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# COMPETITIVENESS OF GEORGIAN AGRICULTURE: INVESTMENT CASE STUDIES

AGRIGEORGIA (FERRERO)

25 July 2014

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# **COMPETITIVENESS OF GEORGIAN AGRICULTURE: INVESTMENT CASE STUDIES**

AGRIGEORGIA (FERRERO)

USAID ECONOMIC PROSPERITY INITIATIVE

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# DATA

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# ABSTRACT

*This case analyzes a major investment by an Italian food industry giant, Ferrero, in the expansion of its global hazelnut supply chain to Georgia. The study describes the nature of Ferrero's AgriGeorgia hazelnut growing enterprise, its relations with the Georgian government and local communities while focusing on issues of value chain development, productivity and labor force quality. Of particular interest to us are the Public-Private Partnership between Ferrero's AgriGeorgia and USAID as part of the latter's Global Development Alliance (GDA) program. Economic Prosperity Initiative, a project of USAID, supported the implementation of this partnership and helped harness Ferrero's technical expertise in bringing new technology, skills and improved organization (including farmer cooperation) to Georgia's smallholder hazelnut growers.*

# ACRONYMS

<b>CSR</b>	Corporate Social Responsibility
<b>DCFTA</b>	Deep and Comprehensive Free Trade Agreement
<b>EPI</b>	USAID's Economic Prosperity Initiative
<b>EU</b>	European Union
<b>EU</b>	EU's Generalized System of Preferences to promote exports from developing countries
<b>GDA</b>	Global Development Alliance (a funding scheme used by USAID to attract and leverage private sector investment in development)
<b>GHGA</b>	Georgian Hazelnut Growers Association
<b>MoESD</b>	The Georgian Ministry of Economic and Sustainable Development
<b>MoJ</b>	The Georgian Ministry of Justice
<b>PPP</b>	Public-Private Partnership
<b>USAID</b>	United States Agency for International Development

# CONTENTS

<b>I. EXECUTIVE SUMMARY .....</b>	<b>1</b>
<b>II. APPENDICES .....</b>	<b>3</b>
A. Background.....	4
<i>Georgian hazelnut production</i> .....	4
<i>Ferrero/AgriGeorgia</i> .....	4
B. Methodology .....	5
C. Findings .....	5
<i>Business Enabling Environment</i> .....	5
<i>The Effects of Investment in Georgia</i> .....	7
<i>Leveraging Private Sector Resources to Promote Economic Development</i> .....	11
<i>Conclusions and Lessons Learned</i> .....	12
D. Recommendations .....	14
<i>Recommendations for Government</i> .....	14
<i>Recommendations for Investors</i> .....	15

# I. EXECUTIVE SUMMARY

AgriGeorgia started operations in March 2007, following a strategic decision by the Italian confectionary giant, Ferrero, to develop and diversify its hazelnut supply base. After six years, the company's total investment stands at more than EUR 40 million, which has included the purchase of 4,000 ha of land, agricultural machinery, construction of facilities and operating salaries. The company has yet to turn a profit. The first 40-ton test harvest was collected in 2012, and full production capacity will not be reached before 2020.

While the overall investment is proceeding, Ferrero has faced significant issues with access to about a third of its landed properties. Ferrero has managed related disputes with the local communities with the active involvement of the Georgian government, resulting in compensation for affected smallholder farmers and land swaps.

Given AgriGeorgia's self-sufficiency in local production inputs and services other than labor, the main "external" aspect of the company's operations is related to a unique portfolio of Corporate Social Responsibility (CSR) activities. AgriGeorgia's CSR portfolio is truly unique in that it includes a major component implemented as part of a Global Development Alliance (GDA) with the US Agency for International Development (USAID). Assisted by USAID's Economic Prosperity Initiative (EPI), this Public Private Partnership (PPP) allowed for the implementation of a massive training program promoting modern but accessible cultivation and post-harvest handling methods. The USAID- and AgriGeorgia-supported training and extension services ultimately reached thousands of hazelnut growers in the Samegrelo region. The effort culminated in the creation of the Georgian Association of Hazelnut Growers (GHGA), which, while nascent, is mandated to propagate modern technologies, facilitate cooperation among smallholder farmers, and represent them in discussions with the government and other industry stakeholders.

Ferrero's decision to set up its operation in Georgia can be said to reflect the country's progress in securing investors' rights. At the same time, the company's early successes should also be attributed to Georgia's generally liberal business environment and the Georgian government's continuous attention and willingness to engage—at a sufficiently senior level—in redressing any grievances or legal complications concerning the company's land acquisitions and relations with local communities. The need for Georgia to maintain this type of supportive engagement with foreign investors is the first key lesson of this study.

The second key message concerns the negative impact of Georgia's current legislative drive to restrain foreigners' access to agricultural land, introduce tougher labor market regulations, and impose a stricter visa regime with many non-EU nations. At best, the moratorium on foreign ownership of agricultural land can be used to gain time to sort out persistent land registration issues, but on balance it sends an overwhelmingly negative message to would-be investors. Because they have the clout and market pull to special government attention to solve their problems, large global players like Ferrero may still be willing to invest in Georgia despite these restrictions. But this favors large companies and depends on the continued willingness of GoG officials to intervene on their behalf. This has its own negative connotation, and it sends the wrong message about rule of law and transparency. Georgia should expedite the process of developing new land legislation allowing for foreign participation in the development of Georgian agriculture.

The third key message of the case concerns opportunities for Georgia to maximize the benefits of foreign direct investment (FDI) by promoting Public-Private Partnerships involving foreign companies, donors and government institutions. The challenge for Georgia is to make sure that Ferrero's presence and willingness to engage in Georgia is fully utilized, not only for public relations purposes, but also to improve the lot of Georgia's smallholder farmers. It may be years before Georgia sees the direct revenue benefit of significant tax revenue from AgriGeorgia and other greenfield agribusiness investment projects. But there are myriad more immediate benefits, from knowledge transfer and

productivity gains to increasing integration of Georgian smallholder farmers into national and global value chains.

