VALUE CHAIN PRIORITIZATION AND GAPS ASSESSMENT

USAID ECONOMIC SECURITY PROGRAM

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ABBREVIATIONS

ADE	Architecture, Design and Engineering
ADB	Asian Development Bank
APS	Annual Program Statement
BOG	Bank of Georgia
BPO	Business Process Outsourcing
BSS	Business Support Services
CAGR	Compound Annual Growth Rate
CAM	Competitiveness Appraisal Matrix
CRM	Customer Relationship Management
DCA	Development Credit Authority
DCFTA	Deep and Comprehensive Free Trade Area
EBRD	European Bank for Reconstruction and Development
EG	Economic Growth
EIB	European Investment Bank
ERM	Enterprise Resource Management
F&A	Finance and Accounting
GDA	Global Development Alliance
GEOSTAT	Georgia Office of Statistics
GITA	Georgia Innovation and Technology Agency
GITOA	Georgia Incoming Tour Operators Association
GIZ	German International Development Agency
GNFC	Georgian National Film Center
GOG	Government of Georgia
GNTA	Georgia National Tourism Administration
G&T	Galt & Taggart
HR	Human Resources
HVM	High Value Markets
IAB	Industry Advisory Board
ICT	Information/Communications Technology
IFC	International Finance Corporation
IFI	International Financial Institution

ISET	International School of Economics at Tbilisi
IT	Information Technology
ITO	Information Technology Offshoring
ISO	Industry Specific Outsourcing
KPI	Key Performance Indicator
LOGFRAME	Logical Framework
MCC	Millennium Challenge Corporation
MELP	Monitoring, Evaluation, and Learning Plan
MES	Ministry of Education, Science, Culture and Sport
MFO	Microfinance Organization
MICE	Meetings, International Conferences, and Exhibitions
MoEST	Ministry of Economy and Sustainable Development
MSME	Micro, Small and Medium-Sized Enterprises
MTPL	Motor Third Party Liability
NBG	National Bank of Georgia
NGO	Non-Governmental Organization
PDF	Partnership Development Fund
PMAG	Packaging Manufacturers Association of Georgia
PMCG	Policy and Management Consulting Group
PPD	Public-Private Dialogue
PPP	Public-Private Partnerships
RFA	Request for Application
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprise
STTA	Short-term Technical Assistance
TA	Technical Assistance
T4L	Training for Life
TVM	Traditional Volume Markets
TVET	Technical and Vocational Education Training
VC	Value Chain
VFX	Visual Effects
USAID	United States Agency for International Development
USG	United States Government

I. EXECUTIVE SUMMARY

OVERVIEW OF FINDINGS

As a baseline for its work to build competitiveness in Georgia through facilitation of investment, high(er)-value job creation, and/or revenue increases, the Program was asked to conduct assessments of value chains within targeted sectors. Its methodology for doing so is addressed comprehensively within this report.

In assessing the potential competitiveness of Georgian sectors and value chains, the Program adopted a market analysis approach that focused largely on demand-side opportunities for Georgian products and services. It did this for two reasons. First, most of Georgia's sectors and many of its value chains have undergone extensive assessments in previous years. Most of these reports, however, focused on strengths, weaknesses, opportunities, and threats within specific sectors and value chains rather than assessing market demand, both globally and regionally. Second, even a cursory assessment of Georgia's sectors and value chains reveals significant disconnects in the understanding of export markets and how to reach them. This has created a vacuum of information among Georgian companies and even the Government of Georgia that has led to over-concentration on domestic and regional markets and a lack of attention to major global opportunities in key sectors and value chains. Market analysis is the primary way to bridge this knowledge gap.

When assessing the market for goods and services produced by and through its major sectors and value chains, a classic Red Ocean/Blue Ocean scenario emerged.[1] Kim and Mabourgne's Blue Ocean Strategy highlights the effect of competition on the ability of companies to compete (a red ocean), and the offsetting benefits of innovation and movement into spaces where companies, regions, countries, et al can find a niche that drives prosperity, hence a blue ocean. Figure 1 highlights the characteristics of a red and blue ocean scenario:

FIGURE 1: RED OCEAN AND BLUE OCEAN CHARACTERISTICS

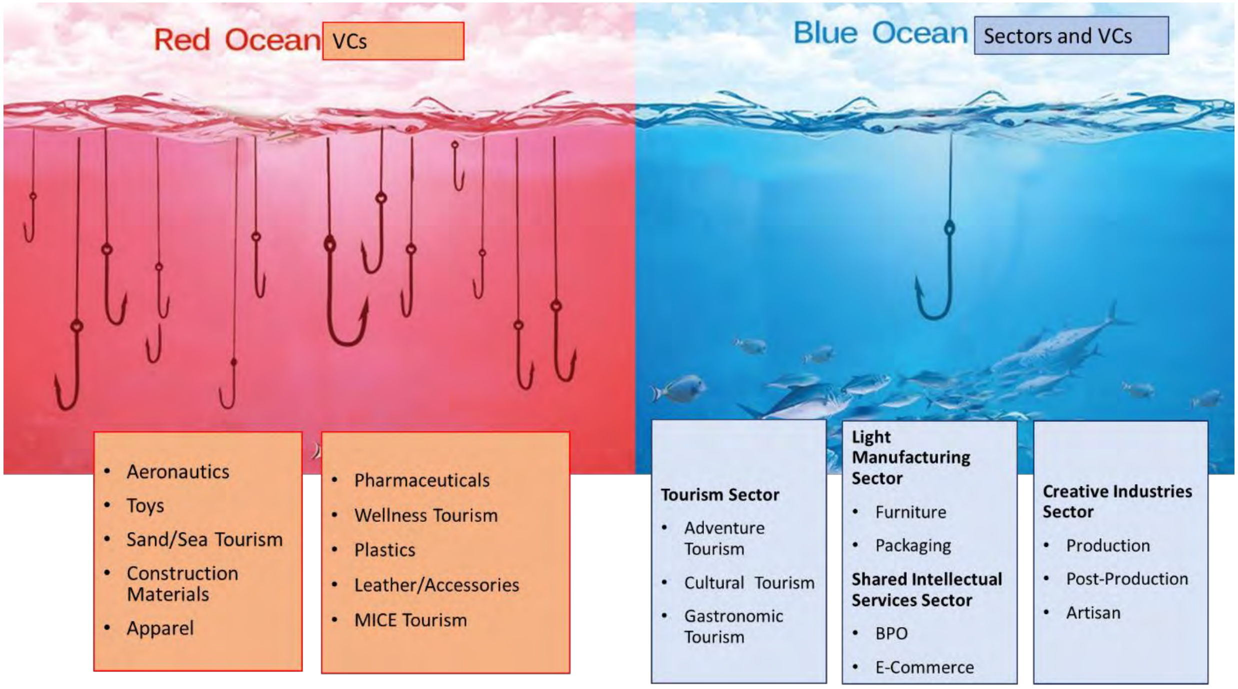
[1] W. Chan Kim & Renée Mauborgne coined the terms red and blue oceans to denote the market universe. Red oceans are all the industries in existence today – the known market space, where industry boundaries are defined and companies try to outperform their rivals to grab a greater share of the existing market. Cutthroat competition turns the ocean bloody red. Hence, the term 'red' oceans.

Kim and Mauborgne postulate that sectors and value chains in a "Red Ocean" are those that try to compete head-to-head on the regional or global markets in the same space as numerous others. This typically creates a scenario where competition becomes so acute that it turns the ocean red with the "blood" of dying companies. The quintessential "red ocean" scenario is survival of the fittest, and it is extremely difficult for small or under-capacity companies to thrive in this situation. "Blue Ocean" sectors and value chains are those that transcend competition because they have either created something that does not exist (e.g. Amazon, Facebook) or have a differentiating factor that makes competition irrelevant (e.g. Tesla). This differentiating factor might be a product, a brand, or a market niche that places a company, sector, or value chain in a blue ocean. On a country scale, examples of these scenarios about. For instance, New Zealand is virtually in a "Blue Ocean" in terms of yacht making/retrofitting because they offer reputation, prices, and quality that transcend the market. Cyprus, on the other hand, is in a "Red Ocean" in terms of sand and sea tourism because of severe regional competition and no differentiating factors.

Utilizing this scenario, it became apparent to the Programs Value Chain Assessment teams that many of Georgia's sectors and value chains were classic examples of the Red Ocean perspective. For decades, some of the country's most visible sectors and value chains have been defending their position against mounting competition by exploiting existing domestic and regional demand that has been both inconsistent and unsustainable. This has put these sectors and value chains within a Red Ocean scenario as competition now surrounds them, leaving "blood in the water" in terms of strategy, sales, and market access. For this reason, the Program is not recommending a focus on some very high visibility value chains that have and are being touted by both the private sector and the Government of Georgia as significant. In-depth market analysis actually shows that the opposite is true…these value chains and sectors, while still having potential, are becoming more competitive, their markets constricted, and their margins diminished in terms of Georgia's competitive positioning.

On the other hand, the Programs Value Chain Assessment and Gap Analysis highlighted a number of sectors and value chains that can provide the country with differentiators that lead to competitiveness, hence a Blue Ocean scenario. Most of these sectors and value chains are not new to the country, but they have been largely under-developed or have not yet been able to access a growing export market that will allow it to exploit its differentiators and thus establish niches that either overcome the competition or make it irrelevant. Figure 2 highlights the Georgian value chains that, in the Program's analysis, are in a Red Ocean or Blue Ocean.

FIGURE 2: GEORGIA'S RED OCEAN VS. BLUE OCEAN VALUE CHAINS



Again, by classifying some traditionally strong value chains as Red Ocean, the Program is not suggesting that they have not been or still could be important. Rather, it contends that they are currently in a Red Ocean because they have not responded to competition and market forces in such a way as to infuse innovation, move up the value continuum, and otherwise drive competitiveness either within the industry or the country. There are initiatives that have effectively focused on these value chains and will likely continue to gain some traction in producing results, yet analysis shows structural and market deficiencies that are significant obstacles within their sustainability in terms of investment, high(er)-value job creation and/or revenue enhancement.

On the Blue Ocean side of the equation, the Program found a number of value chains that have the potential for innovation or at least competitive advantage if the right business activities become the focus of their production and market outreach (see Figure 2). Some of these value chains are well established in Georgia, while others at this time are nascent in terms of number of companies, sales, and/or visibility. In analyzing them, however, the Program's sector specialists viewed their potential impact in terms of global trends and opportunities for market access. Table 1provides an overview of this analysis.

TABLE 1: GLOBAL OVERVIEW OF RECOMMENDED SECTORS AND VALUE CHAINS

Sectors/VCs	Approximate # of Georgian Companies	Current Revenues[2] (Georgia)	Current Revenues[3] (Global)	% of Georgia's Global Market Share	Global CAGR (%)[4]
Tourism					
Adventure	9 tour operators[5]; 20 rafting companies; 5 ski resorts; 55 certified mountain guides, 145 ski instructors; 80 trekking and mountain guide students	$340 million	$302 billion	.	46.00
Gastronomic		$805 million	$362.25 billion	0.002	9.00
Cultural	14 registered sites; 2 (Vardzia and Uplisikhe receive more than 80% of visitors)	$45 million	$1 billion		35.50
Shared Intellectual Services					
Business Process Outsourcing (BPO)	50	$4.1 billion	$85.6 billion	0.08	33.90
Light Manufacturing					
Packaging	20[6]	$9 million (export); $62 million (domestic)	$164 billion	0.00005	11.00
Furniture	100[7]	$1.6 million (export); $116 million (domestic)	$67 billion	0.00002	4.40
Creative Industries					
Production	20[8]	$17.7 million	$867 billion	0.00002	15.00
Post Production	50[9]	$350 thousand	$260 billion	0.000001	7.00
Artisan	100[10]	$4.5 million	$38.9 billion	0.0001	9.20

While Georgia's global market share in a majority of these value chains is miniscule, this represents a significant opportunity for growth if the country's producers can target the right markets, with a differentiated product(s), at the best time. This will take significant market research, altered supply chains, and a strong overall eco-system. More than anything else, it will require a mindset change, especially in terms of light manufacturing where processes and attitudes are strongly embedded in the industry.

The Program's analysis strongly indicates, however, that the most nascent value chains in terms of size/sales may have the most potential for growth. This has certainly been true of countries such as

[2] These figures come from a variety of sources including the GOG and sector associations/clusters

[3] This information comes from global industry sources

[4] This information comes from global industry sources

[5] GIToA (Georgia Incoming Tour Operators Association) member companies

[6] These represent larger firms that produce 95% of sector revenues according to the Package Manufacturers Association of Georgia

[7] The Georgia Furniture Cluster estimates that there are over 1,000 companies in the sector, but only about 100 are of sufficient size to export of even make a ripple on the domestic market.

[8] This includes the total number of companies, but only 4-5 are large and sophisticated enough to work on a major production.

[9] Most of this number are independent contractors

[10] This is an approximation since no data exists that quantifies the total number of artisans in Georgia.

Romania and Jordan that went from no presence on the global scale in terms of creative industries to significant players (see case studies below).

The Program's analysis, therefore, focuses on specific business activities within these value chains that have the most potential for growth.

- **Tourism:** The Program's analysis identified three primary value chains in the tourism sector, namely adventure, cultural, and gastronomic. Within these value chains, specific business activities hold the most potential for investment, high(er)-value job creation, and/or increased revenues. Within the adventure tourism value chain, rafting, hiking, trekking, birding, and eco-tourism hold the most potential. Skiing, while long a staple of Georgia's winter tourism offerings, will continue to have growth potential, but over-development, lack of investment in infrastructure, and increased competition are eroding the business activity's competitiveness. Cultural tourism includes religious and historical attractions. It remains strong though there are definite gaps in infrastructure (e.g. maintenance of attractions), support facilities, and marketing. Also, it is the lowest value of the three identified value chains due to its core demographic, which is mass (bus) tourism where travelers spend proportionately less money than individual travelers. The final value chain in tourism, gastronomic, contains two business activities: culinary and wine. This segment of Georgia's tourism is a major differentiator and will continue to provide economic opportunities in terms of revenues and overall visibility. The "Achilles Heel" of this value chain, however, is weak supply chains and overall spotty customer services that erodes the visitor experience.
- **Shared Intellectual Services:** This sector focuses on the Business Process Outsourcing (BPO) value chain that includes six specific business activities that are potential differentiators for Georgia: Customer Relationship Management (CRM), Architecture, Design, and Engineering (ADE)[11], Human Resources (HR), Finance and Accounting (F&A), and Information Technology (IT). The challenges in the BPO value chain center on increasing competition and lack of language skills among others. Both of these can be overcome, however, with focused interventions. Georgia's e-commerce value chain is currently very small but has great potential especially when linked with the artisan value chain as a cross-cutting enabler.
- **Light Manufacturing[12]:** The analysis of Georgia's light manufacturing sector revealed significant challenges throughout the eco-system, from weak, unsustainable associations to skills gaps to lack of market access, aging equipment, and low-value production. Only two value chains, furniture and packaging, seem to have potential for growth on a global scale and within them certain business activities are the most promising. In packaging, carboard, plastic wrapping (industrial), and paper cups and bags are potential differentiators both in terms of exports and import substitution. In furniture, contract production (private label), custom made, high value wood furnishings, and high-end cabinets and counters are potentially significant business activities. The challenge even in these value chains, though, is that the amount of investment required to compete on a global scale, as well as the past unwillingness of the furniture industry to focus on exports. In addition, investment in

[11] ADE is a specialty value chain. In traditional architecture the synergies would be few, however, architecture firms in Georgia are looking into expanding into providing a wider range of services, especially around interior design, for foreign clients. In these areas there would be overlap, but at this time, architecture firms that are outsourcing-not yet providing much design service – though they want to do so and have the capacity to do so.

