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COMPETITIVENESS OF GEORGIAN AGRICULTURE: INVESTMENT CASE STUDIES

HABIBCO AGRICULTURE AND AGROWEST LTD.

30 August 2014

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HABIBCO AGRICULTURE AND AGROWEST LTD.

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DATA

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ABSTRACT

This case analyses two newly established broadacre agriculture enterprises owned by an Egyptian industrialist in the Republic of Georgia. While technically advanced and connected to superior market channels to local enterprises, one of the businesses encountered substantial and unexpected hostility from the neighboring community. The study examines how this conflict was resolved and suggests how both investors and government can manage issues better to provide superior outcomes for both investors and local communities.

ACRONYMS

CIF	Cost, Insurance and Freight (a trade term requiring the seller to arrange for the carriage of goods by sea to a port of destination)
CSR	Corporate Social Responsibility
FDI	Foreign Direct Investment
RED	SDC-financed Rural Economic Development program
SDC	Swiss Development Cooperation
USAID	United States Agency for International Development
WEF	World Economic Forum

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I. EXECUTIVE SUMMARY

Habibco Agriculture Ltd and Agrowest Ltd, both established in 2012, are two Georgian agribusiness companies owned by the Habib family of Egypt. Habibco Agriculture operates a mixed dry land cereal and pulse cropping enterprise in Bolnisi, Kvemo Kartli on 692 ha, and Agrowest operates a mixed dryland cereal and pulse cropping enterprise on 1650 ha in Ulyanovka, Kakheti. The owners have a seven-decade history of trading and manufacturing in Egypt, and they plan to fully develop both properties with irrigation, establish a vertically integrated livestock operation, and develop vineyards in Ulyanovka.

Upon taking possession of their land in Ulyanovka, it quickly became apparent to the investors that relations with the neighbors were going to be a serious issue. Both parcels included substantial areas that had lain fallow for a number of years, and the neighboring villagers had long used them as common grazing land. At the same time, many Ulyanovka residents had not received their full quota of freehold land during land reform, and they were distressed at being denied free grazing access to what had previously been open to them and free.

When Agrowest arrived with farm machinery, villagers denied them access to the land, threatening violence against the machinery operators and property managers. When Agrowest sought support from the local authorities to mediate the dispute, for reasons that still remain unclear they were unsuccessful.

Nevertheless, Agrowest was in a good position to respond directly to the challenges raised by the local population. They hired a respected local operations manager who was effective in negotiating with villagers and reaching agreement on a package of benefits that would accrue to the local population. The package, which included local sourcing of contractors from the village, employment of some of the key agitators, utilization of Interior Ministry Security Police to secure property rights, and a local social welfare program, sufficiently ameliorated local concerns to allow operations to commence without further conflict. However, some of the locals still have mixed feelings about an commercial operation in their midst.

Once Habibco and Agrowest were able to begin operations, the broader benefits of the investment started to become clear. The companies have been using western technical advisors as well as a skilled Egyptian technical manager with a strong record in cereal cropping. Using modern dry land farming methods and novel crops, the companies are likely to displace a substantial quantity of imported grain. Their first harvest will already see them exporting oilseeds and pulses. The introduction of novel forage crops and raw materials for pharmaceutical manufacture are firsts for Georgia, and the companies are planning to outsource some of their production to neighboring farms. Agrowest is likely to plant around 350 ha of vineyards, which will be a substantial employer of both full-time and seasonal staff from the village, potentially making Agrowest the second largest wine grower in the country. Finally, although it will take as long as six years to come to fruition, the development of labor-intensive dairy enterprises on the properties will eventually create many more jobs for the local population.

Still there is impatience among the local population, and by their timelines the benefits they have been promised are slow to accrue. Given the regional uncertainty and comparatively high risk of doing business in rural Georgia, it is not unusual for investors to execute investment plans in stages, with clear milestones to be met along the way. Local residents who lose access to grazing land have a much higher level of urgency than the cautious investor's pace is likely to match. Hearing government promises of economic and technical benefits from foreign agricultural investment, villagers become frustrated and impatient with the slow pace of benefits accruing to the local community.

The lessons learned and recommendations related to this case fall into two categories: those concerning national and local government and those concerning foreign investors. We recommend

that government track investment pipelines, actively engage with incoming investors, and proactively manage disputes with the community to avoid collateral damage to investors. At the same, time there is an urgent need for the government to finalize the land reform process that began more than a decade ago. The process needs to enable local communities to be more financial viable and give them (and local government) a greater voice in decisions—like land privatization and investment in infrastructure—that will directly the livelihoods and wellbeing of their constituents.

At the same time, investors need to work with a knowledgeable Georgian with ties to the local community. They should actively engage the local government while they are making investment plans, not as a reaction to inevitable concerns raised by local stakeholders. This should include communicating with the local community before commencing operations, developing a Corporate Social Responsibility (CSR) strategy to mitigate any negative impact of the investment on individuals and the community, and considering training, extension services and other capacity building measures for neighboring farmers..