Ferrero's partnership with USAID demonstrates that a strategy to attract investors for the dual purposes of making productive use of uncultivated land and helping local farmers thrive can yield outsize benefits. With the right strategic partnership between government, donors, and the private sector, the latter goal of raising the productivity and improving livelihoods of smallholder farmers becomes even more attainable.

As a result of expected improvements in access to Eurasian and European markets (e.g. under the DCFTA), the Georgian agricultural sector is very likely to receive considerable investment in modern primary production and processing. Such investments—and the export opportunities they will bring—will create ever stronger incentives for smallholder farmers to commercialize their activities, improve product quality and achieve market access. Under these circumstances, well-structured, win-win-based PPPs like Ferrero's partnership with USAID present one excellent way to harness private sector interests to economic development goals.

## **II. APPENDICES**

**A. BACKGROUND**

**B. METHODOLOGY**

**C. FINDINGS**

**E. RECOMMENDATIONS**

# A. BACKGROUND

## GEORGIAN HAZELNUT PRODUCTION

There are approximately 50,000 hazelnut growers in Georgia, and most are located in the regions of Samegrelo (50-55%) and Guria (30-35%). The rest are scattered around Kakheti and Abkhazia. Excluding Abkhazia, the overall annual crop in 2013 reached about 40,000 tons in shell, the equivalent of 20,000 - 25,000 tons in kernel. Some 90% of Georgian hazelnut production is exported, and 80% of exports are destined for Europe. The biggest buyers are in Germany, France, Belgium, Austria, the Baltic countries and Russia. Exports to the EU are subject to zero customs duties under the Generalized System Preferences (GSP+) and constitute more than 50% of all Georgia's total GSP+ exports (USD 124 million out of USD 231 million).

In the last couple of years, a number of factors, including favorable weather conditions and increased and improved use of fertilizers, pesticides and herbicides (often financed by government vouchers) have led to a marked boost in smallholders' productivity in the sector. Even so, productivity remains quite low by global production standards, and inadequate post-harvest handling and storage practices result in considerable quality deterioration and spoilage. Smallholders don't have access to adequate drying facilities (which would vastly improve product stability), de-husking machines (manual labor is used instead) or proper storage (allowing for control of temperature and humidity conditions). Drying in the sun is the predominant practice, which, due to a lack of sufficient space and relatively high ambient humidity, prevents Georgian farmers from bringing hazelnuts to the required moisture content of no more than 6%. To add insult to injury, smallholder farmers are liquidity-constrained, which often causes them to sell 60-70% of their crop in advance (at about half the price) rather than store significant quantities to be sold at a higher price.

## FERRERO/AGRIGEORGIA

AgriGeorgia started operations in March 2007 following a strategic decision by Ferrero to develop and diversify its hazelnuts supply base. Six years on, AgriGeorgia's total investment stands at more than EUR 40 million, including 4,000 ha of land, machinery, and operating expenses and salaries. As expected, given the typical lifecycle of hazelnut plantations, AgriGeorgia is not yet turning a profit. The company's first test harvest of 40 tons was in the fall of 2012, and in 2013 they harvested 400 tons, equivalent to 1% of Georgia's total hazelnut production.

In a market showing rapid, sustained expansion of global demand, Ferrero sees diversifying the global supply, currently 75% controlled by Turkish producers, as a strategic imperative. To make that work, however, production needs to meet Ferrero's strict quality requirements, which Georgian producers have not consistently been able to achieve. The approximately 3,500 ha now under cultivation by AgriGeorgia represent only a small part of Georgia's total hazelnut production potential, so from the very beginning the goal of improving the overall supply of quality hazelnuts was going to mean improving quality and productivity well beyond AgriGeorgia's holdings.

The fact that Ferrero's business strategy coincides with Georgia's national interest to increase the international competitiveness of its agriculture creates an obvious win-win situation. Fortunately for Georgia and Ferrero, in 2011 this win-win translated into the basis for a unique "Global Development Alliance" between the company and the US Agency for International Development (USAID). Brokered and assisted by the implementing partner of USAID's Economic Prosperity Initiative (EPI), this Public-Private Partnership leveraged Ferrero's resources and expertise to design and implement a far-reaching training program for Georgian farmers. The program promoted modern but accessible cultivation methods, post-harvest handling techniques, and sound business practices to thousands of hazelnut growers in the Samegrelo region.

Partially as a result of this intervention, and partially because of improvements in the overall policy framework and other efforts to improve the lot of smallholder farmers (e.g. through government vouchers and microcredit), the level of post-harvest handling by Georgian hazelnut growers started improving in recent years. The samples of Georgian hazelnuts which AgriGeorgia purchased from Georgian farmers and sent to Italy in 2013 scored well on quality tests conducted by Ferrero, which exceed EU requirements. This opened the possibility of the company starting to purchase Georgian hazelnuts on a commercial scale in 2014.

To sustain these achievements, in 2013-14 AgriGeorgia collaborated with EPI and USAID on the creation of the Georgian Association of Hazelnut Growers Association (GHGA), which is mandated to continue to propagate modern growing and post-harvest handling practices, facilitate cooperation and knowledge-sharing among smallholder farmers, and serve as a point of contact and advocate for the sector in communications with the GoG and other stakeholders.

## **B. METHODOLOGY**

This case study is based on a series of interviews with AgriGeorgia stakeholders, including Daniel Dellacha, General Director, Andrea Castagna, Field Supervisor, Merab Chitanava, Head, General Affairs Department; EPI Hazelnut Value Chain managers Aleks Antoniuki and Nia Zarandia; owners and managers of hazelnut processing plants Ushangi Chkheidze and Eldar Meporia (representing AgroWest), and Ali Kizildag (representing Anka Fair Trade); hazelnut growers and farmers from the Tsalenjikha Municipality who benefited from EPI/Ferrero trainings, Kakha Sherozia, Tamaz Kvaratskhelia, and Gela Kvaratskhelia.