[12] Several value chains were evaluated within this sector and while certain business activities in furniture and packaging have the most potential for impact in terms of investment, job creation, and revenue growth, there are business activities within other value chains, such as cabling and synthetic construction materials, that have potential. For this reason, the Program will discuss with USAID potential support for light manufacturing opportunities that have potential to meet its objectives. This support would likely be in the form of market linkages and/or technical assistance rather than financial support.

equipment, which could provide furniture producers with significant global opportunities, typically means reductions in employment. This would further comprehend Georgia's already high unemployment and under-employment rates. These value chains and business activities, however, have a significant upside in terms of increased revenues and investment is Georgian companies are willing to change their processes and focus on niche products.

- **Creative Industries:** Three value chains were identified within creative industries, namely production, post-production, and artisans. In the case of production, business activities such as film and TV series. In post-production, the business activities with the most potential are sound, visual effects and editing. The artisan value chain will link artisans in fashion and jewelry design, wood carving, stone carving, painting and ceramics into an e-commerce platform that will provide them a point-of-sale on the global market as well as a distribution network. The challenge for the sector in general and particular these value chains is their lack of mass. Currently, much of Georgia's success in this sector has come through small production houses that have little global visibility. Also, the country has nascent skilled labor available in the production and post-production value chains. This being said, countries such as Romania and Jordan were in the same situation, but used strategy, targeted workforce interventions, and incentives to generate exponential growth. The Program's analysis indicates that the Creative Industries sector and target value chains have substantial ability to become a differentiator for Georgia.

Table 2 offers insight into the potential for the recommended sectors and value chains to meet Program objectives.

TABLE 2: POTENTIAL FOR GROWTH IN RECOMMENDED SECTORS AND VALUE CHAINS

	Potential for Georgia			Timeframe of Opportunities
Sectors/VCs	Employment	Revenues	Investment	
Tourism				
Adventure	Moderate	Significant	Moderate	Short/Medium
Gastronomic	Significant	Significant	Moderate	Short
Cultural	Moderate	Significant	Significant	Short/Medium
Shared Intellectual Services				
Business Process Outsourcing	Significant	Significant	Small	Short
Light Manufacturing				
Packaging	Small	Moderate	Significant	Medium/Long
Furniture	Small	Moderate	Significant	Medium/Long
Creative Industries				
Production	Significant	Significant	Significant	Short/Medium
Post Production	Significant	Significant	Significant	Short/Medium
Artisan	Moderate	Significant	Significant	Medium

It is clear that while not all are strong in every area, there are specifics indicators that boost their potential for inclusion in Program activities. Determining the exact potential for job creation, investment and revenue increases for each would not be prudent, as this would require speculation that is not supported by data. For purposes of this table, however, "significant" is defined as the ability to produce tens of thousands of jobs, and tens of millions of dollars in potential investment/revenues. "Moderate" is defined as the ability to produce thousands of jobs and multi-million dollars in investment and/or revenues. "Small" is defined as hundreds of potential jobs and/or low million dollar potential in investment.

Each value chain analysis (see Annex 1-6) offers specific targets/interventions for investment, high(er)-value job creation and/or revenue enhancement, but the following table aggregates them to provide overall perspective:[13]

The VC Assessment Team developed growth targets for each sector and value chain based on its analysis of domestic and global trends as well as emerging opportunities. These targets are included in the Annex (in each VC Assessment Report) but is disaggregated by sector and impact type in **Annex 8.**

During its analysis, the Program's VC Assessment Team reviewed Information and Communications Technology and Logistics and Transportation as cross-cutting enablers rather than potential sectors/value chains. Since information technology permeates every sector and value chain, it was not prudent to assess it as a silo, but rather to integrate it into the overall analysis of all sectors and value chains considered. Transport and logistics, when assessed as a sector, require significant up-front investment that mega-projects are required to provide traction. This being the case, the Program felt that it was best considered as an enabler for other sectors and value chains.

E-Commerce also provide linkages to all value chains. As a matter of fact, the Value Chain Assessment Team believes that based on global market demand, it may provide the best opportunity to scale opportunities within target sectors and value chains.

As indicated in Table 8, e-commerce was originally reviewed as a business activity under ICT. The VC Assessment team's analysis, however, highlighted that a) globally e-commerce is viewed as a sector under Shared Intellectual Services rather than a business activity, b) it is one of the fastest-growing value chains globally, c) there are a number of emerging e-commerce processes/opportunities in Georgia, d) the enabling environment for e-commerce in Georgia is being put in place, and e) viewing e-commerce as simply a business activity would limit the Program's interventions to cross-cutting linkages rather than allowing the ability to explore e-commerce as a driver of investment, high(er)-value job creation, and revenue increases. This mindset is consistent with global standards in terms of pursuing e-commerce opportunities.

Globally, e-commerce is one of the fastest growing value chains in existence and is expected to produce more than $4.8 trillion in revenues by 2021. Its CAGR is 17.8%. Unfortunately, Georgia has not been able to capitalize on the e-commerce phenomenon, becoming consumers of on-line goods and services instead of producers of them. This being said, the country is positioned to gain traction in e-commerce, as it has already introduced elements of this phenomenon into society. A case in point is e-payment of bills through a kiosk system as well as e-banking, both of which merge elements of e-commerce with social services. In 2018, Georgians carried out 14.4 million electronic transactions worth more than $630 million, 96% of which were in-country transactions.

Internet penetration throughout Georgia is increasing rapidly (nearly 70% in 2018) and it tops 90% for countries that would be the targets for Georgia's e-commerce platforms. In addition, there are 8.5 million debit cards and 700,000 credit cards in use by Georgians and the amount is growing exponentially each year. Georgia is harmonizing the electronic flow of information among key players in logistics, shipping and transport industries by launching the Trade Facilitation System (TFS). The TFS enables traders, customs brokers, freight forwarders, shipping lines and other players in international trade to submit information through a single entry point. The Ministry of Economy and Sustainable Development (MoESD) is also engaged in developing a draft law on e-Commerce. In addition, e-

[13]These figures are based on the Program's market assessments and are estimated using internationally-accepted average CAGR data by sector. This only highlights impact that could be generated through Program interventions, not the overall potential for the growth of these value chains in Georgia. The latter would require speculation based on insufficient data and prognostication of global trends.

commerce sites such as Phubber (a site for buying, selling, and trading vintage and name-brand clothing) are making significant headway on the domestic market and have the opportunity to scale globally.

Even Georgia's ability to capture .00001% of the global e-commerce market would produce $48 million in annual revenues for Georgian companies. This is possible if a) the legal and regulatory environment is put in place, b) e-commerce sites are developed by Georgian companies, c) logistics/shipping and e-commerce are linked to allow Georgian companies to get to market, and d) secure payment through credit/debit cards or other mechanisms is ensured.

CASE STUDIES

During its assessment of potential sectors and value chains, the Program looked extensively at examples from other countries, which have been successful in the recommended areas of focus. The following are brief case studies of two:

Jordan (Creative Industries): The Jordanian film industry has expanded rapidly since the establishment of the Royal Film Commission (RFC) in 2003, which led to increased support for writers and directors. The RFC has also partnered with the University of Southern California's School of Cinematic Arts to establish the Red Sea Institute of Cinematic Arts—which provides training for students from across the Middle East in all aspects of film-making. Jordan had produced five feature films prior to 2003 but has subsequently produced 150—a measure of the progress that has been made. The RFC has also helped to market Jordan as a location for a number of high-budget US films, including the Oscar-winning The Hurt Locker. Jordan's entire creative services space was buoyed by support from USAID through implementing partners. These interventions focused on support for the Red Sea School of Cinematic Arts, as well as in e-gaming and animation. Both of the latter are now significant employment and revenue generators in Jordan.

Poland (Offshoring/BPO): A late comer to the Offshoring space, Poland has made up for lost time. Over the last ten years, it has gone from a nascent position to being the home of over 1,000 BPO centers that employ more than 200,000 workers. The CAGR for offshoring in Poland is 20%, making it one of the country's fastest growing industries. Warsaw has the largest number of Offshoring centers, but Krakow has the most employees. The country also has 40 Business Support Service (BSS) centers throughout the country that provide higher-value services to clients. This growth has not been confined to the country's large cities, however, as in Katowice, PricewaterhouseCoopers entered into a lease agreement for over 2,000 sq/m in the Silisia Business Park. It increased employment in its BSS operation by over 300 people. This shared services center in Katowice provides services in the field of financial audit, taxation and internal departments services. Over a thousand people work at PWCs offices in the city center.

These case studies are examples of what can occur when a country focuses on the right sectors/value chains, as well as differentiators through niche business activities. The Program believes the same can occur in Georgia, making it a global example of innovation and competitiveness.

II. INTRODUCTION

PROGRAM OVERVIEW

The purpose of the USAID Economic Security Program is to accelerate broad-based growth of sectors outside of agriculture that show strong potential to create jobs, to increase incomes, to increase micro, small, and medium enterprise (MSME) revenues, and to support diversification to more productive economic activities, including tourism and up to three additional sectors.

In fulfilling this purpose, the Program focuses on sectors and value chains that have the most potential to produce investment that will create high-value jobs for Georgians. This requires identifying and improving the eco-system for each value chain, including both the supply and demand-sides, as well as skills development of the workforce, strengthening of institutions that support these value chains, and establishment of co-funding partnerships that catalyze investment and strengthen MSME positioning within the value chains.

The Program scales up impact through synergy, strategic partnerships and investments, while building collaborative alliances between government, the private sector, and civil society. Its innovative and empowering approach creates Georgian solutions to the country's challenges by encouraging co-design and constructive dialogue. The Program will create at least 4,000 new jobs, support at least 600 MSMEs, increase sales of assisted enterprises by $50 million, and leverage $15 million in investment through partnerships.

REPORT OBJECTIVE

The objective of this report is to prioritize up to three additional sectors outside of tourism for Program support, and to propose high potential value chains within these sectors and the tourism sector which will be targeted by the Program for support. Report identifies high potential market growth opportunities in these value chains and constraints to growth/significant gaps in realizing these opportunities; proposes interventions to overcome these constraints, including cost-shared grants and technical assistance; and identifies GOG, donor, private sector resources available that can be accessed in order to leverage and maximize the impact of program assistance, including possibilities for developing public-private partnerships, Global Development Alliances and other partnerships.

The report first provides an overview of the methodology and outcome of sector and value chain prioritization. Then it provides a summary of findings for each priority value chain, including overview of key market opportunities, the business case and expected impact, along with identified gaps and proposed actions. For each priority value chain, a detailed value chain analysis report is included in the Annex. The report concludes with an analysis of investment eco-system, mapping of industry leaders and private sector investment funds and identification of opportunities to access funding for priority investment needs in targeted value chains, including potential public-private partnership opportunities.

III. SECTOR AND VALUE CHAIN PRIORITIZATION

Part and parcel of the Program's overall approach to competitiveness is the identification of sectors and value chains that hold the most potential for investment and high(er)-value employment. The value chain assessments lay the foundation for the Program's work to embrace opportunities, establish market linkages, structure Public-Private Partnerships (PPPs) and much more.

To identify and prioritize high potential sectors and value chains within them, the Economic Security Program used the DAI's *Competitiveness Appraisal Matrix* (CAM) methodology. This methodology has been used around the world to gauge overall competitiveness and investment/job creation potential of sectors and value chains. It is consistent with international best practices, having been developed by some of the foremost experts in international economic development.[14] This methodology uses a pre-defined set of selection criteria and sub-criteria with pre-assigned weights. The CAM is then used to score all potential value chains on a 1-7 scale to determine overall scores and rankings to allow for cross value chain comparisons using numeric scores.

The Economic Security Program team agreed with USAID on the following selection criteria, sub-criteria and weights, which assess the value chain's potential for *competitiveness, systemic impact, and feasibility* of achieving results.

TABLE 3: SELECTION CRITERIA AND WEIGHTS

Competitiveness Potential (45%)	Systemic Impact (40%)	Feasibility (15%)
• Market demand – 10% • Competitive advantage – 15% • Upgrading potential – 10% • Strength of investor interest – 10%	• Number of enterprises – 10% • Job creation potential – 15% • Opportunities for women & youth – 5% • Local supply chain linkages – 5% • Impact outside of Tbilisi – 5%	• Private sector dynamism – 5% • Opportunities for PPPs – 5% • Alignment with GOG priorities – 5%

At their core, these elements were determined based on their potential for market linkages, relevance to the Georgian context, and alignment with the Program's objectives. The elements punctuate that the assets and challenges of specific value chains in Georgia matter less than their potential to move the country toward self-reliance by generating employment and revenues as well as enhancing the quality of life of citizens. For this reason, competitiveness potential/market linkages have the highest weight (45%), followed by systemic impact (40%), and feasibility (15%). Detailed description of all criteria and associated quantitative and qualitative data used to inform the scoring is shown in Table 5 below.

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[14] In 2010, based on DAI's extensive experience applying this methodology on value chain development and competitiveness projects worldwide (including in Serbia, Jordan, Palestine, Ukraine, Moldova and other), DAI experts have been asked by the World Bank Competitive Industries Practice to synthesize this methodology into a Reference Guide for development practitioners. The "Sector Competitiveness Analysis Tools Reference Guide" developed by DAI, has since been used by development practitioners worldwide to select high growth potential value chains and develop strategies to support their growth. This methodology has been tailored to the Georgian context and the Program objectives and can be found at https://youtheconomicopportunities.org/sites/default/files/uploads/resource/World_Bank_Sector_Competitiveness_Report_%28SCAT%29.pdf

The Program's focus is on those value chains that it believes have the most potential to generate investment, increased employment opportunities, and enhanced revenues for enterprises. Based on global experience, the Program's leadership believes that taking a broad view of potential opportunities is the key to finding niche areas (differentiators) that might be the quickest and most productive path to achieving program goals. With this in mind, the Program first identified a long-list of sectors and value chain groupings within them that have traditionally been important to Georgia and/or that could have market potential based on current trends.

These value chains were then subject to in-depth data collection and were scored using the *CAM* based on the data collected. As a result, several value chains were selected for in-depth value chain assessments. These assessments focused on identifying specific market niche opportunities (business activities) that provide the best opportunity for differentiation and thus the ability to generate investment and increase employment.

