Assessment of Specific Constraints to Agribusiness in Georgia and Methodology for Prioritization

Support of Added-Value Enterprises (SAVE)
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Executive Summary

Support of Added-Value Enterprises (SAVE) is tasked with increasing the productivity and income (value added) of Georgia's total agricultural sector from input supply, through production, post-harvest processing and marketing. Central to fulfilling this objective is the identification and mitigation of constraints to legitimate agribusiness. The efficient use of time and USAID monies in this task requires that SAVE accurately identify constraints and establish priorities for their mitigation. This paper reports SAVE's identification of constraints and the methodology by which priorities will be assigned for refinement and further investigation in Phase I, followed by mitigation activities in the course of Phase II.

Constraints were identified

- Through interaction with an initial set of stakeholders,
- Through an extensive literature review of the experiences of past and on-going development projects, and
- By interview with selected Government of Georgia officials, private sector businessmen and officers of international development assistance agencies.

SAVE staff and consultants identified seven categories of constraints (Table 1):

- Policy, Legal and Regulatory
- Infrastructure and Logistical
- Financial
- Market Access, Information and Knowledge
- Quality, Standards and Hygiene
- Production, Inputs and Raw Materials
- Receptiveness to Change

Common to all these categories is a cultural and institutional lack of receptiveness to change, an inadequate understanding of how markets link resources in a chain that runs from input suppliers to final consumers and a myopic obsession with production without reference to the paramount role of consumer sovereignty in a market economy. In response to this, Section 3 examines constraints as they relate to sectors of the market chain.

In determining where and how to allocate resources for constraint mitigation, SAVE will apply a filter or decision tree that asks the following questions:

- Are the constraint, and its solution, within the reach and capability of SAVE?
- Is measurable impact of constraint reduction expected within SAVE's lifetime?
- Will the benefits of constraint mitigation continue after the end of the project?
- Will ameliorating the constraint improve the capital investment or financial climate?
- Will employment and social equity be improved?

- Will mitigation of the constraint have a beneficial near-term impact on agribusiness?
- Will the reaction of Government and the general public be positive or negative?
- Is the constraint recognized as such by the legitimate Georgian business community?

SAVE recognizes that constraints may be clustered or linked and that the application of the decision tree must not be mechanical or rigid. Applied correctly, this decision tree will inform every aspect of SAVE, not least the choice of pilot projects and partners, the selection of policy, legal and regulatory reform initiatives, the focus of training and public education activities and the design and implementation of Phase II.

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1.0. Introduction and Background

1.1. Introduction

This report on agribusiness constraints covers issues that have a significant effect on the agri-business sector. Fiscal, monetary, trade, regulatory, labor, human capital and other constraints pertaining to producers, processors, and exporters are noted and evaluated. The SAVE constraint report also begins to identify policy alternatives and reforms that may be considered pilot projects or areas of Phase II SAVE activity. Evaluation of constraints and their impacts goes hand-in-hand with development of industry clusters, potential opportunity products, and filters to select target sub-sectors and companies.

Both SAVE and the Georgian economy have limited financial, intellectual and calendar resources. If SAVE is to meet its objectives and use its funds wisely, it is necessary to select constraints, companies and product clusters for pilot work in a way that:

- Identifies legitimate constraints and provides the background necessary to focus appropriate resources on their remediation;
- Identifies firms and products that can be leaders in establishing a sustainable Georgian presence in international markets;
- Identifies (and rewards) those entrepreneurs who have bootstrapped their companies up from the chaos of the 1990s and restructured them to take advantage of improving macroeconomic and rule-of-law environments, opportunities created by WTO and Georgia's comparative advantage in the world economy; and,
- Identifies firms and product lines that strengthen the market economy and pay fairly assessed taxes.

1.2. Background

There are a wide range of soils and climatic zones in Georgia resulting in local microclimates with unique capabilities and potential value to agribusiness. A range of microclimates and a relatively long growing season give Georgia the ability to produce a wide variety of deciduous fruits, vegetables, vine crops, cereals, oilseeds, herbs and field crops for the fresh and processed market, at home and abroad. At present, however, Georgia does not produce any agricultural products in the quantity or quality that can serve as a viable core for the country's agricultural and agribusiness growth and development strategy. SAVE faces a high hurdle in this respect.

Private ownership of land has improved the potential for farmers to participate in the supply of products to competitive processors, but uncertainties and non-transparency in the allocation of leased lands – the larger blocks of land most amenable to commercial agriculture and most attractive to agribusiness – must be resolved. Further, Georgia's new private farmers are poorly informed about modern farming practices, private input supply mechanisms remain underdeveloped and meaningful credit programs are accessible to only a few commercial farmers. Inadequate irrigation and drainage systems severely reduce the Georgian farmer's ability to be competitive in both product quality and quantity. Both situations require huge capital investment but are necessary considerations for a long-term rehabilitation of agriculture and agribusiness.

Privatization of the processing, packing and shipping links of the marketing chain is largely complete, although the quality of the existing plant and equipment raises serious doubts about the sector's competitiveness. Much of what remains of the Soviet-era processing system cannot be rehabilitated to comply with the hygiene requirements of international trade in processed agricultural products. Substantial capital investment will be required. But, before that can happen, entrepreneurs and investors need to understand that their investments must be made with respect to what the post-Soviet market wants, not what the Soviet market used to accept.

It is now up to the private sector – with policy support and leadership from government – to initiate and encourage the flow of products along the marketing chain from the farm to the final market. It is not a matter of resuscitating or jump-starting a sector that has collapsed for want of one supporting link. Major capital investment must be induced. Major elements of the system must be aligned to market realities. Producers, processors, shippers, regulators and policymakers must all understand and respond to the new reality. This is the environment within which SAVE will work.

A central element in SAVE's response to this environment will be the identification and facilitation of demand-driven market opportunities for Georgian agribusiness firms. This will be done by identifying competitive advantage where it exists, by encouraging efficiency in marketing chains that can become competitive, and by facilitating the mitigation of constraints that are identified later in this paper.

2.0. Identifying Specific Constraints Affecting Agribusiness in Georgia

The SAVE project team's first task upon mobilization was to identify and evaluate constraints affecting value-added agribusiness in Georgia. The SAVE team sought both primary and secondary information.

Primary information was obtained through direct contact and discussions with agribusiness stakeholders in SAVE's Kick-Off Meeting and Workshop on May 21, 2002. In addition to introducing the overall objectives of SAVE and the mechanisms for Phase I, the workshop was an opportunity for SAVE staff and Georgian agribusiness professionals to initiate serious discussions about constraints to agribusiness in Georgia.[1] Participating in breakout sessions at the workshops were owners and representatives of individual enterprises, government officials, Members of Parliament, representatives of donor organizations, parastatal support organizations and implementing agencies. The list of participants and the program for the workshops is reported in Annex A. Notes from the breakout session discussions on constraints affecting agribusiness are summarized in Annex B. The notes and personal participation of SAVE staff, both national and expatriate, provided important initial information for defining the constraints faced by agribusiness.

Concurrent with primary information collection via the workshop and breakout sessions, a desk study of secondary information from project reports, consultant

[1] Planning, arranging, organizing and implementing the SAVE Kick-Off Meeting and Workshop were carried out almost exclusively by SAVE national staff giving them the opportunity to work together as a group for the first time, to take an active role in project start-up and to participate actively in the definition of SAVE activities for Phase I.

reports, and donor documents from the World Bank, EU TACIS and NGOs, was carried out by Horizon Seed Company.[2] The desk study provided background and context for SAVE's expatriate staff and sharpened the focus on both constraints and the general agribusiness environment in Georgia. The written material provided by Horizon, the list of documents most relevant to the activities of SAVE and the list of other documents reviewed are in Annex C.

In the four weeks following the workshop, SAVE staff and expatriate consultants conducted a series of interviews, visits to companies and organizations, and opportunity assessments geared to testing the list of constraints identified by SAVE. More than 70 meetings and interviews were conducted with industry, government, donors and NGOs. Annex M reports the names and contact information for organizations and individuals who were visited or interviewed. The results from the interviews, the workshop, and desk study are utilized in the current policy assessment and will be retained as a body of knowledge to be expanded by SAVE's accumulation of new knowledge in the remainder of Phase I and in planning policy reform and constraint mitigation in Phase II.

2.1. Comprehensive List of Constraints Identified

As a result of the interviews and SAVE analysis, a comprehensive list of constraints and their impacts on agribusiness (Table 1) was developed. The constraints fall into seven major categories based on the kind of impact they have on agribusinesses in general. The seven major categories are:

- Policy, Legal and Regulatory
- Infrastructure and Logistics
- Financial
- Market Access, Information and Knowledge
- Quality, Standards and Hygiene
- Production, Inputs and Raw Materials
- Receptiveness to Change

These categories, and the resulting comprehensive list of constraints are consistent with those identified in the USAID Assessment conducted in Spring 2001 as part of the planning for SAVE.[3] While lengthy, the process of collecting input from agribusiness, marketing, and policy specialists, then analyzing impacts of the constraints provides the basis for development of activities to address those constraints, in their Georgian context, in the development and execution of Phase II.

Following is the detailed list of constraints. These constraints have not been evaluated through a filter reflecting their importance or impact on added-value agribusiness or exports; rather, they are presented for further analysis. These are constraints reported by members of the agribusiness community.

[2] Horizon is a sub-contractor to ACDI/VOCA under SAVE.

[3] See USAID Assessment, 2001.

2.2 Table 1: Constraints to Agribusiness and their Impacts

No	Constraint	Impacts Identified
I	**Policy, Legal and Regulatory**	
1	Tax code and VAT	Ministry of Finance does not rebate to exporters the VAT paid on inputs, thus reducing the export competitiveness of Georgian agribusiness. Most transactions are shadow. The low, often ignored, land tax is disincentive for efficient utilization of resources.
2	Customs	Vendors of equipment and chemicals are disadvantaged due to extra taxes compared with those who import for their own use. Exporters are exempt from VAT, but customs charges and informal taxes, have the same effect on competitiveness.
3	Standards and certification	Lack of credibility of Georgian standards and certificates increases import costs at port of entry for Georgian exports. Insufficient testing facilities and lack of institutional credibility.
4	Uncertainty in land leasing	Long-term leases may violate current civil code. Long-term, 49-year leases, permitted by a Presidential decree are trumped by a by Civil Code provision. Sound leases are necessary for farmers to make capital investment with security. Lease contracts between State and farmers are often oral and arbitrary. Non-transparent award of leases at district level.
5	Seed law of Georgia	Registration and introduction of new varieties requires at least two years, hampering competitive agricultural production. Waivers provided by Ministry could lead to unfair competition, corruption and suppression of market forces. Testing specification may be appropriate for grain crops, but not for commercial fruits and vegetables.
6	Contracts	Georgian farmers often do not trust contracts and are reluctant to create a paper trail. They do not honor contracts; enforcement is arbitrary and expensive.
7	Education and science	Absence of effective agricultural extension hampers introduction of new technologies, varieties, fertilizer, and technology. Georgian technical and scientific expertise is rapidly becoming obsolete.

8	WTO membership	Membership resulted in the imposition of additional responsibilities. Compliance is incomplete. Acquired rights to defend export position on international markets are not utilized.
9	GOG apathy	Corruption and lack of will to initiate change by government officials is serious. Even when legislation becomes law, real change in the way bureaucrats/bureaucracies work has been slow or negligible. There is little connection between announced reforms and their implementation, *e.g.*, GOST standards and the Seed Law.
II	**Infrastructure and Logistics**	**Impacts Identified**
1	Limited shipping opportunities and capacity in and out of Georgian ports	The low volume of manufactured/processed goods does not justify international carriers adding ships. High volume, low value crops (like nuts and grain) cannot be shipped in bulk. Freight forwarders do not handle partial container shipments.
2	Low capacity of aircraft from/to Georgia; transport terminal and refrigeration at airport	The low volume of goods does not justify international carriers putting on extra flights. Highly perishable or sensitive products (flowers, fresh fish, fresh herbs) cannot get to markets.
3	Competitive transportation cost disadvantage	EU companies have low costs to markets. China reportedly has lower freight rates than Georgia to many major EU ports.
4	Poor roads in rural areas	Vehicle operation costs are increased due to high repair and maintenance costs. The size of vehicles may be limited by size/condition of roads.
5	High transportation cost to mainland Russia	Unofficial payments in northern Caucasus republics reduce competitiveness.
6	Refrigerated transport/ suitable trailers	High percentage of spoilage and damage on transport to market.
7	Poor shipping linkages (producer-warehouse-railway-port)	Few shipping operations are vertically integrated, resulting in too many, inefficient intermediate steps.
8	Inefficient use of containers	Inefficient container use increases freight cost and reduces available routes.
9	Lack of controlled-environment/cold storage or cold storage	For many products the cold chain cannot be properly maintained for quality and safety, thus reducing Georgian competitiveness.

10	Unreliable utilities	Processing plants cannot operate efficiently due to inconsistent electricity. Storage facilities operation and food safety are compromised. Natural gas is inconsistent and firms using it for processing cannot be assured of a stable supply at critical times. Added costs of generators and fuel to operate it increase final cost. Installing owned gas lines adds cost to the production of final products. Estimates indicate production costs from all sources of unreliable utilities add 20-30 percent to production costs, including losses of product and quality when utilities fail.
11	Inadequate capital or retained earnings for new equipment investment; wrong scale equipment for small firms	Small/medium size businesses have to use existing, old equipment with high running costs and poor quality control. Many crops would be more cost competitive if obsolete – *viz.*, Soviet-era – equipment were replaced.
III	**Financial**	**Impacts Identified**
1	Expensive and short-term bank loans; liquid collateral requirements	Farmers and processors have limited access to credit. Loans are suitable for short-term, or trade, finance, but long term investment funds are not possible with high cost credit. Introduction of new technologies, chemicals and machinery is difficult. The requirement to provide liquid collateral for bank loans is hard for small/medium size start-up enterprises. Agribusiness is considered more risky than retail sector by banks.
2	Absence of financial instruments in agribusiness (*e.g.*, forward contracts, warehouse receipts, *etc*.)	There is limited loan funding for agricultural projects. Georgian firms are unable to make long-term business commitments.
3	Unsatisfactory investment climate and lack of foreign direct investment	Potential investors are reluctant to invest in a high-risk environment. Georgian businesses are not sufficiently committed to their businesses to invest for the future.
4	Insufficient number and use of insurance schemes for agricultural	Agricultural production is exposed to uncontrollable risks (natural conditions, weather, *etc*.); lack of insurance schemes adds to business uncertainties, reduces returns and discourages investments in plant and equipment.

IV	Market Access, Information and Knowledge	Impacts Identified
1	Lack of experience in accessing foreign markets outside FSU	Enterprises with promising products or markets have no market strategy, plan, or proper access to market ideas, *i.e*., quality, consistency, contracting and related requirements firms place on their suppliers.
2	Inability to develop, or get information on new, non-traditional markets	Few businesses have computers, access the internet, or understand how to obtain information on potential client countries. Entrepreneurs do not know/understand markets in order to develop new value-added products from present raw material.
3	Insufficient knowledge of commodity brokers and dealers. Few distributors understand Georgian products; Georgian firms do not understand product positioning	Entrepreneurs unable to make the best deals for products or their business and miss opportunities because of a lack of knowledge of foreign markets and marketing. Georgian exporters do not, or cannot, go directly to buyers – *e.g.*, potato sellers who wait with potatoes in Moscow hoping to find a buyer – resulting in spoilage loss.
4	Lack of management skills to respond to market signals	Products and producers without diversified export markets or destinations are exposed to market and price volatility. Exports pass through unnecessary intermediate trade links, which reduce efficiency and increases costs. Georgian producers lack access to market knowledge and intelligence.
5	Inadequate knowledge to modify product packaging labels and ingredients to meet foreign import regulations or buyer demand	Georgian entrepreneurs lack knowledge, and appreciation of, foreign quality standards, labeling, and market requirements. They are insensitive to information about the importance of tastes, preferences and consumer acceptance.
6	Import substitution constrained by foreign competition	Iran's and Turkey's cheap products and expansion into Georgian markets hamper local production. Smuggled goods avoid VAT that Georgian producers must pay.
7	Not using WTO membership advantage	WTO Membership is used mainly a tool to increase Georgian prestige in the world community, not to enhance the competitiveness of Georgian agribusiness.

8	Lack of marketing strategy and international accounting standards	Few businesses have marketing strategies, marketing plans, understand product positioning or the importance of consumer acceptance and demand. They have little direction and "sell" rather than "market". Most firms lack adequate accounting systems and do not understand financial management; therefore, they do not know costs and other factors essential to structuring sound deals or financing their operations.
9	Inadequate information for international businesses on import opportunities from Georgia	This reduces the number of potential buyers and reduces the market opportunities, since buyers do not "think" of Georgia as a potential supplier.
V	**Quality, Standards and Hygiene**	**Impacts Identified**
1	Little use of ISO 9000, HACCP and other international standards and procedures; laboratory testing facilities out dated, under-equipped and improperly certified	Outdated Georgian standards and unreliable methods of product testing mean missing markets, products are not given open entry and most do not even know what HACCP, GMP, or ISO are. Obsolete scientific and technical knowledge. Senior MoAF administrators have some influence within government, but not much in the commercial realm.
2	No representation of international standardization organizations	Georgian entrepreneurs lack knowledge and experience in quality and consistency requirements of foreign markets. There is a lack of both reliable testing and certification capacity in Georgia and a lack of understanding of importance of quality control.
3	Lack of understanding of EU standards and custom clearance procedures	Georgian farmers and processors rarely produce products meeting EU standards. They lack understanding of quality and certification requirements and need for commercial integrity.
4	Lack of knowledge and experience in basic quality requirements of foreign markets	No labs, independent or otherwise, to inspect for items like aflatoxin in hazelnuts or *patulin* in apple concentrate; if these contaminants are found in importing country, product is rejected.

VI	Production, Inputs and Raw Materials	Impacts Identified
A	**Farm related**	
1	Poor knowledge of modern farming technologies; use of old varieties	Farmers lack information on new plant protection chemicals. Small-scale farming results in lack of volume, quality, and consistency in agricultural products. Varieties are not the type the global market is buying, or are too expensive for wide-scale use. Farmers lack access to new equipment. Products do not meet foreign market standards. Volume is too low to meet processors' demands.
2	Lack of wide-scale use of inputs	Appropriate chemicals, seed, fertilizer, *etc*., are unavailable, or "too expensive" for wide-scale use.
3	Low quality of agricultural education	Agriculture is not a prestigious subject. Outdated information or concepts are taught; modern methods and tools are rejected, making instruction inadequate for supplying international markets. Educational institutions are unable to finance or support modern agricultural teaching, technology or methodology.
4	General lack of cold storage and post harvest handling knowledge and facilities	High rates of post harvest damage and spoilage are typical. Poor quality products result in low prices or poor quality processed goods.
5	Uncoordinated small farmers and processors; lack of exporters associations or cooperatives	Although law on cooperatives and associations is adequate, lack of trust between producers and processors inhibits the formation of associations to gain necessary scale and quality control. Small-scale farmers need to cooperate to provide volume to entice/support processors. Unit cost of production is too high to be competitive internationally; more volume would allow processing competitiveness.
B	**Processor related**	**Impacts Identified**
1	Limited technology, knowledge and management skills	Middle management does not have critical professional skills. Technical capacity of equipment is very poor. Management's technical knowledge is often based on outdated procedures, incorrect information on standards, and outdated technologies.