Business representatives shared confidential information such as medium-term business strategy, productivity, employment, relations with local and national government and Social Corporate Responsibility activities. These interviews helped identify the key issues for foreign investment in Georgia's agricultural sector as well as lessons learned and themes of broader significance for improving the national investment climate. When possible, ISET sought to identify other voices to ensure that alternative points of view were included in the report. When included, ISET clearly identified instances where stakeholders' views differ significantly or are contradictory.

## **C. FINDINGS**

### **BUSINESS ENABLING ENVIRONMENT**

Georgia is among a handful of countries in the world that have suitable soil and climate conditions for hazelnut growing (the largest one is Turkey). Nevertheless, Ferrero's decision to enter the Georgian market in 2007 was based on a careful examination of the local business environment in the wake of the Rose Revolution and the spate of liberalization reforms it unleashed. Given the long-term nature of investment in hazelnut plantations<sup>1</sup>, a critical factor was the ability to acquire freehold ownership and use of sufficient agricultural land. Proximity to transport infrastructure (Poti Port) and the possibility of zero tariff exports to the EU under the GSP+ regime were other major factors.

#### **ACCESS TO AGRICULTURAL LAND AND PROPERTY RIGHTS**

When selecting potential locations for its investment in hazelnut production, Ferrero rejected other alternatives, including a pre-crisis Crimea, given unfavorable legislation concerning access to agricultural land<sup>2</sup>. Georgia's situation was unique in that it allowed investors to purchase the freehold

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<sup>1</sup> Yields on individual trees peak after 9-12 years; the productive life cycle of hazelnut trees reaches 35 years.

<sup>2</sup> Ukraine does not allow trade in agricultural land. Instead investors are offered the option of leasing agricultural land, which is acceptable for annual crops but not for the long-term investment required for hazelnut growing.

title to agricultural land and was actively reducing regulatory constraints in the business enabling environment.

AgriGeorgia's land properties now total about 4,000ha, including five large plots that were formerly state-owned tea plantations. A very small percent of land was purchased from private individuals. The five major plots are located in five different Samegrelo municipalities, including Zugdidi, Martvili-Abasha, Chkorotskhu, Tsalenjikha and Senaki.

In 2010, AgriGeorgia finished identifying and surveying its land properties, which they determined included private lands that may have been not properly registered, state land used for grazing by the local communities, and lands occupied by cemeteries and private buildings. 1200 hectares were classified as "problematic," meaning there were significant obstacles to gaining access and use of the land they had legally purchased. With the help of the Ministry of Justice, the Ministry of the Interior and local municipalities, the company managed to review all of the problematic cases. When possible, AgriGeorgia compensated owners of private properties or offered land swaps (e.g. alternative grazing land for the locals).

After 18 months of intensive work, about 290 hectares remained problematic. The plots in question were occupied by farmers and could not be recovered despite the fact that they were in the company's legal possession. Ferrero made the determination that fighting local population was not in their long-term interest, and they presented their concerns to the Ministry of Economic and Sustainable Development (MoESD). The Ministry offered AgriGeorgia 1500ha of alternate land to choose from, from which Ferrero selected the most suitable plots based on location and legal status. The result was a swap of 290ha of problematic land for 290ha of non-problematic land, a deal that was finalized in August 2012, during United Nation Movement (UNM) administration.

Because AgriGeorgia is still reaching full productivity on its present holdings, the GoG's 2013 moratorium on the purchase of agricultural land by foreigners and foreign-controlled entities does not present an immediate threat to their business. If the moratorium remains in effect, however, it will become a constraint on future expansion.

### **LABOR QUALITY**

According to Andrea Castagna, AgriGeorgia's Field Supervisor, the company's biggest professional challenge is to manage the field operations so that everything happens on time. While there are no major issues with local labor quality, work ethic or general attitude, managers do need to invest extra time in explaining the purpose of following procedures. Language, of course, is also a constraint.

The level of remuneration offered by the company is higher than the market. For example, AgriGeorgia's pays a qualified tractor operator around GEL 1,000GEL per month, when similar businesses in the region pay closer to GEL 500-700. And the improved benefits don't stop at direct wages. According to Daniel Dellacha, "we take care of our people, everywhere, not just in Georgia".

All permanent workers are entitled to a lunch served in restaurants located in two of the five main plantations. So-called "social buildings" housing these restaurants are very well equipped to offer other amenities such as showers, changing rooms and a First Aid Center (the first one opened its doors in 2014, another one is expected to come online later this year). Employees are offered an obligatory life insurance plan, and they can go through regular, twice-annual medical check-ups.

All of this, along with career advancement options, is a major motivating factor for local staff, and it does much to ensure that AgriGeorgia has the pick of the best workers in the region.

### **MARKET SUPPORT SYSTEMS AND SERVICE PROVIDERS**

Thanks to its scale, the company is self-sufficient in most, though not all, business services, which for an integrated agri-business includes access to machinery, maintenance, and repairs. AgriGeorgia does regularly contract transportation services to and from Poti port. Likewise, the shelling and

processing of the first commercial harvest of about 400 tons in 2013 was outsourced to a local company.

AgriGeorgia uses the services of the *Meqanizatori* in Abasha as emergency relief, such as when they are at peak load or when their own equipment is temporarily out of order. After some give-and-take with these outsourced operators about “how” to get things done, AgriGeorgia’s work does get performed on time and at a reasonable standard of quality. While this experience is more positive than other businesses have reported, it seems AgriGeorgia’s scale and, more importantly, off-peak demand for services presents an advantage in procuring *Meqanizatori* services. AgriGeorgia’s main season of demand does not coincide with that of other agribusinesses.

The company does apply chemical pesticides and fertilizers, but it does so sparingly and only when needed. They source the chemicals they use locally, and they also make them available for interested Georgian smallholders.

## **INFRASTRUCTURE**

Hazelnut growing does not require irrigation given the favorable climate conditions of Samegrelo. The quality of roads and proximity to the Poti Port are highly beneficial for the company’s import/export operations.