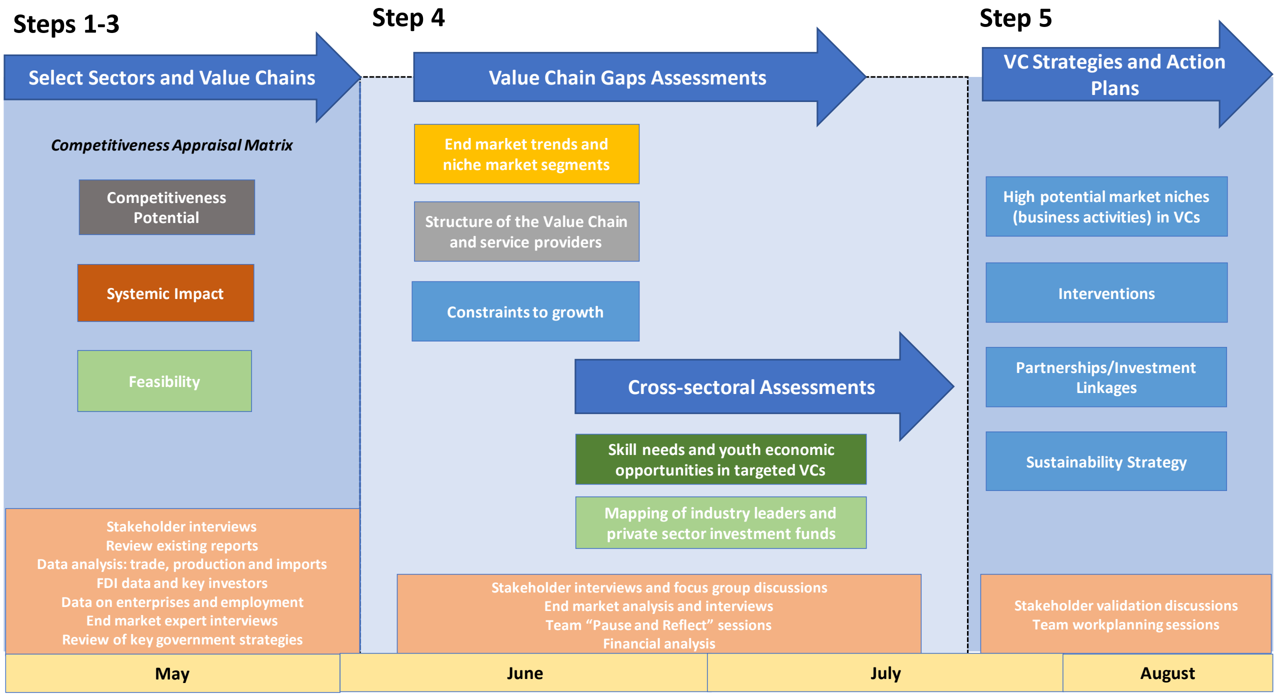
In-depth value chain assessments focused on identifying market opportunities, key constraints to growth, and interventions to address these constraints, including opportunities for public-private partnerships. In each assessment, the team looked at the entire eco-system of a value chain, to determine how each area can be linked to provide the clearest path to investment and job creation. In examining the eco-system, team members looked carefully at the elements that lay the groundwork for investment such as: a) workforce, b) infrastructure, c) access to finance, d) current visibility, e) market size, f) global demand, g) business services, h) policy and enabling environment, and i) potential market linkages. The objective of the assessments was to move beyond a simple categorization of assets and challenges in each value chain, but instead to identify high potential market opportunities with investment and job creation potential and develop a business case for each. Throughout this process the team consulted with end market information sources and experts to ensure that analysis is grounded in global market trends and requirements.

Throughout the value chain prioritization and in-depth analysis, the team used the following definitions:

- **Sector** is defined as a broad categorization of related business activities and groups of firms producing same or similar products or services.
- **Value chain** is defined as a chain of activities required to bring a particular product or a set of related products from inputs to end markets, where the product passes through each activity in a value chain and gains some value at each stage.
- **Business activity** is a specific industry/product or service segment within a value chain which is defined by a specific end market niche/opportunity.

The Program's value chain assessment approach and timeline, as outlined in its initial proposal to USAID, is shown in Figure 3 below:

FIGURE 3: VC ASSESSMENT APPROACH



The Program's approach to conducting the value chain assessments was based on the following multi-step process designed to ensure thorough analysis as well as assessment of market potential.

TABLE 4: SECTOR AND VALUE CHAIN EXPLORATION PROCESS

Process Step		Focus	Outcome
1		Sector/VC Identification and Grouping	Identification of sectors/VCs that may have the most potential
2		Data Collection	Collection of quantitative and qualitative data on identified sectors/VCs
3		Trend Analysis and Scoring	Initial analysis of sector/VC trends and scoring based on data collected
4		Narrowing the Focus – Value Chain Assessments	Targeting value chains for full assessment to identify value chains and business activities with the most potential
5		Finalization of Value Chain Prioritization and Gaps Assessment Report	Development and submission of Value Chain Prioritization and Gaps Assessment Report to USAID

STEP 1: SECTOR /VC IDENTIFICATION AND GROUPING

The first step of the Program's approach was to identify those sectors and value chains that have traditionally been important to Georgia and/or that could have market potential based on current trends. The Program then developed broad sector categories under which to group specific value chains (see Table 3 below). These categories might not align with those classified by the GOG or donor organizations in the past, but based on DAI's global experience, these groupings allowed for the emergence of an eco-system under each sector that frames the analysis.

STEP 2: DATA COLLECTION

The second step for the Program's Value Chain Assessment Team was to collect data on value chains within the sectors that emerged during the identification and grouping. These are outlined in the table below:[15]

TABLE 5: SECTORS AND VCS TARGETED FOR DATA COLLECTION

Sectors	Value Chains	Business Activities[16]
Creative Industries	Production Media	Film production, post-production
	Digital Media	Animation
	Design	Fashion, architecture
Shared Intellectual Services	Business Process Outsourcing (BPO)	Architecture, Design and Engineering (ADE); Finance & Accounting (F&A); Information Technology IT; Customer Relationship Management (CRM); Human Resources (HR) Management
	Financial Services	Auditing, accounting
	Content Development	Web design, local language content, e-commerce[17]
Light Manufacturing	Furniture and Home Accessories	Hardwoods, fittings/inputs, metal
	Plastics	Bottles, injection molding
	Parts/Components	Auto, aeronautics
	Leather	Shoes, fashion accessories
	Construction Materials	Wood, stone, et al.
	Packaging	Plastic, carboard, labeling
	Cabling	All types of cables
	Recycling	Waste, tires, composting
Tourism	Adventure	Mountain, skiing, trekking, et al.
	Gastronomic	Food/Wine
	Cultural	Religious, festivals
	Agro-Tourism	Ecological, historical
	Medical/Wellness	Hospitals, laboratories, spas

The team collected data on other potential value chains/business activities as well, such as MICE (Meetings, International Conferences, and Exhibitions), apparel, construction materials, sand/sea tourism, pharmaceuticals, et al. However, initial analysis indicated that these areas did not hold significant investment potential without substantial investment in infrastructure/market analysis or a recalibration of strategy to focus on movement up the value chain (in the case of apparel). No value chain was ruled out during the data-collection phase, but institutional issues or other challenges emerged with some sectors/value chains that make it difficult to link them directly to investment, high(er)-value employment, and/or revenue increases. This does not mean the VC Assessment Team did not collect data on them or that they were not considered for full assessment, but rather acknowledges what the sector specialists believed were some limiting factors.

Information and Communications Technology (ICT) and transport and logistics were reviewed as enablers for all other VCs. This did not preclude the VC Assessment Team from fully evaluating these sectors but rather provided the opportunity to view them in a different way, outside of siloes, to

[15] Sectors and VCs considered for data collection but not selected included clean technology, education, finance, logistics and transport . Finance and L&T were considered as cross-cutting enablers, however, as they have potential to boost competitiveness across the VC continuum.

[16] The business activities listed are illustrative and should not be considered exhaustive.

[17] E-Commerce includes both content development as well as site design and actual e-commerce sales.

explore their full potential as integrated parts of an overall VC eco-system. They were considered in the data collection phase as stand-alone sectors, but the market analysis of particular sectors and value chains would not have been complete without also considering ICT and transport and logistics as cross-cutting enablers.

As enablers, the Program will recommend support for logistics and transportation and ICT when this will create or enhance opportunities in priority sectors and value chains. For instance, ICT applications within tourism (such as CRM applications, research/analysis, etc.) could add significant value to the sector and its target VCs, thus making it an important potential intervention. Logistics and transportation (specifically shipping/package delivery) can likewise be important to the sectors such as artisans, which links multiple enablers. This cross-cutting approach will allow the Program to support specific interventions that build the potential of all sectors and VCs, while not becoming embedded in a quagmire of mega-projects that take too long to matriculate (e.g. the development of logistics hubs).

The initial data collection included both quantitative (national statistics, reports, global trade data analysis, et al.) and qualitative (interviews, expert analysis, et al.) data. The analysis of the data collected provided the teams with input as to which value chains within the identified sectors should be the subject of a full assessment (see Step 3 below). As part of its due diligence, the VC Assessment Team collected quantitative and qualitative data from a variety of sources, and focused on prior studies, research and/or assessments that have been conducted within the identified sectors. The Program also conducted a stakeholder mapping exercise as part of the data collection process to determine the major players (e.g. government, national and international organizations) in each sector and value chain under consideration. Table 6 below outlines specific organizations with which the team interacted as part of the data collection/assessment process:[18]

TABLE 6: TARGET ORGANIZATIONS FOR DATA COLLECTION PROCESS

Organization	Study/Statistics	Sector/VC
Government of Georgia		
Enterprise Georgia	Sector Reports/Analysis	All
Georgia Innovation Technology Agency (GITA)	Reports/Analysis	Cross-Cutting
Line Ministries	Reports/Analysis	All
GeoStat (Department of Statistics)	Statistics	Macro and Micro-Economic
Georgia National Tourism Administration (GNTA)	Statistics/Reports/Analysis	Tourism
Organizations/Clusters		
Film Cluster	Reports/Analysis	Creative Industries
Furniture Cluster	Reports/Analysis	Light Manufacturing
Tourism Cluster/Associations	Reports/Analysis	Tourism
ICT Cluster	Reports/Analysis	ICT
Georgia Freight and Logistics Association	Reports/Analysis	Transport and Logistics
Georgia Chamber of Commerce and Industry (GCCI)	Reports/Analysis	All
American Chamber of Commerce in Georgia (AMCHAM)	Reports/Analysis	All
Export Development Association (EDA)	Reports/Analysis	All
European Business Association (EBA)	Reports/Analysis	All
Development Agencies/Organizations		
USAID Implementing Partners	Reports/Analysis	All

[18] A detailed stakeholder map is included in each value chain section of this report that outlines the business case for the recommended sectors and value chains.

GIZ	Reports/Analysis	Tourism, Furniture, Creative Industries
Austrian Embassy Technical Cooperation	Reports/Analysis	Mountain (Adventure) Tourism
Millennium Challenge Corporation (MCC)	Reports/Analysis	All
Swedish International Development Agency (Sida)	Reports/Analysis	Apparel
Education		
International School of Economics (ISET)	Statistics/Research/Analysis	All
Universities and TVET Institutions	Statistics/Research/Analysis	All
International/Research Organizations		
World Bank	Statistics/Reports/Analysis	Macro and Sector-Specific
United Nations Development Program	Statistics/Reports/Analysis	Macro and Sector-Specific
Research Organizations		
Harvard Business School	Statistics/Reports/Analysis	Macro and Sector-Specific
Oxford Group	Statistics/Reports/Analysis	All
World Travel and Tourism Council	Statistics/Reports/Analysis	Tourism
TCI Network	Statistics/Reports/Analysis	All

STEP 3: TREND ANALYSIS AND VALUE CHAIN SCORING

As a transitional step in determining which sectors and value chains have the most potential in terms of investment, high(er)-value job creation and revenue enhancement, the Program team conducted a trend analysis of the demand side of each value chains identified in step one. This step focused on market analysis, whereby the assessment team determined the market potential of sectors, value chains, and business activities. The value chains were then scored according to the following criteria shown in Table 8 and ranked accordingly using the DAI's *Competitiveness Appraisal Matrix* tool.

TABLE 7: VC SELECTION ELEMENTS[19]

Selection criteria and sub-criteria	Weight	Key Analytical Questions	Data Sources
Competitiveness Potential	**45%**	**Assesses potential for growth of the value chain**	
Market demand	10%	Strength of domestic, regional and international market demand (current and projected). Has the end market been growing over the past 5 years and is it projected to grow?	• International trade data analysis, export growth trends and global market size growth trends (international and regional markets). • Domestic production and sales data over the past 5 years and trends
Competitive advantage	15%	Does Georgia have a long-term competitive advantage against key competitors in domestic or export end markets? Are there ready market opportunities in higher value segments?	• Qualitative assessment based on industry interviews • Interviews with end market experts and/or buyers, research on end market trends.
Upgrading potential	10%	Ability of the value chain to meet market requirements in higher value market segments and increase value added. Opportunities to address productivity gaps, via new technologies,	• Qualitative assessment based on industry interviews

[19] The weighting system was shared with USAID in advance. Changing the weightings would naturally alter the rankings in Figure 4 below, but the VC Assessment team feels strongly that the stated weights are appropriate for the Program's scope.

Selection criteria and sub-criteria	Weight	Key Analytical Questions	Data Sources
		processes and innovations, and improve competitiveness. Are required human resources available/can become available?	• Qualitative productivity benchmarking based on industry and end market interviews
Strength of investor interest/potential to attract future investments	10%	Presence of ready investors – are foreign and domestic investors looking for opportunities/seeing growth potential in the value chain? Are there key investors that have already begun investing in Georgia and could be leveraged by the project?	• Data on foreign and domestic investment in the sector over the past 5 years and who are the key investors/potential private sector partners for the project • Qualitative assessment based on industry interviews
Systemic Impact	**40%**	**Assesses the breadth and depth of the impact of value chain growth.**	
Potential to benefit a large number of MSMEs	10%	Number of MSMEs involved (or could be involved) in the value chain and able to benefit from growth.	• Data on the number of firms engaged in the value chain, including an estimate of the number of small, medium and large firms (over the past 5 years)
Job creation potential	15%	Potential to create new high-value jobs within the project timeframe.	• Data on current employment in the value chain and, most importantly, the employment growth trends in the past 5 years
Economic opportunities for women and youth	5%	Opportunities for women and youth via self-employment or employment.	• Data on share of women and youth employed • Qualitative assessment based on interviews
Local supply chain linkages	5%	Opportunities for local suppliers and domestic backward linkages.	• Qualitative assessment based on industry interviews
Impact outside Tbilisi	5%	Will working in this value chain yield benefits to regions outside of Tbilisi?	• Qualitative assessment based on industry interviews • Data on MSMEs and employment from above, disaggregated by regions or by Tbilisi/outside of Tbilisi
Feasibility	**15%**	**Assesses the ability to achieve results within the project timeframe.**	
Private sector dynamism	5%	Strength of private sector leadership (presence of an association; readiness of private sector to invest; active participation of leading firms and vision for growth).	• Qualitative assessment based on industry interviews
Potential to leverage project investment via PPPs and other partnerships	5%	Existing eco-system for investment in the VC. Are the institutional structure, workforce, infrastructure and other elements in place to capture investor interest?	• Qualitative assessment based on industry interviews
Alignment with GOG priorities	5%	Alignment with the Government of Georgia development priorities.	• Review and analysis of all relevant government strategies

Based on the CAM scoring using this methodology and analysis, shown below, the team found that outside of the tourism sector, **BPO/BPO** was the most promising value chain. Other high-potential value chains include **furniture, apparel, packaging, media production**, and **post-production services**. In tourism, the highest potential value chains included **gastronomic tourism**, **adventure tourism**, and **cultural tourism**.