II. APPENDICES

- A. BACKGROUND
- B. METHODOLOGY
- C. FINDINGS
- D. RECOMMENDATIONS

A. BACKGROUND

Dr. Samir Morgan is project manager of both Agrowest Ltd and Habibco Agriculture Ltd. Dr. Morgan is a plant breeding specialist with a particular interest in cereals breeding, and he has managed research and commercial operations in Egypt and Zambia. The Habibs are a family of Coptic Egyptian industrialists out of Cairo. In 2012 the family established two agribusiness companies in Georgia, Agrowest and Habibco Agriculture, on properties they purchased from private owners. These included 692 ha of land that Habibco purchased in Bolnisi, Kvemo Kartli, and another 1650 ha of land that Agrowest purchased in Ulyanovka, in the Signagi district in Kakheti. When the companies took possession of the land, both parcels included substantial areas that had lain fallow for a number of years, and the neighboring villagers had long used them as common grazing land.

The 2013-14 growing season marked the first of the two companies' operations. They sowed a total of 1400 Ha of winter crop in October, producing feed barley, milling wheat and feed wheat, with plans to sell 100% of production to Georgian buyers.

Between them, the two companies have invested a total of USD 1.4 million, with about a third of that total comprising the first season's operating costs. At Ulyanovka they employ eight local security guards and eleven operational and administrative employees, of which one is a foreign manager from Egypt. Both companies are wholly owned by the Habib family.

The investors' initial plan for these two properties was to fully develop irrigation to support cereal and fodder crop production. They would have developed grain and fodder storage and intensive livestock production (such as piggeries or dairies) within a two year period, using local management. However, the investors quickly discovered that there was a serious shortage of local management talent in all of these disciplines, and that it would be necessary to take additional to train local managers and introduce Egyptian managers and consultants to the projects. They revised their original two-year timeline to six years, with the goal of achieving something close to fully vertical integration on the two properties.

A major constraint to operations at Ulyanovka arose in September 2013, when locals from Iliatsminda village began protesting against the Egyptian owners operating on their own land and threatening to harm machinery operators. The conflict appeared to be rooted in a historical grievance, as local villagers received less than the promised 1.25 ha per family in the land reform of 2005. Somehow the villagers conflated long government inaction with the arrival and sudden activity of a new foreign investor. Agrowest managers implemented a number of strategies in an effort to resolve the conflict, but the disruption nevertheless resulted in a substantial delay in planting winter crops at Ulyanovka.

In addition to conventional cereal crops like wheat, barley and sunflower, the company has been introducing novel, high-yield forage and tuber crops from abroad. They have also introduced summer crops like mustard, mung bean and canola, which are predominantly aimed at export markets in the

Privatization of Grazing Land: the Iliatsminda Community Perspective

Interviews of local villagers and managers revealed that:

- The 300 Iliatsminda village households adjacent to the property received only 0.75 Ha of land per family in 2005, instead of the 1.25 Ha promised by the state.
- Prior to the Egyptian owners taking possession of the property, the villagers were disappointed with previous investors (M Group affiliate Foodservice LTD) not making good on promised to boost local job creation.
- Villagers without their own machinery were resentful that Agrowest had hired most of the local Soviet-era tractors belonging to Iliatsminda natives for its own operations.
- Most villagers, seeing cereal crops grown at Ulyanovka, assumed that technology used by the foreign investors was no different to their own outmoded practices.
- The company's response to the protests and denial of access to the property included hiring a respected local property manager to negotiate a solution with Iliatsminda and other communities in the region; provision of funds to machinery owners to repair their tractors and rent them to Agrowest; hiring the ringleaders of the protests as laborers, and hiring locals as security guards. This seems to have alleviated the conflict to a certain extent.
- A lack of proper communication seems to be an issue, as the locals remain unaware of the company's longer-term plans and associated benefits accruing to the community.

Persian Gulf. As major producers of cereal, the company will also introduce novel technology to add value to the straw that is a natural byproduct of production. They intend to share the technology with neighboring farmers in cooperation with the Swiss-funded RED project and establish a large modern indoor dairy.

Agrowest is also developing plans to return 350 Ha of Ulyanovka to its original land use, viticulture. As early as 2015 they will begin planting Georgian wine varieties and common international table grapes for export to the Persian Gulf. When fully developed, Agrowest will be the second largest wine grower in the country and one of the largest employers in the Sighnagi district.

B. METHODOLOGY

This case study is based on a series of interviews with both foreign and local managers of the enterprises, who shared confidential information about their businesses and investments, including data on predicted sales and ongoing disputes with members of the local community. This supplements the extensive on-the-ground experience gained by one of the authors, who has been consulting for the two enterprises since 2013 in a technical capacity.

After initial interviews with company leaders we identified challenges, successes, lessons learned and themes that could support broader conclusions about the investment environment, an interview team from ISET-PI visited Ulyanovka and Iliatsminda village to explore the knowledge and attitudes of local villagers. The team interviewed locals, including a tractor operator and security guard employed by Agrowest, as well as the farm's local manager Mikheil Kandashvili. Many neighbors and passers-by joined the interviews, transforming them into focus group-type discussions. Three meetings were held in different parts of the village.

When they are included in the report, ISET clearly identified instances where stakeholders' views of the facts or outcomes differ significantly or are contradictory.