On the other hand, unstable electricity supply is a significant infrastructure bottleneck. In Andrea’s estimate, AgriGeorgia’s electricity supply is interrupted 40% of the time. Occasionally, entire days pass without electricity. To insure itself against frequent outages, AgriGeorgia has had to invest in its own generation capacity and uninterruptible power supply units.

## **GOVERNMENT SUPPORT**

The national government is supportive of resolving issues, as demonstrated by its willingness to organize land swaps. AgriGeorgia representatives participated in a presentation of the amendment imposing a moratorium on the acquisition of agricultural land by foreigners in July 2013, and they were offered assurances that a committee will be established to provide case-by-case approvals for additional land purchases. Daniel Dellacha walked away from those discussions with a level of comfort about his own operations, but he acknowledged that such a committee would probably not be as effective for smaller enterprises.

AgriGeorgia currently faces no issues with taxation, as the company is yet to turn a profit. Nor have they faced restrictions on imports. The company is exempt from VAT on goods purchased as any other agricultural operation in Georgia, and like other companies they can suffer from long delays in reimbursement for VAT. They submitted their first claim for reimbursement of VAT expenses about two years ago, and while they were ultimately satisfied it was only after considerable give-and-take with the Revenue Service. AgriGeorgia is preparing a second claim in summer 2014.

The security situation is quite reasonable. In Andrea’s view, some theft will always occur, but this is not a major problem for the company. The property is fenced and the company maintains its own security department. AgriGeorgia also asks local police to be more alert around harvest time, and they have actively cooperated with the company.

## **THE EFFECTS OF INVESTMENT IN GEORGIA**

The impacts of Ferrero’s investment are mainly related to i) expansion and improvement of locally grown hazelnut varieties, ii) a massive transfer of technological and agronomic knowhow, and, iii) significant employment and earning opportunities for the local population. As the company is not expected to reach full production and export capacity before 2020, its present contribution to Georgia’s trade balance and tax revenues is limited.

In this section we divide the analysis into two parts. First we discuss improvements in productivity, labor force development and other positive impacts related AgriGeorgia's internal operations. Second, we report the results of AgriGeorgia's engagement a public private partnership with USAID seeking to train and better organize thousands of smallholder farmers in Samegrelo.

## **PRODUCT AND PROCESS INNOVATION**

### ***Expanding hazelnut variety and improving productivity***

To increase the overall range of hazelnut varieties in Georgia, and thus improve the environment, increase plant health and productivity, AgriGeorgia imported and planted a number of European varieties. These varieties, mostly Italian, are providing a valuable addition to the local Anakliuri variety, as European varieties are more productive and fall without the husk. This latter quality reduces the number of steps required in post-harvest handling.

Ferrero's impact in this regard is not limited to the company's own plantations. Already in 2007, in the first year of the company's operation, AgriGeorgia created a nursery to provide seedlings of European varieties for its own needs. This was required given the rather high rate of plant mortality and the cost of importing seedlings. By 2012, the company had accumulated a sufficient stock of seedlings to exceed their own needs, including for export to Ferrero plantations outside Georgia. This allowed the nursery to start selling to local farmers, facilitating the propagation of new European varieties beyond the company's own plantations. For local farmers who are members of the AgriGeorgia-supported Georgian Hazelnut Growers Association (GHGA), seedlings are available at cost (see more on GHGA functions below).

A total of 3,500ha is or ultimately will be cultivated by AgriGeorgia, and it will retain some of its land uncultivated and covered by forests. The company is experimenting with different varieties and cultivation methods, and they don't yet have enough results from that work to conclude which tree variety and which cultivation methods are best suited for Georgia. This is in no small part because of the considerable fluctuation in productivity that can simply be the result of natural cycles.

It will take a total of 9-12 years for AgriGeorgia's plantation to reach maximum production capacity of an average of about 2.5 tons per ha. Since their trees are all still quite young, they are producing only about one kilogram of de-husked and dried hazelnuts per tree. When they are mature, the main local hazelnut variety, Anakliuri, can produce as much as 3kg per tree under optimal conditions, and the best Italian varieties can yield up to 5kg. The life cycle of a hazelnut tree spans about 40-45 years, and with good management they can be kept "young" and fully productive until about the age of 35.

### ***Employing modern (industrial) cultivation methods***

AgriGeorgia's method of cultivation is quite different from the methods employed by Georgian smallholders. With their small orchards around their houses, local farmers plant to maximize the number of trees per ha. Industrial production, on the other hand, requires ample space—about 4m—between rows to allow access by tractors and machines. Industrial production is also planned to ensure maximum productivity over trees' life cycle. Trees are initially planted 2 meters apart, and as trees grow the middle trees are removed. This provides for 8-10 years of production from the middle trees as the remaining trees increase to maximum productivity at 9-12 years. The company uses carefully planned drainage, pruning and limited chemicals to maximize productivity, ensure plant health, and minimize the impact on the environment.

### ***Pest control***

Samegrelo is a natural habitat for hazelnut, which means there an abundance of diseases and pests are also endemic to the region. Many of these are transmitted by local insects feeding on wild local species of hazelnuts. Local farmers face a very high turnover of branches and trunks because they tend to treat trees only when the problem is already visible and damage has progressed too far.

AgriGeorgia employs simple methods to detect fungus and insects early on, before they inflict significant damage to the trees. For example, sting bugs can be easily detected by shaking trees early in the morning when the bugs are asleep, a simple technique that locals could easily employ if they are made aware of the possibility.

### **LOCAL EMPLOYMENT AND WORKFORCE DEVELOPMENT**

The impact of Ferrero on employment and the professional capacity of Georgian hazelnut growers goes well beyond the boundaries of AgriGeorgia's own plantations. In this section we focus on AgriGeorgia's internal human resource management.<sup>3</sup>

AgriGeorgia employs a small expatriate staff and about 150 full time Georgia workers. The expatriate staff includes top management (2 persons), logistics manager, field supervisor, and a foreign language instructor for local staff. Up to 1000 seasonal jobs are created for harvesting, pruning and other operations. These are mostly filled by people from remote areas that are not overburdened with their own hazelnut production.

