

# ISET

International School of Economics at TSU  
Policy Institute



პროფესიული განათლება  
ეკონომიკის განვითარებისთვის  
INDUSTRY-LED SKILLS AND  
WORKFORCE DEVELOPMENT

## CASE STUDIES: LEARNING FROM THE EXPERIENCE OF GEORGIAN ENTREPRENEURS



“This publication was made possible through a grant given by the People of the United States of America to Georgia Through Millennium Challenge Corporation ([www.mcc.gov](http://www.mcc.gov)) under the terms of the compact signed between the two countries. The information provided on this website/ in this publication is not official U.S Government information and does not represent the views or position of U.S Government or the Millennium Challenge Corporation and Millennium Challenge Account – Georgia.”

# ISSET

International School of Economics at TSU  
Policy Institute



პროფესიული განათლება  
პროდუქციის განვითარებისთვის  
INDUSTRY-LED SKILLS AND  
WORKFORCE DEVELOPMENT

# CASE STUDIES:

## LEARNING FROM THE EXPERIENCE OF GEORGIAN ENTREPRENEURS

---

### Authors:

Eric Livny  
Tamta Maridashvili

---

### Support Staff:

Andrew Hargreaves  
Guranda Darchidze  
Sara Feldman

---

### Print and video material design:

David Pipia  
Ilia Zatuashvili  
Natalia Glonti



6

ACKNOWLEDGEMENT

7

PREFACE

9

DENOLA:  
DECIDING ON  
THE RIGHT  
BUSINESS  
IDEA

11

GOGI  
ELANIDZE'S  
NEVER  
ENDING  
BUSINESS  
JOURNEY

15

INEBE.  
GE: THINK  
OUTSIDE  
THE LUNCH  
BOX

19

THE CASE  
OF DENOLA:  
PRICING  
STRATEGY

23

OK GOOGLE,  
HOW DO I  
START A  
GOAT FARM  
IN TUSHETI?

27

MARKETING IS  
EVERYTHING!

29

TBILISI  
FURNITURE  
CLUSTER:  
TOGETHER WE  
STAND, DIVIDED  
WE FALL

34

TRAKTOR:  
A SOCIAL  
ENTERPRISE  
FOR THE 21ST  
CENTURY

First of all, we would like to thank Millennium Challenge Corporation for their support in creating these study materials.

Also, we would like to express thanks and gratitude to the entrepreneurs/company representatives who were willing to spend their time and energy for the purpose of improving entrepreneurship education in Georgia. Special thanks to Gogi Elanidze, Mariam Lezhava, Marita Genebashvili, Nino Nanitashvili, Saba Kvantrishvili and Sandro Tchuadze.

And last, but not least, we wish to acknowledge the invaluable assistance of the ISET team for always being ready to brainstorm and give advice.

**This** volume brings together eight case studies of young Georgian entrepreneurs, men and women who had the courage to take a risk and set up their own businesses. The eight case studies allow readers to accompany these entrepreneurs on the challenging journey of doing business in a very difficult environment, with very limited access to finance, knowledge and modern technology. They worked in a very small market inundated by low-quality but cheap imports, and with many small competitors producing roughly the same (basic) goods and services, thus driving each other's profit margins to zero, and with no skilled and disciplined labor to count on and hardly anybody to approach for advice.

This volume is not a regular textbook. The main idea is not to teach, but to inspire and show that people can change their own lives and the lives of others by taking *calculated* risks; to show that one should not dogmatically stick to any business model or idea, but rather be quick to admit to their mistakes (which will always happen) and use them as an opportunity to learn, make adjustments and start again.

Our cases are presented in a manner that will allow readers to appreciate the importance of different stages in the process of establishing and running a business.

- » We start with the question of how one should go about evaluating business **opportunities** and picking appropriate business **ideas**. A case in point is Levan Tchioreli's decision to invest in the production of rubber foam – a key input in the local production of mattresses and furniture. Levan spent time looking for products that he could manufacture which could compete against importers. Rubber foam offered several advantages: its production did not require a massive upfront investment in technology, allowing Levan to start small and experiment with different processes and recipes. Most importantly, however, being cheap per measure of physical volume, rubber foam was extremely expensive (relative to its final price) to transport to Georgia, giving local producers a chance to compete against larger and more efficient foreign producers. Levan took a well-calculated risk, and the story of his company (Denola) is one of great success.
- » Next, we discuss the long road one may have to travel in order to realize his/her entrepreneurial dreams. Gogi Elanidze was born in a Tushetian farming household. It was always his dream to go back to his farming roots, yet, with **no access to finance**, Gogi had to go through many professional and entrepreneurial transitions, moving from country to country and from one occupation to another. Gogi manages risk by keeping his eggs in many different baskets: a small family guesthouse, production of plastic windows, beekeeping, cultivation of peaches, and Swiss-style goat milk farming.
- » The story [www.lnebe.ge](http://www.lnebe.ge) is a story of **product innovation and thinking outside the (lunch) box**. One day Marita and her husband decided to organize a lunch delivery service. However, tough competition and the pressure associated with the need to deliver lunches within a narrow two-hour interval soon forced them to rethink their business model and come up with something else: a menu of special diets tailored to different tastes and needs, with guidance and discounts that encouraged people to plan and preorder their healthy meals in advance.

- » As Denola's Levan Tchioreli learned the hard way, business is as much about production as it is about selling. Introducing a new product to a market saturated with similar products requires a smart **pricing** strategy. How much to charge? Too low and you miss out on profits, too high and you miss out on sales.
- » We may think that successful farms cannot exist on small plots of land. Yet, plot size is not a constraint if appropriate **modern technology** is employed. When considering establishing a goat farm in his native Kvemo Alvani, Gogi Elanidze had to solve (at least) three problems. First, since goats were anything but common in Alvani's sheep breeding community, there was little chance of getting expert advice. Second, Georgian goats are a lowly bunch, each producing only about 0.5-1 liters of milk per day. And third, he was short of pasture land. The solutions he came up with was to use Google search as his main business advisor, import a few male goats from Switzerland, and invest in a Chinese-made hydroponic plant.
- » Marketing may not be everything, but it matters a lot! Even when all you have is a standard product or service, you can still **market** it in a way that no one else does. Sandro, a young Telavian whose family was in the local beer distribution business, had nothing but 3,000 GEL (the credit limit allowed by his bank) when he started his own beer retail shop. His business took off when he added live crabs to his menu and organized the first Bavarian-style Beerfest in Telavi.
- » Even the most boring business can be reinvented. This is what Irakli discovered when he bought the concrete shell of a large Soviet-era industrial building in Avchala. Instead of simply renting out small pieces of his new property at the going (low) market rate, he decided to lure in small- and medium-sized companies working in the furniture sector, and nobody else. The result was the creation of a furniture cluster, Khelosnebis Kalaki, as it is known in Georgian. Irakli's vision and patience paid off. Today, thanks to the very strong **synergetic effect** among companies working in the furniture value chain, rental prices in Irakli's cluster are much higher than in the nearby area, allowing him to further expand and upgrade his business.
- » Entrepreneurship is not only about making money. It is also about **creating value for society at large**, and accruing a part of that value in the form of private dividend or profit. This is the essence of social entrepreneurship, as exemplified by Traktor. Launched by two young Dutchmen and initially financed by international donors, Traktor uses modern communication technology to provide Georgian farmers with information about weather conditions, input and agricultural product prices, and last but not least, farming know-how. While very innovative, Traktor also illustrates the difficulties of **sustaining** a social enterprise beyond the initial donor-supported phase.

.....

At the end of each case, there is a video link. In the videos, entrepreneurs/company representatives themselves tell their stories. The purpose of the videos is to cover the topics which are not discussed in the case study, and/or give more details about topics that have already been discussed. But most importantly, the videos illustrate and give life to the text (e.g. by showing the process of production).

*Note: videos are in the Georgian language.*



## DENOLA: DECIDING ON THE RIGHT BUSINESS IDEA



Though he has a degree in hydropower engineering, Levan Tchioreli has never worked as an engineer. Instead, at the age of 21, he chose to become an entrepreneur. Now, at 41, he has tried many business ideas, some of which worked and others failed. His greatest success came in 2014, when he co-founded Denola.

Denola is an old female name, meaning “a girl” in the Svanetian language. Whilst it would be hard to meet a girl called Denola in Georgia today, thanks to Levan, you can find some locally-produced goods on the shelves of Georgian supermarkets marketed under the Denola brand.