CAM scores for each of the selection sub-criteria seek to answer the analytical questions laid out in Table 8 of the VC Prioritization and Gaps Assessment Report and are included in **Figure 4** below. The CAM scoring methodology uses the 1-7 point scale where 1 represents "poor performance" and 7 represents the "best performance". This convention is used by international competitiveness indices, such as the World Economic Forum's Global Competitiveness Index.

As shown in Table 7, the CAM scoring process draws on a combination of quantitative and qualitative data, and therefore represents an iterative process. General scoring guidance for each of the selection sub-criteria is included in **Annex 7.** The overall assignment of scores relies heavily on expert judgment and analysis of available qualitative information, along with statistics. Once scores are assigned to each VC individually, they are then compared across VCs, to ensure that overall rankings across VCs make sense. The scoring is iterative and is adjusted several times throughout the analysis process, as more qualitative and quantitative findings emerge, sometimes resulting in changing the overall ranking of different VCs. The entire VC assessment team is involved in the process to ensure broad consensus on the final VC rankings and methodological consistency across VCs.

Minor changes to several scores many change the rank of a value chain but are not likely to change the overall portfolio of the top-ranking value chains. Significant changes to the majority of scores for a value chain, may change the overall rank significantly and lead new value chains to rise to the top. This would, however, likely require modification of the overall weights highlighted in Table 7.

Figure 4: Competitiveness Appraisal Matrix

Key Value Chains	**Competitiveness Potential**	Market demand	Competitive advantage	Upgrading potential	Strength of investor interest	**Systemic impact**	Number of MSMEs	Job creation potential	Opportunities for women, youth	Local supply chain linkages	Impact outside of Tbilisi	**Feasibility**	Private sector dynamism	Potential for PPPs	Alignment with GOG priorities	**Total score (out of 100)**	**Rank**
Weights/Score (1-7)	**45%**	10%	15%	10%	10%	**40%**	10%	15%	5%	5%	5%	**15%**	5%	5%	5%	**1**	
Gastronomic tourism	3.1	7.0	6.5	7.0	7.0	2.7	6.5	7.0	6.5	6.5	6.5	0.9	6.0	5.5	7.0	95.4	1
Adventure tourism	2.8	6.5	6.0	6.0	6.5	2.4	6.0	6.0	6.0	5.5	7.0	0.9	5.5	6.0	7.0	87.9	2
BPO (IT, CRM, F&A, HR, ADE)	2.7	7.0	5.5	6.0	6.0	2.4	7.0	6.0	6.0	3.5	6.0	0.9	5.5	6.0	7.0	86.1	3
Cultural tourism	2.7	6.0	6.0	5.5	6.0	2.2	4.0	5.5	6.0	6.0	6.5	0.9	5.0	5.0	7.0	80.7	4
Furniture and home accessories	2.0	6.5	3.5	5.0	3.5	2.4	7.0	5.5	4.0	7.0	5.5	0.8	6.0	5.5	4.5	73.9	5
Apparel	2.0	6.5	3.5	3.0	5.0	2.3	7.0	5.5	6.0	4.0	6.0	0.6	4.0	1.0	7.0	70.0	6
Packaging (plastic, paper, etc.)	2.2	5.5	4.0	5.0	5.0	1.9	4.0	5.0	4.5	6.0	4.0	0.8	5.0	6.0	5.0	68.9	7
Post-production (color, sound, visual effects, animation, editing)	2.1	5.0	4.0	5.5	4.0	1.9	4.0	5.5	6.0	4.0	4.0	0.8	5.0	5.0	6.0	68.2	5
Production media (film and TV)	2.0	6.0	3.0	4.5	5.0	1.9	4.5	4.5	5.0	5.0	6.0	0.8	5.0	4.0	6.0	66.8	6
ICT (web design, local language content, e-commerce)	2.1	6.0	4.0	5.0	4.0	1.9	5.0	5.0	4.0	6.0	3.0	0.6	5.0	3.5	4.0	66.1	7
Toys	2.0	6.0	4.5	4.5	3.0	1.5	3.5	3.0	4.0	5.5	3.5	0.6	4.0	2.5	5.5	58.2	8
Sand/sea tourism	1.8	4.5	2.0	4.5	5.5	1.7	3.0	4.5	5.0	3.5	5.0	0.7	5.0	5.5	3.0	58.2	8
Fashion design	1.9	5.0	4.5	4.5	2.5	1.4	3.0	2.5	7.0	4.0	3.0	0.7	5.0	2.5	5.5	55.7	9
Construction materials	1.6	5.5	3.0	3.0	3.0	1.8	5.0	4.5	1.0	5.5	5.0	0.5	3.0	2.0	4.0	54.3	10
Agro-tourism	1.4	3.5	2.0	4.0	3.5	2.0	3.5	5.5	4.5	6.0	6.0	0.4	1.0	1.0	5.0	53.6	11
Pharmaceuticals	1.4	5.0	2.5	2.5	3.0	1.6	3.0	4.0	4.5	4.5	4.0	0.6	3.5	3.5	4.0	50.4	12
Medical/wellness tourism	1.6	4.0	3.0	3.0	4.0	1.6	2.0	4.5	4.5	4.5	4.5	0.4	2.0	1.0	5.0	50.0	13
Auto/aeronautical parts	1.4	6.0	1.0	3.5	3.0	1.6	4.0	5.0	2.0	2.5	3.5	0.4	2.0	2.5	3.5	47.9	14
Plastics	1.3	5.0	2.5	2.5	2.0	1.5	3.0	4.0	3.5	5.0	3.5	0.2	2.5	1.0	1.0	43.6	15
Recycling (waste, tires, composting)	1.2	4.0	2.5	2.5	2.0	1.1	2.0	3.0	2.0	3.5	4.0	0.6	4.5	3.0	5.0	42.5	16
Leather/fashion accessories	1.1	3.0	2.0	1.0	4.0	1.2	2.0	3.0	4.0	4.0	3.0	0.4	2.0	3.0	2.0	37.9	17

MICE	0.8	2.0	1.5	2.5	1.0	0.9	1.5	2.5	3.0	2.0	2.0	0.5	1.0	3.0	5.0	30.0	18

In general, enterprises in Georgia are facing similar constraints even across value chains and sectors. The small domestic market (of approximately 4 million people) is not adequate to generate sufficient demand, attract significant international investment, or develop domestic production of inputs. As a result, most industries rely on expensive imported inputs, and transportation fees only add to the production cost. This makes it difficult to reach economies of scale, especially when compared with nearby Turkey (a market of 80 million consumers). Most companies lack technical knowledge about standards and requirements needed for international marketing and sales. In order to compete, Georgian enterprises need to develop—and market—a unique set of niche products.

Within tourism, creative industries, shared intellectual services, and light manufacturing, most value chains are not well organized. While several industry clusters exist (in furniture, film, ICT), many are relatively new and are still developing a clear value proposition to attract wide and representative membership. Workforce is another barrier to competitiveness. Georgia lacks the institutions to educate and train workers with the skills needed to serve growth-oriented enterprises. As a result, most companies must dedicate scarce resources to on-the-job training. However, several bright spots are emerging and with targeted investments and support from Economic Security Program several value chains have potential to build skills and a unique made in Georgia brand, and to serve expanding, high-value markets. Overall the top-ranking value chains were selected because they exhibited the following characteristics:

- At least a few companies exporting consistently (either intermediate inputs or finished goods);
- Track record of international investment;
- Georgian companies are investing their own resources in upgrading equipment or in securing international certifications;
- Strong linkages to regional hubs in Kutaisi and Batumi, or otherwise outside of Tbilisi;
- For services, upgrading involves specific training on skills that can be applied immediately;
- Newly created jobs will be high-value through technology or creativity, and will therefore appeal to women and youth; and
- A critical mass of companies that are organized in a cluster with potential to increase value addition and joint marketing/branding.
- In tourism, the gastronomic/culinary and adventure tourism value chains ranked higher than any other tourism VCs because of the tremendous market opportunities created by robust visitor growth (particularly in the high value markets such as Germany and Israel) and the resulting investor activity and interest.

The value chains that were initially considered to have potential such as ICT (content development), toys, construction materials, leather, auto/aeronautical parts and components, pharmaceuticals, cabling, recycling, and plastics received lower scores. That is mainly because each of these value chains exhibits one or more of the following characteristics: lack of an established, long-term competitive advantage for Georgian firms; an industry structure that inhibits future growth; and less potential for impact outside of Tbilisi. Many of these value chains serve the domestic market, with little (if any) experience exporting or potential to link to global value chains. Investments in new equipment or technologies required to meet international standards are static or decreasing. The industry may not be well-positioned due to changing consumer tastes (i.e. from gas to electric cars) or because activities are concentrated in secondary production and re-exports, with little capacity for primary production.

Structural factors also contributed to lower scores for these value chains. Many are characterized by only a few active companies, largely small-scale and without an industry leader, though some are dominated by a few international firms with little need for donor support. In general, there are no existing clusters or associations to support dissemination of technical knowledge, professional training opportunities, or pool resources for trade fairs or other promotional activities. Existing companies may be operating in competitive environments where such significant investment is needed to make them competitive that the Program's interventions would likely not make an impact. Employment is either stable or shrinking, and new jobs are likely to be highly automated, low-skill positions. Finally, these value chains are not effectively linked to other, related industries that could help them to capitalize on economies of scale. Because they are concentrated in and around Tbilisi, they are not likely to create linkages to outlying areas and therefore have little potential to impact areas outside the capital.

Potential however has been noted for e-commerce, as an emerging niche within the BPO value chain. In addition, while fashion design on its own was not considered a viable value chains, in subsequent explorations the team determined that broader artisanal value chain (including fashion design, high-end home accessories, interior design) presents potential growth opportunities. Therefore, while these value chains where not selected for in-depth assessment, they were nevertheless explored by the team in subsequent analyses and discussions with private sector stakeholders and potential investors. Initial findings are included in this report.

STEP 4: NARROWING THE FOCUS – VALUE CHAIN ASSESSMENTS

Following the CAM scoring, all top-ranking value chains were selected for in-depth assessment with the exception of apparel. Since GIZ provides support to the apparel sector, , additional interventions from Economic Security Program could dilute the effectiveness of support and would require close ongoing coordination with GIZ to minimize duplication of efforts. With a rather small cohort of export-ready (or near export-ready) companies in apparel, the value to the industry of simultaneous support by two different donors is questionable. In addition, the current status of the apparel sector in Georgia is clearly "Red Ocean" in most value chains, focusing primarily on cut-and-sew processes where it will be increasingly difficult for Georgian producers to compete with global competition. At that level of the value continuum, success revolves primarily around price competitiveness, which will be difficult for Georgian apparel firms to maintain.

While Information and Communications Technology (ICT) and Transport and Logistics were not selected as stand-alone value chains for support, they were reviewed as enablers for all other value chains and constraints/opportunities related to those areas where evaluated as part of the overall eco-system for targeted value chains.

As part of assessing the value chains, VC Assessment Team looked carefully at specific business activities that provided the best opportunity for differentiation and thus the ability to generate investment and increase employment. VC assessments identified market opportunities, key constraints to growth, and interventions to address these constraints. In each assessment, the team looked at the entire eco-system of a value chain, to determine how each area could be linked to provide the clearest path to investment and job creation. The VC Assessment Team looked at each broad sector and the value chains within them through the lens of a potential investor. This allowed them to move beyond a simple categorization of assets and challenges in each, and instead see its investment and job creation potential. As part of each value chain assessment, the Program also conducted a private sector mapping exercise for each sector and value chain that included potential partners, investors, GOG entities and potential PPP and GDA partners. In addition, cross-value chain mapping of industry leaders and private sector investment funds were conducted in order to identify those individuals and companies that can address investment, job creation, and revenue growth needs in each value chain.

In addition to the market potential of each recommended value chain, the Assessment Team evaluated them in terms of ADS 225.3.1 "Relocation of U.S. Jobs." DAI will comply fully with the ADS regulation prohibiting support for activities that could potentially relocate U.S. jobs or compete with U.S. interests. In doing so, it will carefully analyze each potential opportunity in terms of whether it is "permitted" under the regulation, "not permitted," or considered a "gray area activity." In terms of the former, the Program will consider the opportunity on its merits based on the approved modality for evaluation (e.g. grants manual or PDF approval matrix). Opportunities that fall in the "not permitted" category will not be pursued regardless of their merits. "Gray area" activities will be fully vetted to ensure that no potential to negatively impact U.S. jobs exists. In doing so, it will utilize the guidance under ADS 225.3.1.6. Should this analysis find that the opportunity is indeed "not permitted" under the ADS regulation, the Program will not recommend it for support. In terms of opportunities that are supported by grants, the grant agreement will the relevant clause or provision prohibited the recipient or contractor from implementing prohibited activities. This will also apply agreements with private entities and government institutions.

The Program's findings are included in this report, which justifies the selection of priority sectors, value chains, and business activities for inclusion in the Program's implementation. A summary of market analysis for the value chains within each sector and a business case for each of the high potential business activities within these value chains is included in the following sections. In-depth assessments for each of the value chains are included in the Annex.

IV. SECTOR ASSESSMENT AND GAP ANALYSIS

TOURISM SECTOR (ADVENTURE TOURISM, GASTRONOMIC TOURISM, CULTURAL TOURISM)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Tourism is one Georgia's most important opportunities for broad-based economic growth and development. It is one of the world's largest industries, accounting for more than 30 percent of global services exports, and one of its largest employers, with one in 10 jobs travel and tourism-related. Unlike most other sectors, it is also an industry for which every country is to some degree unique. Competition is driven primarily by a country's image and the quality of the visitor experience, not price. Tourism represented one of the largest sectors of the Georgian economy in 2018, with the direct contribution to GDP estimated at 7.6%. It also accounts for 72 percent of services exports, and $3.2 billion in foreign exchange earnings (2018). Finally, it is a rapidly growing industry, with tourism receipts growing double digits over the past 6 years, or more than three times the global average.

The primary objective of the industry, and of the 2015-2025 National Tourism Strategy, is to increase the value of tourism, by attracting higher spending tourists. While Georgia received 4.7 million overnight visitors in 2018, 77% of were from neighboring countries (Russia, Azerbaijan, Armenia, and Turkey), with only 5.7 percent arriving from the EU, the world's largest and highest spending regional outbound market. However, the share of trips from neighboring countries as a percentage of total arrivals is decreasing, down from 88 percent in 2013 driven primarily by growth in the share of adventure, cultural and experiential visitors from Western Europe and the GCC countries.