The company provides in-house training for tractor operators, brigadiers, etc., and a strong human resources department means it is self-sufficient in staff recruitment and training. Even language training is provided by an expat teacher.

Given the company's large size, internal promotion of local staff is quite common. For instance, having received his CBA from Free University in 2009, Merab Chitanava started as a translator with AgriGeorgia but was quickly promoted to become the company's internal lawyer and later head of general affairs. Such promotion is not uncommon. Two other department heads – logistics, internal control – have been also internally trained and promoted.

### **GOVERNMENT REVENUE, EXPORTS**

At current levels of production, AgriGeorgia's share of Georgia's total hazelnut production and exports is miniscule. But as its trees mature and the company fine-tunes its cultivation practices over the next 6-8 years, AgriGeorgia's annual production will average 8,000-9,000 tons per year. At the present going world market prices of about \$5,000 per ton of inshell hazelnuts, AgriGeorgia's annual exports could well exceed \$40 million per year.

The company pays land tax on its property, but because it has yet to turn a profit it is not currently a source of profit tax revenue for Georgia. The average break-even point in industrial hazelnut production is 14 years, but citing AgriGeorgia's experimental nature and the endemic diseases and pests he faces, Daniel Dellacha estimates AgriGeorgia will take a few years longer. The extent to which Georgia stands to benefit from AgriGeorgia's export activities and profit tax revenues will eventually depend on Ferrero's internal pricing policy.

### **COOPERATION WITH LOCAL GOVERNMENT**

AgriGeorgia has taken a systematic and hands-on approach to engagement and cooperation with its surrounding communities. According to Merab Chitanava, in 2010 AgriGeorgia prepared a questionnaire for local municipalities to assess their needs and encourage applications for assistance. They continue to gather information on a regular basis.

As one example, AgriGeorgia is currently expecting an official request from Martvili to build 1 km of road to help local agricultural development. In Tsalenjikha, the company allocated funds to repair local roads. The local mayor informed AgriGeorgia that he can contribute gravel. This allowed Ferrero to

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<sup>3</sup> We address the company's extensive investment in training and improved organization of smallholder farmers under *Leveraging Private Sector Resources to Promote Economic Development* Leveraging Private Sector Resources to Promote Economic Development.

add to other expenses. Even employment of local staff – security, etc. – is coordinated with the municipality, to make sure that the local population is employed.

### **IMPACT ON THE COMMUNITY**

Given AgriGeorgia's self-sufficiency in local production inputs and services (other than labor), the main "external" aspect of the company's operations are activities falling under the Corporate Social Responsibility (CSR) heading. AgriGeorgia undertakes CSR activities both on its own and in partnership with USAID. Here we focus on AgriGeorgia's traditional CSR activities.

Helping small growers is the easiest and most natural way for the company to engage local communities. According to Merab Chitanava, since 2010 the company has been receiving more and more applications from locals and Megrelians living in Tbilisi who want to develop hazelnut plantation business in Samegrelo. People who want to improve their businesses are coming to ask for professional advice, seedlings from the AgriGeorgia nursery, and help with machinery. As a result of the new voucher system, demand for direct assistance with machinery is declining, but requests for technical advice are on the rise. In 2013, AgriGeorgia received requests for assistance from owners of about 300ha of plantations.

The company also engages in more traditional CSR, including renovating churches, improving village infrastructure, and renting out machinery at nominal prices.<sup>4</sup> Here are a few examples of recent CSR projects:

- Paving a stretch of the Martvili-Senaki road (a shortcut of 2.5km, including bridges and channels at 300,000GEL), which previously could only be used by horses;
- Covering the cost of fuel and salaries of school bus drivers for three schools (2 in Khobi and one in Chkorotsko region);
- Starting in 2009, the company has been investing in local churches. For example, more than 13,000GEL have been donated to renovate a 6th century church in Salkhino;
- Construction of kindergartens;
- Helping reinforce river banks and clean the channel after a flood in Khobi. AgriGeorgia contributed machinery for the cleaning operation and engaged amelioration department staff;
- Free rental of machinery;

<sup>4</sup> For example, AgriGeorgia bought a grader and compacting machine to improve local roads – not exactly the core business of Ferrero.

### **ALTERNATIVE MODELS OF ENGAGING SMALLHOLDER FARMERS**

While certainly the largest, Ferrero/AgriGeorgia hazelnut plantation is just one of a myriad of hazelnut growing and processing operations in a fast developing and extremely vibrant sector. In particular, smallholder farmers supply 36 processing plants selling to Europe and China. The vast majority of these, such as **AgroWest** (processing about 1,500-2,000 ton/year, i.e. about 10% of Georgia's total processing capacity) are not engaged in developing their supply chain. As a result, they are not able to operate at full capacity and enjoy higher market prices after the new year.

An alternative model is developed by **Anka Fair Trade**. A joint venture of two Swiss companies Pakka Ltd. ([www.pakka.ch](http://www.pakka.ch)) and Anka Ltd ([www.ankaltd.ch](http://www.ankaltd.ch)), it invests in its own hazelnut supply chain focusing on organic and, potentially, fair trade production. The company is partly owned and managed by a Swiss/Turkish national Ali Kizildag. In order to promote their business idea, Ali and his partner Ueli Baruffol have initiated the creation of a Public Private Partnership with Austrian Aid and Elkana (a Georgian Biological Farming Association <http://www.elkana.org.ge/>). Their initiative seeks to build the capacity of about 200 hazelnut growers (mostly smallholders united in an association supported by Anka Fair Trade) interested in shifting to organic production.

The point of this PPP is to help farmers transition to organic production, to be certified by Elkana. The resulting supply chain is likely to be quite robust thanks to both parties – Anka Fair Trade and the growers' association - being specialized in organic products. Anka Fair Trade will be willing to pay a premium for organically certified hazelnuts; the association members, on the other hand, will be relying on Pakka and Anka Fair Trade for the processing and marketing of their hazelnuts to Switzerland.