» **Question for discussion:** What criteria would you use when deciding what to produce in Georgia?

One criterion for Levan and his partner was the possibility of gaining a cost advantage over imported substitutes. Competing in terms of cost (and therefore price) could be achieved in different ways.

» **Question for discussion:** How can one gain a cost advantage (produce cheaper) over international competitors?

### The role of transportation

Levan decided to go for an imported product that is expensive to transport to Georgia. Even if a foreign competitor has a large factory and produces huge quantities of a product at a very small cost per unit, a smaller domestic producer could still be competitive if the cost of transporting competing goods to Georgia is sufficiently high as a share of the product's final price.

You may come up with a business idea and only then start thinking where to locate your business, considering the cost of transporting the final product to relevant markets. However, it may happen that you decide *what* to produce based on *where* you think you might locate your business.

» **Question for discussion:** for each of the following pairs of products, which is more expensive to transport to Georgia relative to its price?

1. A 1997 Mercedes E190 vs. a 2017 Mercedes S600 AMG
2. Sturgeon caviar vs. "Lays" potato chips

Levan thought that the following three products could be produced in Georgia in a competitive way:

- a. Cardboard (to be used in the production of packaging materials, such as boxes)
- b. Cotton (for medical or cosmetic use)
- c. Foam rubber (used in the production of mattresses, soft furniture, sponges, etc.)

» **Question for discussion:** What is common to these three products and why do you think Levan considered them as an option for local production?

These three products are not very expensive per unit of weight (unlike caviar!) and are very bulky and expensive to transport relative to their final price.

» **Exercise:** A truck can be loaded with 20 tons of caviar worth 20 mln USD, or 2 tons of cardboard worth 5,000 USD. The cost of transportation, involving hiring a truck from Turkey, is the same at 2,000 USD.

1. What is the cost of transporting one kg of caviar and one kg of cardboard?
2. What is the share of transport costs in the final price for the caviar and cardboard?

## Production technology

It was very difficult for Levan to decide on the right product to produce. In order to make his choice, he traveled to Europe and observed how each of three products are actually produced.

» **Exercise:** Please watch the videos:

Cotton: <https://www.youtube.com/watch?v=orKBbm9JJ1s>

Cardboard: <https://www.youtube.com/watch?v=jNbKlc8tD5I>

Foam: <https://www.youtube.com/watch?v=zi7am1We9SE&t=79s>

Discuss the pros and cons of producing cardboard, cotton and foam in Georgia.

And the winner was ... foam for reasons related to (1) fixed costs and (2) product inputs.

» **Question for discussion:** How are fixed costs and product inputs relevant in choosing foam and not cotton and cardboard?

Denola production process



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=uW23fkXwXcE&t=113s>

# GOGI ELANIDZE'S NEVER ENDING BUSINESS JOURNEY



## Chapter 1 – Pigs

Gogi Elanidze was born into an above-average Tushi family. His father, Daniel Elanidze, resigned from his job as director of the Telavi Cheese Factory in 1988 in order to establish, together with his sons, one of Georgia's first commercial pig farms (disguised as a "cooperative"). The family's farm turned out to be a successful business, allowing him to complete major construction work, and acquire farm land and machinery from the local *sovkhoz*.<sup>1</sup>

Everything was fine until it wasn't.

Daniel Elanidze died, heartbroken, in 1994. Only 59 at his death, Daniel could not bear to see his business fall prey to extortion by greedy mafia gangs in the chaos of Georgia's early years as an independent state.

## Chapter 2 – On the move

During the next 12 years, in a desperate effort to fend for his family, Gogi tried every possible occupation, moving from job to job and from country to country.

In 1994-5, Gogi drove a bus on the Georgia-Turkey line, but, having had his passengers robbed by Mkhedrioni thugs, he decided to get a much safer job as a tax inspector in Akhmeta. However, he did not like this job and so continued his odyssey by growing watermelons and tomatoes in southern Russia, and then sailing a fishing boat in Poti.

» **Question for discussion:** Doing so many different jobs must have been extremely tiring. What could have prevented Gogi from starting his own business in Georgia?

The business environment in Georgia remained very difficult until 2004-5 (and even later). To start a business, Gogi had to save money ("capital") for his initial investment. He also had to figure out what kind of business would be a good fit for his skills and the market.

<sup>1</sup> A state-owned farm in the former Soviet Union.

In 2005, Gogi finally hit the jackpot, landing a risky but well-paid job as a truck driver carrying supplies for the American military in Iraq. In one year, he managed to put aside more than 10,000 USD – paid directly into his bank account in Telavi. It was not much, but was enough money to fuel his thoughts about starting his own business. Also, by that time mafia gangs and corrupt government officials were no longer a threat.

Gogi had no professional education that could help him decide what kind of business to start. However, having grown up in a farming household, Gogi considered the option of going back to his agricultural roots.

» **Question for discussion:** What are the pros and cons of farming from a business perspective?

Cons (challenges)	Pros (opportunities)
1. Production is affected by natural factors beyond a farmer's control (i.e., weather, diseases).	1. Initial investment in skills and capital are quite low for some types of agricultural activities, particularly in villages where people enjoy access to land and water resources, and have the necessary basic skills.
2. The prices of agricultural products are very unstable, both seasonally and from year to year, because they depend on the quantities supplied by other farmers (locally and globally).	2. Selling standard agricultural products does not require special marketing and advertising efforts.
3. Agricultural goods are perishable and have short shelf lives. Cold storage can be expensive.	3. By storing agricultural products, one can get a much higher return.
4. Farming activities are not uniformly distributed over time. In certain periods, there is no work to do, and in other times, you don't get to sleep at all.	4. Farmers can use the time for other business activities, family, learning new skills, or leisure.
5. Some types of farming activities (e.g. wine, nuts and fruit) require a very lengthy period of investment before becoming profitable (of 5-7 years).	5. Some types of farming activities can generate a very quick return (chicken farming).
6. Can be associated with low social status ("peasant").	6. Can be a lot more fun if one likes being in nature and/or working with animals.

Although Gogi had enough money saved for an initial investment, he understood the need to start earning early enough to cover the "working capital" needs of the business – the cost of inputs, salaries, rent and utilities. Farming, at least the kind of high-value farming activities that he thought of, would take a long time before becoming profitable. Moreover, investing in farming seemed to be a risky endeavor due to the low levels of control over the quantity, quality, and pricing of most agricultural products.

## Chapter 3 - Manufacturing

In 2006, Gogi decided to invest in a small factory producing plastic doors and windows. This was a time of large investment in the refurbishment of local schools and public buildings in Kakheti, and Gogi was able to win enough municipal contracts to give him a stable source of income for the next seven years, as well as to pursue the opportunity to go back to his farming roots and make a long-term investment in agriculture.

» **Question for discussion:** What are the pros and cons of diversification?

Cons (challenges)	Pros (opportunities)
<p>1. A specialist can perform a task better than a general manager. For example, a veterinarian is expected to deal with animal health problems on a farm better than a general farm manager who manages crops and livestock together.</p> <p>Therefore, the challenge is that diversification requires one to learn different skills and divide their time between different activities.</p>	<p>1. There can be synergies between different types of activities: for example, one can use factory machinery to produce agricultural equipment. There are very strong synergies between different kinds of farming activities:</p> <ul style="list-style-type: none"> <li>• manure → fertilizer, source of bioenergy;</li> <li>• straw → bedding for chickens, other animals;</li> <li>• grain → animal feed.</li> </ul> <p>Moreover, diversification allows crop rotation practices (e.g., corn planted after soybean benefits from the soybean's ability to fix nitrogen).</p>
<p>2. Limits the scale of each business activity, which can be important:</p> <ul style="list-style-type: none"> <li>• Raw materials, machinery, and other inputs can be purchased at a lower price per unit, if bought in large quantities;</li> <li>• If the (fixed) cost of machinery and other equipment is very high, the per unit cost can be reduced by increasing the scale of production.</li> </ul>	<p>2. In the case of seasonally-compatible activities, diversification allows one to more fully utilize his/her time. For example, to engage in agricultural activities in summer, and do pottery in winter.</p>
	<p>3. In the event that one line of activity become less profitable, it is easier to restructure the business by redeploying resources from one activity to another.</p> <p>Diversification also reduces the risk exposure caused by weather conditions or diseases. There is empirical evidence that risk reduction is a significant motivation for farm diversification (e.g. Lin et al. 1974).</p>

Gogi inherited a small piece of farmland from his father in Kvemo Alvani, most of which was occupied by a dilapidated pigsty and some other buildings. It was not possible to buy a larger plot of land in a nearby area, because Kvemo Alvani is not very land-rich. However, Gogi had some money to invest in his agricultural business, and he had a factory that could be used to produce agricultural equipment.

