consumer demand for tea products.
Additionally, new entrants faced few significant entry barriers. Although the major competitors in the industry had large capital investments in manufacturing equipment, new entrants could easily produce their blends by hand. As a result, between 2010 and 2014, the number of firms in the U.S. RTB tea industry segment grew at an annualized rate of 6.4% (Coughlin, 2014).

Despite low start-up costs, new entrants did face significant challenges to effectively compete with major established firms. Well-developed distribution networks, significant purchasing power, established brand recognition, and efficient production capabilities provided major manufacturers with a significant advantage. However, because large manufacturers tended to offer mid- to low-quality products, many small competitors found success capitalizing on the industry’s increasingly fragmented customer needs by providing highly differentiated, highly tailored products to unique market niches.

Because of the climate conditions required to grow tea, almost all of the tea consumed in the U.S. was grown abroad. The majority of tea that reached the end consumer was originally grown on plantations, small farms and farming co-ops. Regardless of where it was grown, most all processed tea eventually ended up in the hands of brokers who would then sell the product to RTB tea companies and, traditionally, the tea brokerage business was controlled by a handful of large players (Groosman, 2011). After purchasing loose tea from brokers, RTB tea manufacturers would blend the tea--sometimes with spices, fruits, and sweeteners--and package the tea at the company’s site. Some large manufacturers such as Unilever and Hain Celestial were increasingly challenging the traditional supply chain model by growing and/or processing tea at company-owned plantations and contracting directly with large plantations.

Tea grades varied widely from mass-marketed, bulk packaged tea to very high-quality, specialty teas. The quality and variety of tea produced varied across plantations, countries, regions and even the time of year. Consequently, unlike other agricultural products such as coffee, there was no single commodity price for tea. The world price was determined through an auctioning system and the average prices at three of the largest auction centers. Historically, market prices for processed tea had been highly volatile due to changing weather conditions and great fluctuations in supply. Oil prices had also put upward pressure on the tea prices. As a result, a key success factor for firms in the RTB tea industry segment was access to a high quality, reliable processed tea supplier and contracts to guarantee future prices.

The extent to which blending and bagging were automated varied across firms depending on the scale of operations. Large manufacturers relied on capital-intensive machinery to blend and bag tea, allowing them to improve efficiency and reduce labor costs. Smaller firms were more likely to blend and bag the tea without the use of expensive machinery. Due to these differences in operations, large-scale producers tended to run large batches of one product, while smaller producers were more apt to run small batches of several, unique blends. Because of these differences, the cost structure between large-scale and small-scale operations varied significantly.
Much of the success RTB firms experienced also depended on access to distribution channels. In 2013, grocery stores accounted for 19.7% of U.S. RTB tea sales. Restaurants, hotels, and other hospitality firms were responsible for 8.4% of sales while warehouse stores such as Sam’s Club and Costco accounted for 25.1% of sales (Coughlin, 2014). A small portion of tea was sold direct to consumers through the Internet. Additionally, some RTB tea firms were selling direct to customers through company-owned brick and mortar, retail stores.

Given the volume of RTB tea sold in grocery stores, access to favorable shelf space and in-store promotional opportunities was a key component to RTB firm success. Grocers had traditionally relied on wholesalers to purchase tea products, but stores were increasingly negotiating directly with suppliers. As tea companies increased their direct sales to grocers and other retail outlets, more RTB tea firms began investing in order fulfillment and order tracking technologies to efficiently manage orders. Large grocery chains tended to have high negotiating power with RTB firms but firms with innovative products and brand loyalty could mitigate some of the grocer’s power over them. To overcome the challenge of obtaining grocery shelf space, RTB firms had increasingly turned to non-traditional retail opportunities with high pedestrian traffic. RTB firms increasingly sold to retail outlets such as convenience stores, mall kiosks, drug stores, and other retailers with high pedestrian traffic.

The final customer decision to purchase tea was largely driven by brand loyalty and the desire for unique product offerings. Over the last 10 years, RTB tea firms had placed increasing emphasis on product development and had increased investments in development staff and scientists to study flavors. As new trends in the tea industry were constantly evolving, firms able to quickly adapt to customer tastes and preferences were more likely to have success in the market. Additionally, firms that were able to differentiate their products and build brand loyalty were likely to reduce customer price sensitivity.

Industry Competition

Competition in the RTB tea industry was largely dominated by three big manufacturers—Unilever, R.C. Bigelow Inc., and Hain Celestial.

Unilever

Unilever, a British-Dutch multinational corporation, operated in a wide array of consumer goods segments such as personal care, foods, refreshments and home care. It is estimated that close to 8% of its $77.7 billion revenue in 2013 was from tea sales. In 2013, Unilever had the greatest market share in the tea industry—52.2% compared to the next largest competitor, R.C. Bigelow Inc. with 9.8% of the market. Lipton is the tea brand Unilever sold to U.S. markets (Coughlin, 2014).
Unilever’s size gave the company a significant advantage in achieving economies of scale and securing favorable transportation rates. Unilever also owned its own tea plantations shielding the firm from supply volatility.

Lipton’s affordability and brand recognition in the U.S. strengthened sales during the Great Recession. However, increased consumer demand for premium brands between 2012 and 2013 was at the detriment of traditional brands such as Lipton. A partnership between Pepsi and Lipton brought new refrigerated RTD products to market and allowed Unilever to leverage its existing brand, extend some of its existing product lines, and take advantage of consumers’ demand for lightly sweetened teas (Mintel, 2013b).

**R.C. Bigelow Inc.**

R.C. Bigelow Inc., a private, family-owned tea company headquartered in Connecticut, had a tea product portfolio that consisted of more than 100 specialty tea products, many were family recipes the firm hand blended. R.C. Bigelow sold its teas through grocery stores, mass merchandisers, health and specialty stores, and its website. Between 2010 and 2013, the company benefited from the increasing demand for specialty teas with unique flavor varieties. Investments in automated manufacturing capabilities allowed the firm to rapidly expand production to meet its growing demand.

**Hain Celestial Group**

Hain Celestial Group was a producer of natural and specialty beverages. Hain Celestial Group was the result of a merger in 2000 between Hain Food Group and Celestial Seasonings. The Celestial Seasons brand included green, herbal, wellness, and chai teas. Between 2012 and 2013, Hain Celestial Group reported growth across its various product lines but its herbal and wellness teas led company growth (Mintel 2013b).

Between 2010 and 2013, Celestial Seasonings sales growth was further fueled by its increased access to grocery store shelf space that was largely the result of Hain Celestial Group’s increased market power as it aggressively expanded its overall product portfolio. It was expected that its strong corporate capabilities and plans to expand product offerings would continue to fuel tea sales growth for Hain Celestial Group in the years that followed.

**Other Tea Producers**

While Unilever, R.C. Bigelow Inc., and Hain Celestial accounted for 72.8% of tea sales in 2013, the remainder of the market share was divided among 96 other firms. Although a number of these firms were small, niche stores with a narrow regional presence, several smaller, pricier brands such as Starbucks’ Tazo tea, the UK’s Twinings teas, and the Oregon-based Yogi teas grew at the expense of sales to more cost conscious brands such as Lipton (Boyle, 2012).
References