- - Based on interviews with **AgroWest** (Ushangi Chkheidze and Eldar Meporia) and **Anka Fair Trade** (Ali Kizildag, [ali.kizildag@ankaltd.ch](mailto:ali.kizildag@ankaltd.ch)).

- Global Development Alliance (GDA) with EPI. AgriGeorgia supplied its own agronomists and delivered training for 3,000 farmers.

AgriGeorgia has a limited budget for local CSR activities using its own machinery and workforce. Ferrero's central CSR office decides on large projects such as the Public Private Partnership with USAID (see below).

## **LEVERAGING PRIVATE SECTOR RESOURCES TO PROMOTE ECONOMIC DEVELOPMENT**

Brokered and assisted by USAID's Economic Prosperity Initiative (EPI), the Public-Private Partnership between Ferrero and USAID, under its Global Development Alliance (GDA) program, harnessed and amplified the company's resources and knowhow to deliver professional training to thousands of hazelnut growers in the Samegrelo region.

The program was jointly undertaken by EPI and AgriGeorgia. Hosted on AgriGeorgia's premises in Zugdidi, EPI's Alex Antoniuki and Nia Zarandia coordinated the logistical aspects of the entire program, including recruitment of the participants (smallholder farmers), transportation, and organization and management of training sessions. AgriGeorgia provided Italian trainers and necessary equipment.

### **INVESTING IN THE CAPACITY OF SMALLHOLDER FARMERS**

The main purpose of this component of the EPI program was to improve farmers' skills in hazelnut cultivation, harvesting and post-harvest treatment, which aligned perfectly with AgriGeorgia's goal to improve the quality of production across the sector. With EPI funding and grant support and AgriGeorgia expertise and personnel, the first two cycles (2011 and 2012) engaged more than 1000 people each. By May 2014 about 840 farmers had been trained as part of the third program cycle. Trainings took place in a small orchard owned by a village school in Orsantia, which comprises about 250 trees on a plot of 0.5ha.<sup>5</sup>

To incentivize the participants and help with the mobilization efforts, AgriGeorgia donated 1200 pruning tools and spraying machines which were distributed to all training participants at the conclusion of the second cycle of training in August 2013.

Each training cycle consists of 4 sessions, timed to fit the annual cultivation and harvesting schedule:

- December: pruning and thinning (removing bad brunches), MPK fertilizer program
- February: new orchard setup
- End of March-beginning of April: orchard management – integrated pest management, irrigation, weed control
- August: harvest and post-harvest handling

Given that Georgian farmers tend to focus on minimizing production costs rather than maximizing profits, Ferrero collaborated with Anka Fair Trade (see box) to provide EPI trainees with access to modern de-husking and drying facilities, covering the cost of labor and diesel for about 40 days during the 2013 harvest season. A total of 250 ton of hazelnuts were processed of this pilot to demonstrate the commercial value of proper post-harvest treatment. At present smallholders prefer to use (own) manual labor to de-husk hazelnuts, and free "solar energy" for drying. While saving about 10 tetri per kg of hazelnuts, these primitive methods were proven to be inferior from the profit maximization point of view. The price farmers fetched for their de-husked and properly dried produce was some 30-35

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<sup>5</sup> The 600-800kg of hazelnuts produced by the plot each year provides the school with an important source of income.

tetri higher per kilo: 3.30 GEL per kg of dry hazelnuts as opposed to 2.10 GEL for wet hazelnuts on the street (in the process of drying, hazelnuts lose about 25% of the weight).

### **SUSTAINING THE RESULTS OF AGRIGEORGIA/EPI INTERVENTIONS**

In April 2013, to build on the momentum created by the GDA, AgriGeorgia and EPI actively supported the founding of the Georgian Hazelnut Growers Association (GHGA). The plan is to transition EPI's local staff into the management of GHGA when the EPI program comes to an end in September 2014.

At present, GHGA includes 700 individual farmers and 4 cooperatives as members. Membership dues will be introduced after the 2014 harvest. AgriGeorgia renovated and donated a modern facility which will allow GHGA to host trainings and rent out space to input providers, banks and microfinance organizations operating in the hazelnut sector. Service and input providers will be able to use the facility to showcase their products (for a fee).

According to Alex Antoniuki, GHGA could also invest in a storage facility serving the needs of its members. This would certainly strengthen the incentives of Georgian smallholders to join the association and pay membership dues. For this option to materialize, however, there would be a need to purchase and renovate a building of about 2000 square meters next to GHGA offices (with the capacity to fit 2,000-3,000 tons of hazelnuts).

## **CONCLUSIONS AND LESSONS LEARNED**

Investment in perennials like hazelnuts is particularly sensitive to the quality and stability of a country's investment climate, given the time it takes to start production and the cost of securing vulnerable agricultural assets from pilferage and sabotage.

Thus, Ferrero's decision to set up plantations in Georgia can be said to reflect the country's progress in securing investors' rights. At the same time, the company's early successes should also be attributed to the Georgian government's continuous attention and willingness to engage at a sufficiently senior level in redressing any grievances or legal complications concerning the company's land acquisitions and its relations with the local communities. The need for Georgia to maintaining this type of engagement concerning signature FDI projects is a key message coming out of this study.

A second key message concerns the negative impact of the current legislative drive to restrain foreigners' access to agricultural land, the introduction of tougher labor market regulations and a visa regime with many non-EU nations. It is important to understand that a moratorium on land purchases

### **Impact on Farmers. View from Below.**

*(focus group with three farmers from the Tsalenjikha municipality)*

Gela Kvaratskhelia, Tamaz Kvaratskhelia, and Kakha Sherozia participated in the second cycle of AgriGeorgia/EPI trainings, beginning in December 2012. Through attribution is problematic because of favorable weather conditions, the three report improved yields, up to 2 tons/ha.

In addition to growing hazelnuts (2-4ha each), Gela, Tamaz and Kakha are looking for ways to develop and diversify their businesses, including innovative activities such as greenhouse production of hydroponic forage, tomatoes and flowers (black roses). Following the introduction of the new law on farmer cooperatives, they joined forces with 4 other farmers from Tsalenjikha to create – with the help of AgriGeorgia and EPI – a small cooperative in order to gain access to cheap credit or grants, and invest in better facilities for drying, cracking and storage.