C. FINDINGS

THE BUSINESS ENABLING ENVIRONMENT

Since 2003, Georgia has been steadily climbing many international rankings that are meant to reflect the quality of the business enabling environment. The most dramatic of these was ranking 8th of 189 countries in the IFC/World Bank's Doing Business survey, but Georgia has also done well in World Economic Forum's Global Competitiveness Index and Transparency International's Corruption Perceptions Index. Despite these very important advances, all surveys point to a number of major bottlenecks for further investment and economic growth.

For example, according to the Georgian Executive Opinion Survey conducted by the WEF in 2012/13, the three most problematic factors for doing business in Georgia are **access to finance** (19% of responses), **inadequately educated workforce** (14.2%), and **poor work ethic in national labor force** (12.2%). Of almost 100 competitiveness indicators analyzed by the WEF, Georgia ranks lowest on *local supplier quantity* (136 out of 148) and *quality* (129). The country is lagging far behind on other key indicators as well, including *financing through local equity market* (126), *property rights* (120), *foreign market size* (114), and *domestic market size* (102).

While the WEF indicators provide a high level view of the overall investment environment, the contours and characteristics of an individual investment will determine how much of an impediment these issues are in any given case. As a 100% equity-financed operation, lack of access to finance has not been an issue for this enterprise, and market size constraints are not an impediment to a family with a long history as commodities traders. Indeed, Georgia's reliance on imported cereals

means that, even though the market is small, Habibco and Agrowest can maintain satisfactory margins on domestic sales.

Habibco/Agrowest's experience in Georgia has nevertheless presented a few stark examples of how constraints on Georgia's competitiveness manifest in the day-to-day operations of a foreign investor.

ACCESS TO FINANCE

The two enterprises have been funded largely through private family capital from Egypt. Management has indicated its interest in working with an international financial institution as much for political protection as for cash, but they claim to have their own financial resources in Egypt for all stages of development.

LABOR QUALITY

Management found the lack of experienced Georgian farm managers to be a major constraint. They simply could not identify sufficient resources with commercial farming backgrounds, knowledge of recent technology, or relevant vocational training certificates or degrees. In their experience, in Egypt one can easily find experienced foremen and leading hands for agricultural enterprises with 10-20 years commercial experience in large, modern enterprises.

The Habib family initially believed that they could fully vertically integrate their two holdings in a two year period using a single Egyptian project manager and a cadre of experienced Georgian managers, foremen, leading hands and laborers. They had already bought their land when they learned that the Georgia labor market would not be able support this initial timeline. The indigenous human resources simply do not exist, and they have had to reschedule their investment timetable to a six-year plan.

Below the management level, the companies find Georgian labor to have a satisfactory work ethic, but their general knowledge and experience are broadly out of date. Those who have any experience or formal training seem to be stuck with 1980's Soviet methodologies, and people at all levels seem unfamiliar with inputs like herbicides, pesticides, hybrid seed, and seed treatment. Because the companies are using contractors for cultivation and harvest, it's not clear to them how comfortable personnel are with modern farm machinery, but they've adjusted their expectations based on their experience to date. (As an indicator of technical level, one local manager cannot use a computer, and he is currently receiving instruction on how to complete basic tasks.)

MARKET SUPPORT SYSTEMS AND SERVICE PROVIDERS

The two companies have relied on their own domestic and foreign trading networks to find end markets for commodities. They source all seed and chemicals from local distributors, but they are largely dissatisfied with the standard of post-sales service they get from input providers. They also cite the cost of inputs as a drag on their competitiveness, estimate costs to be anywhere from 50 to 100% higher in Georgia than they are in Egypt, depending on the input.

The company is in negotiations with equipment manufacturers in Belarus for tractor and harvester equipment, grain storage and equipment to support the construction of their planned dairy facility. They have dismissed the possibility of buying the equipment from local providers, again citing post-sale service.

In keeping with their findings in the labor market, the company has been unable to find suitably experienced service providers for post-harvest management. They have found very little public or private contract service for grain drying and storage, and there is only one grain fumigation contractor available. Nor are there grain bunkers available for storage, a common element of the agriculture support service infrastructure in Habib's native Egypt.

There is also no local knowhow in adding value to straw and stubble, which means there is no end market for this common byproduct of grain production. Again, these are skillsets and markets that are very well developed in Egypt and other mature farming environments, and their absence removes a common source of income (or cost mitigation) and waste management from grain production operations. Indeed, the two companies are bringing experts from Egypt to turn straw into bio-fertilizer and high value stockfeed. There is no local market, but there is some possibility of exporting these products to Turkey and Iran. The companies are also co-operating with the SDC-funded RED project to demonstrate this technology and resulting feed supplement to grazers and farmers in Kvemo Kartli.

INFRASTRUCTURE

Dr. Morgan emphatically described infrastructure as "the lowest degree you can get!", identifying the irrigation water distribution network as a particular constraint. In his view, the infrastructure (and the management of it) is completely dysfunctional, rendering both properties entirely reliant on rainfall. By comparison, Egyptian amelioration entities provide excellent service, with all available arable land irrigated by state, co-operating with water users association in newly reclaimed desert areas, and with individuals in old irrigation settlements.