- » **Question for discussion:** What type of agricultural business/products would you go for in Gogi's situation?

## Chapter 4 – Honey

The first thing Gogi tried was beekeeping. Since he had a furniture factory, the cost of producing beehives and frames was trivial. Moreover, the best thing about honey is that it can be stored for years – at least until you build your customer base – and the storage is inexpensive, as it does not require expensive equipment. **But how to become a beekeeper if you have never done it before?**

- » **Question for discussion:** What would you do to educate yourself in beekeeping?

As Gogi (49) says, “We have to break out from the traditional way of thinking and follow new trends. Lots of things have changed in the world during recent years; until recently, you had to spend years to learn new things, now it can take a few minutes. You simply have to open your eyes and see how others do it – not only people around you but anywhere in the world. And then, just try it yourself.”

The very first thing he did was to get out of Alvani and wander around Kakheti in search of beekeepers. This “wandering” took a full two months but was worthwhile. Gogi got a lot of useful information, e.g., about the wrong choices people had made when selecting the most appropriate beehive structure.

Honey was a good business and, perhaps more importantly for Gogi's Tushi soul, it gave him the opportunity to get back to Mother Nature, and the traditional shepherd's way of life. Just like his ancestors who migrated their sheep between Tusheti, Shiraki and Alvani, Gogi would load his beehives (about 120 at peak) on a truck and take them on a two-month tour of Kakheti: from the acacia groves of Lagodekhi in early April, to the lush wildflower meadows of Shiraki, and to the linden forests around Kvareli in late May (needless to say, Gogi's honey is really worth trying).

As far as Gogi was concerned, honey was not meant to be the end of his business journey. Harvesting honey twice a year, and being able to store it without substantial costs, gave Gogi another stable source of income. Gogi could now afford to try something new, something that required a lengthier period of learning and investment.

## Chapter 5 – Persimmons

In 2011, Gogi gave a lift to another Kakhetian guy, Dato, who happened to be in the business of growing persimmons and selling them to Ukrainian buyers. These buyers had their trucks circling Kakheti around harvest time, loaded with packaging materials, pallets and all. Selling would thus not be a problem. Gogi got fired up about this business idea and decided to visit Dato in order to learn more about persimmons. A year later, he planted 600 trees next to his father's farm. With a drip irrigation system added in 2016, he expects his persimmon harvest to reach 18-20 tons in a year or two, once the trees grow to full size. Not incidentally, 20 tons of fruit fit into exactly one (Ukrainian) truck.

- » **Homework task:** Groups comprised of three to four students are asked to find out as much information as possible about the rationale of growing persimmons: export prices and markets, initial capital requirements and payback period, profit margin, etc.



To watch the accompanying video, click **here:** [https://www.youtube.com/watch?v=kKyz\\_19t9eA](https://www.youtube.com/watch?v=kKyz_19t9eA)



## INEBE.GE: THINK OUTSIDE THE LUNCH BOX



Marita and her husband first became interested in cooking after getting married. Every day they surfed the internet, searching for different ingredients and coming up with innovative recipes. Inspired by their hobby, they decided to start their own food-related business. Because they had limited financial resources, they were not able to open a restaurant, but instead started an online food delivery service.

### BEWARE OF FIXED COSTS!

Fixed costs are costs that must be paid regardless of the volume of the product or service you sell. No matter how much you sell or don't sell, you still have to pay your fixed costs.

One obvious example of a fixed cost are overheads. Overheads may include rent for the space your company occupies. It may also include your weekly payroll (e.g. your cook).

**Advice:** Keep your fixed expenses as low as possible, especially when you are starting your business. During the first year or so of a startup, your business income may be low as you build up your customer base. Therefore, initially at least, you may not have enough to pay your bills. Having fewer fixed expenses will keep you in business until sales start picking up.

### » Question for discussion:

Why would it be more costly for Marita and her husband to open a restaurant, as opposed to a food delivery service?

The fixed costs are much higher for a restaurant, as you need to rent space in a relatively central (and expensive) location. An online delivery service can operate from an inexpensive location, with lower average cost per unit (e.g. per one khinkali).

Number of khinkali sold per day)	Daily Fixed Costs (rent, basic utilities + core staff cost)	Variable Cost (khinkali ingredients and gas)	Total Average Cost per khinkali	Price per khinkali
100 khinkali	200 GEL	$0.2 \times 100 = 20$ GEL	$(200 + 20) / 100 = 2.2$	0.7
500 khinkali	200 GEL	$0.2 \times 500 = 100$ GEL	$(200 + 100) / 500 = 0.6$	0.7
1,000 khinkali	200 GEL	$0.2 \times 1,000 = 200$ GEL	$(200 + 200) / 1,000 = 0.40$	0.7

To be successful in a market where similar companies were already operating, Marita and her husband tried to offer better quality (e.g. exceptional freshness) and innovative cuisine.

Two main business processes needed to be managed: the kitchen and the delivery service.

**OPERATIONS MANAGEMENT** is an area of management concerned with designing/ redesigning and controlling the process of production of goods and services. It aims at ensuring that business operations are efficient (use the fewest possible resources) and effective (meeting customer requirements).

Operations management is about managing the entire production process whereby inputs (raw materials, labor, and energy) are converted into outputs (goods and/or services). This has strategic (long-term) and day-to-day management aspects. Operations is one of the major functions in an organization, along with management of the supply chain (getting the inputs), marketing (selling the product), finance and human resources.

» **Question for discussion:** What are the fixed and variable costs for each process?

	Fixed costs	Variable costs
<b>Kitchen</b>	Office rent Kitchen gadgets Salaries of cooks (in the short term) Administrative staff salaries Utilities (e.g. office heating)	Utilities (e.g. gas for cooking) Raw food ingredients Salaries of cooks (in the medium term)
<b>Delivery service</b>	Scooters (in the short term) Driver/delivery staff salaries (in the short term)	Oil Scooters (selling is an option in the medium term) Scooters' tear and wear



Marita rented a place, bought kitchen gadgets and hired cooks able to prepare delicious European dishes. Naturally, finding highly motivated, hard-working and professional cooks took a long time. However, what turned out to be an advantage for attracting cooks were convenient working hours. For a delivery service specializing in lunch meals, the cooks could work during the daytime; whereas cooks work very long hours at a typical restaurant or hotel, often late into the night.

To operate the delivery service, they bought scooters and hired people who would deliver the food to customers. Finding such people was not as difficult, because no special skills were required, other than motivation and diligence. Yet, managing a little army of scooter drivers turned out to be more challenging than expected. The drivers often got lost on the way, bringing the wrong lunch boxes to customers; some even managed to lose their scooters, according to Marita.

- » **Question for discussion:** Why did it turn out to be so difficult to manage the delivery staff? Point out the relevant differences between cooks and delivery staff (type of people, incentives they have on the job, and monitoring possibilities). How one should manage these different types of staff?

Besides human resource management, other issues arose. The online orders were largely concentrated in a two-hour interval in the afternoon when people usually have lunch. The company received approximately 200 orders during these two hours and preparing food and delivering it to 200 distinct locations stretched the logistical resources of the start-up to the limit. What further complicated the process was that Marita was totally “obsessed” with the quality of food and demanded that the cooks prepare it after the order was made so that it could be delivered fresh, which further increased the time pressure. For the process to run smoothly, Marita had to hire seven cooks and the same number of delivery staff, which, of course, required larger investment in kitchen gadgets (so that the cooks could work in parallel) and scooters.

- » **Question for discussion:** Why was it costly to have the business process largely concentrated in the two-hour interval?

The main issue with having a “peak load” during a short period of time is that you need to invest much more money in “fixed assets” such as space, kitchen gadgets and scooters. Also, during the peak load hours, the company has to employ a large number of staff, only a few of whom could be paid part-time salaries (you will not be able to hire qualified cooks by only offering a 2 hours/day salary). When demand is not equally distributed over time (during the day and over weekdays), the company will face higher fixed costs for the same sales volume. Moreover, for the same investment size, you will be able to sell less product, thus taking more time to even break even. The online food delivery service worked for several months and remained profitable despite the significant challenges Marita and her husband had to master. However, in response to the high level of stress, Marita never stopped thinking about ways to simplify the business process.