Their motivation is rather straightforward: as they have learned, improved drying and storage can significantly boost the ability of smallholder farmers to use hazelnuts as a store of value. Rather than selling at a low price in the post-harvest glut, farmers can over a longer period of time. Natural drying in the sun reduces the amount of moisture to 10-12%. At this level, hazelnuts can be stored for up to 6 months, but their quality depreciates. Industrial drying is more effective. At 6% of moisture hazelnuts reach export quality and can be stored for much longer.

The farmers also reflected on the possible advantages of AgriGeorgia/EPI-supported Georgian Hazelnut Growers Association (GHGA). They see a number of areas in which GHGA could add value by using economies of scale in the procurement of inputs and sales. An excellent example is jute bags, currently retailed at 4GEL. Given this price, many villagers use cheaper plastic bags, resulting in 15-20% losses from rotting. GHGA could provide superior jute bags at cost (about 50 tetri), greatly reducing post-harvest losses. Another obvious example is marketing: GHGA could coordinate among individual farmers, reducing the cost of bringing hazelnuts to the market.

by foreigners does not solve any problem. As reported by Rabah Arezki, Klaus Deininger, and Harris Selod<sup>6</sup>, at best, it can be used to gain time to sort out the underlying land governance issues:

“Concern about the potential negative effects of large-scale investment has given rise to draft legislation to limit land purchases by foreigners in a number of countries—including Argentina, Brazil, and Ukraine. If foreigners can use nationals as intermediaries, such measures do little to address the underlying issues and may exacerbate governance challenges by limiting competition. **A more appropriate policy response would place priority on efforts to improve land governance—by recognizing local rights and educating local populations about the value of their land, their legal rights, and ways to exercise those rights.** The terms of land transfers must be well known and understood and must conform to basic social and environmental safeguards; and compliance with them must be monitored. Many countries have declared a moratorium on land purchases by outsiders until such safeguards are in place.”

Large global players like Ferrero may be willing to invest in Georgia despite these restrictions provided the Georgian government remains committed to taking special (and continuous) care of their needs. More likely, though, is that investors will see an inherent risk in an investment climate that depends on case-by-case adjudication and support. In any case, Georgia must expedite the process of developing new land legislation allowing for foreign participation in the development of Georgian agriculture.

The third key message concerns the opportunities for Georgia to maximize the benefits of foreign direct investment by promoting Public-Private Partnerships involving foreign companies, donors and government institutions. A steep increase in agricultural commodity prices during the past few years has fueled a global rush for agricultural land. A recent [article on the IMF blog](#) reports that in 2009 alone cross-border land deals finalized or under negotiation involved at least 56.6 million hectares (including 39.7 million hectares in Africa). Some commentators welcome these transnational purchases as an opportunity to overcome years of underinvestment, to create jobs, and to bring new technology to developing countries. Others, though, denounce such investments as a “land grab,” neglecting local rights, extracting short-term profits at the cost of long-term environmental sustainability, and fostering corruption on a large scale.

Ferrero’s investment in Georgia is most certainly a part of this global trend and the challenge for Georgia and Ferrero is to make sure that the company’s presence is not perceived as a land grab but rather is utilized to improve the lot of Georgia’s smallholder farmers. While it may be years before Georgia sees any significant tax revenues related to AgriGeorgia activities, there are much more immediate benefits to reap in the form of knowledge transfer to, and integration of, Georgian smallholder farmers in national and global supply chains.

Ferrero’s partnership with USAID provides direct support for one of the major findings reported by Rabah Arezki, Klaus Deininger, and Harris Selod. It demonstrates that a strategy to attract investors in order to make use of uncultivated land *while at the same time helping local farmers to thrive* can yield large benefits. The latter goal – raising the productivity of smallholder farming activities – may require government and donor support with technology, institutions (such as farmer co-ops), and infrastructure – in addition to any efforts by private investors.

The opportunity to make the traditional small-scale Georgian agriculture more efficient is certainly there since land consolidation is not a necessary condition for achieving efficiency in many types of agricultural production. As argued by Arezki et al,

“...many technological innovations are not particularly scale biased. Information technology, for example, which can be used to better control a large farm, can also be used by small farmers or farmer co-ops. Moreover, very large units of production often emerge because they can deal with market imperfections (access to finance), lack of public goods (infrastructure, education, or technology), and weak governance better than small ones. But, in an environment where public goods are effectively

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<sup>6</sup> IMF Working Paper “What Drives the Global Land Rush?” by Rabah Arezki, Klaus Deininger, and Harris Selod

provided, much smaller operational farm sizes could prevail. Indeed, anecdotal evidence suggests that, in many settings, farms are very large not because of inherent advantages of the technology but because of the superior ability of large operators to deal with market imperfections.”

In the coming years, the Georgian agricultural sector is very likely to receive considerable foreign investment in modern primary production and processing as a result of expected improvements in access to Eurasian and European markets (e.g. under the DCFTA). Such investments – and the export opportunities they bring – will create ever stronger incentives for smallholder farmers to improve product quality and achieve market access. Under these circumstances, well-structured, win-win-based PPPs, such as Ferrero’s partnership with USAID, may be an excellent means of taking full advantage of new economic opportunities.

## D. RECOMMENDATIONS

### RECOMMENDATIONS FOR GOVERNMENT

With a turnover of EUR 8.1 billion and profit before tax of EUR 795 million for the year ending August 31, 2013, Ferrero Group is one of only a handful of global manufacturing giants operating in Georgia.<sup>7</sup> Recommendations presented in this section concern the best options for Georgia to maximize the benefits from investment in primary agricultural production by global industry leaders while minimizing collateral damages related to frictions with the local communities.