In the view of company management, if state irrigation infrastructure were renovated and the property developed under sprinkler and drip systems, they could triple-crop each year, instead of single-or occasionally double-cropping. Based on his experience in Egypt, Dr. Morgan believes he could reach yields of 11-13 tons per hectare with proper irrigation, in both Bolnisi and Signagi districts. Compared to the 3.5 ton per hectare that local farmers average or the 5 tons per hectare Dr. Morgan is expecting per hectare from his two properties this season, it's clear how dramatically this constrain affects his operations.

To address this infrastructure bottleneck, Habibco Agriculture approached the Ministries of Agriculture and Environment through the Georgia United Amelioration Company. He presented a novel private infrastructure proposal developed by a local hydrological engineering firm. According to this proposal, the company would invest some USD 800,000 to renovate a Soviet-era power station to pump water from the Qtsia River to their property—a lift of 155m—and constructing reservoirs to ensure that water would be pumped at peak flow times and stored, rather than depleting water supply when river flow is at a low ebb¹.

This proposal was rejected orally by the Ministry, but the company received no written justification for the decision. Further conversations and offers by Ministry officials to help resolve the issue did not advance, and Habibco manager ultimately concluded that there was no official interest in the project. They are convinced that the decision—or lack thereof—was the result of political, rather than environmental or regulatory concerns, particularly since the project would have completed for water with the downstream Madneuli gold and copper mine. As an alternative, the company will now have to sink bores at USD 80-100 per meter and spend large amounts of money on pumps on each wellhead.²

Despite the sweeping statement about infrastructure, managers concede that conditions of primary roads around their sites are normal by Georgian standards. Internal roads on the properties are poor, but in Bolnisi at least they are being renovated.

Neither property is supplied with gas, making them reliant on electricity to dry grain. This means grain drying is several times more expensive per ton than it would be with an adequate gas supply.

¹ At peak, this would involve pumping 70 cubic meters per hour into two ten-megaliter reservoirs. Water saving irrigation systems (center pivots) would be used to minimize wastage.

² This alternative will also place more stress on aquifers in the region.

PROPERTY RIGHTS

While the Habibco investment did not face constraints in accessing and utilizing its property,³ Agrowest's experience proved to be a dramatic demonstration of the myriad issues and sensitivities surround agricultural land in Georgia. Protesters from the Iliatsminda village physically prevented Agrowest personnel from gaining access to the property, stopped equipment from working, and issued numerous threats of physical harm to company staff. Some community leaders claimed that the land belonged to them, but it had been stolen by politically well-connected Georgian individuals prior to Agrowest's purchase. The impasse resulted in the autumn planting being substantially delayed. The response to this issue is covered in greater detail hereafter.

THE EFFECTS OF INVESTMENT IN GEORGIA

LOCAL EMPLOYMENT AND WORKFORCE DEVELOPMENT

One major benefit of many foreign investments is knowledge transfer, a key aspect of which can be employee training and workforce development. This often includes technical and operational training as well as knowledge upgrades in management, health and safety. At this early stage in the properties' development, knowledge transfer been fairly limited. The two companies employ 40 people as seasonal laborers whose activities include loading and unloading supplies and commodity six times a year for three days. There is only one full-time staff member at Bolnisi; at Ulyanovka there are eight security staff, and an additional seven operational and management staff.

Within six years the two properties should be fully developed and employing at least five times as many full-time staff. Development and operation of vineyards at Ulyanovka will be very labor-intensive at times, providing badly needed seasonal employment. This substantial employment should alleviate some of the initial hostility to the presence of the foreign investors.

EFFECTS ON LOCAL SERVICE PROVIDERS AND SUPPLIERS

The company uses short term contracts to obtain the services of outside tradesmen, including electricians, drillers, and construction contractors for warehouses. At Ulyanovka, Agrowest uses both state-owned *Meganizatori* and private machinery operators. The company also uses local villagers with Soviet-era equipment for cultivation, which doubles as a means to developing closer links to the community. Local machinery owners are paid GEL 25 per ha for plowing plus 25 liters of diesel per ha, and cultivation providers receive GEL 15 ha for machinery use plus 15 liters of diesel per ha. Locals capable of spreading fertilizer mechanically or boom spraying are paid GEL16 plus 5 liters of diesel per ha. Agrowest also rents water tanks from local farmers for herbicide mixing.

Seed and chemical is all bought from Georgian vendors, though the vast majority of input materials are imported. The exception is a seed multiplier in Marneuli, who produces seed for wheat, barley, oats, sunflower and corn.

At present, the companies purchase all of their diesel fuel from SOCAR at roadside filling stations. In late 2014, SOCAR will begin to supply fuel directly to an existing storage and fuelling depot on the Ulyanovka property.

The company also uses the services of some local consultants. YFN Georgia provides soil and plant tissue testing and precision agriculture consultancy services. These include detailed fertilizer recipes

³ Habibco's property at Bolnisi is far from the nearest village, and it is located a plateau. Perhaps as a result, the company has experience none of the problems with their ethnic Azeri neighbors that they faced at Ulyanovka.

and application schedules. In the past, the company has used Multitest to provide some soil testing services, but the local consultants have proven far more cost effective.⁴

Vineyards to be developed on 350ha will represent an investment of more than GEL3.5 million, most of which will be paid to local suppliers, contractors and laborers until vines are yielding grape. According to Mikheil Kandashvili, Agrowest's manager, the company plans to order 70,000 vine roots of the Rkatsiteli variety and 200,000 vine roots of Saperavi from Bidzina Ivanishvili's nursery enterprise in Saguramo.