Research conducted by GNTA and Green Team Global - using specialized reports produced by international marketing organizations - have allowed the Economic Security Program team to prepare the following exhibit illustrating the travel preferences and characteristics of these markets:

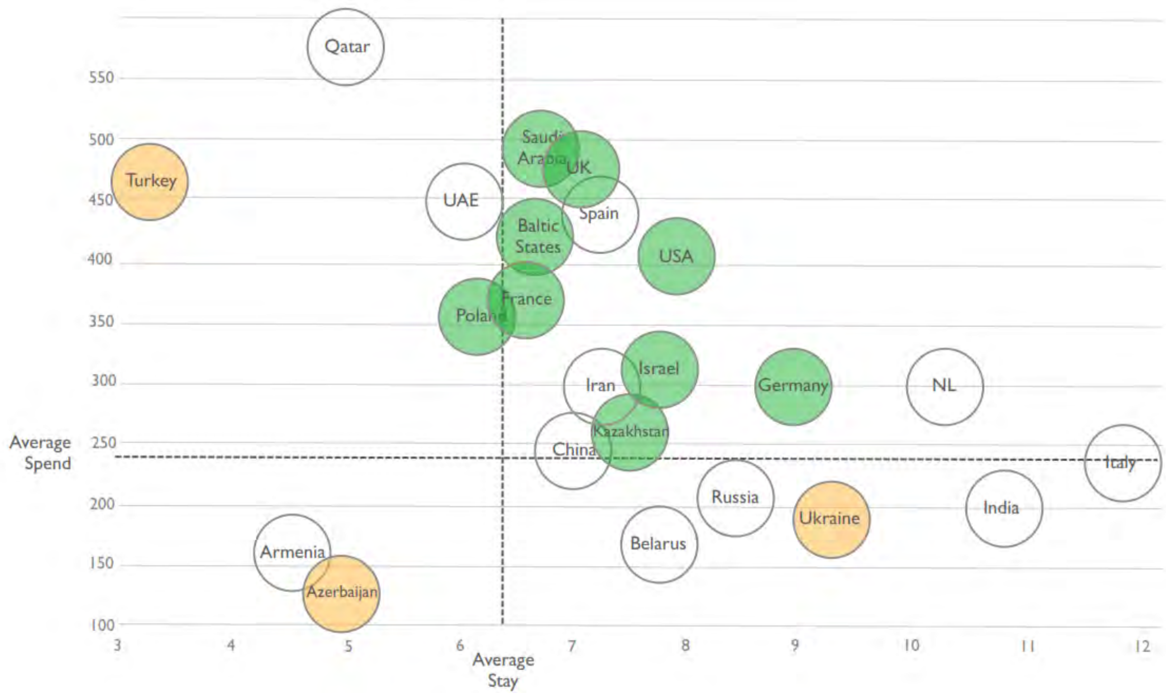
TABLE 8: MARKET ANALYSIS OF HIGH VALUE MARKETS FOR GEORGIA

Market	Size (in million people)	Expenditure (in US$ Billion)	Length of stay (in days)	Products	Georgia's Market Share	Expenditure in Georgia (in US$ million)
Germany	69.6	82	13.1	• 14.6 million skiers • 19.5 million nature/adventure trips	0.09%	103
USA	93	135	15.6	• Attracted to cultural attractions (58%), good food (54%) and the opportunity to relax (51%) • 41 million birdwatchers	0.045%	42.9
Poland	12.6	9.4	6	• 4 to 5 million skiers • Top reasons to visit Georgia: food and wine,	0.53%	37.7

Market	Size (in million people)	Expenditure (in US$ Billion)	Length of stay (in days)	Products	Georgia's Market Share	Expenditure in Georgia (in US$ million)
				culture, nature, and active adventure.		
Baltic States	6.2	2.5	6.5	• Top reasons to visit Georgia: culture (73%), food and wine (54%), visit to protected areas (35%),	0.74%	24.5
France	44.2	81.2	10.2	• Top reasons to visit Georgia: food and wine (73%), cultural heritage (40%), visit to protected areas (25%),	0.067%	29.8
UK	71.7	54.9	9.8	• 48 % enjoy city breaks • 45% enjoy adventure travel	0.041%	43.1
Israel	15	18.2	10.2	• Favorite activities: cultural heritage, cuisine, adventure and natural parks.	1.4%	128.3

Those were identified as high value markets (HVM) in a series of workshops organized by the Program between consultant Hugh Hough from Green Team Global and senior staff at the Georgia National Tourism Administration (GNTA) in July 2019. Mr. Hough was brought by the Program to support GNTA's strategy to proactively manage the crisis generated by the Russian flight embargo of July 8, 2019. This selection responded to their positioning as high expenditure/high length of stay markets. Figure 5 presents the prioritization of these markets by GNTA and the Program team:

FIGURE 5: PRIORITY HVMS SELECTED BY GNTA AND ECONOMIC SECURITY PROGRAM[20]



The spectacular growth rates in arrivals from those markets continues to present an incredible market opportunity for the country's private sector. In 2018, while international arrivals to the country grew at a rate of 9 percent, visitor arrivals from HVMs grew by a spectacular 39 percent. The table below illustrates growth rates and total arrivals from those origin markets versus the more traditional volume markets (TVM):

TABLE 9: GROWTH RATES IN SELECTED ORIGIN MARKETS FOR VISITORS TO GEORGIA – 2018

High Value Markets (HVM)			Traditional Volume Markets (TVM)		
Country	Total No. Visitors	Growth Rate	Country	Total No. Visitors	Growth Rate
Baltic States	46,000	52%	Azerbaijan	1,424,000	9%
Germany	64,500	50%	Russia	1,405,000	23.8%
Kuwait	15,000	40%	Armenia	1,270,000	-1.4%
Poland	67,000	37%	Turkey	1,100,000	9%
France	22,000	36%	Ukraine	177,000	4%
UK	29,500	35%			

[20] The reason Germany was selected over the Netherlands even though the latter spend roughly the same but stay longer is that the only time volume matters in tourism is when high value locations are viewed side-by-side and priorities have to be selected for effectiveness purposes. This is what happened here. It is not the NL will be de-emphasized, but rather that Germany offers more mass in targeted value chains (mainly adventure) than NL. This graph shows tourism as a whole and is not aligned to selected VCs. When this occurs, Germany is an obvious choice over the NL in terms of selecting a finite number of markets that have the most potential for growth since it has a higher volume of adventure travelers.

High Value Markets (HVM)			Traditional Volume Markets (TVM)		
Country	**Total No. Visitors**	**Growth Rate**	**Country**	**Total No. Visitors**	**Growth Rate**
Israel	155,000	35%			
US/Canada	42,000	25%			
Saudi Arabia	51,000	13.5%			
AVERAGE GROWTH RATE		**39%**	**AVERAGE GROWTH RATE**		**9%**

On average, visitors from HVMs spent **8.5 days** in country over the last four years versus **2.9 days** for visitors from TVMs. Moreover, according to data produced by the GNTA especially for the Program, the average expenditure per visit for HVMs in 2018 was around **USD$744** versus **USD$269** for TVMs.

Tapping into this opportunity require strengthening three key value chains and related business activities: **nature/adventure tourism, cultural heritage tourism and culinary tourism**. The selection of these value chains was discussed with GNTA and the private sector during a visioning workshop conducted as part of this assignment by the Program on July 25th, 2019. The inclusion of additional value chains was also discussed but as presented in Annex 1: Tourism Value Chain Assessment, it was determined that structural, product, and competitive deficiencies constrict their growth potential, along with policy and deregulation activities that are time consuming and are not guaranteed to be approved in the lifetime of the project. The Program will address policy issues that have direct impact on priority value chains (e.g. Hotel Tax law to support DMO sustainability) but will eschew broad policy interventions in value chains that have additional, significant challenges to competitiveness.

ECO-SYSTEM

The ecosystem for the three selected value chains is very similar considering that all of them are treated as part of the broader tourism sector. The graphic on the right illustrates the overarching eco-system for the adventure/nature, cultural heritage and culinary tourism value chains:

PRIORITY VALUE CHAINS AND BUSINESS ACTIVITIES FOR GEORGIA

There are seven primary business activities under the selected tourism value chains, which in turn, encompass a large and diverse numbers of specific companies, as illustrated in Table 8 below

TABLE 10: PRIMARY BUSINESS ACTIVITIES IN SELECTED VALUE CHAINS

Value Chains	Business Activities	Type of Business
Adventure/Nature Tourism	• Ski & Winter Sports[21]	• Tour and ground operators

[21] Ski and winter sports are significant business activities currently under this value chain. The Program's support in this area, however, will likely not be in supporting additional investment in resorts, as Georgia's ski areas are already over-developed to

	• Sports Adventure • Hiking, Trekking • Birdwatching[22]	• Mountain Guides • Lift operators • Bars & restaurants • Adventure & Birdwatching guides • Lodges • Guesthouses • Bus or transportation companies
Cultural/Heritage Tourism	• Cultural heritage visits • Religious sites and pilgrimages[23]	• Tour and ground operators • History Guides • Bars & restaurants • Lodges • Guesthouses • Bus or transportation companies
Culinary Tourism	• Wine Tourism • Traditional Georgian Food	• Vineyard operators • Bars & restaurants • Lodges • Guesthouses • Bus or transportation companies

Sources: GNTA, GITOA, MRG, APA, ACHP, Culinary Academy at Free University, Gastronaut, Adjara Group, United Airports. Elaboration: Economic Security Program

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

To keep our eye on the target, we will focus on growing Georgia's market share of those markets with the goal of increasing visitor expenditure and resulting economic stimulus to the economy. Table 8 below illustrates our preliminary targets for each of the selected markets:

TABLE 11: GEORGIAN MARKET SHARE OF SELECTED HVMS (CURRENT AND TARGET)[24]

HVM	2018			2024		
	Market Share	Visitors	Expenditure	Market Share	Visitors	Expenditure
Germany	0.09%	64,000	71.6 million	0.5%	345,000	392 million
US	0.045%	42,000	36.9 million	0.2%	200,000	189 million
Poland	0.53%	67,000	37.7 million	2.5%	325,000	232 million
Baltic States	0.74%	46,000	24.5 million	3.2%	200,000	163 million
France	0.067%	21,500	29.8 million	0.22	100,000	84 million
UK	0.041%	29,500	43.1 million	0.15%	110,000	161 million
Israel	1.4%	157,000	128.3 million	3%	450,000	362 million
TOTAL					**1,730,000**	**1,583 million**

the point of damaging the product. Focus will likely be on improving the product, promoting major events, and linking all parts of the winter value chain to create a "12 month" tourism experience.

22 There are over 41 million birdwatchers in the United States alone according to the U.S. Fish and Wildlife Service and the CAGR for this business activity is growing exponentially. https://www.fws.gov/birds/bird-enthusiasts/bird-watching/valuing-birds.php

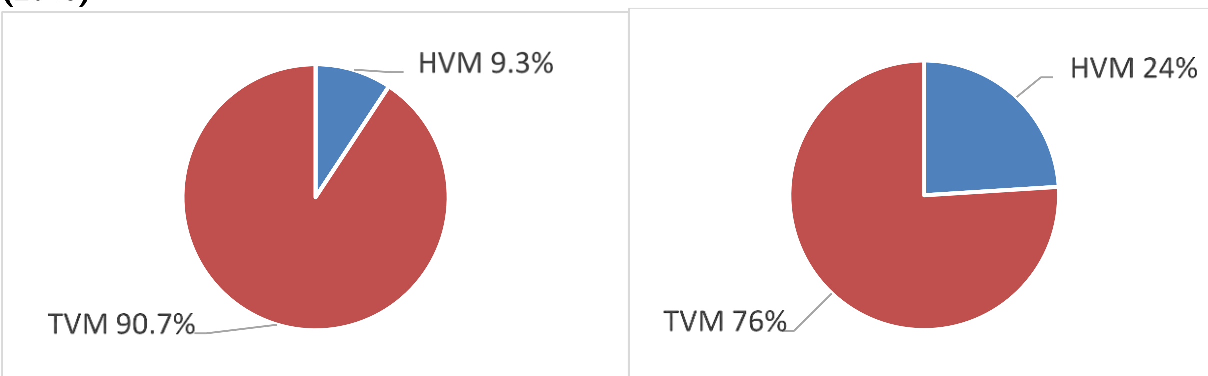
23 Once the VC Assessment is approved, the Program will engage with the Georgian Orthodox Church to develop a strategy in terms of supporting product development, marketing, and overall marketing of religious sites.

24 Targets were set in cooperation with GNTA's priorities and considering NTS (national tourism strategy) 2025. Assumptions of growth of % (market share) is in-line with growth of HVM Y/Y growth of about 30%.

BUSINESS CASE

The targeted market in the selected three value chains are not only growing faster, their economic impact is also higher, relative to its size. According to statistics developed with GNTA, while proposed HVM accounted for less than 10 percent of total visitor arrivals, they represented 24 percent of all visitor expenditure.

FIGURE 6: MARKET SHARE OF HVMS V TMVS – ARRIVALS AND EXPENDITURE[25] (2018)



Perhaps more significant than just an economic boost to the Georgian economy, growing these markets would counter the heavy reliance on Russian visitors. In 2018, almost 32% of all visitor expenditure (and resulting economic impact) came from Russian visitors.

TABLE 12: TOTAL EXPENDITURE PER ORIGIN MARKET (2018)

Market	Expenditure per Visit	Total expenditure
High Value	$910	504.09 million
Traditional Volume (minus Russia)	$234	931.9 million
Russia	$450	668.6 million
TOTAL		**2,104.6 million**

As the Russian flight embargo demonstrate, reliance on this market presents high risks for Georgia's economic security as ongoing conflict between the two countries could very quickly result in a crisis for the tourism sector. On the other hand, emerging data from GNTA suggests that the drop in Russian visitors resulting from the embargo was effectively offset by growth of arrivals from HVM countries[26]. In a very important sense, the current situation presents an opportunity to pivot Georgia's tourism industry towards a fundamental shift in paradigm. Rather than continuing focusing government and private sector efforts towards volume markets in general – and the Russian market in particular – there is now a general consensus and renewed interest to grow the country's market share of the European and GCC markets.

In that regard, ESP will focus its activities on improving collaboration, marketing and product development on the three selected value chains targeting visitors only from the selected HVMs, thus

[25] GNTA will track this data over time in absolute terms, both in aggregated form (all the HV countries) and disaggregated (by country).