- » **Question for discussion:** How would you change Marita’s business model so that sales are not as concentrated in a two-hour interval?

One way to avoid the peak load problem is to switch to a different product – prepackaged meals that are cooked in advance and only need to be heated in a microwave oven. Such meals can be produced the day before and delivered to customers any time.

Marita discovered that the market for lunches was already saturated by competitors providing freshly-cooked meals. Therefore, she had to do something else. The something she came up with was **dietary meals**, customized for a few types of diets. Marita initially considered selling individual dietary meals for each customer, but she later decided to go for a higher level of standardization and offer four standardized menus to choose from.

- » **Question for discussion:** Why did Marita opt for standardization? What makes standardization appealing?

Standardization brings economies of scale in production. One person (a chef) can develop each dietary menu option, train staff, and monitor the quality of each meal sold. The professional qualifications required for the personnel in charge of cooking are much lower in the case of a standardized menu. With a standard menu, you need large volumes of a limited number of ingredients, allowing you to get better prices and save on transport and other “transaction” costs.

Marita offered four types of fixed menus, which she updated from time to time. For example, beef tongue was taken off the menu since it did not appeal to Georgian tastes. The dietary menus were created in consultation with doctors, nutritionists and fitness instructors. Marita attempted to negotiate with famous nutritionists for permission to use their names to advertise the diets, but the nutritionists were very cautious about protecting their reputations and did not agree. Marita has now started similar negotiations with fitness instructors.

- » **Question for discussion:** How could Marita further reduce the cost of operating her business and scale it up?

With the four dietary menus on offer, Marita tried to convince customers to plan their orders in advance by offering discounts on **weekly pre-orders**, in particular, on orders of a **full-board** menu, which included not only lunches but also breakfasts and dinners. Under this plan, clients could place weekly pre-orders and pay a **fixed price** (ranging from 189 GEL to 249 GEL, depending on the type of diet).

Inebe menu for Monday



Given that nobody had ever offered anything similar to Georgian customers, Marita launched the new offer in parallel with the existing lunch delivery service. The first customers of the fixed-price weekly menus turned out to be existing customers, as they already knew and appreciated the excellent quality of Marita's business.

The new offer turned out to be so successful that Marita's business discontinued its traditional lunch delivery service and concentrated solely on the weekly dietary menus. Every evening, from Monday to Friday, customers can get a full-board menu for the next day.

The new business model has dramatically reduced the logistical challenges and costs facing the company. First, advance payments had a positive impact on liquidity. Previously, Marita would be paid by customers *after* paying for the raw materials. Now, she gets paid in advance, reducing her financing costs. Second, having information about future orders allowed advance planning, avoiding excessive waste of raw materials, or a situation where the business runs out of a critical ingredient.

Third, by being able to **cook in advance** and **deliver orders throughout the whole day**, Marita only needed one chef and another person to deliver the orders (typically, in the evening, when there is less traffic). It has become easier to monitor quality. There is no more need for scooters and inattentive drivers. Also, Marita needed less space and could sell some of the kitchen equipment. Finally, the less stressful working environment made staff feel more comfortable, making it easier to hire and keep professional employees.

Marita attracts and cultivates customers through Facebook and phone consultations. Apart from getting feedback through direct communication, Marita also analyses her customer database to understand people's preferences and buying behaviors. For example, gender differences became clear: while women are the majority of [www.inebe.ge](http://www.inebe.ge) customers, men are better at keeping their diets, meaning that they are less likely to quit if they start a diet. Moreover, men more often opt for a fitness diet. Information like this helps Marita design more effective marketing strategies and target current and future customers.

As a future extension of her start-up, Marita plans to add a service to deliver dietary ingredients together with appropriate recipes. This would allow her to develop a new market niche for customers wishing to cook delicious meals by themselves, and in this way have fun and save some money in the process.

In order to get more information about [inebe.ge](http://inebe.ge), visit the following websites:  
<https://inebe.ge/> | <https://www.facebook.com/inebe.ge/>



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=fTbcsGCJaJY&t=60s>

## THE CASE OF DENOLA: PRICING STRATEGY



After 20 years of trying out different business ideas, Levan Tchioreli decided to start local production that could compete with importers. To gain a cost advantage over international competitors, he explored several imported products that are expensive to transport to Georgia and ended up selecting foam rubber (as used in the production of, for example, mattresses).

There were three main factors behind Levan's choice. First, taking up a lot of space and being cheap, foam rubber is relatively expensive to transport. In other words, the cost of transporting foam rubber (as a share of its final price) is quite high, giving local producers an advantage, even if they are not as efficient as their foreign competitors. Second, transporting the inputs required for the production of foam rubber – chemicals such as polyurethane or natural latex – does not cost as much. Third, producing foam rubber made sense for Levan because the relevant production technology was simple enough to avoid a substantial initial investment in skills and technology.

Although very excited about the business idea, Levan and his co-founder did not rush into building a comprehensive business plan or recruiting a team. Instead, they started experimenting with product prototypes, and brought in European technicians who could train Georgian staff and test product quality. Next, they introduced the product to potential clients – mattress and furniture producers.

The product-market fit was validated: producers expressed interest in Denola's foam rubber, since it was of reasonable quality and cheaper than the imported product. The time had thus come to expand the scale of production and experiment with additional products, such as dish sponges, which also use foam as the main input. Denola entered the market with dish sponges and furniture foams. There was one more question to address before actually placing Denola's rubber foam on the market: what should the pricing strategy be when introducing their new products?

Levan's challenge was not unique. Many entrepreneurs struggle with pricing. How much to charge? It's clear that the right price can make all the difference – too low and you miss out on profits; too high and you miss out on sales.

- » **Question for discussion:** Propose relevant criteria for deciding the pricing strategy for a new product. *[Examples: own production costs, competition with local and imported products (competitors' prices), the quality of your product relative to the competition, the opportunity to 'brand' your product as something special, the opportunity to use product price as a signal of quality (for some products) – the latter only works in business to consumer (b2c) marketing when quality is difficult/impossible to assess in advance.]*
- » **Question for discussion:** Compare the following three new products: a piece of enamel jewelry made in Signagi, bottled Saperavi wine from Mirzaani (a village in Kakheti), and a Georgian smartphone produced in Kutaisi. How would you price these products relative to the competition? What could you do to increase the price well above competition?
- » **Question for discussion:** How does rubber foam compare with these products when it comes to pricing? Is it more similar to enamel jewelry or smartphones?

Foam rubber is a standard product, such as a smartphone. It has to meet certain technical requirements and cannot be priced much above other products that have similar physical properties (screen size, memory, and camera resolution for phones; elasticity and durability for rubber foam). An established producer, such as Apple, can try to price its product well above the competition, as they have done with the iPhone X, by associating it with a “special” story. However, this is an interesting experiment in marketing, and Apple’s success is far from guaranteed. As a general rule, a phone model should be priced very close to the competition (for example, a Samsung model that has the same properties and components).

In the end, because of the properties of rubber foam as a product, Denola used a minimum markup pricing strategy for both dish sponges and furniture foams. The objective was to cover production costs, but to be as inexpensive as possible relative to comparable imported products. Given that Denola’s products did not have any recognition in the Georgian market, this pricing strategy was supposed to enable the company to attract the most price-conscious consumers, and to compensate for the lack of established reputation.

This market penetrating pricing strategy helped Denola substitute for 80% of imported rubber foam used in the production of mattresses and furniture. However, quite unexpectedly for Levan, substituting for imports in the case of dish sponges did not work as successfully.

- » **Question for discussion:** What is the difference between rubber foam for mattresses and dish sponges when it comes to marketing?

Whereas dish sponges are sold directly to consumers (through supermarkets, drugstores, etc.), rubber foam for industrial use – as in the production of mattresses or furniture – is typically sold to businesses. Business-to-business (B2B) transactions are a very important part in any value chain. Take the example of a simple shirt. There is a very complex value chain that begins with the production of cotton or some other fiber, which is then woven into cloth. This is then cut and sewn into a garment, packed, transported and distributed through various channels until we finally pick it in Tbilisi Mall. Businesses in Uzbekistan sell cotton to local spinners (who produce thread), who sell it to weavers (who produce cloth), who sell it to garment makers and so on. All these businesses buy inputs with the ultimate aim of adding value and moving products down the chain until they finally reach us, the Georgian consumers.