2	Outdated processing lines, labeling and packaging equipment and processing methods	Products do not meet foreign market standards, and processors do not know what the standards are. Volume of products is too low to meet sales demands from major markets. Processors cannot provide a consistent product. Poor packaging technology and equipment will not meet standard requirements. Processors and packers import most packaging materials from other countries due to poor quality in Georgia. VAT is levied on imported packaging but not rebated on export. Glass containers are imported from Turkey and Armenia.
3	Unreliable supply of raw materials, inconsistent quality and use of waste products	It is a problem to achieve large-scale production, large volumes and quality products. Many processors base their processing and planning around processing a waste product rather than producing a product. This makes them unreliable suppliers and suppliers of last resort.
4	Farmers do not honor production contracts, or cannot enter into them	Inconsistency in raw material supply is the general rule, creating an inability of processors to plan for production or marketing.
5	Lack of modern warehouse, handling and storage facilities	Poor handling and storage result in poor quality inventory and damage due to mishandling and spoilage.
6	Underdeveloped re-export industry	Georgian entrepreneurs miss opportunities to capture value-added in re-exporting products to regional markets.
7	Poor logistical expertise of firms and freight forwarders	High cost of transportation and increased transport time and poor maintenance of the cold chain reduce product quality.
8	Poor understanding of international practices for trade, for finance, and for business transactions (*e.g.*, letters of credit, contracts, agencies)	Cash economy mentality is inconsistent with global business processes and hampers Georgian trade. Standard financing methods and terms of trade are poorly understood. Importance of long-term agreements and consistent business is poorly appreciated.
VII	**Receptiveness to Change**	**Impacts Identified**
1	Nationalistic mindset	Georgians of all classes consistently express the sentiment that Georgian agricultural products are better that competitive products, but do so without objective or market criteria for their opinions.

2	Deeply embedded acceptance of corruption	The acceptance of corruption – whether stealing from the state or paying protection money to the traffic police – is a serious impediment to achieving the competitiveness that will be necessary to export Georgian agricultural products.
3	Active denial of world standards	The propensity to value products and behavior by Georgian norms rather than market-relevant measures results in missed opportunities.
4	Scofflaw behavior	The public flouting of traffic regulations conveys an unhealthy attitude of contempt for rule-of-law society and the ethics of international commerce.
5	Acceptance of shoddy service	The willingness of Georgians of all classes to accept poor service from the private and public sectors encourages low domestic standards and broadcasts a lack of understanding of business values to potential investors and buyers.
6	Questionable legitimacy of private enterprise	Many Georgians do not yet distinguish between value-added entrepreneurship and rent-collecting behavior of corrupt officials and monopolists.
7	Peasant mentality	A large fraction of the Georgian population seems to accept the outrageous behavior of the elite and corrupt classes without question.
8	Acceptance of authority	Mid-ranked bureaucrats and private sector managers are loath to correct their supervisors or others of higher position, often suppressing important information for fear of angering the supervisor.
9	"Production first" mentality	Consumer sovereignty and production-for-the-market are concepts that have made only limited headway in the post-Soviet value system. Many Georgians – and many non-Georgians – express the attitude that value added in (primary) production is more valuable than value added in marketing (see section 4.1, below).

3.0. Assessing Constraints by Sector of the Market Chain

Following are more detailed discussions of constraints by area.

3.1. Constraints Impacting Production Agriculture

In reviewing consultants' and Farmer to Farmer volunteers' reports, there are classes of constraints that are common to most primary agricultural producers. Producers are working with outdated varieties or breeds, poor machinery and a dearth of agricultural chemicals. Consequently, their substandard products have little or no market outside Georgia.

The constraint most often reported to the foreign experts in their reports is the lack of adequate technical production information. This takes the form of modern farming techniques, how to use new farm chemicals and how and when to harvest their crops in such a way as to optimize their marketing opportunities. The university system and the Ministry of Agriculture and Food institutions have outdated information and are unable to provide meaningful "extension" services to primary producers. Some information is available through international assistance programs and from the few input suppliers of agro-chemicals. However, in general, the Georgian farmer lacks information on modern production techniques. Fish producers report poor growth of small fish. Beekeepers have parasite problems. Lettuce producers lack soil amendments and apple producers have disease problems. Consultant are often able to point out methods of overcoming these problems, but too frequently the appropriate solution requires access to materials or techniques not available in Georgia.

Collectively, there is a pent-up market demand for agricultural inputs in Georgia. However, poor market infrastructure and import-related issues (regulations, financing, VAT, *etc*.) inhibit the development of the input sector. Very few producers belong to associations or organizations that could collectively bargain for larger amounts of inputs at lower costs.

The lack of capital, the need for market development and the formation of producer associations are important, but of a secondary nature in the opinion of many producers. The opinions of producers, however, are conditioned by their lack of appreciation of how marketing strategies and producer associations have contributed to productivity gains in more developed economies.

3.2. Constraints Affecting Import Substitution

Import substitution is a way of increasing domestic markets by replacing imports. However, the domestic producer must give the consumer a better product or a better price than the importer. Georgian agribusiness professionals regularly complain that taxes and constraints make Georgian products more expensive than those of neighboring countries <u>and</u> that the finished products are smuggled into Georgia to avoid taxes that apply to Georgian-produced products. In some cases, this is true. The truth may even include product dumping.[4] In other cases, however, the difference is not in input costs or taxes. Rather, the relative production efficiency is lower in Georgia because poor yields, bad post-harvest handling and poor management increase per-unit costs. Presently, Georgia suffers a comparative

[4] Dumping is difficult and costly to prove. Candidate “dumped” products in Georgia include powdered milk and beef from EU countries and chicken from several western hemisphere producers.

disadvantage in the production of some key agricultural products, among them poultry meat, eggs, most dairy products and refined vegetable oils.

The case of poultry and dairy products stands out as an example of the usefulness of the market chain approach to analyzing the agribusiness economy for Georgia. Georgia lacks the support industries necessary to produce sufficient volumes to meet domestic demands. Examples of inadequate support industries include insufficient animal feeds to sustain the livestock and flocks through the winter months, substandard veterinary services, lack of modern processing facilities, inadequate cold storage facilities and inefficient transport facilities.

Georgian producers are also unable to meet the domestic demand for refined sunflower oil. Sunflower is the preferred oil of most Georgian households; however, national production only meets 30 percent of total demand. Locally produced oil is adulterated with imported soybean to "stretch" the supply, but even that is not enough. The shortfall of cooking oil is made up with imports of sunflower, soybean, safflower, and canola oil from Turkey and Western Europe. By using better agronomic techniques to raise per-hectare yields, and with improved oil extraction facilities, Georgia could offset significant amounts of imports. These techniques would pay for themselves, if producers knew about them, if there were an input supply system that could provide them and if there were credit for producers to buy the inputs.

Quality of production and produce also affects domestic competitiveness. Imported food products may not be cheaper in absolute terms but the quality is higher; and, in many cases, there is less spoilage. As Georgian consumers are increasingly introduced to attractively packed and labeled foodstuffs, they come to expect and demand the same quality of Georgian products. As long as Georgian producers try to appeal to the “traditional" markets for their products, they will be at a disadvantage. Increasingly, over time, Georgian producers will have to introduce modern processing and packaging, as well as lower their production costs, in order to compete in their own country.

3.3. Investment and Credit

Most Georgian enterprises, regardless of the sector in which they perform, are cash-poor, a fact that negatively impacts all business plans, production and processing decisions. When Georgian businessmen approach a lending or financing institution they are at a disadvantage because they have not addressed the very issues that a lender is interested in: **How will the borrower make enough money to repay the loan?** For the most part businesses are able to develop a production or processing strategy, but they fail to develop a sound business plan in terms of cash flow, profitability, market strategy and product market plans.

In a similar vein, investors and trading partners – whether domestic or foreign – must be assured of the technical and financial soundness of the firm, as well as their business integrity. To be successful, SAVE must proactively assist prospective clients and firms working on marketing “deals” with planning and financial training and assist them with the documentation necessary to develop a sound business plan that will be attractive to a lending institution.

3.4. Technical, Production and Processing Information

A primary constraint to agribusiness in Georgia is the predominance of out-dated Soviet and Eastern European processing lines. Many of the facilities have been unused and unmaintained for more than a decade. Moreover, they were not designed for the needs of current markets or hygiene regimes. Those plants that are operating, produce below their capacity.

Upgrading, modernizing, and improving the plant and equipment of processors is an important part of improving their competitiveness. The problem is how to do this in an environment in which banks are unwilling to provide long-term investment capital at internationally competitive rates. Clearly, this is one of the major issues SAVE must wrestle with in the development of its Phase II strategy. Finding candidate firms with good management, solid business plans and scope for achieving long-term competitiveness will allow SAVE to mid-wife long-term production contracts that utilize trade finance and project finance to develop alternatives to domestic bank loans. Similar approaches have been used in other countries facing similar problems. The key will be to identify the product and market opportunities that are suitable for this purpose.

3.5. Long-Term Versus Short-Term Perspective

The constraints identified in this report – and by numerous other projects and reports[5] – are not unique to Georgia. Agribusiness around the world has overcome similar constraints. A large part of SAVE's mission is to move Georgian agribusiness to the point where there is a sufficiently large self-interested constituency to institutionalize the factors that are pro-business and suppress or marginalize business-hostile factors.

In its 2001 report[6], the USAID assessment team acknowledged two approaches to encouraging agribusiness in Georgia:

- To work first on the enabling environment, then to introduce a project once a better environment has been created; and,
- To develop viable market-oriented agribusiness opportunities and thus provide positive reinforcement for a concurrent effort in educating policy makers and agribusinesses on the impact of mitigating policy and regulatory constraints.

SAVE will work to the second point, emphasizing that the development of successful constituencies of businessmen, newly employed workers and profitable producers will embolden and encourage reformers and entrepreneurs to demand and implement greater policy reform. Policy change, by itself, can only provide incentives for new business; it cannot guarantee that trade and investment will follow. SAVE's Phase II strategy must provide the leadership to show the market relevance of constraint mitigation. Central to the issue of market relevance are demand driven sales and induced investment in productive capacity.

[5] See Annex C.
[6] See 2001 Assessment of Agribusiness, USAID.

3.6. Legal and Regulatory Constraints Priorities Affecting Agribusiness Domestic and Export

3.6.1. Protecting Producers against Counterfeit Products

Georgian exporters complain of losing market share – especially in the FSU – to counterfeit products. The Georgian wine and mineral water industries are especially vocal on this issue. Counterfeiting of Georgian products is done by misrepresenting low quality products originating in other countries with labels that appear to authenticate the products' origin to be Georgia. WTO membership will probably not be of much use in curbing this practice because most FSU countries are not WTO members. The fact that large and politically powerful interests like the international computer software and music industries are not successful in suppressing counterfeiting in the FSU suggests that Georgian companies are unlikely to find much sympathy for their complaints in the near term.

3.6.2. Standards and Certification

Currently, Georgia adheres to the old Soviet GOST standards, as modified and amended by Sakstandarti's certification system. The basis of this system is primarily normative and diminished in effect by a lack of credible testing capacity, adequately trained personnel and funding. This has resulted in Georgian certificates not being recognized by other countries. While these standards are often stricter than those found in western countries, they are usually mandatory and cover a wide range of products. By contrast, the rest of the world has moved to voluntary classification systems, with a reduced number of mandatory standards. Because of this lack of harmony in standards systems between Georgia and the developed world, the export marketing process is less efficient and more expensive than it needs to be. This is a constraint that negatively affects Georgian product competitiveness by omission as well, *e.g.*, there is no GOST standard for frozen vegetables. Hence, all issues of quality must be decided privately between the buyer and seller by contract, which entails higher transaction costs and narrows potential markets for Georgia agricultural products.

Another constraint to Georgian exporters is found in the way Georgian law addresses the testing problem. Georgian laboratory testing may be performed by private entities under government tender, a situation that would appear to be consistent with efficient government. Unfortunately, some employees of Sakstandarti, the government agency overseeing the licensing process, own – in part or whole – some of the firms that have been licensed to date. This potential conflict of interest further undermines foreign confidence in Georgian products and continues to create opportunities for corruption.

3.6.3. Food Safety and Testing

Hygiene and sanitary inspection of production are typically a mere formality in Georgia. Rarely are plant and production inspections actually performed; sanitary certification is usually issued to the exporter for a simple payment. One of the main causes of perfunctory hygiene and sanitary inspection is that there are no facilities or money available to finance testing and inspection in this area, even when called for by law. A related problem stems from multi-jurisdictional authority to supervise food safety and testing. The result is to confuse rather than clarify what the relevant requirements and procedures are. This confusion creates opportunity for abuse.

3.6.4. Tax Code

There are several different types of taxes that qualify as constraints to Georgian agribusiness and exports. First on the list for many exporters is the Value Added Tax (VAT). The primary problem is that the Ministry of Finance does not refund VAT paid on inputs upon export of the input, as required by law. SAVE staff and consultants were told that the Georgian courts are instructed (unofficially) not to grant VAT refunds. A firm's current VAT obligation may be offset against the VAT refund due on products sold domestically, but export-specialized firms will not be able to claim the full value of the VAT credit.[7] For other firms, reclaiming VAT may result in a seasonal, interest free loan to the state. Under the best of circumstances, this is not an efficient way to manage cash flow.

In general, business taxes are complex, rarely uniformly applied and excessively high.[8] The 31 percent wage tax was often cited by interviewees as an example of an excessive rate. In terms of the tax collection process, tax inspectors generally make their rounds unannounced – especially when pressed by Government revenue shortfalls – and they negotiate a "reasonable" tax bill. This process has obvious implications for informal payments and for business planning, as taxes become due immediately upon being assessed.

3.6.5. Uncertainty in Leasing and Owning Agricultural Land

Two thirds of agricultural land in Georgia is still State-owned.[9] Farmers access State lands through leases. Several constraints to agribusiness are seen in the leasing procedure and law. A legal constraint is that a "right to void" is granted by the Georgian Civil Code to any of the parties who enter into a lease contract running longer than ten years. Another constraint stems from the widely practiced custom of relying only on verbal agreements between small farmers and the State in setting up leasing arrangements. Such agreements are not legally binding. Finally, legal conflicts between the State property-registering organ (Technical Inventarization) and the State agency for land registration (State Department of Land Management and Registrars) also have caused ownership confusion. All of the above have contributed to the problem of not being able to use land as credit-securing collateral.[10]

Land leases are determined at the district level by a committee of local officials who award leases based on non-transparent evaluations of "business plans" submitted by applicants. In most cases, the lease rate is the minimum allowed: the land tax rate on private land of the same quality. This is not a market that allocates land efficiently. The system is also rife with special payments by farmers to the lease allocation committee.

An obstacle to the development of a dynamic and rational land market in Georgia is caused by application of excessive fees to re-register land after a change of

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[7] SAVE staff were told by one processor/exporter that his claims for VAT refunds now exceed GEL 50,000.

[8] The high rates of taxation may to reflect a cultural value that business is somehow not legitimate. High rates also create "head room" for corruption.

[9] This figure includes hay meadows and pastures. The State's proportion of arable land is less.

[10] Even without these complications there is not much of a market for private land, as the parcels are typically less than one-third hectare and the financial sector is too shallow to provide mortgage finance.

ownership. Consequently, the process of consolidating economically viable land holdings by commercial farmers is impeded.

3.6.6. Introduction of New Seeds and Plant Varieties in Georgia

In order to offer agricultural products demanded by today's market, it will be necessary for Georgia to introduce new seeds and plant materials to maintain market competitiveness. Achievement of this goal is frustrated by the Georgian "Law on Permission for the Distribution of Agricultural Crop Varieties, Seeds and Planting Material." This law mandates a three-year testing period before new crop varieties and cultivars can be made available to the public. This procedure is unnecessarily lengthy since there are successful risk-containment models utilized by other countries. Elsewhere, market forces and "Truth in Advertising" laws are adequate to protect farmers from fraudulent sales practices. Because of its restrictive testing requirements, enterprising Georgian farmers have begun to smuggle seed and cultivars into the country. Finally, the law is flawed in that fruit-bearing trees may require up to seven years before they can be fully evaluated.[11]

3.6.7. Customs Process

Relevant legislation does not set up clear requirements for procedures to be followed and documents to be presented to Georgian Customs at export. Ambiguity allows Customs officials excessive discretion in their job performance, which creates opportunities for "unofficial" payments to expedite an exporter's shipment. Further, few of the certificates required for passage through the Georgian Customs process are accepted by customs offices abroad, which results in unnecessary Customs paperwork being carried out and a prolonging of the Customs process. Only the phytosanitary certification and Form A for transportation of freight are required by foreign countries. The Georgian certificate of origin issued by the Chamber of Commerce is not accepted abroad; the verification stamp of the Chamber of Commerce Expertise Committee is not required for normal international trade.

Customs also often ignores MoAF rules. For instance, the Gori Fruit Growers Association recently attempted to import 120 saplings via airfreight for scientific testing purposes to determine their suitability for cultivation in Georgian soil. MoAF rules allow such shipments to be duty-free. The Growers Association received the attestation of the local Gori horticultural institute as to the scientific nature of their transaction and then applied for and received an import permit through the MoAF. Unfortunately, when the saplings arrived and members of the Growers Association attempted to collect them at the Tbilisi airport, they were required to pay a duty of $500, $5 per sapling, in order to get their saplings through Customs because the Customs officers ignored the MoAF documentation granting them duty-free status. Obviously, a bureaucracy working at cross-purposes is not going to be successful in promoting a revival of Georgian agriculture.[12]

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[11] The folly of this regulation is made clear when one considers what is necessary in the case of apple trees only. There are about five rootstocks and ten new varieties that are of interest to Georgia. If these were to be planted in four different locations with six different planting systems and two different irrigation modes, 2,400 test plots would be required. If each test plot were to be one hectare only, the cost to the nursery industry would be prohibitive. If these plots were established in Gori District, they would occupy almost one-quarter of the estimated ten thousand hectares of apples in the district.