[26] This topic is further discussed in Annex 3: Tourism Value Chain Assessment.

building the country's economic resilience to political shocks arising from the volatile relationship with its powerful neighbor to the north.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

- ***Disarticulated use of healthy marketing budgets.*** While GoG agencies involved in marketing activities (GNTA, NWA and MRG) enjoy healthy budgets; these are implemented with varying degrees of efficiency. There is little coordination among agencies and between them and the private sector.
- ***Dispersed investment in tourism marketing.*** GNTA serves a long list of 25 markets through hired publicity, campaigns, participation in travel fairs, study tours and FAM trips, all of which is done in isolation from the private sector. As a result, they are stretched thin and the impact of their significant investment is limited on the targeted HVMs.
- ***Lack of certification and liability insurance.*** While most visitors from HVMs to Georgia are independent travelers, the use of tour operators among them is twice as high as all visitors to the country (12% v 4.5%, respectively). The lack of third-party liability insurance among Georgian inbound tour operators and ground handlers for adventure tourism products limits their ability to reach important segments of the HMVs who have higher than average expenditures rates.
- ***Lack of a Georgia brand tailored to HMVs.*** While GNTA has invested significantly in the development of marketing campaigns, it lacks a brad development strategy and marketing plan specifically tailored to the HMVs. All four departments at GNTA work in silos and there's a need for strategic guidance supporting product development and infrastructure development.
- ***Unreliable and substandard visitor transportation services.*** 88% of all HMV visitors are independent travelers. Moreover, demographic changes - such as the increase of the "millennials" share of the travel market – anticipate that this trend will continue. However, Georgia lacks a reliable visitor transportation system facilitating the movement and distribution of independent travelers to areas with high potential.
- ***Lack of appropriate facilities and services in protected areas and cultural heritage sites.*** Visitors from HMVs represent the largest share of arrivals to protected areas in Georgia with 48% of the total. Increasing their numbers will require a solid strategy for the development of improved interpretation, guiding, camping, and other types of services and facilities at the most popular and high potential sites.
- ***Lack of commercial loans tailored to the needs of tourism MSMEs.*** Commercial financial organizations have not developed financial products specifically targeted to the tourism sector. Therefore, capital investment and operational capital for businesses comes from grants, profits or personal loans (typically mortgages guaranteed through properties), making extremely difficult for small business to upgrade facilities or operations.
- ***Misalignment between educational curricula and industry needs.*** With the exception of a couple of private sector-driven initiatives (such as the Adventure Sports Academy and the Culinary Academy), there is a severe misalignment between what education organizations produce and the needs of the industry. This gap is addressed through training workshops but does not meet the needs of a rapidly expanding tourism industry.

PRIORITY INTERVENTIONS

To grow this business activity, the Economic Security Program will facilitate catalytic investments in workforce training, create pathways to youth into entry level jobs in the tourism sector , facilitate investments into the sector and strengthen industry collaboration to address joint concerns. For example, the Program will:

Support to update National Tourism Strategy 2025 and operationalize Tourism Action Plan. Rather than just providing technical assistance to develop more reports, the program will guide the process of creating a series of theme-specific working groups with just the right number of stakeholders from the public and private sector. These solution-focused working groups will address issues like improved selection and participation of GNTA and the private sector in trade shows or the opening of a specific historical site for tourism purposes. By building trust among these stakeholders, the Program will support the implementation of an articulated, multi-stakeholder Action Plan for the tourism sector in the upcoming years.

B2B Market Linkages program for 'export ready' tour operators and event organizers. Building a Georgia brand requires consistent and reliable links between international tour operators and Georgian inbound operators. The Economic Security Program will work with GNTA to improve operational marketing activities to include effective B2B elements and build commercial networks in HVMs. We will also work with GITOA and other tour operators to improve their offer and marketing activities to better align them with market priorities.

Tourism association led product development and marketing support. Visitors from HVMs will not be able to spend more money unless there are more products and services for them to use. The development of these services, however, will require technical and financial support to Georgian MSMEs along the selected value chains to being them up to European standards and develop consistent relationships with tour operators and travel media in HVMs.

Investment promotion of natural and cultural themed tourism services. In 2018, more than 1 million people visited protected areas for the first time. Of all protected areas in Georgia, 2 of them accounted for almost 35% of all visits. There is an urgent need to diversify the number of popular sites to decongest Prometheus Cave and Kazbegi National Park by implementing a tourism concessions and commercial services strategy for the system. This strategy and accompanying policies and regulations would promote private sector investment in badly needed infrastructure and management upgrades.

Matching Tourism Industry Labor Demand with Supply while Strengthening Training Providers. Using the successful model of the Mountain Guide Association and the Adventure Sports Academy, the Economic Security Program will support the private sector in the implementation of embedded training and capacity building initiatives that could be institutionalized and not rely on donor funding for its continued operations. For example, we will work with GITOA to improve the quality of service providers in rural areas where they operate and with Airbnb Experiences to ensure that service provision meets a minimum criterion of safety and reliability.

Exploration of the Creation of a Tourism Alliance. The Program will explore the potential for development of a Tourism Alliance, but its initial focus will be on creating informal mechanisms for public-private dialogue and cooperation that will build the level of trust necessary to develop this level of collaboration. The GOG has been "hot and cold" on the development of such an alliance and its formation must be organic rather than contrived.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

- **REI and Columbia Sportswear:** Building on partner GTG's existing relationships with REI and Columbia Sportswear, the Economic Security Program will engage these companies to cost-share promotional activities such as Media Trip and Sweeps Promotional Campaigns to promote Georgia among their global customer base.
- **Marriott International:** The Program has already engaged Marriott International and local investors in a GDA opportunity for the development of the new Courtyard Marriott in Kutaisi.

Using the Program's Partnership Development Fund, we will support training of local youth and women in Marriott's international service standards with the commitment that they will be employed as soon as the hotel opens in 2023.

- **Airbnb:** Working with local providers and Airbnb to develop a "guest experience platform" that highlights high-end Georgian properties for top-tier consumers. Airbnb would provide the platform and marketing, while the Program would work with local providers to build capacity and increase standards.

SHARED INTELLECTUAL SERVICES SECTOR

BUSINESS PROCESS OUTSOURCING VALUE CHAIN (CUSTOMER RELATIONSHIP MANAGEMENT, FINANCE AND ACCOUNTING, ARCHITECTURE AND ENGINEERING, HUMAN RESOURCES, AND INFORMATION TECHNOLOGY)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Shared Intellectual Services are defined as exported services conducted by a business in one country and consumed by a business in another country – as part of a firm's strategy to perform functions globally[27]. These strategic decisions to de-couple corporate services, such as customer management, information technology, finance and accounting, design, and human resource management -and perform them anywhere in the world- have played the key role in the formation of the BPO value chain[28]. Globally, the structure of the BPO value chain consists of three main verticals: general business services that can be provided across all industries known as business process offshoring, information technology services that can be provided across all industries known as information technology offshoring (ITO), as well as services that are industry specific BPO (ISO). Within each of these vertical activity groups are the specific business activities (CRM, ADE, F&A, IT, HR).

The global market for outsourced services is growing and will continue to grow. In 2018 outsourced service revenue was $85.6 billion and is expected to grow to $343.2 billion by 2025. This will continue the steady global growth of the sector which has almost doubled since 2000 when it was a $45.6 billion global market. In 2018 BPO accounted for 28% of revenue of the overall global BPO value chain at $23.6 billion. The lowest end of BPO consists of transactional tasks within CRM, accounting for only 3% of the total market. The middle range of BPO comprises repetitive yet judgement-based activities. Here most revenue is derived from processes highly connected to trade in goods and commodities (Supply Chain Management), accounting for 81% of the BPO segment.[29] KPO services are the highest value-added horizontal segment of BPO.[30] Of these the global legal process outsourcing market was estimated at $2.3 billion in 2015, with 80% of the projects being offshored.[31] The rest of the processes pertaining to BPO capture less than one fourth of the total market segment. In 2018 ITO accounted for 68% of

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27 Global Value Chains Center at Duke University. https://gvcc.duke.edu/

28 BPO is used in the context of this report to describe a tier of services that traditionally are referred to as 'back office operations.' The rise and increasing sophistication of IT and communications platforms and networks have allowed an ever growing number of services to be moved from the back office to international service providers.

29 Statista. https://www.statista.com/statistics/189800/global-outsourcing-industry-revenue-by-service-type/

30 KPO is Knowledge Process Outsourcing (e.g. financial processes, programming)

31 Grand View Research. https://www.grandviewresearch.com/industry-analysis/legal-process-outsourcing-lpo-market

revenue the global BPO value chain at $62 billion. [32] The lowest end of the segment, infrastructure, accounts for around half of the global segment market size, while tasks within the middle-end of the ITO segment, such as IT Consulting and Software, account for 31%. The highest value-added sub-segment, Software R&D, accounts for 17% of the ITO segment. Industry Specific Outsourcing (ISO) is much harder to get accurate data on considering the fragmented nature of the channel.

Georgia currently participates in the global market for Business Process Outsourcing via several business activities:

- **Client Relationship Management (CRM).** There are a number of small, medium and large CRM companies in Georgia providing CRM services. They deliver a variety of customer-facing services that focus on managing a company's relationships and interactions with current and potential customers. CRM represents 90% of employment for the BPO Value chain with call centers the most common CRM service offering in Georgia. Companies also offer higher-value forms of customer interaction services including live-chat and email. The primary market that Georgian CRM firms serve is Europe, with CRM services targeted at their client's customers also residing in Europe. Most firms provide more than one type of CRM service, but provide those services for only one client – acting as a captive contractor. Some firms are in the process of leveraging CRM platforms and client relationships to move into higher-value Enterprise Resource Management (ERM).
- **Finance and Accounting (F&A).** As the name implies there are two main types of service offerings in the F&A business activity – those pertaining to *finance* which represent money management and the process of businesses acquiring needed funds for investment or operations; and those services pertaining to *accounting* which represent summarizing, analyzing and reporting business financial transactions to regulators, oversight and tax collection agencies. Larger finance and accounting firms generally provide both types of services, smaller firms focus more on accounting services. There are hundreds of registered finance and accounting firms in Georgia, however the vast majority are serving local companies. There are two primary reasons for this, first, accounting services especially as they pertain to tax and other regulatory environments are location specific, i.e. each jurisdiction has different tax and other regulations necessitating local expertise and difficult to offshore. Second, new tax and accounting rules coming into effect in Georgia means large firms (those most likely to provide BPO) are at full capacity handling domestic client's near-term compliance needs. While capabilities exist for F&A, capacity is being stretched by domestic demand.
- **Architecture, Design and Engineering (ADE).** The ADE sector is well developed in Georgia with both local and international firms providing a wide range of services. ADE is the largest business activity by revenue, however the vast majority of it is earned in the domestic market. Within ADE, it is Architecture services that are being exported by small companies leveraging a skilled Tbilisi-based workforce at relatively low wage rates, typically 4x-5x lower than in Western Europe. For those firms that do provide architectural-related services, the most common include 3D modeling, rendering, and design services. Georgian Architecture providers typically take design concepts from a partner firm abroad, and then perform the bulk of the manual work turning those ideas onto actual drawings, models, renderings, and the instructions necessary for construction. These are then sent back to the BPO partner firm for final alignment with local regulations and local approval. Building and engineering codes are guided by local regulations and almost always need local sign-off prior to construction – complicating the offshoring process.
- **Human Resource Management (HRM).** The HR sector in Georgia is small with total sector turnover not more than $20 million, including both domestic and international sales. Those firms that are providing services to foreign clients are primarily engaged in recruiting and consulting services and are mostly doing so for foreign firms looking to locate in Georgia, not as a BPO service.

[32] Statista. https://www.statista.com/statistics/189800/global-outsourcing-industry-revenue-by-service-type/

Because of the small size of the sector and types of services provided there are very few HR BPO providers in Georgia.

- **Information Technology Offshoring (ITO).** IT plays a dual role in the BPO value chain. First, as a service that can be offshored, and second, as a platform and enabler for activities across the value chain. There is a large demand for Information Technology services in both the domestic and the global market; and the needs of each market differ greatly. For domestic clients, IT firms are engaged primarily in app development, IT-support, database support, and web design. For international clients, IT firms provide the infrastructure for other offshored services, application integration, and application development based on cost efficiencies especially in wages. These services are provided both as a direct service, as well as an internal function within another offshored service especially CRM and ERM which rely on cloud-based software and databases. There is also an emerging group of Georgian IT firms that are providing much higher-value contract research and design services. While the first set of companies rely on junior programmers coming out of local Universities, this emerging second set rely on more senior and experienced programmers they build teams around to produce working prototypes (hardware and software). Current R&D contracts include products for telecommunications and IoT devices.

Western Europe is the key market for Georgia's BPO providers, followed by Eastern Europe and the Middle East with limited opportunities in other locations such as Italy and Turkey. The largest national markets in these regions are the United States, Germany, France, the UK, and Russia. Each of these locations is growing their service imports as well as having regionally high levels of spending on BPO. There is also a growing 'secondary market' in countries that are already locations for providers BPO providers but are reaching their capacity to deliver, primarily the Baltic States and Romania.

ECO-SYSTEM

The BPO value chain is relatively new in Georgia and the eco-system around it, shown in the graphic, is not yet well formed. The value chain is rather fragmented with each firm having their own channel to the end market buyer – in almost all cases another firm. Industry cooperation is limited by the fact that firms in the different channels in the value chain are providing services that often are completely unrelated to each other; and they are providing these to clients operating in vastly different industry sectors. In Georgia there are not yet business associations, industry associations, investor associations, or business service providers that are specifically serving Georgia's BPO sector. The sector has not yet coalesced enough to establish an industry association or other form of sector representation. There are also very few intermediaries or business service providers in the value chain. When firms do receive technical and other types of support it is usually from the client serving the role of the 'mother company' who also plays an important role in financing operations and growth, especially for captive contractors.

Enterprise Georgia plays an informal role in the BPO value chain as the organization currently keeping track of both investor interest in the sector, as well as the Georgian firms currently exporting services into the global value chain. While Enterprise Georgia's official role is to promote the sector and attract foreign direct investment, as the leading organization working across the BPO value chain, they have become a de-facto sector representative.

While the skills profile of workers in each of the four business activities varies, in general each business activity requires a relatively high level of skill and a University Degree is typically a de facto requirement across all four business activities. Each business activity has sector-specific technical skill needs that will vary based on the requirements the sector. Common across them is a requirement for strong foundational skills of reading, writing, numeracy, critical thinking, and communication. Foreign languages, while not a foundational skill are important in all four business activities. Georgia has ***75 Higher Education Institutions and 125 VET Institutions*** spread throughout the country. Amongst these institutions there are public and private Universities offering degrees relevant for all four business activities. However, all employers across the four business activities felt that the skills young people possess upon graduation are not relevant enough to start working without further training. To get young people up to the level they need to be able to deliver the services clients demand, all employers engaged in some type of on-the-job training for new employees.