GOVERNMENT REVENUE, EXPORTS OF GOODS AND IMPORT SUBSTITUTION

Land tax remittances are GEL 69,200 a year for Habibco Agriculture and GEL140,250 a year for Agrowest. Agrowest pays GEL 4,000 a year in property tax on its buildings. Annual salaries for both companies are GEL 240,000 per year, which would translate into Income Tax remittances of GEL 48,000 from the staff. All profits are reinvested or given to charity, so to date there has been no dividends tax liability. It is likely that Agrowest is the largest taxpayer in Ulyanovka, and one of the larger taxpayers in the Signagi district. In contrast, in Bolnisi it is likely that the Madneuli and Quartzite mines, which compete with Habibco Agriculture for water supply from the river, pay much larger royalties and tax payments that dwarf Habibco's tax remittances.

The two properties are likely to produce around 5,000 tons of wheat per year, including both milling and feed, and around 2,000 tons of feed barley. If storage can be secured in Bolnisi, prices will be much higher than an off-the-header price. Around 1,000 Ha is under wheat and 400 ha under barley.

Assuming half the wheat harvest is milling quality and half is feed, and that a third of the wheat can be sold out-of-season, the CIF value of wheat imports substituted by the companies' activities will be USD 1.59 million.⁵ The two companies are also likely to produce more than USD 580,000 of feed barley to service Georgia's poultry, sheep and pig industry, all of which are import-replacement or export-oriented industries.⁶

If irrigation were fully functional and Dr. Morgan was routinely achieving his target 13 tons/ha yield, the import replacement would be closer to USD 4.13 million a year, with USD 1.52 million of barley adding value in Georgia's livestock industry.

PRODUCT AND PROCESS INNOVATION

Habibco and Agrowest are in many senses just beginning in Georgia, but they are already introducing a number of new crops and demonstrating better ways of farming. As their operations mature and they become more established producers in their respective communities, there will be a natural transfer of knowledge to surrounding farmers.

Georgian farmers commonly use seed stored from last year's harvest without undertaking any seed dressing or testing for fungus or viruses. As a result, disease is commonly transmitted vertically from generation to generation, and fields are regularly contaminated by infected seed.

Local farmers also fail to utilize the land in their possession to its full potential. A typical production calendar for winter crops for local smallholders is planting in October, harvest in June, under dry land

⁴ The overall cost of using the consulting company is cheaper than using Multitest, results are graphically presented both as bar charts for individual nutrients and mapped on a GIS map plot-by-plot, and fertilizer recommendations are backed by solid research from major American universities and research institutions.

⁵ Off-the-header milling: 1667 ton @ USD 330/ton= USD 385,110
Off-the-header feed: 1667 ton @ USD 300/ton= USD 350,100
Off-season milling: 1167 ton @ USD 380/ton= USD 443,460
Off-season feed: 1167 ton @ USD 350/ton= USD 408,450
Total Wheat: 5000 tons = **USD 1,587,120**

⁶ Feed Barley Off the header: 1400 tons @ USD 280/ton =USD 392,000
Feed Barley Off-season: 600 tons @ USD 320/ton=USD 192,000
Total Barley: 2000 tons = **USD 584,000**

management with a normal 2.0-3.5 tone per hectare yield off the header. Summer crops are not grown dry land in Bolnisi. At Ulyanovka, local farmers produce dry land oats and sunflower.

Habibco Agriculture and Agrowest are introducing many modern farming practices, products and cultivation technologies that combined represent dramatic improvements over current practices in Georgian agriculture. These include many **innovations in plant nutrition and conservation tillage** that will increase yields and sales, and lead to better product quality. For example:

- Using certified imported seed, produced by professional seed breeders and guaranteed free of disease
- Testing soil and plant tissue to guide fertilizer composition and application rates
- Using blended fertilizer, much of which is imported. Georgians farmers tend to use only locally manufactured ammonium nitrate, so crop production is severely affected by chronic phosphate deficiency.
- Using herbicides to reduce competition for moisture and nutrition between weeds and crops
- Using fungicide to control rust on cereal crops

The companies are also introducing **novel crops** to the Georgian landscape. Some of those to be produced in the 2014 season include canola (rapeseed) and a mungbean hybrid. Seeds are imported from India by local grain trader, Landmark LTD, and the finished products are for export to Turkey, Canada and Dubai. Anticipated dry land yields are 1.5 - 1.8 tons per hectare in canola and 1.5-2 tons per hectare for mungbeans.

The companies are also introducing **perennial fodder crops**, some of which have not been grown in Georgia before. This includes:

- Alfalfa, for silage and hay, a common product in Georgia
- Aramanthe (a perennial forage, producing around 150 ton wet mass per hectare and 10 tons of oilseeds per hectare for both livestock and human consumption. This is a novel product to Georgia.
- Topinambur, producing tubers that are pressed for some 50 tons of spirit per hectare and 300 tons of green mass silage per hectare per year. (This is low protein but high mass silage.). Topinambure also yields inoleine for treatment of diabetes. This is also a novel crop, and local consulting firm Eco-Progress Biotech Co., a subsidiary of a Russian company, is supporting the project.