» **Question for discussion:** How is selling to businesses different from selling to consumers?

Business clients may be more “rational” and have the ability to properly test a product in a lab. They therefore may care less about the label, and more about the actual quality/price ratio. In B2B sales, the number of customers is much smaller, and the seller and buyer personally know each other and engage in regularly repeated transactions that rely on trust and reputation. Any attempt to cheat or sloppiness in production or delivery will immediately result in a breakdown of trust, ending any future commercial relationship between the parties.

Dealing with business clients was fairly easy for Denola. It only had to demonstrate that the quality of its product was sufficiently good (relative to its price) and that it could deliver on time according to the technical specifications demanded by the client. In the B2B market segment, the most important thing for Denola was to maintain its reputation.

The problem with dish sponges was that the market was full of competing imported products, with prices ranging from relatively expensive (for established brands such as Procter & Gamble) to relatively cheap (for Iranian sponges).

» **Question for discussion:** Denola decided to undercut the competition and be the cheapest seller of dish sponges in the Georgian market. Was this a smart decision?

Prices can be looked upon as an indicator of quality, just as found in the following experiment conducted by William Poundstone. In the first test, Poundstone offered subjects two options of beer: a regular option at \$1.80, and a premium option at \$2.50.

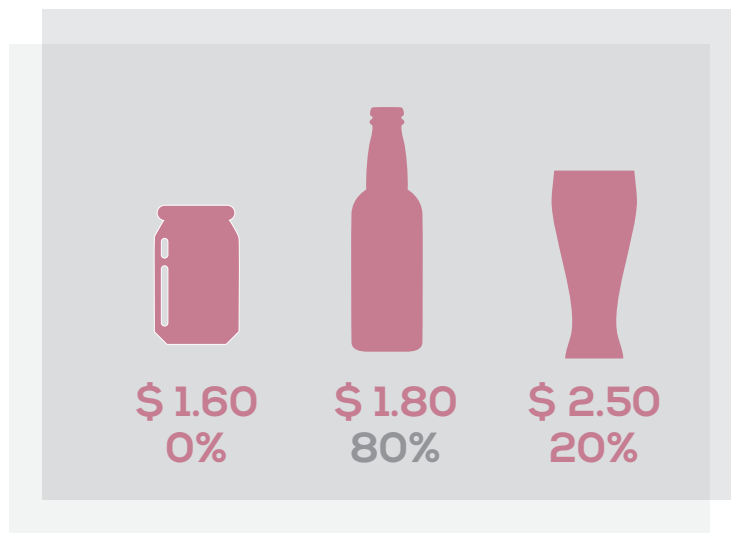
» **Question for discussion:** What do you think the result of Poundstone’s experiment was?

Four out of five people chose the premium option, even though it was more expensive.



In the second test, Poundstone added a third beer variety, priced at \$1.60 (i.e., cheaper than the regular option in the first test).

» **Question for discussion:** What do you think the result of the second test was?



Oops. The cheap beer was ignored and, all of a sudden, four out of five people preferred the standard \$1.80 beer.

In his third test, instead of adding a cheaper beer, Poundstone added a more expensive, \$3.40 super-premium beer.

» **Question for discussion:** What do you think the result of the third test was?



» **Question for discussion:** Can Denola's failure to penetrate the market for dish sponges be attributed to its initial pricing strategy? What alternative would you propose based on Poundstone's experiments?



To watch the accompanying video, click **here**:  
<https://www.youtube.com/watch?v=XMcvTVSBoGI&t=1s>



## OK GOOGLE, HOW DO I START A GOAT FARM IN KVEMO ALVANI?



Gogi Elanidze was born into an above-average Tushi family. His father, Daniel Elanidze, resigned from his job as director of the Telavi Cheese Factory in 1988 in order to establish, together with his sons, one of Georgia's first commercial pig farms (disguised as a 'cooperative'). The family's farm turned out to be a successful business, allowing him to complete major construction work and to acquire farm land and machinery from the local *sovkhoz*.

Everything was fine until it wasn't.

Daniel Elanidze died, heartbroken, in 1994. Only 59 at his death, Daniel could not bear to see his business fall prey to extortion by greedy mafia gangs in the chaos of Georgia's early years as an independent state.

During the next 20 years, in a desperate effort to fend for his family, Gogi tried every possible occupation, moving from job to job, from country to country and, finally, from business to business.

In 2013, when his small manufacturing business started winding down, Gogi decided to go back to his agricultural roots and start something new on his father's dilapidated pig farm. He knew he wanted to engage in dairy farming but could not decide right away whether to go for cows or goats.

- » **Task:** Students split into three groups. One group has to sell the idea of starting a cow farm. The second group advocates a goat farm. The third group serves as the jury and evaluates each of the two business ideas.

	Cow farm	Goat farm
<b>Costs</b>	Up to 15-18kg of grass daily per head (or free, if pasture is available all year round), cost of one calf or heifer, injections, milking equipment, cold storage, transport, fuel and electricity.	Up to 3kg of grass daily per head (or free, if pasture is available all year round), cost of one kid, injections, milking equipment, cold storage, transport, fuel and electricity.

<b>Revenues</b>	Average lactation period (days) x average daily amount milk x price (ranges from 1 GEL per liter in high season to 2 GEL in low season).	Average lactation period (days) x average daily amount milk x price (ranges from 1 GEL per liter in high season to 2 GEL in low season).
<b>Local expertise and services</b>	Local community breeds cows (and sheep), therefore there is enough local expertise and services (artificial insemination, feed, and veterinary services).	Local community does not breed goats, therefore local expertise and service provision is very limited.
<b>Marketing</b>	Demand is high because everybody consumes cow milk or uses it to produce cheese and other dairy products. However, supply is very high and is concentrated around a few months of the year when free pasture is available.	Low awareness of goat milk benefits (does not contain allergens) and products, such goat cheese. Demand is relatively low, but so is supply.

Gogi could have started a dairy cow farm, but he did not own enough pasture land and feeding cows all year round would have been very expensive for him. He also knew that everybody around him produced cow milk, and he thought that doing more of the same would not be a very smart business idea.

On the other hand, he had read about the health benefits of organic goat milk. He had heard about French goat cheeses. He was familiar with the myth that goats would eat almost anything, from apples to bark to unsold Christmas trees and brooms. But how on Earth would he get started? Since goats and goat milk were anything but common in Alvani's sheep breeding community, there was little chance of getting expert advice or learning from the experience of others.

» **Question for discussion:** How would you go about acquiring basic knowledge about goat milk farming?

Luckily, Gogi had a computer connected to the internet, and was thus able to teach himself, at least as far as the basics were concerned. When we met him one Saturday morning on his father's farm, Gogi was using drawings he found online to refit an old pig house to accommodate the goats he had just bought on the local market.

By then he knew that the local goats were a lowly bunch, producing only about 0.5-1 liters of milk per day, as compared to the 4-6 liters of the elite Swiss breeds.

» **Question for discussion:** How would you go about increasing the productivity of your goats?

The simplest solution was to import male goats from Switzerland in order to improve the local breed, a process that would take 3-5 years. Gogi read online that given the size of his farm, he would initially need 5-6 Swiss billy goats; unfortunately, transporting even such a small number of Swiss goats turned out to be a financial impossibility.

» **Question for discussion:** How would you go about decreasing the cost of transporting a small number of goats from another country to Georgia?



After an extensive search, Gogi found another goat milk enthusiast in Natakhtari with whom he could join forces to save on delivery costs. A deal was struck, and in May 2015, five Saanen billy goats proudly stepped onto the red carpet rolled out for them in Kvemo Alvani.

A year later, 29 of Gogi's nanny goats (the best he could find) gave birth to 39 kids. While the little snow-white babies are strikingly similar to their aristocratic fathers, Gogi knows that it will take a couple of additional generations and at least three more years for his goats to reach the original Swiss level of productivity.

Gogi had a very limited pasture and quickly ran out of old Christmas trees and brooms. As Gogi's herd increased in size, the cost of feeding the animals became too high for his farm to be profitable.

» **Exercise:** Cutting or minimizing production costs is not always a good idea.

