

## Tea selling in Taiwan: The key roles of tea intermediaries

The Taiwanese tea industry got its start when tea trees imported from China got planted in the Taiwanese hills in the mid-1800s. By the late 1920s, there were about 20,000 tea farmers in Taiwan, who sold their product (so-called *crude tea*) to one of about 60 tea intermediaries, who in turn sold it to 280 tea refineries located in Ta-tao-cheng, on the ocean, to ready for commercial sale and exportation. The tea intermediaries traversed the hills of Taiwan to search for and buy tea and then bring it down to the dock to sell to refineries.

But they also suffered a poor reputation among both farmers and refineries. Intermediaries were accused of exploiting the market by buying low and selling high; critics suggested that a simple direct trading system could be instituted to bypass them completely. Thus in 1923, the Governor-General of Taiwan set up a tea auction house in Ta-tao-cheng. Farmers could ship their tea directly to the auction house, where a first-price, sealed-bid auction would determine the price refineries would pay to obtain the products. The auction house's operating costs were covered by farmers' membership fees, trading charges, and subsidies by the Governor-General, so the tea intermediaries suddenly had to compete with the auction house. Despite this new and well-supported form of competition, the intermediaries not only survived, they ultimately forced the closing of the auction house. But how could this outcome arise if they were just "exploiters" of the buy-sell situation?

The answer is that they weren't. They served key functions. First, the intermediaries *facilitated search* in the marketplace. An intermediary would visit many farms, finding tea to sell, which constituted an upstream search for product supply. With the product supply in hand, the intermediary would take samples to a series of refineries and ask for purchase orders. Visiting multiple refineries was necessary because the same variety and quality of tea could fetch very different prices from different refineries, depending on the uses to which they would put the tea. This search process repeated every season, because each refinery's offer changed from season to season. The intermediaries thus found buyers for the farmers' harvest and tea supplies for the refineries.

Second, tea intermediaries performed various *sorting* functions. Crude tea was highly heterogeneous; even the same species of tea tree, cultivated on different farms, exhibited wide quality variations. Furthermore, 28 different species of tea trees grew in the Taiwanese hills! The appraisal process, at both intermediary and refinery levels, therefore demanded considerable skill. Refineries hired specialists to appraise the tea they received; intermediaries facilitated this process by *accumulating* the tea harvests of multiple farmers into homogeneous lots for sale.

Third, tea intermediaries *minimized the number of contacts* in the channel system. With tea farmers and 60 refineries, up to

1,200,000 contacts would be necessary for each farmer to market the product to get the best refinery price (even if each farmer cultivated only one variety of tea tree). Instead, each farmer tended to sell to just one intermediary, such that about 20,000 contacts existed at this first level of the channel. If the average intermediary collected  $n$  varieties of tea, and we assume that each of the 280 intermediaries negotiated, on behalf of the farmers, with all 60 refineries, we find  $[60 \times 280 \times n]$  negotiations between intermediaries and refineries. The total number of negotiations, throughout the channel, in the presence of intermediaries thus was  $[20,000 + 16,800 \times n]$ , a value that exceeds 1,200,000 negotiations only if the number of tea varieties exceeded 70. But because there were only about 25 tea varieties in Taiwan at the time, intermediaries reduced the number of contacts from more than 1 million to about 440,000.

Such value-added activities had been completely ignored in the attacks made on the tea intermediaries as "exploiters." The resulting failure of the government-sanctioned and government-subsidized auction house suggests that, far from merely exploiting the market, tea intermediaries were efficiency-enhancing market makers. In this situation, the intermediation of the channel added value and reduced costs at the same time.