[12] Presumably, Customs would have settled for a lesser fee, under the table. A politically powerful growers' association might have made sufficient noise and representations to the Gori MP, the press,

3.6.8. WTO

For reasons of national prestige, Georgia was one of the first FSU countries to apply for and be accepted for WTO membership. However, Georgia has not taken advantage of the opportunities that WTO allows for domestic trade exemptions if imports can be shown to be damaging an industry or sector that has promising potential for fostering local production or to improve a negative taxation balance resulting from WTO tariff compliance. The benefits of WTO membership could be greater than mere membership status. Georgia will probably need deadline postponements in adopting the necessary legislation to comply with WTO requirements and standards.

3.6.9. Contracting

Georgian export customers invariably require their own or an international jurisdiction to decide contract disputes, a reflection of a low level of foreign confidence in the fairness of Georgian courts. The establishment of a branch of the International Court of Arbitration may alleviate some of this foreign distrust, but this will serve only the interests of the largest companies, because the minimum dispute considered by the court is $100,000. Georgian exporters typically will negotiate a solution when a dispute arises with a purchaser, offering price discounts on merchandise or some other incentive to resolve the dispute.

Regarding domestic contracting, it is uncommon for Georgian parties to enter into written agreements. One reason may be the lack of traditional practice to do so, especially between farmers and processors and exporters. Another may be a consequence of the businessperson's desire not to create a paper trail that could render his business more vulnerable to investigation by tax and other authorities.

3.6.10. Establishing Farmer Cooperatives

If registered under the appropriate provision of the Georgian Law on Entrepreneurs, the legal requirements for establishing a farmers exporting cooperative should have been met. Unfortunately, there exists a confusing piece of legislation called the Georgian Law on Cooperatives, which seems to be intended to rehabilitate the old Soviet concept of *Tsekavshiri*, a central government-controlled farmers' union. If future farmers' cooperatives mistakenly register under the latter law instead of the Law on Entrepreneurs, the aims of the cooperatives could be impeded by this Soviet throwback, and property disputes with the still-existing ex-Soviet organization could arise.

3.6.11. Establishing Foreign Banking Entities in Georgia

Foreign banks are effectively shut out of the Georgia credit market by the Georgian Law on Commercial Banks, therefore cutting out what could be a major factor in making the Georgian credit market more competitive and dynamic. This law states: "No one shareholder or group of shareholders of a commercial bank in Georgia shall own or control more than 25 percent of the starting capital of a Georgian bank." Having only 25 percent control of its banking operations is considered too risky by most foreign banks. However, if petitioned, the National Bank of Georgia (NBG) may grant exceptions to foreign registered banks that have a Georgian banking license. Few foreign banks will find this a satisfactory arrangement, though, because

this special permission has no legislative basis and could be rescinded at the whim of the NBG.

4.0. General and Pervasive Constraints

SAVE does not have sufficient financial or human resources to address all the constraints identified in Table 1, even if the duration of the project would allow it. In fact, some of the constraints identified, though real, might best be ignored, at least for export-oriented businesses.

The first two categories, Policy, Legal and Regulatory and Infrastructure and Logistics, affect agribusiness in a general way by conditioning the business environment in which agribusiness must function. As a result, they have dramatic overall impacts; and they are difficult to deal with because they are pervasive. The most important, and dramatic of these general constraints is corruption, a major constraint to business but also to the development of long-term trust relationships that lead to long-term trade contracts, foreign direct investment, and the overall image of Georgia as a participant in the global economic community. USAID has instructed SAVE to recognize that this constraint exists and that it must be considered when selecting companies, products, and individual entrepreneurs with whom SAVE will work; however, general corruption is not a constraint SAVE has the resources or experience to address directly. SAVE will document the costs of corruption where it is specific to agribusiness – as in the case of mandatory police escorts of produce trucks – and will work with associations and reformers to create effective, issue-based constituencies to eliminate specific impacts. In the long run, this may be the only truly effective way the international and donor community can effectively intervene.

SAVE will contribute to breaking the (non) Receptiveness to Change constraint:

- by training its own staff in market-responsive attitudes, them moving them into private enterprises; and,
- by identifying and helping those enterprises that are already receptive to change.

The market will reward those who are change-receptive.

4.1. The "Wonderful Georgian Products" Problem

The inability to finance the reconstruction, or replacement, of out-dated facilities is a nation wide problem. As long as production to meet international standards is based on old equipment, Georgia has a diminished chance of succeeding in the international marketplace.

Interviews indicate that Georgian producers and processors frequently feel that if they have a product, they will be able to sell it. This is the reason finance is frequently indicated as the number one problem they face. Producers and manufacturers alike assume that their problem is "production-oriented".

Education, introduction to market makers in other countries, visiting new markets, and being exposed to the demands of buyers are necessary for producers and processors to fully appreciate the importance of markets, and not production, as their greatest challenge. When questioned in depth, most business people acknowledge that market information and marketing ability are important factors in their lack of success. However, when the discussion moves away from marketing to almost any

other topic, the result is a return to the set of fundamental positions that too many producers and processors in Georgia continue to have:

- "We can produce anything that is needed."
- "Our production will meet your standards, whatever they may be."
- "We know everything needed to produce the product."
- "Technical and professional assistance are not necessary, as we are already the best technicians."
- "Georgian 'whatever' is the best in the world, as everyone knows and clearly it is only necessary to get the 'good news' out."
- "Had producers and technicians been in charge of the Soviet Union, production would have met targets."
- "Just give me the money, I can handle everything else with no problem."
- "You will be happy with the result."

Changing this mindset is essential to the progress of agribusiness – and every other would-be value-added activity – in Georgia. SAVE's strategy will be to work with entrepreneurs who have moved beyond this mindset and are willing to deal with the world as it is, not as they would have it be. Successful entrepreneurs will be emulated by others.

4.2. Naiveté about the Real World

There is a serious lack of knowledge and information among many participants in the Georgian agribusiness sector about the effect of the market on distribution of their product. **Many producers and processors make planting and processing decisions based on the false assumption that once produced, a product can be sold.** While this may seem incredible to first time visitors, it is encapsulated by interviews recently conducted by SAVE staff with two businesses in the essential oils and fruit and vegetable processing areas. In both cases the SAVE consultant was told "bring me a guaranteed sale for 'X' and I will be able to produce 'Y' quantity next production season." This was followed by an indication of how much the buyer would have to invest for the production to occur.

The important point in this example is the pervasive, naïve assumption that this is the way the international agribusiness economy works. **Many producers believe that it is not necessary to show the buyer they can:**

- Produce a product that will meet market standards
- Provide the expertise and the technical knowledge to the production or process
- Utilize the equipment and plant or mobilize the raw materials and inputs to Produce a consistent quality and quantity product
- Prove they can even deliver on these "claims" to produce the product

The ideas expressed in these conversations, and the naiveté about the role of the market is the result of what agribusiness-marketing professionals refer to as "production mentality", that "What I can produce is more important than what the market demands." Producers and processors have to learn that production, of any kind, does not drive the market: **the market drives production**. There is plenty of

proof for the importance of this fact lying unused in warehouses and storerooms around the world.

5.0. Prioritizing Constraints for Greatest USAID SAVE Mitigation Impact

5.1. Developing a Methodology for Ranking and Prioritizing Constraints

In order to rank the constraints in order of priority for attention under SAVE, a systematic methodology is being proposed. SAVE will use a "Decision Tree" approach to evaluate the constraints, and then rank them based on their relative impacts. Detail on the process of ranking the constraints is included in the next section.

The following questions make up the basic constraint evaluation for the Decision Tree:

Question 1: "Are the constraint, and its solution, within the scope of the SAVE project?"

Question 2: "Is measurable impact from constraint reduction expected by the end of the project?" For instance, once gained, will access to markets have a measurable impact? The impact might be evaluated in currency inflow, volume of exports resulting, or employment created.[13]

Question 3: "Will the constraint remain in effect after the end of the project or will meaningful progress be made to break it?"

Question 4: "Will mitigation of the constraint improve the capital investment or financial climate?" One of the ultimate objectives of the SAVE project is to attract international capital to Georgia's agribusiness sector. Improvement of the capital investment climate is a vehicle to reach this goal.

Question 5: "Will the employment level and social equity be improved?" This is a primary goal of SAVE.

Question 6: "Does the constraint have a short-term impact on agribusiness?" Short-term impact means that the impact will be "visible" in the initial stages of the project's lifetime.

Question 7: "Will the reaction of the Government of Georgia and public be positive or negative to SAVE activity in this area?"

Question 8: "Is the constraint recognized by Georgian business as a constraint?"

An example of the application of the Decision Tree to the constraint "Market Access" is presented in Annex G.

[13] SAVE will propose that trade, investment and employment be the indicators by which USAID measures the success and impact of this project.

5.2. Ranking Constraints for Phase I and Phase II: An Informed Approach

SAVE proposes a two-stage approach based on the filtering questions listed in the previous section. This approach will assure the constraint mitigation has an impact on SAVE Project deliverables.

"Rule Filters" will determine whether a constraint meets the initial requirements for a SAVE activity. The four Rule Filters are:

- Removal or mitigation of the constraint is within the scope of the SAVE project
- Removal or mitigation of the constraint will improve the capital investment climate
- Removal or mitigation of the constraint will have a measurable impact by the end of the SAVE project
- The constraint will no longer have a dominant effect by the end of the SAVE project

Some important agribusiness constraints will not pass through this filter, for instance "irrigation and drainage projects", "road rehabilitation", *etc*. SAVE will not address these issues directly, because their impact is outside the scope of SAVE's activity as defined above. However, SAVE will monitor plans and progress of other projects, the GoG, and donors in these areas, and will provide recommendations where they impact the viability of value-added agribusiness.

A constraint like "tax code and VAT" would pass this initial stage of filters, even though it is not a primary concern of SAVE. These constraints are areas where interaction between SAVE staff and Georgian counterparts in business, associations, and GoG may have positive impact as new initiatives are developed. However, the ability of SAVE to have meaningful impact through its own activity is limited.

The second set of filters, "Shadow Filters" allow prioritization. The Shadow Filters are:

- Removal or mitigation of the constraint is likely to have positive short-term effect on Georgian agribusiness
- Removal or mitigation of the constraint will have a positive effect on social equity and employment
- The constraint is recognized by the Government of Georgia and by the public
- The constraint is recognized by Georgian agribusiness

The filters will be applied initially and as an on-going process. As changes occur throughout the implementation of the project – *e.g.*, in the Policy, Regulatory and Legal areas where there is a natural flux as a result of legislative action – SAVE will monitor the impact of constraint mitigation on those agribusiness areas most important to SAVE. The policy activities of SAVE will be carefully targeted to assure they meet the primary criteria, that they have a positive, immediate impact on agribusiness viability and that they improve the general social condition.

Table 2: Filters Applied to Assess Agribusiness Constraints Impacting SAVE Project Deliverables

Step one: Basic selection criteria "Rule Filters" - the selected constraint fulfills these requirements

Step two: Ranking of constrains "Shadow Filters" - the constraints are ranked according to importance to SAVE project's goals

Selection of constraints by Rule Filters

#	Constraint	Filter				Status
		1	2	3	4	
		Removal or mitigation of the constraint is within the scope of the SAVE project	Removal or mitigation of the constraint will improve the capital investment climate	Removal or mitigation of the constraint will have a measurable impact by the end of the SAVE project	Constraint will no longer have a significant effect at the end of the SAVE project	R-Could be removed M-Could be mitigated O-Is out of reach of the SAVE project
I	**Legal, Policy, Regulatory**					
II	**Infrastructure and Logistical**					
III	**Financial**					
IV	**Access to Markets**					
V	**Quality and Standards**					
VI	**Production and Related Issues**					
VII	**Receptiveness to Change**					

Constraints ranked by Shadow Filters

#	Constraint	Filter				Ranking
		1	2	3	4	
		Removal or mitigation of the constraint is likely to have positive short-term on Georgian agribusiness	Removal or mitigation of the constraint will have a positive effect on social equity and employment	The constraint is recognized, by the Government of Georgia and by the public	The constraint is recognized by Georgian agribusiness	A - Highest priority B C D E - Lowest priority
I	**Legal, Policy, Regulatory**					
II	**Infrastructure and Logistical**					
III	**Financial**					
IV	**Access to Markets**					
V	**Quality and Standards**					
VI	**Production and Related Issues**					
VII	**Receptiveness to Change**					

5.3. Keeping the Activity for Constraints Focused

SAVE will keep the process focused on constraints that are important to agribusiness and to the SAVE project objectives by continually testing constraint mitigation activities against the following question set:

- Why was the constraint addressed?
- Intrinsic factors – What would be the consequences for agribusiness if the constraint remains active?
- Who should address the constraint?
- What resources are needed to ameliorate or mitigate the constraint?
- What is the amount of effort the SAVE project can allocate to mitigate the constraint?
- Is the SAVE project's lifespan enough to mitigate the constraint?

The following considerations are important when applying the control point evaluation to monitoring and focusing SAVE activities in constraint mitigation:

- The control point evaluation is used after the constraint analysis.
- The control point evaluation is used at the steps where a constraint must be addressed and specific measures have to be taken.
- A subsequent step in the process may be more effective for controlling a constraint and may be the preferred control point.
- More than one step may be involved in controlling a constraint.
- More than one constraint may be controlled by a specific policy or constraint mitigation activity.

An example of the control point constraint analysis is included in Annex H.

6.0. Analyzing Constraints and Opportunities

At present, SAVE has several concurrent responsibilities. One is the identification of constraints and analysis to determine where to focus attention. Another is the development of product and industry cluster possibilities that could lead to synergistic development. A third is the development of deals and opportunities. The fourth is policy analysis and development of a friendlier environment. Another is identification of educational opportunities, development of creative ideas for overcoming constraints, and developing methodologies. Another is providing USAID with input and recommendations for a Phase II strategy. A sixth is training SAVE national staff in the tools and approaches that will allow them to assist Georgian companies with opportunities identified.

In the process of constraint identification and the development of a ranking methodology, SAVE staff and consultants have also done substantial analysis and brainstorming on new opportunities, analysis of promising sectors, and researching the question of "What works and why?" in Georgia.

6.1. Case Study: Nikora Ltd., a Success Story

From fourteen companies interviewed as part of the constraint assessment, one of the SAVE consultants selected one of the companies to develop a case study and success story to highlight ways the company 'overcame constraints'. This task was not

undertaken to try to change the environment, but to find ways to adapt to the environment that would allow success "in spite of conditions". There is no tacit approval or disapproval of the company or its approaches to business; the purpose is to learn from its experience.

Nikora, Ltd. began operations in 1998 under the direction of Mr. Vasil Sukhiashvili and has grown to a 2002 sales year projection of 8,400,000 Lari. The owner has overcome one of the primary constraints identified by almost all agribusinesses, financing, by utilizing his own investment from income as an expatriate worker for eight years in Russia, utilizing creative financing from suppliers and distributors, and managing growth and operations to control cash flow.

Mr. Sukhiashvili noted a lack of high quality processed meats in Tbilisi. In spite of the poor economic conditions, he thought the people in Tbilisi would buy quality-processed meats if they were priced competitively with other processed meats. Although he did not conduct a formal market research study, he had eight years experience in the processed meat business in Moscow, and a sense of what created 'value'. Nikora was founded with $150,000 of seed money from his own savings, that of his family, and a partner from Moscow for whom he had been working; the partner's ownership was 15 percent. No money was borrowed; the machinery purchased was old machinery from locations in Tbilisi. Potential investment partners were contacted; however, all were looking for a large return on investment and very rapid growth. Mr. Sukhiashvili knew that the meat business was competitive and the margins were relatively low, so he focused on controlling the cost of production and reinvesting earnings for expansion.

In the first months of operation, the company almost failed by attempting to 'buy' market share and operate in a traditional manner of purchasing raw materials and processing them for inventory. One of his first creative moves was to establish two traders as his 'suppliers', he entered into a long=term fixed price supply relationship with them, and required each to provide a $5000 bond to be used to purchase product on the import or spot market if they were unable to supply him at any time during the year.

He quickly learned the importance of marketing and market chains. Sales on consignment were quickly depleting his cash flow and products were frequently not merchandised properly since the shop owner had no risk or exposure if the products did not sell. He opened his own shops to control this process and increase his control of the presentation of his product. He knew that high quality products must be presented in a high quality way. After opening his first shops, he was approached by investors interested in opening similar shops to sell his products and other complimentary products. He realized that franchising the shops eliminated his need for capital and inventory financing. The franchise owner receives 10 percent of the gross revenue to cover his operating costs and provide a profit. The shop owner is not responsible for the cost of product, which is provided by Nikora. Nikora collects the money from the shops daily and holds it until the end of the month, thus he was no longer financing consignment inventories for long periods, but recovering cash flow on a daily basis. The result from the first investors encouraged other investors to ask for similar franchises.

For distribution outside Tbilisi and outside his own shops, Mr. Sukhiashvili had been working with a number of distributors. These distributors were often creating more competition for him than they were supporting his products. He selected one distributor, agreed to help finance him, and borrowed money for refrigerated trucks and equipment.

The distributor received five percent of the gross sales price, but Nikora collected the money daily to improve cash flow. Mr. Sukhiashvili uses a written business and marketing plan, and maintains a sophisticated budget, production tracking, and accounting program to help determine the results of each week's operations.

In order to improve performance, he has transferred 30 percent of the company (from his 85 percent ownership) to the employees, making them partners as well as employees. He now produces 70 products, up from 15 produced initially, and has recently started exporting to Armenia and Azerbaijan. He now employees 250 people, up from 30 at the end of the first year. He believes that most businesses in Georgia are too focused on rapid profit and are unwilling to grow their business by reinvestment.

Lessons he has learned that apply to other businesses in Georgia:

- Have a written business and marketing plan, identify constraints as an opportunity and find the solution to the constraint that result in a competitive advantage.
- Now the prices of products produced in the market and be competitive.
- Manage raw material supplies, prices and quality to assure they do not have a detrimental impact on the business.
- Manage cash flow carefully, growth creates cash flow problems for companies whether in Georgia or developed countries, and reinvest earnings, buying "toys" must wait.
- Borrow carefully, whether at Georgian or LIBOR interest rates, it still is a cost.
- Look for win-win solutions.
- Don't be afraid to "think out of the box."

This is an example of the kind of entrepreneur and company that SAVE hopes to identify and work with as clients throughout the project to generate employment growth. The detailed description of Nikora, in the form of a case study, is found in Annex D.

6.2. Case Study: The Apple Concentrate Industry

A case study of the apple juice concentrate industry was prepared as a starting point for SWOT analyses to be carried out by SAVE staff. This case study began a "market chain map" of the sub-sector to be used in subsequent education and training programs, as well as for SAVE staff development. A detailed write up of the case study is found in Annex E.

Given the current activity with a potential buyer of apple juice concentrate from the UK, it was determined that an exercise based on a Market Chain Analysis like the one proposed by ACDI/VOCA, as a framework for SAVE, would help to identify the key elements of the market chain and also provide a learning experience for staff. It also provides a suitable way of developing information on the potential competitiveness of the concentrate industry in Georgia. Studying the linkages provides information useful to marketing professionals on SAVE.