- **Attract investment by global industry leaders as a means of promoting Georgia’s international recognition.** Ferrero’s very presence in the country and its commitment to a long-term investment project, such as AgriGeorgia, can be considered a vote of confidence for the Georgian economy and excellent (free) advertising for Georgia as a target for international investment. Facilitating the arrival of global industry leaders –in agriculture and any other sectors of the economy, such as wine and mineral water, tourism, transport and logistics – may be the most cost-effective means of promoting Georgia’s international competitiveness and integrating it into global supply chains.
- **Utilize improved access to the EU market under the DCFTA to promote investment in (new) high value crops and agricultural products.** Ferrero’s investment in hazelnut plantations took advantage of free access to the EU market available to Georgian firms under the GSP+ scheme (in 2013, hazelnuts constituted more than 50% of all Georgia’s total GSP+ exports). The signing of the Deep and Comprehensive Trade Agreement (DCFTA) between Georgia and the EU expands the list of goods admitted to the EU market, opening up opportunities for investment by Georgian and international investors in a number of areas, including higher value crops like berries and kiwi. The Georgian government should proactively identify and publicize such investment opportunities.
- **Maintain a consistent policy framework concerning foreigners’ access to land and immigration.** Ferrero’s investment was made in the context of a generally liberal business environment, availability of cheap freehold land, and a liberal visa regime for both management and labor. Georgia’s attraction as an investment destination has been eroded by a spate of recent legislation including the July 2013 moratorium on the acquisition of agricultural land by foreigners and subsequent changes in visa and labor regulations. While Georgia certainly has the right to adopt a more conservative stance on these issues, the government should be fully cognizant of the negative implications of recent changes for investment and economic growth.

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<sup>7</sup> Other examples of global companies with presence in Georgia are Hipp, Pernod Ricard (until 2009) and HeidelbergCement.

- **Complete land reforms and ensure smallholders' formal and informal rights in the process of land privatization.** Given the prominence of Ferrero in the overall foreign investor landscape, the government did a reasonable job in arranging land swaps and compensating smallholders whose (formal and informal) property rights have been neglected in the initial privatization of agricultural lands. Yet the difficulties faced by Ferrero in gaining access to, or swapping, “problematic” lands should serve as a reminder of the urgency for Georgia to complete ongoing land reforms and develop policy measures ensuring the rights and livelihoods of smallholders in the process of large-scale privatization and repurposing of land.
- **Leverage private sector expertise to develop smallholders' skills.** As is obvious from this case, the main positive impacts of investment in primary agricultural production are related to technological upgrading. The new hazelnut varieties as well as modern cultivation and post-harvest handling techniques brought by Ferrero have a tendency to be slowly adopted by neighboring communities and commercial farmers. However, the ripple effect of these innovations could be accelerated through purposeful public-private partnerships seeking to propagate new skills and technologies. The Global Development Alliance between Ferrero and USAID should be looked upon as a model for such purposeful partnerships.
- **Leverage private sector resources to strengthen farmer organizations and link them to national and international value chains.** AgriGeorgia and, even more so, Anka Fair Trade, provide good models of linking smallholders to agricultural value chains by, on the one hand, paying a premium for higher quality and/or organic product and, on the other, developing the capacity of farmers to meet the required standards. The business opportunities related to organic production and the need to gradually adopt EU food safety regulations may provide an impetus for both land consolidation and greater cooperation among smallholders. The Ministry of Agriculture and Agricultural Cooperation Development Agency (ACDA) should take this possibility into account when supporting farmer co-ops and associations.

## RECOMMENDATIONS FOR INVESTORS

Ferrero's approach to building its business in Georgia, the care it exercised in handling community and government relations, and its success in engaging international donors supporting the Georgian agricultural sector carry many lessons that other investors can learn from.

- **Seek compromise and avoid confrontation with local communities.** Ferrero's experience in exercising its property rights with respect to “problematic” lands should be carefully studied by other investors in Georgia. In the end, the company chose not to confront the village communities who had claims on some of the assets acquired by the company in 2007. Instead, it approached and actively collaborated with the government of Georgia to arrange land swaps or compensation for the affected communities.
- **Invest in people and local government relations.** The company's approach to human resource development creates a sense of commitment on the part of local employees while also helping stay on good terms with the local government and communities. As far as full-time local staff is concerned, AgriGeorgia provides a very competitive remuneration package including slightly above-market compensation, healthcare insurance, meals and other amenities. It also invests in employee training (including English language) and offers considerable promotion possibilities. Up to 1000 seasonal workers are employed by AgriGeorgia at harvest and other seasonal field operations. These are hired in coordination with the local authorities in Samegrelo in an effort to better accommodate local needs.
- **Have sufficient scale and pool resources to be able to deal with deficiencies in local service provision and infrastructure bottlenecks.** The scale of AgriGeorgia's operations in Georgia allows it to be self-sufficient or well protected against deficiencies in local service provision and infrastructure (e.g. frequent interruptions in electricity supply), agricultural

machinery, road construction, maintenance and repairs. What is particularly commendable is the company's willingness to share its resources (e.g. machinery and technical expertise) with the local government, communities and agribusinesses. This helps generate goodwill for the company on the one hand and to find useful business synergies on the other.

- **Take advantage of available donor funding and public policies** (e.g. support of farmer organizations, cheap loans and vouchers) to pursue win-win strategies involving the company, local communities and the country at large. Ferrero's engagement in modernizing smallholder hazelnut production is a win-win for the company and Georgia, because the goal of promoting Georgia's productivity is consistent with company's strategy to diversify hazelnut supply to the global market. The same logic underlies efforts by Anka Fair Trade to integrate smallholders and farmer co-ops into its supply chain. Identifying such win-win synergies is a key to success in building *sustainable* public-private partnerships.
- **Take advantage of new opportunities to invest in Georgia in order to export to the EU market.** The Georgian hazelnut growing and processing sector has seen a flurry of business activity in recent years – of which AgriGeorgia and Anka Fair Trade investments are leading examples – as a result of improved access to global markets e.g. under GSP+ regime. The Deep and Comprehensive Trade Agreement (DCFTA) Georgia has initialed in June 2014 will open up additional opportunities in primary agricultural production and processing that investors should be examining in the nearest future.

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