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

Of the five broad business activities within the BPO value chain represented in Georgia, four (CRM, ADE, IT, F&A) are offering offshoring services for international clients. In HR, Georgian HR firms are small and primarily serve domestic clients (some of whom are international firms) and is not at this time viewed as a potential niche market with high growth potential for Georgia. Four high potential niche business activities have been prioritized for Georgia:

- **Higher Quality CRM and Contact Centers.** Traditional CRM consists mostly of call centers where operators answer basic customer questions often following a script. These call centers rely on low cost locations and high volume. As the retail industry transforms and moves increasingly online, retailers are looking for CRM to provide higher level of interactions with customers, better customer service, and do this through new mediums of communication including email, chat, SMS, and twitter. It is difficult to grow these services in most of the lowest-cost locations because of the lack of language skills, cultural sensitivities, and customer mindset within the labor force. Also, interacting with customers in a written form requires higher level language skills than in call centers. These higher-level CRM services are being nearshored and provide an opportunity for higher value growth in nearshore locations despite CRM being a mature service. Buyers require high level language skills in the customer's primary language, cultural understanding and sensitivity of the customer, customer service and problem-solving mindset, sufficient class A office space office for adding staff and IT platform with reliable and high-speed international internet connectivity that is 'always up'. Georgia is well positioned to provide contact center services. Georgia has the client contacts, the relevant skills (human resources) and is located near Western Europe. While many of Georgia's competitors in Eastern Europe and the Baltics also have these assets, Georgia can offer the same high quality services at a lower cost. Salaries in higher-level CRM are also higher than entry level jobs for youth in retail or other sectors where youth typically get their first job.
- **Enterprise Resource Management (ERM).** Globally the largest segment of business process outsourcing (BPO) is not client relations management (CRM), it is enterprise resource management (ERM), and within ERM it is activities that are related to supply chain management that generate the most revenue for outsource service providers. Historically supply chain management had been outsourced, but not offshored, as it was seen as too complex, data centric, and requiring real-time response to be effectively managed from a global location. With the emergence of cloud computing and robotic process automation (RPA) companies are increasingly looking to foreign providers to take on greater responsibilities and step-up from CRM to ERM provision as an integrated service package - from the first customer interaction, through the re-stocking and warehousing of the

product, to shipping and any problem resolution. This simplifies services for firms as they are dealing with fewer vendors, rationalizing vendor management, and investing in those that are trusted and reliable and can support increased competitiveness and cost reductions. Firms are increasingly looking to existing BPO providers to provide more integrated service packages. They are looking for existing and trusted relationships with clients, knowledge of the internal and external supply chain processes, IT platforms and workforce that supports supply chain management, in addition to language and communication skills. Georgia-based CRM already have the relationships and trust through existing CRM contracts, as well as the language and communication skills. Georgian Services Group is the leader in stepping-up from CRM to ERM but others have not yet followed and Georgia still lags competitors in Eastern Europe and the Baltics.

- **Mid-stream Architecture Contract Services.** The architecture field is late to the outsourcing revolution. Very specific architecture related functions do have a history of being outsourced, typically those associated with a computer program such as AutoCAD or similar around drawing and rendering programs. This is changing as companies look to outsource more of the architecture process including design, modeling, and development; retaining only initial concept and final regulatory approval in the home office. Providing complete-package services to architecture firms is attractive as costs tend to be five times higher in developed markets for architecture services. As more of the process is outsourced, the specific computer program that is used in drawing and rendering becomes less important. If the provider needs to interface directly with the client firm as a piece of the process, they need to use the exact same software – and knowledge and training of the most in-demand programs by international clients such as REVIT and ArchiCAD is still lacking in Georgia. However, when the BPO company provides the entire service, there is no IT integration and the program used is much less relevant. This is an emerging market for Georgia with current providers tending to provide program-specific rendering services, with an emerging but small group providing integrated services. Georgia has the education system and human talent to provide both the stand-alone and integrated service packages but are not yet training in the most current programs and technologies.
- **IT Software and Hardware Product Development.** There is a significant global labor shortage for IT professionals – especially for those with knowledge of the latest programming languages and design methods. It is estimated that by 2020 the technology, media, and telecommunications sectors will be short 1.1 million workers.[33] This talent shortage, coupled with the explosion of remote and contract work (which can be performed from anywhere in the world), has driven up wage rates globally – it no longer matters where the work is performed. This has led to the explosion in programming and other types of skills and training programs in new locations. As IT services are increasingly offshored to these new locations as part of the desperate search for talent, many of the legal and regulatory frameworks in these new locations do not provide the types of protections for intellectual and other property that are necessary for firms to move beyond contracting-out to programmers, and into contracting full service research and design product development. Buyers are looking for critical mass of senior programmers, project managers, and junior programmers in order to implement agile IT project teams, as well as strong legal and regulatory frameworks for intellectual and other property protections along with transparent enforcement mechanisms. Ukraine is the regional leader in IT service provision, however, many firms are looking beyond Ukraine for higher-value product development as Ukraine's intellectual property protections are weak, have poor infrastructure, and are running out of software engineers. Georgia will never be able to provide the volume of IT professional that Ukraine can, but it does have the regulatory framework within which projects can be based and run even utilizing contract labor from other

[33] LinkedIn research.

locations. Labor is mobile, regulatory frameworks and enforcement are not. This is not a typically Offshored Service but is an opportunity for Georgia in a relevant sector.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

The BPO value chain is positioned to grow significantly in Georgia over the next few years attracting foreign and domestic investment and creating employment growth for skilled young people – driving this growth will be customer relations management (CRM). BPO value chain is unique in that it needs no material inputs (imported or domestic); has limited regulatory barriers to entry; its service exports flow freely into international markets; and relies primarily upon the knowledge, skills and attitudes of Georgia's workforce to create value.

In Western Europe, Germany is the key market for Georgian BPO providers. In 2017 the German BPO market spend was $2.4 billion. Firms in Russia and other Russian-speaking countries traditionally have been clients of Georgian firms, primarily due to Russian language skills in Georgia, but the size of the Russian market at $300 million is relatively small compared to that of Western Europe $16 billion

Obtaining accurate and granular data on the Georgian BPO value chain is difficult as the Georgian National Statistics Office (Geostat) does not collect BPO value chain specific data. Where data is collected by Geostat, it is not at a sufficiently disaggregated level in order to provide a useful basis of analysis for the BPO value chain. However, services play an outsized role in Georgia's economic performance representing 58% of Georgian exports by revenue; in 2017 Georgia exported products worth $3.21 billion[34], while at the same time exporting service worth $4.49 billion[35]. When viewed through the lens of GDP, the global average share of Trade in Services as a percent of GDP is 13% in 2017 for all countries, while for Georgia it is 42% of GDP.[36] Georgia outperforms the world when it comes to the growth of service exports, growing faster than the global growth average every year except for 2014. For the years 2010-2018 global growth in service exports averaged 6% per year. Georgia has outperformed global growth in services by 3% over that period, averaging 9% growth per year. At the same time Georgia's global market share for service exports has doubled from .04% to .08%.

BUSINESS CASE

Traditional growth of BPO has been driven by firms as a cost cutting-measure, but that is starting to change. Businesses are increasingly looking to their BPO partners to do more. Powered by cloud computing they are looking for service providers as key business enablers and to support business transformation, in addition to cost savings. However, cost is still an important factor in the global BPO market. Potential clients for Georgian firms who are looking to corporate services are looking for locations with proximity to the European market at the nexus of low wages for skilled human resources, while having a liberal investment and tax regulations with low location costs. As costs rise in the Baltics and Eastern Europe, firms are increasingly looking to Georgia to locate their labor-intensive BPO operations – especially CRM. At the other end of the spectrum, firms are also looking to invest in IT, both to support CRM operations and provide a wider range of contract IT services. This IT growth is driven by a global shortage of skilled programmers and Georgia's relatively low wages for skilled workers.

Georgia has implemented a suite of liberal tax, labor and investment regulations to attract foreign direct investment. This has resulted in a 2018 Ease of Doing Business ranking of 6th out of 190 nations; ranking

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[34] Atlas of Economic Complexity

[35] WTO Trade in Services Database

[36] World bank. https://data.worldbank.org/indicator/BG.GSR.NFSV.GD.ZS

2nd in both “starting a business” and “protecting minority investors.” Consequently, Georgia ranks highly on lists of investment-friendly countries prepared by site selection firms working to re-locate BPO. Specific regulations and policies include the creation of virtual information technology trade zones that exempts investors from taxes or duties on the revenue earned when selling their product or service outside of Georgia, and does not require licenses, permits or any other regulatory document to carry out business activities in the Georgia. Georgia also has flexible labor codes including no minimum wage, no social-security type tax for employers, and flexible contract termination. In addition to these specific policies, Georgia is relatively corruption-free and politically stable.

Value creation in BPO is driven by human resources and information technology; and Georgia has a well-educated workforce with many of the cross-cutting skills necessary for the service industry. Georgians have high rates of educational attainment with 75 Higher Education Institutions and 125 VET Institutions, spread throughout the country. Georgia also benefits from a legacy of foreign language learning throughout the country. Almost 20% of young people have University degrees, while around 56% complete upper secondary general education. More girls than boys attend university, resulting in a higher share of young women with higher education. The educational attainment of young people is improving compared to educational attainment levels of those aged 15+.[37] It is not just a skilled labor force that is drawing service-exporting firms to Georgia, it is this skilled pool of people against a background of relatively low wages in a tight regional labor market for in-demand skills. Several BPO providers described the current potential for CRM growth as essentially ‘unlimited’ were it not for the constraints placed by the limited pool of workers in Georgia.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

The following are key constraints that exist in each of high potential business activities. In addition, several cross-cutting constraints to the BPO value chain as a whole have been identified.

Higher Quality CRM and Contact Centers. The global market for high quality nearshored CRM services is growing and Georgia has the opportunity to grow along with it. CRM providers in Georgia, specifically call and contact center operators, all described growth as potentially unlimited in the near term were it not for two key constraints, quantity human resources and office space. While further growth in the longer term will require access to new markets particularly the US market.

- ***Lack of human resources.*** There is sufficient existing demand from European clients for CRM (particularly call and contact centers) to grow over the next 2-4 years. What limits growth is the number of potential employees available in the labor market. CRM production has a one-to- one, customer-to-bodies growth trajectory. Additional service requires additional people regardless of size. CRM firms need people with foreign language skills. Foreign language skills take a long time to develop and training is not provided by employers. Finding ways to upgrade language skills, and employ those outside major cities with language skills, can help address gaps in the short term. Longer term will require improvements in the education system.
- ***Insufficient office space available:*** Every CRM provider is planning to hire more people and grow. A typical call center requires 10 square meters per person, not including hallways, break and dining rooms, etc. This space represents a significant investment, yet the investment is not the constraint, it is finding the space itself. While vacant office space is available, CRM firms need Class A space that is customizable to their business needs (at European standards). CRM companies experience that there is very limited actual Class A space available in Tbilisi and none at all that exists outside of Tbilisi that is move-in ready. This should not be confused with the availability of “brownfield” sites, which is an industrial term. Also, the lack of space (as identified by CRM companies themselves)

[37] ETF. Youth Transition to Work in Georgia. 2018.

refers to top quality, move-in-ready space. This type of space in sufficient size is in extremely short supply outside of Tbilisi and some other major cities.

- ***Lack of access to new markets.*** Georgian CRM firms are almost exclusively serving European and regional clients. The relationship with the market depends on the firm structure and personal relationships – captive contractors interact very differently with their client than do contract service providers. For providers who do not have a captive market, contracts with clients tend to be relationship and personality driven, primarily based on personal connections with the client. These personalized relationships limit Georgian firm's ability to engage with and attract new clients, especially in new markets. This lack of professional marketing limits firm's ability to grow. Many firms are serving the European market, necessitating European languages, yet Georgia's strongest asset is probably the wide-spread adoption of English, which helps but is of limited utility in Europe. The biggest CRM market, and the one which can best tap in to Georgia's strong English-language capabilities is the US, the market most firms want to access, but are not currently doing so.

Enterprise Resource Management. The key constraint to moving from CRM to ERM is that few Georgian firms are providing ERM services and Georgia does not have a reputation in the market for this work. In addition, for firms that want to upgrade their service offerings and begin to provide ERM service there are no technical resources or financial products in Georgia to help them do so.

Mid-stream Architecture Contract Services. Architecture faces both short term and longer term constraints.

- ***Lack of modern skills.*** Georgian Universities are not training students in modern computer design skills demanded by international clients in drawing and rendering, especially REVIT and ArchiCAD. This is a constraint that can be addressed in the short term.
- ***Lack of strategic partnerships in key end markets.*** Each national/local architecture market is unique due to the local nature of building and construction regulations. This makes it difficult to contract out certain services. To ensure compliance with local regulations and sign-off from local authorities requires a local partner architecture firm. Georgian Architecture firms do not have the necessary strategic partnerships in new markets that will allow them to perform work there.
- ***Lack of marketing.*** Most Georgian architecture firms have little experience planning longer term marketing strategies outside of design competitions and have a complete lack of local market understanding to develop the needed market linkages for sales into local architecture markets in Europe and Asia. Current architecture-related BPO service contracts are built upon personal relationships within a specific market and there are no systematic efforts to understand or enter new markets.

IT Software and Hardware Product Development. There are few market access issues as standards are global across the industry. There is no Georgia IT brand yet. However, the primary constraint is around skills and technologies. Given the high labor requirements of programming to deal with increased project volumes, firms will require new employees at both senior and junior levels. In addition, the foreign clients will require techniques, tools, and programming languages that are above the capacity of many smaller IT firms.

- ***Lack of higher-level human resources and skills.*** Georgian Universities are not training students in the skills demanded by international clients in automation services (cloud computing, NetOps, DevOps, DatOps); or embedded services (Linux, hardware design, FPGA-MDL). In addition, scrum and other project management techniques common in managing IT projects in developed markets are not common in Georgia. There is also a lack of senior programmers in the Georgian market around which project teams can be built and who young people can learn from.

- ***Outdated technologies.*** Domestic demand coming from banks, telecommunications, and gaming is for a lower quality (different techniques and languages) service and product. These old programming languages and database technologies are not appropriate for international clients, making it difficult for Georgian firms to leverage experiences from domestic market sales and services into international contracts.

CROSS-CUTTING CONSTRAINTS TO GROWTH OF BPO

- ***Lack of marketing and international brand.*** Georgian BPO providers lack experience in marketing and sales and there is lack of market knowledge and contacts in the global BPO value chain - in Europe - and beyond. In addition, there is not yet any brand around the Georgian BPO sector
- ***Insufficient information available for potential investors.*** Georgia has gotten a lot right when it comes to the business enabling environment, even more so when it comes to information and related technology. Georgia often ends up towards the top of the lists of site selection companies when they are searching for locations for foreign investment. However, when these firms investigate further, Georgia cannot provide them with the location specific information they need on the skills in the labor force and the operational costs for running the business, which competitor countries are able to provide. This information gap precludes may potential investors in CRM and other labor-intensive industries from selecting Georgia for their operations.
- ***Lack of incentive programs.*** Competing countries, especially those in the Balkans and Eastern Europe, have well developed incentive programs for CRM firms to locate in their countries. Georgia has none. Enterprise Georgia is under resourced when it comes to pro-active investment promotion. At the same time the BPO value chain is still to fragmented to take on that role itself.

PRIORITY INTERVENTIONS

The Program will support the following activities across all high potential business activities.