Apples have been grown in the Gori Valley since 1888; Gori was a principal supplier of fresh and processed apple products to the Soviet Union. Since 1991, there has been no investment in the apple industry and apple yields have fallen. Many orchards have also been destroyed because they had deteriorated beyond the point of salvage.

Constraints at Each Level of the Market Chain

Producers

1) There is a general lack of equipment. Fertilizer injection equipment is old or does not work, and equipment for cultivating and weed control is inadequate. Spraying equipment is old. Cost makes fungicides expensive. Both trees and fruit suffer from disease as a result. The irrigation systems and equipment are old and in disrepair; in dry years yields suffer, as do the trees.
2) Shipping containers for raw material to the fresh and processed apple markets are inadequate and inappropriate.
3) Cold storage units remaining from the Soviet era do not work; apples are stored in basements and inadequate cellars with at least a 20 percent storage loss.
4) There are 10,000 ha of apples grown with a total yield of 100,000 MT, or 10 MT per ha compared to 75 to 80 MT per ha in similar climatic zones in other countries. No new rootstock has been introduced into the Gori valley, the last variety introduced was from the US in 1975. Fertilizer products are not available or are too costly for the producers to purchase. The quoted prices are reasonable from a world market standpoint, but producers are not sure their yields will increase so they are afraid to invest in the inputs. Producers do not perform soil or tissue samples and still operate on the belief, prevalent from Soviet times, that their soils are 'naturally fertile' and do not require potash or potassium. Pesticides are available in Tbilisi, but the growers have to find them, and they have to pay high prices because of import duties. There is no integrated pest management program to limit pesticide use based on 'need'.

Value-Added Processors

5) Equipment at each of the processors in the industry sector is much different. One has very good equipment, modern sorting equipment, and good packaging. The others have old equipment, poorly maintained and in need of significant modernization. Storage and finished product handling is similarly diverse. All of the processors have reportedly been able to export some product but the sustainability of these transactions is still in question.
6) The companies use imported containers for shipping products for export and have had trouble getting them. They ship products in bulk, thus labeling and other packaging are not problems for them.
7) The companies express varying comfort levels with market information and access to markets. They all mentioned the need for market support and had little data about competitors like Poland, China, Germany and Bulgaria. There are no testing laboratories, only one company has its own laboratory. Raw material costs account for 65 percent of a self-reported cost of production of $450/MT (compare this to $300/MT in the US).
8) Only one processor indicated it had public sanitation inspectors. Certifications for export are easily obtained according to all the companies, including the certificate of origin and the phytosanitary certificate.
9) Total capacity of the sector is 4500 MT/year; this consists of both filtered and unfiltered concentrate. The production level for the last year is approximately 60 percent, but with a significant amount of carryover inventory still in storage as the new processing season begins.

10) All of the processors felt they could meet EU standards, but had no proof of this, and exhibited limited understanding of the main EU standards.

Importers/Buyers

11) World market prices of concentrate have fallen from $1,300/MT in 1999 to approximately $800/MT. There is adequate concentrate in the market. Georgian concentrate acidity, at 3.5 percent, compares favorably with Poland at 4.5 percent. The cost of delivery of the concentrate $200/MT to a major EU market compared to $25/MT for Polish concentrate is a competitive disadvantage. None of the firms has a "marketing" program. They largely operate as order takers with limited contact to buyers.

6.3. SWOT Analyses and Product Opportunities

As part of the process of training staff on specific tools and methods for analyzing business opportunity and potential, developing business-planning capability, and understanding markets and interactions within the markets, SWOT analysis has been conducted on several of the products and industries where SAVE is currently evaluating potential pilot projects. The purpose of these SWOT analyses is to help determine if the companies or industries have the potential to be suitable SAVE pilot activities or long term client activities for SAVE.

While these analyses are based on current levels of information and background on the company or industry, they are useful in identifying key elements that require further study, market assessment, or evaluation. The analyses are presented in their current form, as they are working documents, not final presentations, for opportunity development in progress.

SWOT analysis is an extremely useful tool in assessing the "real" (as defined above) constraints for an agribusiness company or sub-sector versus those that are "perceived". It is also an effective analysis for evaluating how serious the constraint's impacts are on an individual company or industry sub-sector. The SWOT analysis is also the first step in the identification of potential pilot projects. The importance of the SWOT analyses is to show the way these tools are used to:

- Identify opportunities
- Analyze constraints
- Evaluate capabilities of a company or industry
- Organize the analysis and data collection
- Provide a tool for education and information transfer
- Continually re-evaluate and update information

SWOT analyses conducted by SAVE staff, as a result of market opportunity work and as a direct result of this activity in Assessment of General Agribusiness Constraints are found in the Annexes as follows:

Annex I: SWOT of Samegorbro Ltd.
Annex J: SWOT of Bubble Ltd.
Annex K: SWOT of Apple Juice Concentrate Industry
Annex L: SWOT of Hazelnut Processing Industry

7.0 Conclusion

In this assessment, the SAVE project team have all contributed to the development of a methodology to be applied to prioritizing constraints for further development in Phase I and to guide the Policy Assessment. The SAVE project team have also identified, through primary and secondary sources of information, a comprehensive list of the general constraints (that is the policy and regulatory constraints) and the specific constraints (those specific to an industry group or product). This list of constraints has been presented here and discussed. Finally, the SAVE project team have begun the process of staff and team development by beginning the detailed analysis of several opportunity products and several industry sub-sectors in a more detailed way using case studies and SWOT analysis to better understand the constraints in each case, and to identify ways in which they can be mitigated.

As a result of the analysis, initial priorities of constraints have been provided to the SAVE staff for the development of the Policy Assessment. Following is a list of several of the policy constraints, deemed by the methodology presented here to be priorities, along with examples of the recommendations for further action by SAVE on each of these.

Table 3. Example of Specific SAVE Activities Resulting From Prioritizing Constraints and Developing Appropriate Responses.

No	Constraint	Some Impacts Identified	Possible SAVE Activity
I	**Policy, Legal and Regulatory**		
1	Seed Law of Georgia	Registration and introduction of new varieties requires at least two years, hampering competitive agricultural production. Waivers provided by Ministry could lead to unfair competition, corruption and suppression of market forces. Testing specification may be appropriate for subsistence grain crops, but not for commercial vegetable and fruit varieties.	Provide education and white paper analysis to top MoAF officials on how the current Seed Law waivers hamper competitive agricultural production. Cooperate with MoAF officials to prepare the amendments to existing Seed Law that will allow non-restrictive introduction of new varieties important to export development, in Georgia. Cost share, possibly via a pilot project, the introduction and propagation of new varieties of key crops in Georgia; *e.g.*, potatoes, onions and fruit cultivars.
II	**Market Access, Information and Knowledge**		
1	Lack of experience in accessing foreign markets outside FSU	Enterprises with promising products or markets have no market strategy, plan, or proper access to market ideas, *i.e.*, quality, consistency, contracting and related requirements that buyers place on their suppliers.	Identify and select groups of firms that are willing, and committed, to change "production mentality", to "market mentality" – to produce what the market demands – then work with them on market development and training. Develop a market chain strategy for selected firms to assist them to identify target markets and products that have market potential. Utilize small grants or a pilot project to cost-share introduction of a product like blanched hazelnuts into the existing markets that is presently dominated by a third country. Provide technical expertise and knowledge to adapt the processing of current

			products to tastes and preferences, or formulations, which would be of interest to foreign buyers. Identify and explore, perhaps with pilot projects, alternative transportation avenues for products.
2	Insufficient knowledge of commodity brokers and dealers. Few distributors who understand Georgian products, and no Georgian firms who understand product positioning	Unable to make the best deals for products or their business. Missed opportunities because of a lack of knowledge of foreign markets and marketing. Do not, or cannot, go direct to buyers, example – potato growers who wait with potatoes in Moscow hoping to find a buyer while product loses quality and value.	Pilot project or cost-sharing grant to assist in development of a potato marketing firm. Market research to allow producers to market direct to final markets. Competitive positioning of producers. Conduct education and training activities, possibly including exchange programs, to introduce marketing and processing personnel to the international product-marketing opportunities and modalities. Take a select group of young professionals from processing and export firms to meetings like the annual IAMA meetings, the largest gathering of food professionals. The last conference was on food safety in the market chain, clearly a topic that affects Georgia. Policy analysis and support through EU and British officials for a friendly import environment. A specific, immediate example might be, to help provide support for a waiver of duty on Georgian apple juice concentrate to the EU. This could be supported by evidence of China's predatory pricing policy (proven by US and Australian counter tariffs) and small proportion of the market. Potential buyers of the apple juice concentrate have indicated a willingness to assist Assist Georgian exporters in development of market positioning and other creative ideas for overcoming constraints and entering new markets.
III	**Quality, Standards and Hygiene**		
1	Little use of ISO 9001, HACCP and other international standards. Laboratory testing	Outdated Georgian standards and unreliable methods of product testing mean missing markets; products are not given open entry. Most producers do not even know	Assist the Georgian Government in specific domestic policy development regarding food safety, hygiene, testing and regulatory programs by simplifying and tying Georgian standards to internationally accepted standards. Identify those firms willing and committed to make investments of time and capital necessary to implement best manufacturing practices, to become ISO

	facilities outdated, under equipped, improperly certified.	what HACCP, GMP, or ISO are. Obsolete scientific and technical knowledge.	certified, to learn and implement HACCP, and to maintain their own quality control management program. Develop a program of ISO and HACCP certification and training to assist qualified firms in implementation. Develop a marketing program to promote select Georgian firms' adherence to ISO and HACCP to EU and US buyers. Develop a branding program and a certification label that can be tied to this process. Conduct policy analysis to encourage the Government to reduce or eliminate the outdated and unenforceable GOST standards by identifying the potential it creates for corruption and the constraints it imposes on companies that cannot meet the standards and cannot test for them, but meet EU standards. Identify and link Georgian firms willing to follow BMP and *Codex* standards to Western companies which are willing to mentor and assist the Georgian firms to become fully qualified suppliers and manufacturing partners. Identify and explore the potential for investment development and investment promotion by Western firms with those Georgian firms that are willing to adopt tight standards and quality control. Identify and provide policy assistance on the impact of GOST standards on new export development. Provide policy assistance to support simplification to a BMP/HACCP standard of company compliance rather than state intervention, especially for export companies.

ANNEXES

Annex A*

SAVE Project Assessment on General Constraints to Agribusiness

Workshop Agenda and Notes of General Session Presentations

* The detailed minutes are located in the archives at ACDI/VOCA SAVE office.

Workshop Agenda

10:00 – Aleksandre Kavtaradze, Project Director, SAVE Project.
Introduction of the Project

10:05 – Alfred Williams, Senior Business Development Advisor.
Office of Economic Restructuring, USAID/Caucasus/Georgia

10:10 – David Shervashidze, Deputy Minister.
Ministry of Agriculture and Food

10:15 – Self-introduction of Georgian stakeholders.

10:20 – Michael Peden, Chief of Party (COP), SAVE Project.

10:45 – William Bateson, Agricultural Product Specialist.

10:50 - George McGurn, Legal and Regulatory Policy Specialist.

10:55 – Jim Holderbaum, Vice President, ACDI/VOCA.
Description of the SAVE market chain approach

11:15 - Coffee Break

11:30 – Breakout Groups.
Tasks assigned by COP, Michael Peden

12:55 – Summary of Proceedings, Next Steps.
Michael Peden, COP

Brief Notes of General Session Presentations

Mr. Aleksandre Kavtaradze, SAVE Project, opened the session introducing the SAVE project to invited guests and stakeholders.

Representatives of Economic and Restructuring Office, USAID/Caucasus: Mr. Alfred Williams, Senior Business Development Advisor and Mr. Gerald Anderson, Economic and Restructuring Director, addressed the audience expressing their vision, objectives and goals of the SAVE project and its role in the development of Georgian agribusiness.

The Honorable David Shervashidze, Deputy Minister, Ministry of Agriculture and Food, congratulated SAVE on winning the project and expressed appreciation to USAID. He assured Dr. Michael Peden, COP of the SAVE Project, that the Ministry of Agriculture and Food will actively participate and assist SAVE in the implementation of the Project.

Following the introduction of the SAVE project, a brainstorming session was held to determine the products and product clusters, which have export potential.

Management of the SAVE project felt the workshop, together with the input of stakeholders who are involved in the day to day activities of Georgian agribusiness, would serve as the best source for information about current activities and constraints in the agricultural sector of the Georgian economy. Attending stakeholders represented many different sub-sectors of the Georgian agribusiness community.

Attending were:

Ms. Lali Dateshidze
Chairman, Association "Institute of Medicinal Herbs"

Ms. Nana Adeishvili
Executive Director, ? ERMA

Mr. Ramaz Khurtsikashvili
Director, Georgian-German Engineers Bureau, Telavi

Ms. Marina Kitiashvili
Director, Gorkoni JSC, Gori

Mr. Zezva Tsiskarishvili
Deputy General Director, TBC Bank

Mr. Givi Gachechiladze
Director, GeoAgroExport Ltd.

Mr. Jaba Ebanoidze
Director, Association for the Protection of Landowners' Rights

Mr. Dato Kbiladze
State Department of Statistics

Mr. Nodar Gvenetadze
Director, Bubble Ltd.

Ms. Nana Nemsadze
President, Elkana, Biological Farming Association

Mr. David Chikovani
Association of Georgian Exporters

Mr. Zurab Saganelidze
Director, Samegobro Ltd.

Mr. Avtandil Tskrialashvili
Gori Fruit Producers Association

Mr. Levan Dadiani
Caucasian Mtianeti (Highlands) People National Center

Mr. Temur Iakobashvili
Statistics Center of Georgia

Ms. Tamar Mchedlishvili
Deputy Chairman, Geostandard, Government of Georgia

The introductory portion of the workshop was followed by breakout sessions. As a result of the breakout sessions, SAVE was able to ascertain that legal, informational, production, marketing, storage and transportation constraints were important for the stakeholders.

At the end of the preliminary session, remarks were made by individuals from the SAVE staff:

Dr. William Bateson
Agricultural Economist

Mr. George McGurn
Regulatory and Legislative Specialist

Dr. James Holderbaum
Vice President, ACDI/VOCA

Dr. Michael Peden began the breakout session. Two working groups were formed and independently started discussions on identification of products, product clusters and agribusiness constraints. At the end of the session the suggestions where shared with the general audience.

Annex B*

SAVE Project Assessment on General Constraints to Agribusiness

Notes of Workshop Breakout Sessions

* The detailed minutes are located in the archive files at ACDI/VOCA SAVE office.

Participants in breakout sessions resulted offered the following list of agribusiness constraints.

I Legal

- Ineffective taxation system
- Creation of effective VAT reimbursement system for exports commodities
- Hidden and semi-official fees
- High bank interest rates and limited availability of credits for agriculture production
- Licensing and quota system for stocking up of medical and botanical plants and wild grown berries
- Pirating of Georgian producers trade marks by non-Georgian producers
- Re-export
- Clear and simple list of documents for exporting
- Absence of certification program/system for organically grown products;

II Production/Processing*

- Instable and low quality supply
- International standards and quality control
- Outdated equipment
- Outdated technologies
- Improper storage facilities
- Improper packaging
- Labeling
- Communication with suppliers
- Non-existence of international standardization organizations
- Outdated standards and unreliable methods of testing

III Market Information**

- Lack of information on demand of outer market
- Price structure
- Transportation
- Lack of information on business opportunities in Georgia
- Unsatisfactory packaging.
-

IV Transportation

- Low level of airfreight from/to Georgia
- Full usage of containers space
- Corruption and criminal environment in Russia

* Increasing of exports will not heavily affect prices on the local market, hence there is a potential for production increasing.

** Potential exporters prefer EU or Gulf markets vs. to former Soviet Union markets.

The following products and product clusters have been determined to have export potential.

Fresh Products

- Apples
- Early/baby potatoes
- Herbs and spices
- Kiwi
- Hazelnuts
- Chestnut
- Citrus
- Strawberries
- Mushrooms
- Mulberry
- Off-season vegetables

Wild Grown

- Berries
- Chestnut
- Wild rose
- Medical & Botanical plants

Processed Products

- Essential oils:

    Rose
    Eucalyptus
    Laurel
    Dill
    Basil

Hazelnuts

Dried Products

- Eucalyptus
- Herbs and species
- Garlic
- Prune
- Persimmon

Individually Quick Frozen (IQF) Products

- Berries
- Vegetables
- Cherry

Juices

- Apple and wine vinegar
- Apple and strawberry juice concentrates
- Other fruit juices

Organic farming products

Honey and honey by-products

Meat and milk products

- Calf
- Trout
- Lamb
- Ostrich
- Cheese powder
- European (French, "Gouda") cheese

Assessment studies and SWOT analyses were considered to be the most logical and reasonable for being the next step taken by the SAVE project staff in order to clear the current picture of Georgia's agribusiness reality.

Annex C

SAVE Project Assessment of General Constraints to Agribusiness

Horizon Group Desk Review of

Previous Projects and Reports

Detailed Report and List of Documents

The present report contains a non-comprehensive overview of the available studies/reports on Georgian agribusiness, developed by various entities since 1997. The emphasis is made on the identified constraints, lessons learned and the recommendations made by the implementing entities.

1. *Export And National Marketing Development For Horticultural Products In Georgia* (Report on Consultancy Mission, FAO, 2002)

The consultancy report is based on the activities carried out in November 2001 by the marketing consultant Mr. P.G. de Balogh. The report gives a comprehensive analysis of the horticultural sector in Georgia, its historical background, assessment of its present state and the projection of its potential for the future. The major objective of the FAO Fruit Sector Rehabilitation Project is being stated as to improve the horticultural sector of Georgia and the supply of products both in quantity and quality, streamlining the present marketing system towards the home market, the export trade and the processing sector. Special attention is given to the problems related to the apples sector, as it represents the most important horticultural crop in Georgia.

Below is given the summary of the major constraints identified to exporting fresh and processed produce:

Production problems:

- Orchard management is not good, resulting in low yields and low income to growers.
- Some of the varieties produced are not suited to modern market requirements.
- There is insufficient planting material and lack of capital to introduce the new marketable varieties.
- Old irrigation systems do not function in many locations, as they were based on pumping. Nowadays producers lack pumps, facilities and regular supply of electricity.