	High-quality feed	Low-quality feed
<b>Fixed cost of maintaining a goat farm (one worker, electricity)</b>	500 GEL/month	500 GEL/month
<b>Feed cost</b>	400 GEL/month	200 GEL/month
<b>Milk production</b>	500l	300l
<b>Price of milk</b>	2 GEL	2 GEL
<b>Total cost</b>	900 GEL	700 GEL
<b>Total revenue</b>	1,000 GEL	600 GEL
<b>Total profit/(loss)</b>	100 GEL	-100 GEL (loss!!!)

Instead of cutting the cost of feed (which was impossible anyway), Gogi went back to Google and asked how one can grow green mass on a small plot of land. He entered just a few key words, and Google came up with the "hydroponic feed production plant" solution.

Gogi could choose among many different models and producers, but he ultimately chose to buy a Chinese plant simply because it was the cheapest. Since the Chinese company he got in touch with had never heard of Georgia, they asked him to pay the full price in advance. Gogi just closed his eyes and wired the entire amount (8,700 USD). He had been hoping to have at least part of his investment financed by the Georgian government's "Invest in Georgia" program. Although he had applied, he could not afford to wait four months for the review process to be completed. His goats needed to be fed.



Gogi's hydroponic plant



After many sleepless nights over the course of four months, the plant finally arrived in Kvemo Alvani. But Gogi's challenges did not end there: there were no instructions enclosed, at least certainly none in a language he could understand. Luckily, Google once again came to Gogi's rescue. By googling "hydrophoniuli" (in Georgian), Gogi stumbled upon a guy in Kobuleti who had a similar hydroponic plant installed on his farm. Gogi called him and was pleasantly surprised to find out that he was interested in learning more about Gogi's goats and was willing to come all the way from western Georgia to Gogi's farm, to share knowledge and help with the installation.

Gogi now has 50 beautiful goats that look very much like their Swiss fathers. In two years, he expects them to reach the original Swiss level of productivity (4-6 liters/day).

For the moment, Gogi does not have enough milk to justify investment in a modern cheese production facility. Finding a buyer for his milk turned out to be challenging as well, given that large processing companies were not interested in buying and transporting small quantities of milk from Alvani. The minimum daily quantity required by most of them was about 150-200 liters, which Gogi can only hope to reach in a few years' time.

For the time being, Gogi drives his milk to another Kakhetian village, Shalauri, about 30km away from his village, where he sells it to a small cheese producer. The quantity he is able to sell at this stage does not bring in much money, but is still sufficient to cover the cost of feeding the goats. In a few years, Gogi expects to reap the full benefits of his investment.



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=e0CV1Lk-fNc&t=3s>

## MARKETING IS EVERYTHING!



Sandro Tchuadze, a native of Telavi, went to Tbilisi to pursue a (useless) bachelor's degree. After getting a piece of paper certifying his educational achievement, Sandro got married and came back home to help with logistics and marketing in his family's slow-developing beer distribution business. However, instead of staying in the business and just waiting for something good to happen, Sandro decided to pursue new opportunities. It all started with Sandro getting a message from his bank that his new credit card had a borrowing limit of 3,000 GEL.

» **Question for discussion:** If you were in Sandro's place, what would have done with 3,000 GEL?

As Sandro already had some experience and knowledge of the beer business, he decided to open a beer shop. The first place he rented was a tiny shop, about 16 sq. meters, which had the advantage of being affordable: it cost Sandro only 150 GEL in monthly rent. However, the location was not great, nor was the building's exterior appealing to potential customers. To compensate for these disadvantages, he invested all his energy (not money, since he had none) in advertising his new business.

» **Question for discussion:** How would you advertise your business without any money?

Sandro created a personal Facebook account for his Ludis Sakhli (not a business page, which are costly) and added as many people from Telavi as possible. He spent several days identifying people living in Telavi, friends of friends, friends of friends of friends, all of whom he invited to follow his shop. Within two weeks, he managed to reach 4,000 people.

» **Question for discussion:** What would you do (think of anything new and different) to attract customers to a bar?

Sandro thought of selling not only beer but also live crabs, which was something new for Telavians. He took photos of live crabs in his aquarium and posted them on Facebook. Many people became interested and came to check out Sandro's place, his live crabs, and, of course, his beer. Ludis Sakhli came to be recognized as a place to visit in Telavi. It was now necessary to sustain and expand his customer base.

» **Question for discussion:** How would you go about sustaining and expanding Sandro's customer base?



Telavi is famous as the capital of Georgia's main winemaking region, Kakheti. Sandro's **clever marketing** idea was to use not wine, but beer as the theme for a number of fun activities (which he advertised through Facebook), such as beer drinking competitions.

After a successful year, Sandro was confident enough to open a new beer shop to serve a **different segment of customers – young Telavians** who would go to the central square to hang out with friends in the evenings. Sandro found a suitable place, closer to the square that was larger and much nicer than the previous one. After renovating the place, he added **wine** to his assortment of beverages, as **tourists** frequently stumbled into his shop asking for Georgian wine.

Sandro's success story spread throughout the town. After some time, another beer shop, very similar to Sandro's, opened in the neighborhood. Three more opened in the following months. Sandro had set a new trend in Telavi, but now he faced much tougher competition.

» **Question for discussion:** What could Sandro's response to increasing competition be? Was his business able to survive?

To compete with other shops, Sandro had to **keep his prices as low as possible**. The low-markup/high-volume strategy turned out to be well-suited for the thin wallets and large wine-and-beer bellies of his fellow Kakhetian customers. Sandro's sales exceeded expectations, but he continued to invest every single tetri he made in order to stay ahead of the competition.

One thing Sandro had to do was to maintain **product quality**. Dispensing equipment has to be regularly cleaned and the beer itself has to be sold fresh, with its color and taste meticulously monitored.

To accommodate customer demand, Sandro expanded his **product variety**. Currently, he offers 16 varieties of beer, including **kvevri beer** from Aspindza in the Samtske region and a few other exotic beers. Additionally, he serves 30 types of fish and wines. Most recently, he added food items that go well with beer: burgers, French fries and other snacks.

Last but not least, to differentiate himself from the competition, Sandro used his social network and connections at the local municipality to organize a Telavian version of the German **Oktoberfest**. Everything was planned and executed meticulously. Female waitresses in traditional Bavarian outfits delivered excellent beer and live music was played in every corner. Telavian motorcycle riders also joined the festival and advertised it by rallying in the streets.

Sandro was no longer concerned about competition!



Telavian Oktoberfest



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=muoJ2hg2tlw&t=2s>

## TBILISI FURNITURE CLUSTER: TOGETHER WE STAND, DIVIDED WE FALL



Avchala is located on the outskirts of Tbilisi, in the middle of nowhere according to the Georgian capital's standards. And yet, a 4 ha plot in Avchala, which back in Soviet times used to house a large carpet manufacturing plant, is now a bustling “craftsmen city” or Khelosnebis Kalaki, as it is called in Georgian.

After the USSR's collapse, Avchala's carpet factory quickly turned into a barren concrete carcass surrounded by swamps where only frogs would enjoy singing. Irakli Koberidze bought this carcass and the swamp in 2007.

- » **Question for discussion:** How could Irakli utilize the newly acquired space? (*Sell to an industrial investor, renovate and start his own manufacturing business, create a shopping center, sell/rent out the whole space to several large or many small businesses*).

A year later, the Russo-Georgian war and the global financial crisis caused prices in the real estate market to collapse. Many businesses went into bankruptcy, people lost their jobs and foreign investors were no longer lining up to invest in the Georgian economy.

- » **Question for discussion:** How did these events affect Irakli's plans? Which options remained available to him? (*The only option available now was to rent out small pieces of the property and wait for better times*).

The rental prices of property in such a remote location as Avchala were extremely low and so Irakli started thinking about how to increase the value of his space for future clients. At the minimum, he had to provide basic conditions for people to move in: drain the swamp, improve the access road, bring electricity and gas into the building, fix the roof, etc. Fixing these things required some additional expense, but there was no other option. After this basic investment, Irakli could get some clients into his space; however, the rental price he could charge was exactly equal to the (very low) prices charged by his neighbors. But even at these very low prices it was difficult to convince businesses to move to his location. There was nothing special about the former carpet factory's concrete carcass to justify a higher price.