The companies are bringing in technical experts from Egypt to demonstrate **value-adding of cereal straws** with inoculants, to convert them into high protein stock feed for sheep and cattle, or fertilizer. In conjunction with the SDC RED program, which is providing technical support for dairymen and potato growers in Kvemo Kartli and Samtskhe-Javakheti, these techniques will also be demonstrated to small farmers and grazers in Bolnisi. To value-add its own straw residues, forages and grains, the company's ultimate goal is to establish a large **modern indoor dairy** like those to be found in Israel and Egypt. This would be a first for Signagi district.

It should be noted that a shortage of high-quality fodder in winter is a major constraint on both the sheep and cattle industries in Georgia, and that the meat and livestock export industry will never reach its full potential unless this issue is addressed. The innovations Agrowest can bring to forage production have the potential to dramatically improve productivity in the sheep and cattle industries much more broadly if adopted elsewhere.

The company also plans to plan 350 ha of **wine and table grapes** at Ulyanovka in the next two years, which will restore many of its stony south-facing slopes to their original use and transform the company into Georgia's second largest wine grower. Many vines were removed in the district during the Gorbachev-era anti-alcohol campaign, but the property has a historic reputation for producing

table and wine grapes of acceptable quality. Very few dedicated growers of table grapes exist anymore in Georgia, and most of them are Egyptian or Iranian.

Once they have completed successful field trials on their own land, the companies aim to extensively **outsource production** of oilseeds, forage and tubers to neighboring farms. As this is the first season of summer cropping, however, none of the neighboring farms have yet shown signs of imitation or emulation of the companies' activities and no outsourcing has yet been arranged.

Dr. Morgan's view is that the lack of funds and practical farm management knowhow will limit adoption of new crops by neighboring smallholders. He recognizes that the companies will need to develop training programs for contract growers, and Agrowest is sponsoring the development of an East Kakheti Farmer's Club as a forum for technology transfer for cereal and forage growers in the Sighnagi and Shiraki districts.

COMMUNITY RELATIONS AND THE ROLE OF GOVERNMENT

Iliatsminda (formerly Ulyanovka) is a medium size village, consisting of about 300 households. The local population is very heterogeneous, with many having been recently resettled from other regions of Georgia. This mix of people and circumstances did not help manage the conflict that broke out in the fall of 2013 or the negotiations that followed. Despite the lack of any visible Egyptian involvement in Agrowest's day-to-day operations, yet another complicating factor may be memories of conflicts with another "foreign" community, that of ethnically Russian Molokans, who once populated the village.

According to Archil Jangulashvili and other members of the community, the root cause of the conflict that erupted with Agrowest—and the lingering sense of hostility toward its activities—was an earlier grievance that had nothing to do with Agrowest. In the initial round of land reforms in 2005, Iliatsminda families received only 0.75ha, a full half hectare less than the 1.25ha they were entitled to under the law.⁷ While land had changed hands since then, the previous private owner had made no changes on the ground, and villagers had free access to it as grazing land. Unfortunately for Agrowest, the company became the target for popular anger that boiled over when everything suddenly changes for the local population, even though Agrowest had nothing to do with the original sins of privatization or botched land reforms.

Mikheil Kandashvili, Agrowest's property manager, believes that another part of the problem was a history of broken promises by earlier investors. Promises of new jobs never materialized, and indeed the previous owners had uprooted about 25 Ha of vineyard that had employed local workers.

Finally, while Agrowest's practice of hiring local tractors paid dividends for the owners of those tractors, it also dramatically increased demand and competition for their time. Locals would have found themselves waiting and even paying more for tractor time after Agrowest arrived. The only alternative, using *Meqanizatori* equipment, is not affordable for many villagers⁸, even though their better machinery might present higher quality of service.

While it did not prevent the immediate disruption, Agrowest's **management response** to the property invasion at Ulyanovka was ultimately effective for a number of reasons. First and foremost, the company engaged a qualified property manager, Mikheil Kandashvili, who is himself a successful farmer and rural entrepreneur. Mr. Kandashvili is a local man who commands respect in Iliatsminda

⁷ The project team did not independently verify this claim.

⁸ Locals report that plowing 1 Ha costs 80 GEL with a local tractor as compared to 115 GEL charged by *Meqanizatori* and that the local service fee for sowing is 25GEL/Ha compared to 36GEL charged by *Meqanizatori*. It should be noted that government vouchers have been introduced by the Georgian government to offset the cost of *Meqanizatori* services for individual farmers, and that managers of *Meqanizatori* branches are under political instruction to give preferential service access to smallholders.

and neighboring communities. It was Mr. Kandashvili who was able to engage in direct discussion with the protest leaders and the community.

Agrowest also recognized the value of community engagement. They deliberately hired more local labor than it needed at the property⁹ and announced that they would supply substantial quantities of flour from their own harvest to landless families in the village. They have also pledged to build a vocational school in Ulyanovka, to be operated by the Georgian Church, and a free medical clinic. To further spread the benefits of Agrowest investment, the company contracted locals to support cultivation with their old equipment.¹⁰

Agrowest is also helping local contractors to repair their old tractors and implements by providing loans to be repaid after contractual obligations are completed. According to Khundashvili, in the future Agrowest may purchase new tractors and hire the same locals as drivers. As part of the deal, machinery operators would be allowed to use the company's tractors to cultivate their own plots. Another motivating factor could be fringe benefits - bonuses or in-kind compensation, such as seed.