Marketing problems:

- Large suppliers and buyers have disappeared. Markets have become fragmented and more competitive.
- More skill is needed for a successful export business today. Specialized trading companies are needed for this activity.
- The domestic marketing system remains disorganized and inefficient. There is no formal wholesale trading system established. Some type of Producer Marketing Organization could become an alternative channel of distribution and create vertical coordination between farmers and traders.
- The wooden crates used for exporting fruits to Russia need to be replaced by more expensive carton boxes for exporting to Europe. They should be preferably waxed to support shipments in a more humid atmosphere.
- The targeted market preferences need to be studied to present the product properly.
- Packaging needs to be changed to become uniform in size and weight, showing the prescribed information on the boxes (*i.e.*, origin, product, variety, size, number of fruits, packers' name).

- Old Soviet standards were used by the large packing plants. These specifications are comparable with EC standards. These standards are just informally retained on the national market. There is no entity in charge of regular quality control of marketed fruits. But, for foreign markets the grade and packaging standards are of great importance.

Transportation problems:

- Temperature should be controlled, avoiding heat and freezing.
- Proper stacking of the packages should be done.
- Administrative delays at the border cause excessive transit time.
- Variable expenditures paid in transit are higher than the taxes. These payments originate from unsettled political situation in some of the border regions and from the unsettled customs clearance procedures.

Storage problems:

- Unavailability of proper storage facilities with controlled atmospher does not allow storage for long periods with subsequent sales in the off-season for higher prices.
- Investment is not available for erecting modern storage facilities.
- Irregular power supply creates problem for ventilating storages.

Processing problems:

- Most existing processing facilities have antiquated equipment that cannot meet the increasing quality requirements of the old and new markets.
- Foreign companies are not attracted to invest into the processing industry or to make joint ventures with local producers.

Import restrictions:

- Russia has imposed a 20 percent VAT that is also applicable to the import of fresh fruit.
- Entry price system exists in the European countries: if at a certain time the entry prices have not reached a certain level, import duties are imposed.

Opportunities:

- During last years some improvements occurred in the Russian market through the establishment of wholesale markets. Simultaneously, the participation of small-scale enterprises in the trade is being promoted. Increased competition has created an increased demand for higher quality product.
- Creation of Water Users' Associations under the World Bank irrigation project will require the active participation of the beneficiaries in their organization.
- There is an urgent need to improve the production technique and the participation of farmers in the marketing of their products. This can be achieved by the establishment of professional growers' associations.

- Opening railway to Russia would offer an easier and cheaper means of transporting fruits, including refrigerated railcars.
- A discount rate can be obtained for transporting fruits with empty containers waiting in Georgia for return freight to Europe.
- Sales opportunities should be investigated in Byelorussia, Ukraine and the Baltic states.
- For fresh fruit the Western European market has hardly any potential, as there are preferred modern varieties of apples, which are not yet produced in Georgia.
- Contact should be established with a few specialized importers in Europe. Test shipments should be organized.
- A certification system for organic products needs to be put in place. In the short term, there are no possibilities for export of organic products. They should first be directed towards the home market.

2. Georgian Policies and Experience with WTO. (CERMA, June 2002)

Georgia joined the World Trade Organization (WTO) on June 14, 2000. This membership gives certain benefits to Georgian exporters to other member states of WTO and also puts liability of treating imports from these countries in a supportive manner.

The relevant extract from the WTO membership obligations includes:

- Application of the same excise duties for imported and local products (including tobacco and alcohol products).
- Bringing freight forwarding services and inspection in compliance with the WTO procedures and rules, namely with the agreement on import licensing, determining of the country of origin, anti-dumping execution, subsidies and compensation measures.
- Changing the old Soviet "GOST" standards into international "ISO" standards.
- Decreasing categories of imported products subject to compulsory certification. The process of transition to the voluntary certification system should be completed.

Benefits of WTO membership for Georgia include the following:

- Products originated from Georgia will fall under the Preferential Trade Regime in other 136 member countries of WTO without bilateral agreements, *i.e.*, low customs tariffs will be applied to them when entering these countries.
- International disputes related to trade will be settled through WTO dispute committee.
- Georgian legislation will be harmonized with the international norms.
- Low tariffs will exist for the raw materials and industrial equipment, increasing opportunities for their import into Georgia.
- Georgia's integration into the global economic system will be supported, stimulating further liberalization of trade and introduction of new technologies, increasing competitiveness of Georgian product.

However, low import tariffs put Georgian producers in competition with more developed foreign exporters. It will remove the possibility of defending the local market and local producers from cheap imports.

3. **Country Strategy Paper 2002-2006. National Indicative Program 2002-2003.** (EU/EC, November 2001)

Partnership and Cooperation Agreement (PCA) between Georgia and EU implies the respect of democratic principles, the rule of law and human rights, as well as the support of a market economy.

The EU strategy for 2002-2006 will promote regional cooperation and establishing an effective regional market in the Southern Caucasus, establishing business climate conducive to foreign and domestic investments, removing obstacles and struggling corruption. The primary objective of EU/EC will be poverty reduction and sustainable economic growth, raising the deteriorating social standards and improving the poor living conditions over the longer term.

TACIS is the main financial instrument supporting the implementation of the PCA and providing grant assistance for projects in priority areas. One of the strategic directions include strengthening the agricultural sector, mainly through the development of rural infrastructure and agro-processing enterprises, adopting effective measures to preserve soil fertility, establishing a rural credit policy, optimizing the existing tax and customs regime, further privatization of vacant state-owned land, introduction of a cadastre and land registration system, development of land and real estate markets involving the banking and insurance systems. TACIS is currently engaged in a project to develop best-practice program budgeting and internal audit methods in the Ministry of Agriculture.

4. **Georgia: An Update Of Agricultural Developments.** (World Bank, July 2000)

Key constraints to sustainable agricultural growth in Georgia include agricultural policy, investment and management capacity in the agribusiness sector, land reform, and public investment in agriculture.

(a) Policy Constraints:

- Interventions in the wheat market through the controlled release of government reserves, which were created and is maintained through food support programs of the EU and the US.
- Pensions paid in kind in 1998, by distributing flour from the imported donor wheat. The method for selecting mills for processing wheat was not transparent.
- Exemption of primary agriculture from VAT increases tax burden on processing enterprises.
- Frequent changes in VAT applied to the bread and flour industry.
- Direct state subsidies to wine and tea production in 1995-1997.
- VAT charged at the customs on the imported goods.

- The enterprise privatization program has transferred the ownership of companies to private entities, but this has not achieved any significant increases in output, because the new owners have been unable to attract new management and capital, or to access new markets.
- The government has stopped direct intervention in the pricing of agricultural products, but it continues to exert strong influence on the prices of wheat and bread through the releases of grain reserves.

(b) Land Reform:

- While there has been progress on the reform agenda over the last few years, both policy and structural changes continue to be required before agriculture sector realizes its potential. The government still owns 74 percent of all agricultural land, including most pastureland and meadow, and 43 percent of all arable land and land under perennials. It imposes restrictions on land sales.
- The land reform has stopped short of creating a viable land market. The initial land privatization program has resulted in a large number of very small farms (averaging 0.75 ha), small private farms supplemented by leased land, and larger farms leased by legal entities. Without a land market it is unlikely that the agricultural sector in Georgia will reach its full economic potential.

(c) Export and Import:

- Without a significant change in the quality and marketing of Georgian export products, they will soon not be able to compete in the CIS markets.
- Excessive dependence on Russian and CIS market for exports imposes high risk of failure related to the political and financial instability in these countries. Alternative markets should be sought. Wine, water and canning industry sectors could improve their results by jointly promoting Georgian products in new markets and self-regulating product quality for export.
- Primary constraints for exporting Georgian agricultural products at this time are their low quality, the unreliability of supply, and the lack of ability to deliver large volumes.
- It is estimated that 60 perccent of agricultural chemicals used in Georgia are imported illegally, frequently after their expiration date, or under the wrong name.
- Product falsification and copyright infringement is a major problem in domestic, as well as in other CIS markets.

(d) Agribusiness privatization:

- The level of direct foreign investment in the agricultural sector remains low.

- Managerial and entrepreneurial skills are a major constraint to the Georgian agro-processing sector. Soviet-era managers, who have focused on production, have found it difficult to adjust their management strategies to include the marketing and finance. Marketing strategy was generally limited to contacts in the Russian or Ukrainian markets.
- Many of the managers could not adjust their production practices to meet the higher quality standards of more competitive markets.
- Managers of the newly privatized enterprises had no experience of managing in a market economy. The donor funded programs provide training and development of managerial skills to entrepreneurs, including hands-on experience and internship programs in the US and Europe.
- The local consulting business is beginning to emerge. It provides a useful conduit for changing business practices in local companies. Donor assisted programs for consultants should also be encouraged by the Government.

(e) Regulatory environment:

- Legislation has been considerably changed in recent years. A civil code has been passed covering general commercial practices. However, the enforcement of legal and judicial systems responsible for implementing these laws are not adequately funded and are perceived to be corrupt. This creates an environment of uncertainty and discourages larger, long-term investment. The inability to enforce contracts significantly increases transaction costs, as businesses develop other mechanisms for contract enforcement.
- Tax rates and customs duties are considered by the business managers as punitively high. Administration of tax collection is still poor due to the high level of corruption.
- The political environment in Georgia is considered by many investors to be unstable. This results in a very high-risk premium required on investments made in Georgia. Creating a stable investment environment should be the primary objective of the government, because without it the large investments required to turn the agriculture sector around will not occur.

(f) Capital markets and investment:

- The banking system had a total capitalization of about $126 million in 2002. It is unlikely to be a major source of medium- or long-term capital for the sector that requires billions of dollars. The legal and judicial system do not support the quick transfer of assets upon default of borrowers. The resale value of fixed assets is low in the current economic climate, making it difficult for the banks to lend for longer-term. They prefer liquid assets, such as precious metals and stones as collateral.

- Letters of credit are only beginning to emerge as a method for ensuring payment on delivery in the Russian market. In most cases sales to the Russian market rely on payment one or two months after delivery, after the purchaser has managed to sell the product. Following the collapse of Russian markets in 1998, many suppliers now request advance payments for delivery.
- Excessive levels of taxation discourage large-scale international businesses, which do not wish to get involved in illegal activities, to compete with small-scale illegal operators.
- Insufficient information is available during privatization for serious foreign investors to conduct adequate due diligence.
- Unclear accounting practices, and inability to conduct clear financial and legal due diligence on existing companies before purchase.

5. Agricultural Input Markets in the Caucasus. (IFDC, February 1998)

Constraints:

- Channels for distribution and sales are weak, fragmented and void of business structure.
- The ability of farmers to use crop protection chemicals even if available, is limited by knowledge, poor or no application equipment, and high prices relative to prices received for agricultural products.
- The use of agricultural machinery is constrained by the age of equipment and lack of spare parts.
- Seasonal credit becomes available from banks and/or NGOs in some geographical areas. But the lack of inputs does not promote demand for seasonal credit. Thus, synergy between seasonal credit and input use has considerable scope for development.
- It is highly unlikely that the restructured parastatals will develop into strong, reliable and profitable suppliers of inputs. Therefore, an alternative should be developed, *i.e.*, a network of private input dealers.
- Inadequate credit and high interest rates act as a severe constraint on input use and dealer development.
- Underdeveloped land markets are another constraint on input use and dealer development.
- Because of the small market, it is possible the fertilizer market to get monopolized and prevent the development of a dealer network. This should be controlled by the State.
- The lack of agricultural extension service is a major constraint to allowing the farmers learn about the new inputs. Private dealers should provide extension advice to farmers, while the dealers get training from the extension services or research institutes.

- The current capacity of the rail and highway transport sectors is not adjusted to handle with the large volumes of fertilizer transportation.
- The superphosphate plant in Sumgait has a poor location in relation to the market.
- The capacity of Rustavi plant is limited to the production of 350,000 Mt of ammonium nitrate per year.
- Laws to ensure the quality of agricultural inputs should be developed and implemented.

a) Documents and Projects Reviewed in Literature Review

#	TITLE	SOURCE	DATE	RELEVANCE
1.	Export and National Marketing Development for Horticultural Products in Georgia	FAO	2002	High
2.	Georgian Policies and Experience With WTO	CERMA	June 5, 2002	None
3.	Country Strategy Paper 2002-2006 National Indicative Program 2002-2003. Georgia	EU/EC	November 30, 2001	Medium
4.	Samtskhe-Javakheti Integrated Development Program	UNDP Georgia		Low
5.	Recent Economic Developments and Selected Issues	IMF	April 7, 2000	Low
6.	Georgia: an Update of Agricultural Developments	World Bank, Iain Shuker	July 24, 2000	High
7.	The Agrarian Economies of Central and Eastern Europe and the CIS *Situation and Perspectives*	World Bank, Csaba Csaki, John Nash	1997	Low
8.	Georgia: Poverty Update	World Bank	January 10, 2002	Low
9.	Georgia Republic Poverty Profile Update	World Bank	June 1, 2001	Low
10.	Georgia Poverty and Income Distribution *Volume II: Technical Papers*	World Bank	March 1999	Low
11.	Georgia Poverty and Income Distribution *Volume I: Main Report (Draft)*	World Bank	March 1999	Low
12.	Project Appraisal Document on a Proposed Credit and GEF Grant to Georgia for an ARET Project	World Bank	April 11, 2000	Low
13.	Survey on Land Privatization Process in Georgia	EU K. Jean, J. Mariannick	Apr-Aug, 1999	Medium
14.	Georgia, Armenia and Azerbaijan: an Assessment of Agricultural Input Markets in the Caucasus	IFDC	February 1998	Medium
15.	Relief and Recovery Assistance for Vulnerable Groups	WFP	May 2000	Medium
16.	Agricultural Output as a Georgian Macroeconomic Indicator *(Discussion Paper)*	IRIS	August 1998	Low
17.	Socio-Economic Survey of the West Georgia and Shida Kartli Regions	TSU, IRC, UNDP	June 2000	Low
18.	Observations on Agriculture in West Georgia	SCF	July 2000	Medium

19.	Georgia Agricultural/Agribusiness Sector Assessment	Heron, Lee, Winter - USAID	March 2001	High
20.	Completed Projects of International Organizations, Operating in the Agricultural and Food Sectors of Georgia 1995-2000	Ministry of Agriculture and Food	February 2002	Medium
21.	Georgia Market Reform and Agricultural Assessment	USAID	September 2000	High

Annex D

SAVE Project Assessment of General Constraints to Agribusiness

Success Story

Case Study of a Firm Overcoming Constraints

In Financing and Investment

Consulting Report by:

David Yurosek

Import Substitution and Financing – Nikora Ltd.

Introduction

SAVE agribusiness consultant, David Yurosek, visited and interviewed the management of 14 Georgian agribusiness enterprises. Part of his assignment was to identify an enterprise that could be described as a "success story" in overcoming the constraints to profitable operation and sustained growth in Georgia. The second objective of this report is to understand and explain how one company has overcome constraints and how these lessons-learned might be utilized to show other companies in Georgia that constraints can be overcome and that a company can be successful in a free market economy without illicit assistance.

The selection criteria

- Presently profitable and exhibiting a potentially successful growth pattern
- No GoG involvement, external influence or special benefits/support
- Not a company that had been privatized for a value well below its capital value
- Primary business involvement in exports or import substitution

Nikora, Ltd. easily met these criteria. Nikora, founded in 1998 by Mr. Vasil Sukhiashvili, has grown from zero production and revenue, to an estimated GEL 8,400,000 sales this year. Mr. Sukhiashvili utilized his own money to establish the company. He overcame the main constraints that were enumerated by other entrepreneurs: financing, taxes, raw material supply, and marketing. Through some very savvy and strategic steps, Nikora succeeded where others have stalled or failed.

History and Overview

The consultant interviewed fourteen companies, several of which had achieved a measure of financial success. Only Nikora, however, met all the criteria given above. During the interviews, it was apparent that Georgian agribusiness firms face four priority constraints: financing, taxes, raw material supply and marketing.

Prior to founding Nikora in 1998, Mr. Sukhiashvili worked in Moscow for eight years, where he developed many of his ideas for the formation and operation of Nikora and accumulated the seed money necessary to realize his entrepreneurial ideas. Notwithstanding the low incomes in Tbilisi, Mr. Sukhiashvili thought that Georgians would buy quality-processed meats if they were priced competitively with other processed meats. Mr. Sukhiashvili stated that he did not do any market research to determine this: it was his "gut feeling". (His instincts were right, but AV/SAVE would not recommend that others invest their life's savings on the basis of instinct or "gut feelings".)

Mr. Sukhiashvili founded Nikora with $150,000 of his own savings, money from his family and a 15 percent partner from Moscow. There were no borrowed funds. No bank would lend under conditions that Mr. Sukhiashvili could afford in 1998. He purchased used machinery, but machinery that was capable of producing meats to EU standards. He and his staff were diligent in maintaining that machinery. He sought partners with a brand name and investment capital, but none were interested due to his old machinery. Further, potential investors of the day wanted a large, quick return on their investments. Mr. Sukhiashvili was willing to accept low initial margins and to grow his business by reinvesting his earnings.

Production, Distribution and Marketing
In the first months of the operation, Mr. Sukhiashvili operated like other meat processors in the production, distributing, and marketing of his products. Nikora began with fifteen products. Market penetration was very difficult, as most of the distributors and the shops he served did not pay him. The shops also purchased products from the established processors who were competitors of Nikora. To gain market penetration, Mr. Sukhiashvili sold the processed meats at prices lower than his costs. Nikora attempted to distribute throughout Georgia with numerous distributors.

After two months, Mr. Sukhiashvili faced the problems of raw material supply and prices. He traveled around the country meeting with numerous traders of beef and pork products. Finally, he selected two who agreed to supply beef and pork at stable prices, year-around. With two traders, he was assured of a back-up supply if one encountered difficulty in meeting his supply agreement. He also kept a $5,000 reserve to purchase product on the open market, if necessary. The stable supply price enabled him to know what his raw product cost would be and to price his retail products at a stable level.

Once production and input supply issues were worked out, Mr. Sukhiashvili began to look for better distribution and marketing strategy. He achieved the independence he needed from wholesalers and middlemen by opening his own, private, product-focused shops. That solution, however, required more capital than he had, even after he borrowed against his machinery and a flat he owned.

Mr. Sukhiashvili found his solution by offering franchises to private shop owners and investors. He controlled the product quality and pricing in those shops but he used other people's money to open and stock the shops. He also provided some management and financial services to the shop owners. Without the need to own shops, Nikora could concentrate on increasing cash flow and capturing market share.

By its second year of operation, Nikora had name recognition and market share that gave it a position of strength from which to deal with distributors who would place Nikora products in non-franchise shops. He identified what he regarded as a reliable distributor and helped to finance him. This was a concept Mr. Sukhiashvili had seen implemented in Moscow. He borrowed against his personal assets to purchase three new refrigerated trucks, computer equipment, and other items to support the distributor to deliver products to the Tbilisi shops and to the other markets handled by Nikora. The distributor received five percent of the gross sales price, but Nikora controlled the cash, allocating some of it to the distributor and the balance to reduce the bank debt.