- » **Question for discussion:** What could Irakli do to make his property more attractive for potential clients? *(Advertise, offer discounts on a first-come-first-served basis, open a nice canteen/restaurant on the premises, invest in restrooms, minivans to take people to Avchala from a few central places in Tbilisi).*

Inspired by Richard Porter's book, Irakli had a brilliant idea. Businesses can benefit from being located close to other businesses working in the same or related industries and form a "cluster". And because they benefit, they will be willing to pay a higher price for space if there is "synergy" between their business and those of their neighbors – similar manufacturers, providers of inputs and services (such as design or equipment rental).

- » **Question for discussion:** How, in your opinion, do businesses benefit from co-location in the furniture, IT, ceramics, and retail industries?

### **SYNERGIES WITHIN INDUSTRIAL CLUSTERS CAN TAKE MANY SHAPES:**

First, there are strong synergies from co-location of vertically-related businesses, such as input suppliers and manufacturers.

- Proximity helps build trust and knowledge of each other's abilities, facilitating quick and informal contractual relationships between people and businesses. When trust is there, businesses will sell to each other on consignment (i.e. getting paid for inputs or services only when the final goods are sold to the consumer) or outsource parts of large orders to each other.
- Proximity greatly reduces the cost of transporting goods. Input suppliers have a local customer base and can serve their local clients faster and cheaper. Downstream businesses, in turn, save money, don't have to wait for delivery, and can keep their inventory costs to a minimum (no need to keep stocks of anything).

Second, when firms co-locate in a cluster, very strong horizontal linkages emerge among seemingly competing firms.

- A common pool of workers emerges, making it easier to hire new staff and match workers to jobs. Moreover, when one company is not fully utilizing its labor force, it can "rent out" its redundant workers to another company. As a result, everyone is happy: workers are paid extra and gain experience; companies that "rent out" workers reduce their costs and have happy employees; companies that employ their neighbors' workers are able to handle large orders in a timely manner, without spending time and resources on hiring and training new employees.
- Geographical proximity allows the creation of a larger pool of equipment to be shared among co-located SMEs. For example, a CNC router is a very expensive machine (priced in the 10,000-60,000 USD range, depending on size) used for precision cutting of hard materials, such as wood, aluminum, steel, and plastics. Such machines are prohibitively expensive for typical small and medium-sized companies. However, when many SMEs companies are co-located, then they can share a CNC router, thereby greatly reducing their production costs, increasing quality, and expanding the range of possibilities. Similarly, many SMEs have specialized profiles and appropriate (large and small) machinery, which can also serve their neighbors (for a fee, or even for free – you scratch my back, I scratch yours). Moreover, they can get things done on the spot, without going to external providers.
- Geographic proximity is also a boon for knowledge "spillovers" and informal exchanges of ideas. Such spillovers can be facilitated by the existence of common dining areas or coffee shops where people can meet each other. People can also observe each other's work: for example, in Irakli's furniture cluster, carpenters have been able to watch a very experienced Greek carpenter specialized in wood carving. Such free "master classes" are delivered every day by people specialized in the processing of other materials, such as leather, aluminum, stone, glass and concrete.

Irakli understood that his space was not a good fit for retail or IT (too far from the center, not properly renovated). However, furniture seemed like a good choice because, by 2010, Tbilisi saw a resumption of economic growth and people resumed renovating and refurbishing their houses. Demand for locally-produced furniture thus started picking up. The question for Irakli was how to attract furniture producers, many of whom were clustering around the Eliava market, to Avchala.

- » **Question for discussion:** How does one start a new furniture cluster? (*Irakli initially focused on bringing in major input suppliers by offering them a deep discount for warehousing space. He let them buy the space they needed and invest in its renovation; later, he started bringing in SME manufacturers, attracting them with low rental prices and access to input providers*).

Irakli's strategy worked very well. Bearing in mind the synergetic benefits of co-location for companies operating in the same industry, he resisted the temptation to let out his property to businesses not related to furniture manufacturing. There are currently about 180 companies located in Irakli's Khelosnebis Kalaki, spanning the entire furniture value chain: from suppliers of inputs, to providers of services (e.g. design or equipment rental), to furniture manufacturers. Employing a total of close to 2,000 people, these companies differ in size and specialization. It is easy to find almost any necessary expertise within the cluster: wood and steel bending, wood carving, lamination, precision cutting of all relevant materials – natural wood, laminated MDF or plywood panels, glass, marble and stone.

- » **Question for discussion:** What can Irakli do to strengthen the synergies within the furniture cluster and utilize them to further develop his own business?



*One piece of furniture may be built using many different materials: glass, metal, wood and plastic*

Irakli has a keen interest in helping individual companies within the cluster. Each and every morning, he randomly chooses 5-6 companies to “inspect” and learn about the challenges they face. In this way he is able to provide timely solutions to infrastructure bottlenecks, such as on-demand storage space, and connect people to each other whenever they are short on ideas, skills or equipment. In 2016, he ventured to partner with a public college (“Spektri”) in order to train young professionals for the cluster. His current focus is to create a furniture designers’ association and bring young designers into the cluster so as to take his furniture producers to the next level in terms of innovation and branding. Another way to bring innovation into the cluster is to encourage cluster members to participate in exhibitions, link them with donors, financial partners and potential clients.

Clustering furniture producers is good for Georgia, but it is also a lucrative business. Just 10 years ago, the price of a square meter in Avchala stood at about 5 GEL. Today, Irakli can sell the same space for as much as 100 USD/m<sup>2</sup>. Rental prices in the cluster are 50-70% higher than in the surrounding area. Companies are willing to pay a premium in order to be located close to others in the furniture industry.

At the moment, most companies in the cluster are operating in the medium-quality segment of the furniture market. However, if/when Irakli is successful in bringing his cluster to the next level of quality, premium companies will be willing to pay – and Irakli's profits will increase further.

## 66DesignLab outsourcing furniture production to Khelosnebis Kalaki

Owned and managed by Sandro Nachkebia, 66DesignLab is a studio providing a wide spectrum of services such as furniture design and manufacturing, interior design and construction, exterior design



and landscape planning, graphic design and advertising. All services, except furniture manufacturing, are done in-house. Furniture manufacturing is outsourced. Initially, Sandro worked with a number of large “one-stop-shop” manufacturers with the capacity to implement projects of any size and complexity. Despite the comfort of working with a single large producer, Sandro found that such projects were often delayed due to their relatively small size. The alternative was to work with several small firms specialized in different aspects of the production process.

**Transaction costs.** When shopping or doing any kind of business deal (“transaction”) you pay for certain goods or services. However, you have to spend time and effort to actually make the deal. For example, you have to drive to a shop or pay lawyers to draft a contract. These costs are referred to as “transaction costs”.

» **Question for discussion:** What are the pros and cons of dividing a project into smaller pieces to be outsourced to a number of smaller companies as opposed to working with a single large company? *(The “transaction costs” of dealing with several small contractors are quite high. For example, one has to find reliable contractors that offer acceptable price and quality, contract and communicate with each, monitor their product quality, transport various components from each producer and oversee the final assembly process).*

Working with many small producers could have been a nightmare for Sandro's business; however, he managed to greatly reduce his “transaction costs” by working with companies belonging to the Avchala cluster.

- » **Question for discussion:** How could working with a cluster help reduce Sandro's transaction costs? *(With many alternative providers in the same location, Sandro does not have to spend a lot of time searching for partners; moreover, thanks to the rumor mill working inside the cluster, Sandro can easily find out who is a reliable partner (competition within the cluster pushes companies to produce at a high quality); contracting partners is as easy as going through a supermarket with a shopping list; furniture is assembled on the cluster's territory, reducing transportation costs).*
- » **Question for discussion:** How is a cluster different from a large factory? *(In some sense, clustered companies are like a large factory with many specialized departments. However, there are two major differences: first, the various “departments” within a cluster consist of small companies that duplicate each other's functions and compete; second, there is no factory director to provide coordination).*

**Knowledge is in the air!** Kote Sebiskveradze's “House Services” is furniture manufacturing business located in Avchala's Khelosnebis Kalaki. From his perspective, being part of the cluster provides the following benefits: saving on the cost of transporting materials, ability to employ temporary workers when facing large orders, obtaining supplier credit, and gaining access to any necessary equipment without leaving Avchala's territory. Additionally, Kote emphasized the many opportunities to learn from others in the cluster. For example, he has mastered many techniques – such as stone carving and wood bending – by observing how they are performed by others in the cluster.