In parallel to local engagement, Dr. Morgan met with senior government parliamentarians, who pledged to assist and made numerous representations to Kakheti parliamentarians and community leaders to resolve the problem. This was ultimately not successful but company management recognize the efforts as sincere.

Early on, when property invasions and protests were an issue, Agrowest retained the Security Police for 4 months, who maintained a 24 hour armed guard on site. While it may have exacerbated feelings of injustice among the villagers, the step immediately halted the invasion of Agrowest's property. In 2014, the Security Police were replaced with local civilian guards, and four more guards are to be hired this season.

With the exception of villagers cutting down trees on the property's windbreaks, the situation appears stable now. Local guards could not recall a single recent instance of external threat, theft or damage to equipment. Fences have been installed on the road side of the land only, primarily protecting crops from unsupervised cattle. The company describes the local police as helpful, and farming operations now take place under normal conditions.

Even so, interviews with Ulyanovka residents suggest that things might have gone more smoothly from the outset if Agrowest had done things differently. Certainly Agrowest could have better explained its technical approach and how it might benefit the local population over time.

Unfortunately, it seems Agrowest still has no formal mechanism for doing this. Villagers are not informed of the innovative aspects of Agrowest's operation, and they lack the technical skills and education to discern any difference unaided. Even though a lot goes on behind the scenes, villagers see only the same cereals fields cultivated with the same Soviet-era tractors. Nor are villagers fully aware of the company's longer-term plans to develop more job-intensive projects or engage in CSR initiatives that will benefit the community. This continued deficit in communication undermines the goodwill Agrowest could rightly be building, and it's a problem that both investors and government could easily address.

⁹ Agrowest targeted the most vociferous protest leaders and offered them jobs, which most instantly accepted.

¹⁰ Genadi Melashvili, a tractor operator at Agrowest, comes from a nearby village, Magharo. Using his own tractor, he plows, sows, and distributes fertilizer on the farm. Genadi is generally happy for see the farm creating employment opportunities for the surrounding villages, and he is hoping to get some of the elite seed varieties used by Agrowest after the first harvest.

D. GENERAL CONCLUSIONS AND LESSONS LEARNED

Habibco Agriculture and Agrowest are relatively immature enterprises. When they have built and expanded into vertically integrated livestock production and viticulture operations, they will likely be substantial employers and taxpayers in their regions. The jobs they create and the broad benefits they present to the community will ameliorate much of the local resistance that greeted their entry to the market in Signagi district.

The grievances that came out of poorly implemented land reforms nearly a decade ago are still simmering in these villages, and the underlying cause presents a complex problem nationwide. Land registration and land use issues will continue to present a significant impediment to commercial investment in rural areas, especially if they result in land invasions or denial of access to lawful investors. In the case of Agrowest, the government could have mitigated much of the conflict with targeted land swaps or privatizing additional state lands to ensure villagers did not suddenly lose access to grazing land. Given the tax revenue that Agrowest will generate, the cost of such measures would ultimately be a small price for the state to pay for having a modern, vertically integrated enterprise operating in that jurisdiction.

The government also could have played a more effective role in mitigating conflict once community concerns escalated to open protest and property invasion, though to be fair Agrowest has not been a proactive partner in communicating with the government. Indeed, investors following in Agrowest's footsteps would do well to engage with government at the national, regional and local levels. Even when communications between national and local governments are weak, a proactive investor working through local allies and intermediaries can serve as a bridge. For investors and government alike, it is very important to pre-empt conflict, educate each other about expectations and sensitivities, and to assist in budgetary planning.

Ultimately Agrowest management proved to be flexible in dealing with conflict, and they learned a great deal about how to manage community relations. The lessons came at a cost, however, and there is little doubt that they should have taken a more proactive approach to preparing and engaging the community. They might have made disbursements to community projects before operations started, rather than putting out fires after they broke out. This would have developed significant goodwill in the community and prevented Agrowest from being tainted by the legacy of earlier investors and their unfulfilled promises.

Employing a respected local manager almost certainly saved Agrowest from business failure, but there is still a great deal of misunderstanding in the Ulyanovka community about Agrowest activities and future plans. Early and effective communications to a broader swath of the community would have improved understanding of what the company is seeking to achieve, and how the community will benefit. A full-time public relations manager from the village would be a good investment, and it may help to build business linkages they need for effective outsourcing of production operations.

For both business reasons and the community engagement it would entail, investors should also have a clear plan for extension activities. Coordination with Ministry of Agriculture, seed/chemical vendors, and aid agencies may provide a ready framework for field days and training sessions. Efforts to form and engage local farm groups are laudable, but they would have had a greater impact on community relations if they were initiated before farm operations began.