All the agreements between Nikora and its investors, suppliers, and the distributors were gentlemen's agreements. Mr. Sukhiashvili was able to execute all of these changes between the second and fourteen months of his operations.

Mr. Sukhiashvili stated that Nikora pays all required taxes. He does not believe in trying to avoid the tax burden. He stated that for the products Nikora imports, there is a 35 percent tax that is paid when the items enter Georgia.

This business model has been, for the most part, the one that Nikora has utilized from the first fourteen months of operation to the present. Every three months Mr. Sukhiashvili reviews the business model to make necessary adjustments. Nikora has a written

business plan, which includes a financial plan, including an annual budget, marketing plan, and production plan. Nikora has made changes in the business plan over the years as new constraints have developed. Mr. Sukhiashvili stated that this business model would be the one that Nikora will continue to execute, as long as it is able to grow. If growth slows down, he will review the business model and make the necessary changes to sustain the growth.

Examples of changes of this are as follows: Presently Nikora is purchasing frozen meat products from Germany, using a written contract with the company that guarantees Nikora a stable price for the year. Mr. Sukhiashvili negotiated this agreement in Germany in order to have a consistent supply of quality meat to process. He stated that there are times that the quality meat in Georgia is poor and he utilizes the meat from Germany to mix with the Georgian meat to maintain his quality. Furthermore, at certain times of the year there is a shortage of meat and Mr. Sukhiashvili has this frozen meat inventoried that allows Nikora to have a constant supply of product.

Mr. Sukhiashvili has motivated the employees of Nikora by granting them 30 percent ownership of the company. Nikora has very little turnover and few health or accident related problems. Mr. Sukhiashvili presently owns 55 percent of Nikora; the Russian partner retains his original 15 percent ownership.

The growth of Nikora has been phenomenal over the three-plus years of operation:

- At the end of the first year, Nikora was producing 15 products; presently Nikora produces 70 products.
- Gross revenue has grown from 500,000 Lari in the first year to an estimated 8,400,000 Lari this year. A compound growth annual rate of over 40 percent.
- Nikora exports approximately five percent of its product value (about GEL 420,000) to Armenia and Azerbaijan. Assets have grown from $200,000 at the end of the first year to $700,000 presently.
- The employee base has grown from 30 to 250.
- Nikora now owns 10 shops and 12 refrigerated trucks; 35 more retail outlets operate under franchise.
- Mr. Sukhiashvili wants to open 30 more retail outlets in the next two years.
- Nikora recently purchased $500,000 of used machinery from a Dutch company and is making $60,000 worth of structural improvements.
- Mr. Sukhiashvili has negotiated a credit line from the Dutch company and borrowed $150,000 at 20 percent interest from a Georgian bank.

Nikora has reduced its dependence on unreliable public utilities by acquiring its own 300 KW generator and constructing a large water storage tank. Cooking facilities can work on diesel as well as gas. Nikora, in agreement with the Dutch manufacturer, will send two employees annually to the Dutch facility for training on operation and maintenance of the machinery. Mr. Sukhiashvili expects to repay his bank loan from cash flow over the next five months.

Mr. Sukhiashvili stated that Nikora received no outside assistance from NGOs or other agencies. However, he indicated that he would like some assistance in assessing and pursuing new goals and opportunities.

Mr. Sukhiashvili's vision of Nikora's future includes vertical integration to produce and process pork and pork products for export to Russia. In order to do this, he wants to build a feedlot for pigs. He thinks there is enough feed in Georgia to do this; if not, he will import it from wherever it can be obtained least expensively. His market analysis reveals that there is a shortage of pork in Russia and that Russia is importing frozen pork from other countries. He thinks Nikora can be competitive in price and quality with the benefit of the freight advantage enjoyed by Georgia. He and his partner in Moscow have a distribution company there to distribute the frozen pork in Russia. Mr. Sukhiashvili stated that there are enough veterinarians in Georgia to assist in such a venture. The major drawback is investment capital.

Mr. Sukhiashvili states that the major constraint now faced by Nikora is incessant badgering by GoG officials. Government officials, attracted by Nikora's success, come the to the facility daily to solicit bribes. One of Nikora's responses to this harassment has been to provide Nikora products to President Shevardnadze and his family, free and on a frequent basis. He has a document of receipt from the President; when GoG officials come to harass him, he shows them the stamped document and is left alone.

Conclusion

Mr. Sukhiashvili stated that the lessons he has learned in the growth cycle of Nikora are quite simple: "To improve production quality and keep a small margin of profit and to reinvest the profit." He thinks that the major reason many companies are not successful in Georgia is that the owners want to make a large gross profit and not reinvest the cash flow into their business. He thinks that to be successful, a company must have a business plan and evaluate it quarterly, to determine if there are any changes that need to be implemented.

Nikora's processed meat products are import substitutes, replacing products that were formerly imported. SAVE's consultant could not determine the amount of meat being imported to Georgia, but an informal survey of Tbilisi retail outlets revealed a number of processed meat products from Bulgaria, Russia and Turkey.

Other businesses in Georgia can learn from Nikora growth by utilizing the concepts of entrepreneurship that Mr. Sukhiashvili has so skillfully adapted to current Georgian conditions.

- Have a written business plan that identifies constraints as opportunities for creative solutions.
- Have a quality product that is priced competitively with lower quality products.
- Have contracts with the raw material suppliers that enable the processor to be profitable.
- Have an adequate accounting system to be able to account for all the processes of the business.
- Assiduously reinvest cash flow to increase market share and sustain growth.
- Borrow only as needed and for short periods; and utilize cash flow and make credit arrangements with suppliers whenever possible.
- Provide a win-win situation with the critical components of the market chain.
- Finally, do not be afraid to "think out of the box".

The other successful companies SAVE's consultant visited also practiced many of these same principles.

Annex E

SAVE Project Assessment of General Constraints to Agribusiness

Case Study

Case Study and Market Chain Mapping of the Apple Juice Concentrate Sub-sector

Initial Information to Support SWOT Analysis

Consulting Report by:

David Yurosek

Market Chain Analysis
Constraints for Apple Concentrate

The Market Chain Analysis (MCA) as fashioned by ACDI/VOCA, is one that establishes the linkages of each component in the market chain (MC) from the producer through the customer. These linkages are for all of the components that can elucidate the production cycle of a product from the producer level through to the final purchaser. The intent of the linkages is to illustrate the strengths and/or the weaknesses of the chain for the marketing of the final product. If there are constraints within the components of the MC, then there can be possibilities of the final product not being competitive for the export markets. Since the analysis in this section is concerning the export of Georgian apple concentrate, the number and complexity of the constraints are causing the processors of Georgian apple concentrate not to be competitive on the global market.

Success of apple concentrate being competitive is the result of successful linkages. Failure of apple concentrate on the global market is the result of unsuccessful linkages.

The strategy of the MCA is to identify the individuals and/or enterprises that are represented in the various components in the production of the MC. To recognize all enterprises and their interdependencies in the generation of income and profit of the product for the export market as their role to execute a successful and/or unsuccessful export product. Furthermore, to determine the constraints that is hindering the linkages.

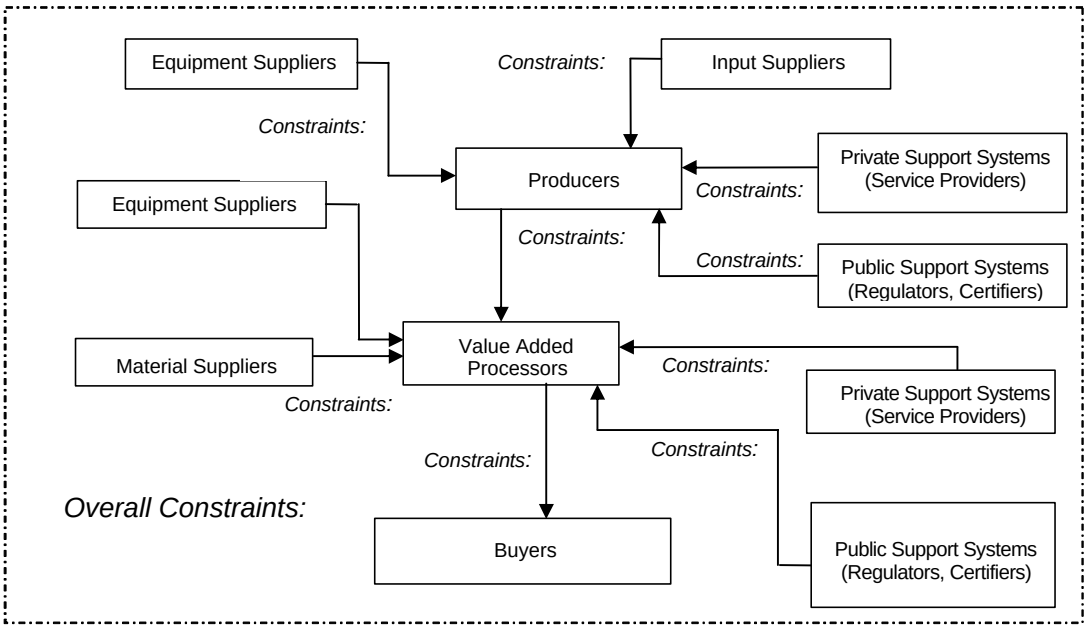
The area that was researched was apples from the Gori Valley. This is the premier region in Georgia for growing apples. Apples initiated to be grown in the Gori Valley in 1888. During the Soviet Union era, this was the premier area for cultivation of apples. Gori provided the fresh and processed apples to the FSU.

Since the downfall of the Soviet Union, the apples of the Gori Valley have suffered significantly from lack of technical assistance. Furthermore, during the last several decades of the Soviet Union era, either modern cultural activities and/or new varieties were implemented in the Gori Valley. Consequently, there is an extensive void in the quality and yield of the trees and cultural practices in the Valley.

As will be illustrated in the narrative below, the constraints are not only at the producer level, but permeate the processor level. Hence, the apple concentrate that is being processed in Georgia is not competitive in the global market and the processors are utilizing only 60% of their capacity. Furthermore, what is being processed and sold is not profitable. Unless the constraints are mitigated, the Georgian apple concentrate industry as it is today will possibly continue to diminish.

The constraints will be enunciated per the MC diagram as fashioned by ACDI/VOCA. One condition that is not the responsibility of the Georgian apple concentrate processors is the global price of apple concentrate. The price has dramatically fallen over the last five years, consequently causing many global areas having difficulty being competitive.

SAVE Market Analysis Chart



Producers:

5. Availability of Equipment – Soil, Plant Protection and Harvesting

The availability of equipment for soil cultivation is very limited. The tractors are at least 15 years old and in most cases older. The names of the tractors are Belarus and DT, being from 45 to 75 horsepower. They are the old Soviet models. They have very little cultivating equipment for controlling weeds and therefore weeds are a problem. There are very few tractor mounted fertilizer injectors for use on to the trees.

The type of spraying equipment is very old, again 15 years and older, and most is old Soviet type equipment. It is in disrepair and does not spray accurate amounts of the pesticides on the trees for plant protection. Therefore causing disease problems on the trees and affecting the fruit production.

There is a paucity of irrigation equipment. Most orchards are gravity irrigated, and when there is no gravity fed irrigable water, the trees are not irrigated. In a dry year the trees suffer from lack of irrigation, which reduces yield and quality.

6. Shipping Containers of Raw Material

All the apples are harvested by hand and many are placed into 25 Kg. boxes and/or anything that is available for storing and transportation. These are the same materials that are utilized for shipment to the juice concentrate companies from the farm gate.

7. Cold Storage Units

There are cold storage units in the Gori Valley that remain from the Soviet days. The refrigeration units do not work and therefore the buildings cannot be cooled and

product cannot be stored in the structures. The apples are stored in the basement of the farmer's houses and approximately 20% of the apples are spoiled during the period they are stored.

1. Inputs – Public/Private Support System

There are 10,000 hectares of apples that are grown in the Gori Valley that produce approximately 100,000 MT. Therefore, the average yield is approximately 10 MT per hectare. In 1888 the first apples were planted in the Gori Valley. In the last 25 years there has been no new rootstock brought into the Gori Valley. This consultant was told, that approximately 40% of all the apple rootstock are from the United States and the last rootstock of United States' varieties introduced into Gori Valley was 1975. The balance is old Georgian and Russian varieties.

The major elements of fertilizer are not readily available, mostly Phosphate and Potash, to the Gori Valley producers. The cost of the Phosphate and Potash are relatively high, $130.00 for Phosphate and $80.00 per ton for Potash. This is imported from Russia mostly and is of very low quality. Nitrogen is readily available in Georgia and the price is reasonable at $120.00 per ton. Minor elements *i.e.*, magnesium, copper, zinc, *etc*., are not available.

Producers do not perform soil and/or tissue analyses; therefore, the amount of fertilizer that is applied is totally by guess. As this consultant was told, the farmers were qualified enough to understand the needs of the tree and applied the necessary quantities of fertilizer. The lack of necessary fertilizer is one of the constraints that will reduce the yields and quality of the apples.

The availability of pesticides is questionable for the Gori Valley producers. Dupont does have a distributor in Tbilisi, but the prices of the products are quite high due to the VAT and custom taxes that are applied to the pesticides that are imported to the country, approximately 35% total tax. There is not an Integrated Pest Management (IPM) program for the producers to understand when to utilize the pesticides. The producers apply them when they think necessary, since there is not a pesticide professional that can recommend when and how to apply pesticides.

The pesticides that are of lesser cost are imported from Russia and the qualities of these pesticides are very questionable. Either the Russian seller or the importer change the chemical make-up of the products and therefore the results can be very costly to the producer.

There are not extension or research systems developed by the Government of Georgia (GoG) to support the apple producers. There are no service providers and/or distributors to apply the inputs for the producers. Due to old varieties, the lack of modern cultural practices and inadequate inputs, the yields in the Gori Valley are very poor, as heretofore mentioned. The average yield per hectare is 10 MT, whereas the apples grown in the Colombia Basin in the state of Washington, average 75 MT per hectare. This allows them to sell their apples at a lower price for processing.

Value Added Processors:

2. Equipment Suppliers

There are several value added processors for apple concentrate in Georgia. The three companies that were interviewed by this consultant were Gorkoni and Samegobro in the Gori Valley area and one in the Tbilisi area, Relco. There were contrasting comments that were made by the companies concerning many of the constraints that were endemic to the processors.

Equipment with Samegobro is relatively new, 1989. The processing technology was excellent due to the methods of purchase by Samegobro, who purchased the equipment from a Dutch company and have Dutch engineers come to the facility to assist in maintenance and repair of the machinery. The sorting and packaging was excellent and provided Samegobro with a sanitized product.

Relco had older processing equipment and Gorkoni was extremely old. They lacked the new technology for the processing of the apples for juice concentrate, the costs were higher, and quality was less. Furthermore, the packaging and sorting were inferior lessening the quality of the processed product. Sanitation was inferior at Gorkoni and poor at Relco.

Storage for Samegobro was excellent. They had large stainless steel tanks in a refrigerated area and were able to inventory their apple concentrate product for 18 months. Gorkoni and Relco had poor storage containers, poly coated, therefore creating the possibility of an un-sanitized product and the inability to store to gain the best market price.

3. Input Suppliers

Relco is using stainless steel inner wall containers for shipping and transporting through Poti to Germany. They had a difficulty in obtaining these containers, adding to their costs of transportation. Samegobro and Gorkoni utilized similar containers for shipping and did not experience any problems in obtaining the containers. They stated that there were no problems with sanitation and quality on arrival in Europe.

None of the companies had any labeling requirements, therefore were not a constraint for any of them.

4. Private Support System

Samegobro, Relco, and Gorkoni all mentioned the need for market support. There was none in Georgia, therefore they did not have access to market information such as the understanding of product balances in the EU countries, market prices, and supply from the competing countries to make marketing decisions with. The competing countries were Poland, China, Germany and Bulgaria. With good market information, the processors could make enhanced marketing decisions concerning when and where to export their products.

All companies stated that there were no testing laboratories that could be utilized for testing their products. Samegobro had their own laboratory, therefore not in need of one. Relco and Gorkoni did not have laboratories and could utilize such a facility with their product.

The total costs of producing the apple concentrate are approximately $450.00 per MT for Georgian processors. The raw materials are 65% of the costs of production. The approximate cost for processing in the United States is $300.00 per MT.

All the processors stated the interest rates for working capital and long-term debt needed to operate their businesses was too high, 22%-25%. Therefore, they borrowed in very small quantities and were unable to gain economies of scale in their processing. Gorgoni could not borrow funds to update their equipment to be cost effective. Leasing may be a positive option.

5. Public support system

The public support system was not a constraint for any of the aforementioned processors in the MCA. There were sanitation inspectors in the case of Samegobro, but was not mentioned by Relco and Gorkoni as a constraint. Quality assurance, safety inspectors, environmental inspectors were occasionally in the various operations, but did not present any constraints to any of the processors.

Certifications from the GoG were easily obtained for export and were not a constraint for the processors. There were nominal costs for the certifications for obtaining any documents that were required for export, such as certificate of origin and phytosanitary.

The total capacity of Relco was 1000 MT per year. The total production for Relco in 2001 was 600 MT. The reason for the inability to meet capacity were two reasons, as cited by Mr. Armen Mathevosyan, Managing Director of Relco, he stated that the cost of the raw material was too high for the international market price of apple concentrate. The price that he was paying was 6 Tetri per Kg. Second constraint was the international market price as heretofore mentioned was very low, which had been driven down by over supply from China and other EU countries.

Samegobro had a capacity of 3000 MT, and in 2001 produced 2000 MT. Again the reason was due to the low international market price as compared to the cost of goods sold for Samegobro. Mr. Zaur Sagahelidze, Managing Director and Part-Owner of Samegobro, stated that he still had 1000 MT of apple concentrate in inventory and was surveying the EU market in attempts to find market prices that were favorable to his production costs to sale the inventory. Both Relco and Samegobro processed clear filtered apple concentrate. Mr. Sagahelidze stated that the raw material costs were not the constraint for his company; they were paying 5 Tetri per Kg. When questioned by this consultant if would it be more profitable with the reduction of the raw material price of the apples, the reply was yes.

Gorkoni processed unfiltered apple concentrate and it was stated by Mrs. Marina Kitiashvili, Managing Director, their production in 2001 was 600 MT, with a capacity of 1,500 MT. The reason for not realizing their capacity was the inability to have the

working capital for purchasing the raw material. All producers were able to produce a product that would meet the EU standards.

11. Importers/Buyers

As heretofore mentioned, the international price on apple concentrate, whether filtered or unfiltered, has deteriorated significantly the last few years. In 1999 it was approximately $1300 per MT, last year the market was approximately $800 per MT. The EU buyers are able to buy the product that they want. Even though the acidity level of the Georgian concentrate is good, 3.5%-3.75%, 4.5% from Poland, as compared to the low acidity level of the apple concentrate from China, 1%-1.5%, the EU buyers are buying the various acidity levels in the international market at different prices and mixing them together for a final product that is acceptable to the final consumers.