It may be possible to learn certain things from textbooks or YouTube videos, but sometimes learning requires the ability to observe how others do things first hand, as well as opportunities to ask questions and receive expert guidance and advice. Learning from books is easier in the case of “codified” knowledge, such as when solving mathematical problems. It is much more difficult to codify and transmit “tacit”





Kote Sebiskveradze working

knowledge involved in arts and handicrafts. Hence, the advantage of being located close to informed colleagues in a cluster.

**Synergies in consumption and production.** For Gocha Giorgadze, the founder of LTD “Faraoni”, the main advantage of being part of a reputable cluster (as opposed to the Eliava market where his business was located until 2007) is improved access to clients who come to “shop” for furniture in Khelosnebis Kalaki, opportunities to cooperate with other producers in the cluster, and training programs offered on site.

.....

**What’s next?** Irakli’s Khelosnebis Kalaki is one of the first industrial clusters in Georgia. Created without a single dollar of donor or government funding, this cluster has recently become a target for donor assistance by GIZ. A prominent Bulgarian consultant working with the cluster seeks to organize the Georgian producers in a formal association and enable them to perform large institutional orders. The inspiration for this effort came from the Bulgarian furniture cluster – an association of more than 50 SMEs headed by a small secretariat providing design, client relations and coordination services. In addition to manufacturers, the Bulgarian cluster includes several designers and three universities. Members in the Bulgarian furniture cluster are not co-located. The main synergy among them is related to their ability to take on – as a group – large-scale projects for leading European brands such as IKEA, Hilton, Marriot, etc.



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=HXZeX6J-dzA&t=19s>

# TRAKTOR: A SOCIAL ENTERPRISE FOR THE 21ST CENTURY



Donors often finance projects that seek to promote social and economic development in countries like Georgia – focusing on creating jobs, improving the living conditions of poor people, protecting their rights, and helping them learn new skills or acquire access to valuable information. Poor people often cannot pay for services that others may be in a position to provide. Hence, the role for donors.

When Nino Nanitashvili, 24, joined two Dutch guys, Jonne Catshoek and Mark van Embden Andres, they started thinking of cool, innovative ideas to contribute to Georgia's development and interest potential donors.

- » **Question for discussion:** Do you have any ideas about how **you** could promote Georgia's development? How would you go about convincing international donors that your idea is worth supporting?

Jonne and Mark had been in Georgia for a number of years before meeting Nino and understood that Georgia's development is impossible without improving labor productivity in the agricultural sector. When brainstorming, they immediately focused on agriculture and design the project based on the needs of farmers in Georgia.

- » **Question for discussion:** Why might traditional Georgian agriculture not have been very productive?

One reason, though certainly not the only one, is that Georgian smallholders lack information about how their productivity could be dramatically improved by making **small and inexpensive** changes in the way they cultivate, store and transport traditional crops.

Nino and her Dutch partners thought that modern ICT could help deliver relevant information to the farmers.

- » **Question for discussion:** How could one use modern ICT to deliver information to Georgian farmers?

Their initial idea was to make instructional videos (e.g., how to plant and take care of walnut trees) which would be made available online for free. They did not expect that the videos would soon attract more than three and a half million views, showing that their idea had been spot-on.

After harvesting his hazelnuts, Levan rushed towards the processing factory in Senaki. To his disappointment, he was paid less (per kg) than Nana, his neighbor, who sold her nuts just a few days ago. He was told that his hazelnuts were not dry enough and had started rotting. Levan picked his hazelnuts all at once at the very end of the harvesting period. In contrast, Nana and her family collected hazelnuts every time they fell to the ground. How did she know how to do it right? She watched a few videos on Traktor's platform ([www.traktor.ge](http://www.traktor.ge)).

Today, Traktor is Georgia's most popular online and mobile education platform for farmers, with a monthly number of unique visitors on the Traktor website of about 30,000 during the high season, while the mobile application has 10,000 users. Traktor still prepares advisory videos featuring farmers sharing their own experience of what works well and what does not. For example, a farmer might describe a particular technique to prune trees which increased his harvest by 30%. Moreover, the application has a detailed weather forecast and a calendar that suggests when to start pruning, planting, fertilizing, harvesting, etc.

However, Traktor faced the risk that the money coming from international donor organizations would run dry at some point. Thus, they had to find ways to sustain their enterprise by making it commercially viable, i.e. to be able to continue to serve their beneficiaries after donor funding is phased out.

- » **Question for discussion:** How can Traktor sustain itself after donor funding is no longer available?
- » **Question for discussion:** Traktor has considered the following three options:
  1. Charge for consulting services delivered through videos;
  2. Place commercial ads in instructional videos and/or on Traktor's website/application and get paid for advertisements;
  3. Sell agriculture-related products through their mobile application and the website.
 Discuss the advantages and disadvantages of each approach.

Charging for consulting services delivered through videos (or other channels) was dismissed by Traktor because in dealing with farmers, they noticed that farmers would be unlikely to pay for such a service *initially*, as the government offers similar information (through so-called "agricultural extension services"). These are not of the same quality and are not offered in a technologically innovative way, but are completely free-of-charge.

The advertising model also presented significant challenges since it was not acceptable for the donor financing Traktor in its startup phase (commercial advertising of particular products may contain incomplete or inaccurate information).

Instead, Traktor tried to generate revenue by selling agriculture-related products through their mobile application and website. The idea was not to import the products, but rather to provide an online platform connecting Georgian farmers to existing vendors of relevant products.

- » **Question for discussion:** Would Georgian farmers be willing to buy products through Traktor's online platform or application?

While the number of visitors and application users is high, online shopping is not very common in Georgia yet, so only a modest percentage of users are used to buying products online. And since those sales are the major source of revenue for the startup, sustainability remains a challenge.

The biggest issue is that Traktor is an online platform. Not being able to physically try out and touch a product is probably one of the biggest disadvantages of Traktor's online shopping experience. Georgian

farmers are not experienced online shoppers and do not always know whether what they are offered online is the real deal.

To overcome this hurdle, Traktor did not require farmers to pay in advance. Payment was to be made only upon delivery. However, online sales still did not pick up. What could have gone wrong?

- » **Question for discussion:** Why did Traktor have a hard time increasing its online sales despite not requiring advance payment?

The special thing about shopping in a local Georgian store is that one can negotiate the price and defer payment until after the harvest. This may be critical in cash-starved rural communities. Other advantages of the face-to-face shopping experience include the ability to compare products and to ask for advice from other shoppers and/or shop owners.

- » **Question for discussion:** How could Traktor compensate for the disadvantages of online shopping?

Traktor introduced a call center and live chat service to provide an improved customer service experience, somewhat comparable to face-to-face shopping. They hoped that by making their expert personnel available for advice they would compensate for the insecurities and inconveniences associated with online shopping.

As far as marketing is concerned, Traktor encouraged their clients to spread the word about their service quality and trustworthiness by rewarding them with discounts for any referrals. Traktor's Facebook page has become wildly popular, attracting thousands of viewers (<https://www.facebook.com/traktorapp/>).

These strategies have had a significant positive impact, as sales are up ten-fold in the first quarter of 2018 compared to 2017. The business is however still looking for additional innovative options to boost its market share.

- » **Question for discussion:** Can you think of alternative strategies to sustain Traktor's social enterprise?

Traktor's online platform could be used to create specialized social networks/communities of Georgian farmers. For example, hazelnut growers in Samegrelo could register on the platform in order to receive and share information about modern cultivation and post-harvest treatment techniques, weather forecasts, input types and prices, real-time hazelnut prices in different locations, etc. While in the startup phase, Traktor had to rely on expensive experts and devote staff time to create video materials, etc., in the future, Traktor's platform could be used to crowdsource information and expert advice that otherwise would be very expensive or impossible to receive. This would make Traktor much less expensive to run.

At the same time, Traktor could generate revenue by selling access to its specialized networks to wholesale distributors and retailers interested in reaching out to Georgian farmers. This would be very similar to how Facebook, YouTube and other social networks earn money by selling targeted ads.



To watch the accompanying video, click **here**: <https://www.youtube.com/watch?v=DIq07qspC5U>



**ISET-PI** is the leading independent economic policy think-tank in Georgia and the South Caucasus, a one-stop shop for policy research and consulting, training and public policy discussion. The organizational synergies between ISET-PI and the International School of Economics (ISET) at TSU ensure the intellectual and financial sustainability of both institutions, as well as their contribution to the strengthening of education, democratic governance, civil society, and economic development in Georgia and the region.