Regrettably, in its response to an existential crisis Agrowest rewarded bad behavior. By engaging in illegal property invasions and intimidating behavior, the villagers of Ulyanovka won significant concessions, even though the company was in no way responsible for the difficult situation the villagers were protesting. While this may have resolved Agrowest's situation, it may well create an

incentive for other communities with grievances over land allocation to invade other commercial properties.¹¹

While it is too early to tell, it will be interesting to evaluate the results of the first harvest and whether there is a real improvement in productivity over farms using traditional cultivation methods. When it is available, data on import substitution and exports from these enterprises can provide valuable insights into the contribution that foreign invested agribusinesses can make into improving Georgia's food security and reducing the trade deficit. It will also be worthwhile to track the development of these enterprises over the next five years to evaluate changes in their impact on unemployment, utilization of contractors and local suppliers, technology transfer to local farmers and local social welfare programs.

RECOMMENDATIONS FOR GOVERNMENT

Over the past decade, the Georgian Government has made a lot of progress in building Georgia's reputation as a place to do business. However, the challenges faced by Habibco and Agrowest highlight a number of areas that seem to contradict that progress. Unless these issues are addressed, Georgia could lose the momentum it developed in 2003-2012 as a destination for FDI in agricultural enterprises.

- **Actively track investment pipelines and engage with incoming investors:** It is important that local government not be caught flat-footed by FDI in their jurisdiction. When commercial investors take possession of a property, it is important that local government make contact with them, clearly understand their future plans, advise them on any local sensitivities, and act as an honest broker in any disputes with the local community. There should be open communication channels between national and local governments about potential investments in their jurisdiction.
- **Actively manage government disputes with the community to avoid collateral damage to investors:** It is important that outstanding grievances between government and community are effectively and promptly addressed, lest commercial enterprises entering the district become caught in the crossfire. In this case, inadequate allocation of land in 2005 resulted in an innocent party being entangled in the dispute.
- **Finalize the land reform process begun a decade ago in a transparent and efficient manner:** The complex issues surrounding land registration go well beyond the immediate case of Agrowest and Habibco. Whether it is local villagers being issued less land than they were illegally entitled to or the potential for conflicting claims and illegal occupation of land, the conflicts arising from poorly implemented or incomplete land reforms will continue to plague agricultural development.
- **Allow for more budget autonomy for local governments:** Devolution of decision making and fiscal responsibility to regional and local officials would likely ease the entry of commercial investors into local communities. If local officials had some level of control over cash flows and budget based on tax revenues from enterprises in their jurisdiction, they could play a more active role in improving infrastructure and the operating environment. They could also help ameliorate any difficulty that the commercial enterprise's entry may cause the community. Not less importantly, being financially dependent on the level of business activity in their jurisdictions, local governments would have stronger incentives to attract and support investors. They would be more motivated to engage with investors, pro-actively manage any disputes and mediate in communications with the local communities and national government.

¹¹ In contrast, the ethnic Azeri community next to Habibco Agriculture's Bolnisi enterprise behaved in an exemplary manner. It is to be hoped that Habibco will find a way to reward their neighborly conduct in Bolnisi with employment, outsourcing opportunities and technical assistance.

- **Improve decision-making and transparency in infrastructure investment decisions:** When requests for infrastructure upgrades are made by investors, it is important that government perform a rational and transparent cost-benefit analysis. Many such investments would mitigate upfront costs with increase tax revenues and employment. If proposals must be rejected, the reasons should be clearly explained. In this case, a proposal to introduce an investor-financed irrigation scheme was rejected without any explanation.

RECOMMENDATIONS FOR INVESTORS

While Habibco encountered a number of challenges that could have been mitigated by different decisions by the public sector, the case also highlights a number tactical missteps y the company that might have been prevented.

- **Engage the local government when making investment plans:** When taking possession of a large property, it is important to make contact with local and regional governments to inform them of current and future activities. A transparent investment timetable, staff hiring timetable and projection of future tax remittances may reduce the risk of misunderstanding and convince local officials of the importance of the enterprise to the local community.
- **Engage the local community before commencing operations:** It is important that villagers and government be kept informed about the development timetable surrounding foreign investment in agriculture. More than four years can pass between breaking ground and the first meat or milk products landing on supermarket shelves, and in this case the time will stretch to six years. Investors should cultivate realistic expectations, as not everybody in the village will be a contract grower or employee within the first two or three years of operations. Investors should consider approaching local governments with their investment timetables and future tax payment projections. They should leverage their own commitments to secure agreements from government that displaced villagers will be compensated.
- **Develop a proactive Corporate Social Responsibility (CSR) program to mitigate any negative impact of an investment:** It is prudent to pre-empt conflict with neighbors by initiating community welfare programs before fencing and field operations begin, rather than after. Such community activities demonstrate good faith and build multiple channels of communication with many levels of the community before any contentious activity begins.
- **Develop a formal technical extension program for neighboring farmers:** Commercial operations can also make a significant contribution to agricultural technology transfer to neighboring farmers. Investors should consider developing a formal extension program, which is inexpensive to run, and marketing this to the community well in advance as a side-benefit of the presence of their enterprise in the community. Co-operation with Ministry of Agriculture and various foreign aid programs, such as SDC-financed RED program in this case, may provide a framework for extension that can be built upon.
- **Work with a knowledgeable Georgian to facilitate investment:** It is important that investors secure the services of a mature, experienced and trustworthy individual to deal with senior government officials and to ensure smooth, uninterrupted channels of communication.

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