The cost of delivery of the Georgian apple concentrate to Germany, the largest market for Georgia, is $200.00 per MT, compared to the concentrate from Poland, which is $25.00 per MT. The concentrate from China can be delivered to Germany for approximately $75.00 per MT. China produces approximately 33% of the world's apple production. This causes the FOB price that the Georgian processors receive to be lower.

Buyers for the most part are contacted by fax or phone. Both Samegobro and Relco traveled to Germany once a year to meet with the buyers. Samegobro traveled throughout the EU for a customer base, whereas Relco sold his entire production to a partner in Germany. Gorkoni did not travel to the EU on a regular basis.

Annex F

SAVE Project Assessment of General Constraints to Agribusiness

Horizon Group Analysis and Comparison of Georgian, US, EU and BMP (*Codex)* Food Safety Standards

COMPARATIVE ANALYSIS OF GEORGIAN, EU AND US
FOOD SAFETY STANDARDS

Horizon Group
June, 2002

Background

Food safety (hygienic) norms in Georgia are specified in the Order of the Minister of Health # 301/n of August 16, 2001. The Order contains norms of the allowable levels of the hazardous elements in food, *i.e*., toxic elements, microbiological and radioactive substances. These norms are obligatory for all food produced in or for those imported into Georgia.

Below is given a comparative analysis of food safety norms for four products:
- Processed meat (sausage);
- Milk and dairy products;
- Dry fruit;
- Fruit concentrate.

Food safety comparative norms are indicated in the Tables 1-4 below. The comparison is based on the EU and US norms obtained from the Internet. Georgian food safety norms are not available on the Internet, but rather in the form of a publication – *Legislative Messenger of the Ministry of Justice*.

The comparison showed the following:

a) Toxicological Norms:

1. Georgian safety norms are concerned with the levels of six elements (Lead, Cadmium, Mercury, Arsenic, Copper and Zinc), while EU standards are concerned with three (Lead, Cadmium and Mercury).
2. Cadmium content norms were found similar in Georgian and EU safety requirements for meat and fruit concentrates. For dry fruit Georgian norm is more stringent than that of the EU. As for milk, EU norms do not cover Cadmium content, while Georgian norm does.
3. Lead content norm is five times more stringent in the EU than in Georgia.
4. Micotoxins are measured in food of vegetable origin. Norms are the same in Georgia and in the EU. (Aflatoxin B_1, Dezoxinivalenol (Vomotoxin), Zearalin, $T\text{-}_2$ toxin, Patulin). Aflatoxin M_1 is measured in milk and dairy products. They are the same in Georgia, US and EU.
5. Aflatoxin B_1 is controlled in the dry fruit in the US and EU, but not in Georgia.
6. Aflatoxins $B_{1,}$ B2, G1 and G2 are controlled in the dry fruit in the EU, but not in the US or Georgia.
7. Micotoxin Patulin is acceptable in fruit concentrates in Georgia and US. In the EU it is not adopted yet, but is under consideration.
8. Residues of global pesticide (hexaclorciclohexane, DDT and its metabolites) are controlled in all food items in Georgia.
9. Antibiotics (Grizin, Bacitracin, Tetraciclin group, Levomicetin, Penicilin, Streptomicin) are not allowed in Georgia.

b) Radioactive Safety:

Cesium-137 and Strontium-90 levels are controlled in all food products.

c) Microbiological Safety:

Georgian norms control aerobic mesophile bacteria, e.coli, salmonella spp, staphylococcus aureus, sulfite reduction clostieds, molds and east fungi.

Information on the microbiological safety norms in the EU was available only for meat products. Georgian norms are close to the EU ones. Differences exist for aerobic mesophile bacteria colony, where Georgian norm seems more stringent than that of EU (1-2.5 * 10^3 bacteria/gr allowed in Georgia, as opposed to $5*10^5$ bacteria/gr in EU).

In general, food safety norms in Georgia are quite close to that of EU and they should not impose a constraint to exports. Constraints to the producers and exporters may come from the implementation of the actual control over the food safety, as the laboratories of the Sanitary-epidemiological service of the Ministry of Health are not properly equipped to carry out precise analyses.

Product	Characteristics, not more then (mg/kg)	Countries, Unions				Comments
		EU	GEO			
Beef, sheep, pig and poultry	Lead PB	0.1	0.5			
	CADMIUM	0.05	0.05			
	MERCURY	---	0.03			
	ARSENIC	---	0.1			
	COPPER	---	5			
	ZINC	---	70			
	NITROZAMIN	---	0.002			For smoked products
	BENZ (A) PIREN	---	0.001			For smoked products
	ANTIBIOTICS					
	Levomicetine	---	PROHIBITED			
	Tetracycline	---	PROHIBITED			
	Grizin	---	PROHIBITED			
	Bacitracin	---	PROHIBITED			
	PESTICIDES					
	Heksaklorcikloheksani (α,β,γ-isomers)	---	0.1			
	DDT and its metabolites	---	0.1			
	RADIONUCLIDES					
	Cesium-137	---	160			bk/kg
	Stroncium-90	---	50			bk/kg

Toxicological characteristics of food products

Table 3.

Product	Characteristics, not more then (mg/kg)	Countries, Unions				Comments
		EU	GEO	USA		
Milk	Lead PB	0.02	0.1			
	CADMIUM	---	0.03			
	MERCURY	---	0.005			
	ARSENIC	---	0.05			
	COPPER	---	1.0			
	ZINC	---	5.0			
	MYCOTOXINS:					
	Aflatoxins M_1	0.0005	0.0005	0.0005		
	ANTIBIOTICS	---	PROHIBITED			
	Levomicetin	---	PROHIBITED			
	Tetracycline	---	PROHIBITED			
	Streptomycin	---	PROHIBITED			
	Penicillin		PROHIBITED			
	INHIBITORS	---	PROHIBITED			Milk and cream
	PESTICIDES					
	Heksaklorcikloheksani	---	0.005			Products according to
	(α,β,γ-isomers)		1.25			fat
	Aldrin&Dieldrin			0.3		Products according to fat
	Benzene Hexachloride			0.3		Products according to
	(BHC)	---				fat
	DDT and its		0.05			
	metabolites		1.0	1.25		Products according to fat
	Ethylene Dibromide			0.1		Products according to fat
	Heptachlor&Heptachlor epoxide			0.1		Products according to fat
	Lindane			0.3		Products according to fat
	RADIONUCLIDES					
	Cezium-137		50			bk/kg
	Stroncium-90		25			bk/kg

Toxicological characteristics of food products

Table 4.

Product	Characteristics, not more then (mg/kg)	Countries, Unions				Comments
		EU	GEO	USA		
Dry Fruit	Lead PB	0.1	0.5			
	CADMIUM	0.05	0.03			
	MERCURY	---	0.02			
	ARSENIC	---	0.2			
	COPPER	---	5			
	ZINC	---	10			
	PESTICIDES					
	Heksaklorcikloheksani (α,β,γ-isomers)	---	0.005			
	DDT and its metabolites	---	0.1			
	RADIONUCLIDES					
	Cesium-137	---	200			bk/kg
	Stroncium-90	---	240			bk/kg
Groundnuts, nuts and processed products intended for direct human consumption or ingredient	AFLATOXIN B1	2	---	2		
	AFLATOXIN B1+B2+G1+G2	4	---			
	Benzene Hexachloride (BHC)			0.05 (Apple)		

Product	Characteristics, not more then (mg/kg)	Countries, Unions				Comments
		EU	GEO	USA		
Fruit concentrates with sugar	Lead PB	0.1	0.5			
	Lead PB		0.1			In tin package
	CADMIUM	0.05	0.05			
	MERCURY	---	0.03			
	ARSENIC	---	0.1			
	COPPER	---	5			
	ZINC	---	70			
	CHROME	---	0.5			In chrome package
	Micotoxins					
	Patuline	---	0.05			Apples
	Benzene Hexachloride (BHC)			0.05 (Apple)		
	RADIONUCLIDES					
	Cezium-137	---	80			bk/kg
	Stroncium-90	---	70			bk/kg

Microbiological Characteristics Table 5.

		Meat (boiled sausages)	Milk	Dry Fruits	Fruit concentrates with sugar	Comments
Aerobic mesophile bacteria Colony per 1gr (1ml)	EU	$5*10^5$				
	GEO	$1*10^3$	$3*10^5$	$5*10^4$	$5*10^3$	
Escherichia coli (forms)	EU					
	GEO	1.0	-	0.1	1.0	
Salmonella spp.	EU	25				
	GEO	25	25	25	25	
Staphylococcus aureus	EU	2				
	GEO	1.0	-	-	-	
Sulfite Reduction clostieds	EU					
	GEO	0.01	-	-	-	
Moulds	EU					
	GEO	-	-	500	50	
Yeast mushrooms	EU					
	GEO	-	-	-	50	

Pesticide Characteristics

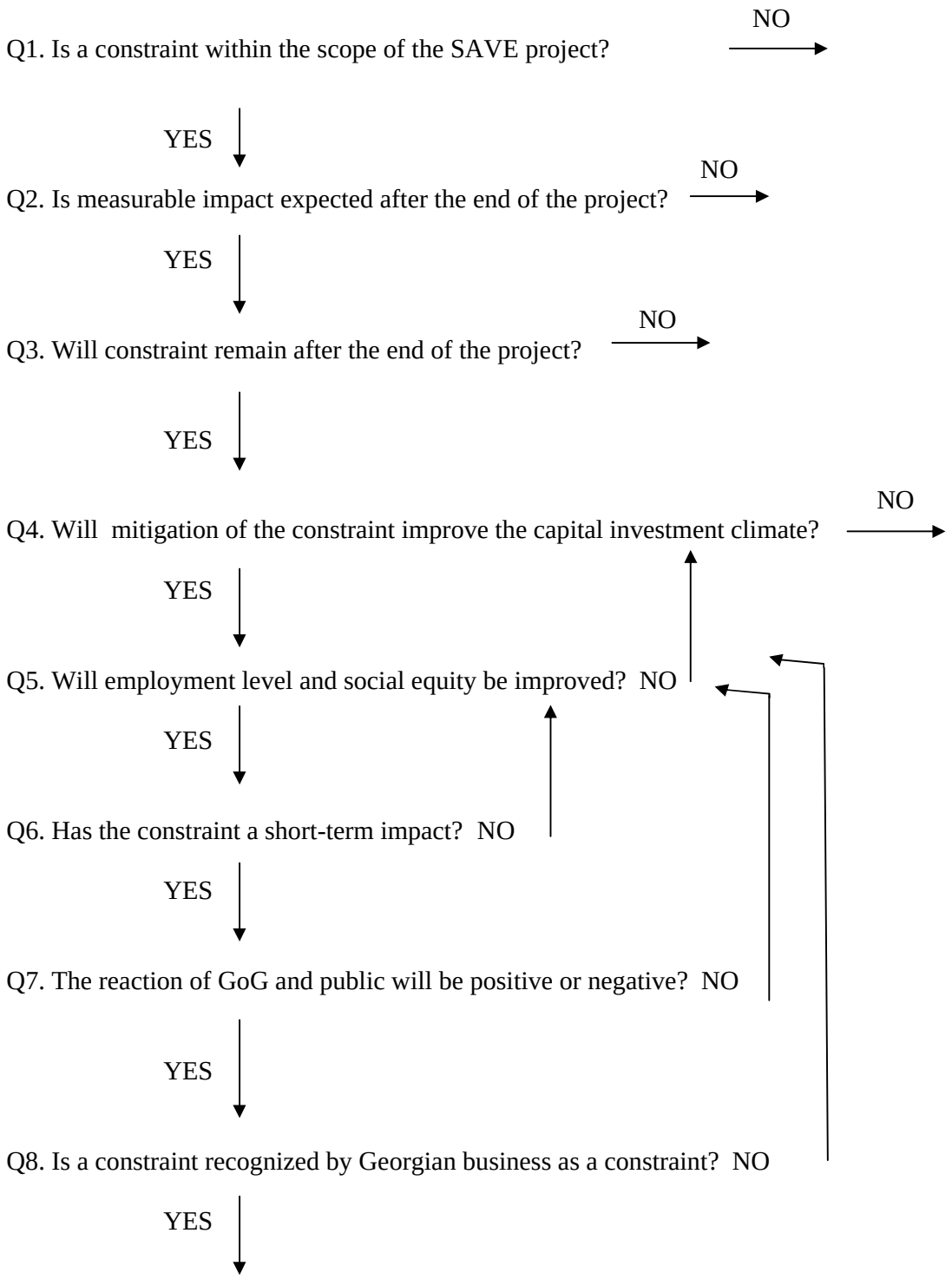
#	Pesticide (Active Substance)	Product	Norm mg/kg	Commercial name of the preparation	
1	2.4 butyl ether	All types of food	PROHIBITED	Butanone, Phenagin	
2	2.4 d-acid	All types of food	PROHIBITED	Amidim, Biutrilid, Dialen, Desarmon, Land master, Lontrin, Tresor, Sangor	
3	2.4 d-ether	All types of food	PROHIBITED	Chistolin	
4	2.4 d-octil ether	All types of food	PROHIBITED	Octapon	
5	N-(izopropox carbonil)-0-(4-chlorphenilcarbamoil)-ethanolamin	All types of food	PROHIBITED	Cartolin 2	
6	N-methil-0-tolilcarbamit	Milk products	PROHIBITED	Dicrezil	
7	0-(4-tret-buthil-2-chlorphenil)-0-methil N-methil-amidopospate	Milk products	PROHIBITED	Amidofos, Ruelen	

Annex G

SAVE Project Assessment of General Constraints to Agribusiness

Example Decision Tree Analysis for Constraint – Market Access

Decision tree application to evaluate constraint – "Market Access".



The constraint "Market Access" was ranked as level 1, or the constraint is important and SAVE project has sufficient resourses to ameliorate it.

Annex H

SAVE Project Assessment of General Constraints to Agribusiness

Example of Control Point Analysis for Follow-up and Control of Constraint Activity Focus in Implementation

Control Point Evaluation for Monitoring and Focusing the Constraint Mitigation and Policy Activities of SAVE

Q 1. Does this step involve a hampering factor of sufficient likelihood of occurrence and severity to warrant its control?

YES

NO → Not a CCP

Q 2. Does a control measure for the hampering factor exist at this step?

YES

NO

Modify the step

Is control at this step necessary? → YES

Q 3. Does this step eliminate or reduce the likely occurrence of a hampering factor to business?

YES

NO → Not a CCP → Stop

Q 4. Is control at this step necessary to prevent, eliminate, or reduce the hampering factor?

YES

NO → Not a CCP → Stop

CCP

SAVE project focus.

Annex I

SAVE Project Assessment of General Constraints to Agribusiness

SWOT Analysis of Samegobro, Ltd. – Example Analysis

SWOT Management Team

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Apple Juice Concentrate Processing

SWOT Analysis for "SAMEGOBRO" Ltd.

The following SWOT analysis is based on evaluation of Samegoboro Ltd. processing plant. At present, this is one potentially viable producer of concentrated apple juice (AJC) in Georgia

STRENGTHS:

Raw material supply – Apple is the major fruit produced in the Shida Qartli region of Georgia and one of the few fruit products produced in significant amounts. According to 2001-2002 statistics, during the past season approximately 90 000 tons of apples were produced in Georgia.

According to the information supplied by Gori Fruit Growers Association: 15-20% of total production goes for processing.

As there are not many processing companies in Georgia, approximately 20% of apple production is processed, another 20% is waste, not good for processing, and the rest 60%, is sold locally and outside (Russia, Ukraine) to fresh markets.

Only 10-15% of the growers are true "commercial" operators; that is, selling their harvest into commercial channels.

Location – The Samegoboro Ltd. plant is located in the major apple producing area, Shida Qartli region. This reduces the transportation costs and improves the quality of raw material. It also makes technical assistance and market information more effective.

Organized collection process – Plant has already organized collectors in the producing area. The people will arrange apple collection from individual farmers. Individual farmers also bring in their products and sell to processors directly.

Current/modern technology – Samegobro Ltd. is equipped with modern processing and filtering lines produced in Italy (Manzini) and Switzerland (Bucher). Equipment was installed and is maintained as needed by Italian and Swiss specialists. Repair and maintenance costs are the responsibility of Samegobro Ltd. The company has the capacity to process 30, 000 tons of raw apples per season. The processing season lasts for 4-5 months.

Power supply – Plant has multiple sources of power and is protected against uncontrolled power interruption that is a common problem for Georgian processors.

Specification of concentrate – At 65^{0}-70^{0} brix and an acid content around 3 the product is acceptable for international trade to blenders and bottlers. International standard AJC is quoted at 70-71 brix.

WEAKNESSES:

High cost of raw material – Inefficient production results in low yield and high cost of raw product. Higher yields would lower the unit production costs. Inefficiency comes from insufficient application of technology and management.

Financial –Company can qualify for local loans; however, the interest rate is 24% and is considered to high to be used for long-term investment or longer-term working capital. The company has explored the idea of producing lemon concentrate, and some other products, but feels it needs additional working capital.

Market – Absence of marketing strategy. Although, this may be partly a result of lack or unavailability of market information, as well as comfortable conditions with current buyers from Germany and Austria. The lack of a strategy is a severe shortcoming. Existing relationship seems t be more a lease or finance contract than a sale. Lack of a marketing strategy, or plan, reflects the company's reliance on the German "partnership" to buy most production rather than seeking new markets or other relationships.

Unsold stock – 1000 tones of apple juice concentrate is left unsold, nine months after the end of the previous processing season, in the warehouse of Samegobro Ltd.

Narrow client base – Concentrate is exported to Germany (and perhaps Austria) through Jahncke.

Planning and management – Samegorbro does not seem to recognize the cash flow and operational impacts of the inventory it is carrying over. This is reflected in the intent to borrow money for lemon concentrate. An experienced manager would recognize that this inventory, with no clear plan for its liquidation, reflects a clear lack of market or business planning and is not a good risk for a loan for new production.

Quality – Sante Walsh Products (Georgian company, producing juices from concentrate) indicated that apple concentrate quality produced by Samegobro Ltd. was not high enough to meet their specification, possibly because of missing ultra-filtration processing**.**

Raw material prices and concentrate selling prices – The local price of apples moves independently of the world market price for AJC making the processing margin volatile. Risk increases as a result.

No apple re-investment: Over time, apple orchards have been destroyed with very little re-establishment, making the long-term viability of the apple processing industry questionable, unless vertical integration occurs from processing to production.

Taxation: Complicated government tax system reduces profitability and income.

Tariffs: EU tariff on juice concentrate makes Georgian AJC more expensive than some competitors.

Inability to manage exports – The company has shown no ability to manage exports and market development. Previous exports were achieved based on buyer initiative

Cost to the export markets of Western Europe – Transportation cost is higher than costs to Poland, who has become a primary supplier to EU processors.

OPPORTUNITIES:

Domestic market – Drinks packagers; Sante Walsh Products and Coca Cola both import apple concentrate or bases using apple concentrate. Domestic market growth would reduce exposure to price and transport risk as well as add new market options.

Export markets – EU is a large market in which Georgia will not draw the attention of competitors. SAVE project is close to closing a test deal with a UK buyer.

Alternative products – There is international demand for other fruit flavors which might also be exported, *e.g.*, pomegranate, lemon, *etc*. This would provide added volume and increase the annual use of the plant, reducing unit costs.

Other domestic markets – Other firms, for instance Kazbegi, produce flavored, carbonated soft drinks as well. These firms might provide another potential consumer of apple concentrate.

THREATS:

Unreliable supply - Weak financial position makes company an unreliable supplier – they may not be attractive to some potential buyers.

Smuggling – Although the main drink manufacturers in Georgia are not involved in smuggling, domestic producers face competition from illegally imported (smuggled), packaged juices, mostly from Russia, Turkey and Greece.

Replacement of old equipment - long term: the plant is working below capacity, it is unclear if the company has enough retained earnings or depreciation reserves at the level of operation to replace the equipment or maintain long-term stability.

Maintenance: Reserves are not sufficient for emergency maintenance or replacement of processing equipment components.

Local demand - Demand for fresh market apples from the domestic fruit market leads to competition for raw material, price fluctuation and reduced production. This trend further increases unit costs.

Financial management: Inventory and cash flow management suggest a potentially risky financial future.

Market strategy – the Company's strategic view that apple processing is a waste product of the fresh market, with raw material pricing, quality standards, and procurement strategies based on that view, is not a strategy that will inspire buyers.

Investment – Lack of investment, either by the company or producers, in apple production and handling, hurts competitiveness over time.

Potential projects:

1. Deal for a test shipment, 20 tons, of concentrate to be concluded early July, potential follow up business from old inventory if quality and price are acceptable from test shipment (potentially $0.55mn currently in store)

2. Explore the opportunities of co-operation with Coca Cola Georgia, Kazbegi and other drink processors

3. If any activity is successful, technical assistance will likely be required

Potential pilot cases:

1. Market analysis and market research on apple juice markets.

2. Test market to key markets and test preferences.

3. Evaluate price strategy and structure and educate seller, to price the products so that they are competitive in the market.

4. Train in marketing strategies, market positioning and improved presentation, for instance (*e.g.*, create website).

5. Explore other possibilities for sourcing apples, investment in processing and organizing collection.

Annex J

SAVE Project Assessment of General Constraints to Agribusiness

SWOT Analysis of Bubble Ltd.

SWOT Management Team

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Hazelnut

SWOT analysis for "Bubble" Ltd.

Hazelnut production and processing have always been traditional and successful businesses in Georgia. This is a SWOT analysis for the hazelnut processing and marketing company "Bubble" Ltd. At present, this is the one of the major producers of shelled hazelnut in Georgia.

STRENGTHS:

Raw material supply and labor availability – Hazelnuts are traditional cultivars for the Western Georgia, especially for Samegrelo region. This region is the major supplier of raw material for Bubble Ltd. Hazelnut pickers are experienced and labor cost is not high.

Quality of the raw materials and the quality of processed shelled nuts – The variety, locally called "Anakliuri" is acceptable for European and Asian markets as in-shell as well as shelled hazelnuts. Bubble Ltd. mostly processes this variety.

Hazelnuts' collection – Bubble Ltd. has contracted collectors from the nut producing areas. These collectors are buying nuts directly from the farmers, sorting them and send them directly to the plants. The collectors are responsible for the quality of the nuts. The initial sorting process takes place at this very first stage.

Transportation from the field to the plant – Transportation is done by private truckers. There are plenty of trucks available in the region so the transportation is not a problem.

Processing plants are located in the producing area – Bubble Ltd. has two processing plants in Zugdidi, which is in the primary hazelnut growing area. Having the plants close to the nut producing areas reduces the transportation cost. In addition, "Bubble" Ltd. has one plant in Tbilisi, which processes hazelnuts shipped from Eastern Georgia and Azerbaijan.

Equipment – New, modern Italian equipment has been installed in all plants of "Bubble" Ltd.

Power supply – An auxiliary power system is operational. This allows Bubble Ltd. to operate without any interruptions.

Recycling process – After the nuts are shelled, the shells are utilized as the fuel for driers.

Packaging – New Italian equipment allows optional packaging. The nuts could be packed in 0.2 kg., 80 kg. or 800 kg. boxes.

Experience in exporting – Hazelnuts have been exported from Georgia for a long time. The primarily markets were Soviet Union, Germany and Italy. Bubble Ltd. has the experience in exporting.

Value-added products for the local market – "Bubble" Ltd. has a hazelnut-roasting machine. Roasted nuts are packaged in 200g bags, which are popular at the local market. This product has also an export potential.

WEAKNESSES:

Distance from the Market – Poor connections and high transportation cost to European and Asian markets increases the product's end price, which makes it less competitive.

Hidden (inside) defects of raw material – It is a common world practice to have a net around hazelnut in order to avoid nuts contacting the soil. Georgian growers do not use this method of harvesting. Dropped hazelnuts are not picked up on time; they remain on the ground and absorb moisture. This causes development of a molding process in the hazelnuts and may cause unacceptable levels of aflatoxin.

Sorting and quality check – At Bubble Ltd. plants hazelnuts are hand-sorted. There are few professional sorters to assure the quality of the nuts. Hazelnuts from the fields are not laboratory checked for the presence of aflatoxin.

Narrow and undeveloped market – Currently Bubble Ltd., exports hazelnuts only to Germany and Italy. The company has no marketing strategy.

Limited availability of varieties – Limited number of hazelnut varieties are cultivated in Georgia and the only one, called Anakliuri is exported to Europe or Asia.

Raw material prices – The usual fluctuations of world market prices affects the price of hazelnuts in Georgia. The Georgian farmers are not aware of this and are not willing to sell at market prices. Whenever the price drops in the European market, Georgian farmers still request the same price for their hazelnuts. This situation can make it economically unfeasible for the company to buy and process nuts.

OPPORTUNITIES:

World market – The world market for shelled hazelnuts and hazelnut containing food products is expanding. This makes it possible to expand company's production. New value-added products could be launched on the market.

New orchards and varieties – Hazelnut farming in Georgia is becoming more and more popular. New promising varieties could be introduced. This eventually will lead to increased production, will improve quality and will diversify raw materials. The cost of raw materials will probably go down and supply will improve.

Value added products – Increase in value added production, *e.g.*, roasted nuts, paste, chocolate spreads, *etc.*, will allow the company to enter new markets.

THREATS:

Competition with other producers – Turkish hazelnut production covers 75% of the processed hazelnut supply to Europe and Asia. This creates huge challenge for Bubble Ltd. to be competitive on the market.

Inability to replace or renew equipment – There are no foreign investors involved in Bubble's business. All new equipment has been purchased through local investors. The local funds are limited and there is no contingency plan in the case of breakdown of the equipment.

Unsold stock from the last year – Farmers hold back last year's crop. There is a great possibility that the old product would be mixed with this year production and the quality of the raw materials will decrease.

Fluctuation of the market price – Last year the world price for processed hazelnuts dropped tremendously. However, Georgian farmers still keep their prices unchanged. This created a great challenge for Bubble Ltd. as they become less competitive in European and Asian markets.

POTENTIAL PROJECTS:

1. Market research.
2. Identifying new buyers.
3. Launching on the market value added products.
4. Establishing the new orchards.
5. Introduction of the new varieties.
6. Improve staff qualification through training.

Annex K

SAVE Project Assessment of General Constraints to Agribusiness

SWOT Analysis of Apple Juice Concentrate Industry

SWOT Management Team

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Apple Juice Concentrate Processing

SWOT Analyses for Apple Juice Concentrate Sub-sector.

The following SWOT analysis is based on review of the plants processing raw apples into apple juice concentrate. One of the processors makes clarified concentrate, the others produce unfiltered concentrate.

STRENGTHS:

Volume of Production, Raw Material Supply - According to statistical data in 2001, approximately 90,000 Mt of apples were produced in the Shida Qartly region of Georgia. Currently, trade negotiations are being held between Georgian and Russian Governments on supplying fruit and off-season vegetables to Russia. Georgia will be able to export into Russia 30 000 Mt of fresh apples.

Fresh market consumption is reserved for the best quality apples. The rest go to processing industry or are used as animal feed. Hence, there should not be any constraints with supplying the industry with cheap raw materials. The apple industry share in overall fruit production is estimated to be 80%.

The elevation of Shida Qartly region is 588 -700 meters. The climatic condition in this region is favorable for fruit, especially apple production. The primary apple harvest window is September – October. During this period, average air temperature, is 15^0 Celsius (approximately 58 degrees Fahrenheit). Summer average temperature (June - July) is 20 - 24^0 C (68 -73 degrees F). The hottest month is August with temperatures often reaching 40^0 C (104 deg. F). Strong, harmful frosts are very rare in this region. Apple trees in Gori region can withstand temperatures to -30^0 C (approx. –22 F).

Based on data from 1999, 'summer' apple varieties occupy 1,500 hectares (about 3,705 acres), while 'winter' varieties occupy 9,500 hectares (23,465 acres). Pear trees reportedly occupy 800 hectares (1,976 acres).

The following apple varieties are grown in Gori and surrounding regions: Winter Banana, Champagne, Renette, Kekhura, Georgian Sinap, Canadian Renette, Lansberg's Renette, Golden Delicious, Bellefleur Yellow, Star Crimson and others.

Raw material quality -The quality of raw materials (brix, acidity index) is acceptable and suitable for juice and concentrate production.

Labor availability - Labor cost in the region is relatively low. Experienced apple pickers, as well as trained agronomists and mechanics are available.

Transportation - Processing factories are located nearby to orchards; trucks and truckers are readily available. Most factories have easy access to railways**.**

Local market capacity and import substitution -Apple juice is a popular product in Georgia. At present most of the apple juices that are sold in the Tbilisi markets are imported from Russia. There is a good potential for a local producers to substitute the import.

Availability of inputs - Agricultural inputs as well as spare parts for machinery are available on the market.

WEAKNESS:

Low yields - Low input agriculture practice limits the apple yields, thus the farmers have relatively high break- even prices.

Financial - High interest rates for agriculture loans. Lack of operational capital and hence cash flow problems.

Georgian banks are reluctant to issue long-term, low interest loans to agriculture processors. This leads to inability of processors to modify and upgrade processing lines and introduce new technologies.

Markets and marketing- Processors have poor or no marketing strategy. They lack the information for local, as well as for export markets. Processors generally, have limited, or no experience in international trading and international transactions.

Production Related - Processing lines and technologies are out dated. At the plants, there are limited cold storage capacities. Sanitary conditions do not match the international standards, ISO standards are not implemented, none of the processors have any understanding of the HACCP system. Poor control of raw material quality reflects in the presence of microbial or fungal toxins in finished products.

Processing plants have no access to modern laboratory equipment to monitor the in finished product the level of certain toxins like patulin. This may result in non-acceptance of that product by marketplace.

Cost of product - The usual fluctuations of world market prices affect the price of Georgian juices and concentrates. Even the best Georgian managers are not aware of this and are not willing to sell their product at given market prices. This results in overstocks.

Poor connections and high transportation cost to European markets mitigates the cost of the product.

Power supply - In rural regions of Georgia the power supply is unstable. This may affect the quality of finished product and ability to store raw materials.

OPPORTUNITIES:

Domestic market -There is an expressed demand in Georgia for apple juices and concentrates. At present Georgian juice and soft drinks producers, *e.g.,* Coca Cola, uses imported concentrates to make apple juices. Blend juices using apple concentrate as filler are becoming more and more popular.

Export markets - USAID's *Support of Added Value Enterprises* (SAVE) project will expand market opportunities. Support in training and implementation of international phytosanitary and quality standards like ISO 9001 and HACCP will make the finished products more competitive in the international markets.

Apple juice concentrate is used as filler for blended tropical fruit juices. Market trends show an increase in juice consumption versus carbonated soft drink consumption. This is another long-term opportunity.

Alternative products - Domestic and international demand for fruit flavorings is increasing. This allows the producers to diversify the production and to enter new markets.

THREATS:

Local and international market prices - At present, Georgian processors have low profit margins, that makes them vulnerable to slight reductions in world markets prices. The world market for apple juices and concentrates is highly competitive. Foreign companies are using new "21st" century technologies for juice and concentrate production. If Georgian processors will not upgrade their technologies, their products will become non-competitive in international and domestic markets.

Production Cost - Cheap and low quality juices from Russia may block the domestic market for Georgian producers. High production cost and low profit margins make them less competitive even on the domestic market.

Overstocks - Many factories have overstocks that cause cash-flow problems to them. If not properly stored, these overstocks will become unacceptable to market.

PILOT CASES:

1. Facilitate the establishment of "Fresh Apple Packer's" cooperative. Provide training in sorting, grading, labeling and final packing of fresh apples for domestic and international markets. The leftovers will be used as a raw material for processing factory and will create the steady pipeline of cheep raw materials.

2. Connect the processors with international brokers. Assist in contract design.

3. Assist the producers in introduction of the specialized varieties for processing industry, establishment of specialized apple orchards for processing industry.

Annex L

SAVE Project Assessment of General Constraints to Agribusiness

SWOT Analysis of Hazelnut Industry

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Hazelnut

SWOT for the Industry

Hazelnut production and processing have always been a traditional and successful business in Georgia. In order to study the current status of the hazelnut business, SAVE staff performed a SWOT analysis of the leading hazelnut processing companies to identify opportunities and constraints that the industry sub-sector faces. The following SWOT analysis is based on those interviews.

STRENGTHS:

Plentiful supply – Hazelnut is a traditional plant for Georgia, especially for the Western regions. Georgians are experienced in growing this plant and processing it afterward. Georgia exported fresh hazelnuts and processed product to the FSU as well.

Quality of raw and processed nuts – The existing variety, locally called "Anakliuri", is marginally acceptable for European and Asian markets as in-shell nuts as well as the shelled; it may even be preferred for some uses.

Hazelnut collection process – The Hazelnut collection process is organized by the processing plants. The plants have collectors developed from the nut producing areas. Collectors buy nuts directly from the farmers and send them to the plants. The collectors are responsible for the quality of the nuts delivered to the plant.

Organized transportation from farmers to the plants – Transportation is done by the trucks from the production area to the processing plants.

Processing Plants – There are existing processing plants in the production area.

Power – The industry has auxiliary power when the local power supply is unstable.

Labor cost – This is a high labor activity, low labor cost for skilled labor is an asset.

Experience – Experienced nut graders and pickers exist.

Recycling process – After the nut cracking process, nutshells are stored and then burned in special stoves as the fuel for driers and heaters.

Experience in exporting – Hazelnuts has been exported from Georgia for a long time, primarily into Soviet Union, but also into Germany and Italy. Therefore, local hazelnut growers and processors have experience in production and processing for export.

Local market - There is local demand and taste for hazelnuts, which would include processed products.

WEAKNESSES:

Cost to Market – Poor connections to European market raises transportation cost and increases the price of the product. They cannot compete with European production.

Hidden defects of raw material – It is a common practice to have a net around hazelnut in Europe in order to avoid nuts falling on the ground. Georgian growers do not use this method. Dropped hazelnuts are not picked up on time and they remain on the ground and absorb moisture. This causes development of hidden mold in the hazelnuts. That affects sorting, grading and quality control.

Lack of professional sorters – All sorting of hazelnuts is done by hand. There are only a few qualified women identifying the quality of the nuts in each processing plant.

Narrow client base – Georgian hazelnuts are presently exported to Germany and Italy only by local companies.

Limited availability of preferred varieties – There are only a few varieties of hazelnut grown in Georgia. Only one variety is acceptable for export to Europe and Asia and it is discounted due to the sharp point on the seed.

Raw material prices – Georgian growers are not familiar with fluctuation of hazelnut prices in the world markets. When the price drops in markets, Georgian growers hold the same price. Often growers make unreasonable demand for processors to purchase nuts.

Production of the new varieties – New, popular varieties need to be introduced in Georgia.

OPPORTUNITIES:

Experience – Farmers have experience growing hazelnuts. This can be an asset in marketing.

Organic/Natural Production – It might be possible to obtain certification for organic or natural production (2-4 years).

Caucasus location – Location and existing native hazelnut area might be a marketing advantage.

Alternative supplies – Turkish production so dominates supply that many buyers/processors would like to establish alternative suppliers.

Export market – There is a renewed interest in natural proteins and products. Hazelnut is a preferred taste in some markets and further processing is possible.

Interaction investment – Creating private orchards close to the plants gives the opportunity for the plants to have a sufficient, cheap supply of product and control costs. Transportation cost would be decreased as well.

Investment by farmer's associations – Gathering existing farmers into groups will give the same result if it is accompanied by investment.

Unsold Production – Farmers have stocks of unsold production, this could depress prices and provide better margins for processors.

THREATS:

Local Taxes – Taxes in Georgia are complex and for exporters the VAT is a financial obstacle.

Interest cost – The interest rate on a bank loan at local commercial banks is 24% APR. There may be insufficient investment funds without lower interest rates and operating funds will be limited.

Corruption – Taxation system gives local business no other alternative but to hide their income so they can avoid tax payments and protect the business. It gives tax authorities great opportunity to receive bribes from local businesses.

Competition – Turkish hazelnut production provides 75% of processed hazelnut exports to Europe and Asian countries. This creates a huge challenge for Georgian hazelnut processors in exporting their product.

Shortage of depreciation or maintenance reserves – There are no foreign investors involved in hazelnut production and processing in Georgia. All new equipment was purchased through local investors. The local funds are limited and there is no contingency plan in the case of breakdown of the equipment.

Unsold stock from the last year – Farmers are holding unsold hazelnuts from the last year. There is a great possibility that product would be mixed with this year production.

Farmers holding stock – Farmers are willing to hold inventory in the face of falling prices rather than take a lower price. Processors may not be able to operate their plants unless they pay uneconomic prices for nuts.

Unstable suppliers – This makes Georgia an unstable supplier. Processors may not have nuts to sell any year so cannot enter long-term supply contracts.

POTENTIAL PROJECTS:

1. Market research.
2. Market identification for new products.
3. Identifying new buyers.
4. Formulating new, finished products.
5. Establishing new orchards by processing companies.
6. Planting the new varieties.
7. Improve training.

Annex M

SAVE Project Assessment of General Constraints to Agribusiness

Contact List – Contacts for Assessment of General Constraints to Agribusiness