Higher Quality CRM and Contact Centers

- ***Support short and long-term skills development.*** Support short term courses in partnership with University and Language training centers to help language learners take a 'step up' from the B1 foreign language skill level they are likely to have post- secondary school to the B2 or B3 level required for CRM. For longer term skill development, work with secondary school systems to quality assure and certify language learning at all levels ensuring graduates have market relevant language skills.
- ***Develop a new soft skills / customer service learning module*** in partnership with CRM providers and aligned with Georgian learning standards at the secondary level. This will include experiential learning modules where young adults can experience an actual workplace, internship and apprenticeship programs.
- ***Support CRM expansion outside of Tbilisi.*** Identify locations with concentrations of foreign language skills and work with firms to bring CRM services to new locations outside of Tbilisi. Potential locations include Kutaisi, Telavi, Batumi, and Zugdidi.
- ***Support the development of cooperation schemes*** between smaller BPO providers in Georgia, to allow them to become a member of an international BPO association and be visible on international radar, where most sales take place.

Enterprise Resource Management

- ***Increase awareness of ERM opportunities.*** Work with Georgian providers to develop a series of 'success stories' that highlight the business case for using Georgian firms for higher value BPO services such as ERM.
- ***Provide capacity building and technical training*** for a core group of emerging Georgian CRM firms that is tied to grants and technical assistance for providing the new ERM services in new markets.

Mid-stream Architecture Contract Services

- ***Develop new Architecture technology courses*** with Universities and the private sector that can be delivered anywhere, in the classroom or on the job, that are aligned to international standards.
- ***Improve international marketing:*** Support Georgian architecture firms to participate in European design competitions and design salons to build a reputation and connections to Architecture and related firms in European markets. In addition, conduct a market survey of international, national and local architecture markets and train architecture firm management teams on marketing and sales strategies.

IT Software and Hardware Product Development

- ***Improve training opportunities.*** Working with IT degree granting Universities, either through their standard curricula, or their demand-driven training centers, provide increased technical training for small firm staff and management training for firm owners/managers on Agile, Scrum and similar project management techniques. Develop new IT courses with the private sector that can be delivered anywhere, in the classroom or on the job.
- ***Support the temporary import of senior programmers and IT specialists.*** This will create a spillover effect with Georgian junior programmers. Program would be a 3-6 month stay/work program placed within a Georgian firm. One senior programmer can facilitate professional development of at least ten Georgian workers, who later cascade that learning to others. Actively engage diaspora to participate in this program.

Cross-cutting

- ***Provide market linkage support to Georgian providers.*** In cooperation with Enterprise Georgia help Georgian firms participate in international trade fairs (e.g. Web Summit in Portugal) to acquire knowledge about modern trends, develop contacts and sell their services. Provide technical training for small CRM and other BPO companies management and staff on marketing to international clients. Working with an international marketing firm with experience in the CRM sector develop a Georgia-specific CRM slogan and market a brand that draws upon the quality and closeness of Georgia to developed markets.
- ***Improve information services to investors.*** Work with Enterprise Georgia to establish a labor market observatory which would collect information on regional skills profiles, operational costs, among other critical pieces of information and be the platform for sharing that info with potential investors and the public. Conduct a market survey on investment promotion schemes from competitors. Provide technical assistance to the Ministry of Economy and Sustainable Development to develop investment promotion packages.

Public-Private Partnership Opportunities

Partnership opportunities in BPO include:

- **Online retailer and Majorel.** Majorel has rapidly grown to over 1,200 employees with plans to expand to 4,000 employees over the next 4 years, but to do so they need to expand beyond Tbilisi. Of the five major language learning areas in Georgia, Majorel has already invested in Tbilisi, Kutaisi, and Batumi – only Zugdidi and Telavi remain. To support continued expansion Telavi could be the next location for expansion as the Telavi Iakob Gogebashvili state university already offers German language learning. The project would work with Majorel to set up a German language call center in Telavi and create a pipeline of local work-ready German-speaking youth into employment.

CREATIVE INDUSTRIES SECTOR

PRODUCTION VALUE CHAIN (FILM, TELEVISION)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

The global film box office revenues are forecasted to reach $50 billion in 2020[38], with the United States and China being the largest film markets in the world, followed by the UK, Japan and India. In 2018, 8,204 feature films and 496 original series were produced worldwide, representing a 10% and 86% growth rates between 2014 and 2018 respectively. According to conservative estimates[39], the value of international feature film production made outside of California was $4.6 billion in 2015. The market for independent lower budget films is shrinking, while the six major Hollywood film studios (Warner Brothers, Disney, Fox, Paramount, Sony and Universal) continue to dominate the global box office. US represents the biggest film market with the largest number of films produced and highest film production budgets. Chinese film market has been growing significantly and is expected to overtake the US in 2020 in terms of box office revenues.

Georgia participates in the global film value chain as both a film producer and as a film production service provider, as represented by its two main business activities:

- **Film Production (co-production):** Georgia produces an increasing number of feature films, short films, documentaries, and short animated films each year. International film festival circuit is the main distribution channel for these films and they usually do not generate commercial revenues. Georgian film production is publicly funded by the Georgian National Film Center (GNFC) and usually co-produced with other European countries, due to GNFC's limited annual budget. Even though few movies shown at international film festivals globally enjoy commercial success, increased film production is an important feature in maintaining Georgia's reputation as a film producing country. 2018 was a successful year for Georgia with several awards at international film festivals and the first Georgian film for which Netflix purchased global distribution rights.
- **Film Production Services for Feature Films and TV Series:** Georgia is emerging on the global film industry map as a filming location and Georgian film production companies are increasingly offering production services to international film studios and independent film makers. These services include finding a location, managing production process, providing rental equipment, hiring local crew, stunt services, special effects services, rental of sound stages and facilities, set design, construction and decoration, organizing logistics (transport, accommodation), providing security, hair and make-up services, catering, laundry/dry-cleaning, etc. The industry grew significantly in the past three years, as a result of the 20-25% cash rebate incentive by the *Film in Georgia* program of Enterprise Georgia introduced in 2016, as well as heavy marketing efforts with

[38] https://www.statista.com/topics/964/film/

[39] "Global Film Production Incentives", White paper by Olsberg SPI, June 2019

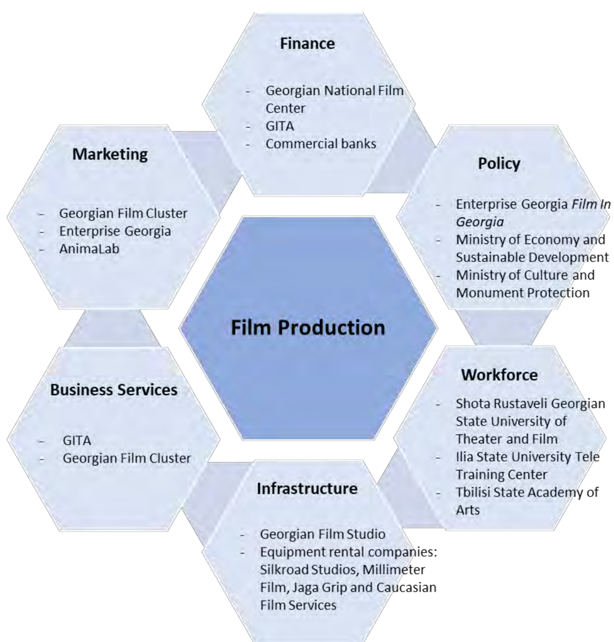
support from Enterprise Georgia. Since the start of the program in 2016, 28 film projects were supported within the framework of the program (with 15 completed) and 99.8 million GEL (approximately $33.6 million) in qualified expenses were spent in Georgia, employing more than 4,000 local cast and technical crew.

While the industry statistics are limited, it is evident that the production media industry has been growing overall during 2013-2017 at the rate of 23% annually, reaching total revenues of $17.7 million in 2017.

ECO-SYSTEM

The film production industry in Georgia is represented by about 10 small film production companies with 2-6 full-time staff each who produce films, and about 10 established Georgian production companies with on average 5-10 full-time employees who focus on film production services. Only 5-6 companies can accommodate a big movie project and usually service 2-3 projects per year. The industry draws on 150-200 freelance technical and artistic crew who represent the entire capacity of the industry and are in high demand during the peak production season. The eco-system for supporting growth in this value chains is still nascent, with the weakest elements being workforce, access to finance and business services. However, several organizations are in place that can serve as a foundation for eco-system development, with additional ones included in the graphic:

- ***Georgian Film Cluster*** includes 40 companies and individual members. While not a fully sustainable organization yet, it nevertheless represents a strong voice for the film industry in Georgia and is engaged in international marketing, workforce development, and representing the industry interests with the Government.
- ***Enterprise Georgia*** through its *Film In Georgia* program represents the key proponent of the film industry within the Government of Georgia and is responsible for the cash rebate program. It also provides marketing and promotion for the industry at major industry events, organizes meetings with major film studios, location managers and independent producers, as well as FAM tours for Hollywood producers to Georgia.



- ***Georgian Innovation and Technology Agency (GITA)*** offers grants to start-ups in creative industries and some basic business training and incubation services.
- While existing training providers do not offer practical training required by the industry, there are two main schools for film professionals in Georgia – ***Shota Rustaveli Georgian State University of Theater and Film*** and ***Ilia State University Tele Training Center***. Additional schools include ***School of New Cinema at the Caucasus University and Tbilisi State Academy of Arts***.
- ***The Georgian National Film Center*** under the Ministry of Culture and Monument Protection of Georgia continues to be active in supporting Georgian film production through competitions and funding awards for co-production.

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

Due to extremely competitive nature of the international film market, the main growth opportunities for Georgia include capturing a share of the film production budget spent worldwide, rather than competing directly in the consumer distribution segment. Therefore, the most promising business activity for Georgia is the **film production services.** Georgia can increase its current revenue share from film production services offered to major film studios and independent film makers in export markets, with a particular focus on attracting more clients (particularly major film studios) from higher value markets – US and China, as opposed to current lower budget Indian market. This market opportunity is supported by the following global market trends:

- The industry has reached a "tipping point", where earlier marketing efforts are paying off and prominent film studios are coming to Georgia. Until recently, the main markets for Georgia included India and European countries (France, UK, Norway, Sweden, Ireland), with lower budget films, and one Chinese movie filmed in Georgia. But in 2019 the industry achieved a breakthrough by attracting the first major US Hollywood film studio, Universal Pictures, to film *Fast and Furious 9* in Georgia in the summer of 2019, which could open up potential future opportunities with both Universal and other high budget Hollywood film studios.
- Industry experts believe that major film studios will remain in strong position and the global cinema industry is expected to experience a steady increase in revenues over the next five years. Hollywood-made films will continue to dominate global box office and these films will increasingly both be set and shot abroad[40]. Film studios will be more and more looking for new and unique locations, with the US film studios accounting for the largest market share and highest film production budgets.
- Chinese market demand for film will continue to grow and China is projected to overtake the US market in 2020 in terms of the box office revenue. The first and only Chinese movie filmed in Georgia, *The Mask*, accounted for the largest amount spent in Georgia so far (over $4 million) and the highest number of people hired by a single movie (1,900). This represents a lucrative high-value market for Georgia.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

Economic impact of film production services is significant due to 1) number of people employed during film shooting, even on contract basis, 2) supply chain spillovers into auxiliary services (tourism, transportation, catering, construction, accommodation, restaurants, etc.), and 3) proven links to growth in tourism based on international benchmarks. International experience shows, that film industries were able to grow substantially within the span of just several years as a result of financial incentive programs. Film production spending in Hungary grew from $1 million in 2003 to $400 million in 2017. In the Czech Republic the introduction of the 20% incentive grew the film industry foreign investments from $40 million in 2008 to $260 million in 2017. Georgia's film industry growth trends in the past 2-3 years, confirm that such growth is possible in Georgia as well.

This business activity offers opportunities for higher value jobs. Even though these are seasonal contract-based jobs (usually up to 40 days), salaries in this industry are higher than the current average salary for Georgian employees which is 1,124 GEL/month (approximately $410/month).[41] Film industry also offers opportunities for entry level unskilled jobs. Number of people hired per movie has ranged between 100 and 400 people. (The Chinese movie *The Mask*, used more than 1,900 people.) Full-time

[40] Global Entertainment and Media Outlook: 2019-2023, PwC

[41] Source: GeoStat: https://www.geostat.ge/en/modules/categories/39/wages

employment is limited to full-time staff of production companies, which is currently estimated at less than 100 people, but companies estimate that full-time employment could double with doubled production. Doubling the volume of films produced would also double the volume of film professionals/crew required, currently estimated at 150-200.

In addition to hiring of local crew and other film professionals, there is significant spillover impact in terms of money spent on auxiliary industries and services – hotels, restaurants, catering, transportation, carpenters, designers, car rental, etc. In addition to spending during the film shooting, international statistics show proven impact on subsequent growth of tourism following the success of international film productions, since 15% of world tourism is film tourism[42].

BUSINESS CASE

In 2018 8,204 feature films and 496 original series were produced worldwide, with the value of international feature film production made outside of California estimated conservatively at $4.6 billion in 2015. Film budgets for a major film studio range from $70 million to $300 million and average $5-8 million for an independent film, with production costs representing the largest cost category which can be as high as 50% of the total budget[43]. The United States is the key market for film production services with by far the largest number of movies produced and the highest movie budgets, followed by China and the UK. China and US represent the most lucrative higher value markets globally, compared to large volume, but lower budget Indian Bollywood movies.

Between 2016-2018, Georgia captured approximately 29.9 million EUR (or approximately $33.6 million) in local spending from 28 foreign films. While this represents a rather small share of the total market value for film production, examples of high budget film spending in Georgia, demonstrate the magnitude of the value that Georgia could capture in the future. Chinese film *The Mask* spent more than 3.6 million EUR/over $4 million in Georgia, hiring 1,900 people. Universal Pictures, set to shoot in August 2019, is planning to spend approximately 9.7 million EUR/$ 10.7 million during 5 weeks of filming of *Fast and Furious 9*, employing around 1,000 people, including 200 crew members[44].

When location scouts for international film production companies or film studios are looking for suitable film production locations they are first looking at production costs/budgets, qualified workforce, and favorable regulatory environment. Additional considerations include security, easy logistics, suitable locations and easy communication with the local production company. The *Film in Georgia* cash rebate program represents a major incentive for attracting international film projects to Georgia, combined with lower costs, variety of locations and landscapes, flexible and simplified rebate process, lack of licenses for filming, and film friendly society. Georgia's key competitors as a filming location include Eastern European countries – Hungary, Bulgaria, Serbia, Croatia, Romania, all of which offer some form of financial incentives for foreign film companies. However, filming costs in Georgia are reportedly 30-40% cheaper than in Hungary and Romania. In addition, Georgia offers a variety of landscapes and locations, which can appeal to film studios that are looking for new and unique locations.

While Georgia is slowly gaining reputation, it is still new on the film industry map and does not have the established relationships with film studios that its competitors do. In addition, Georgia's main bottleneck to growing the industry is lack of sufficient supply of trained and experienced crew members. As more

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[42] For example, "Mission Impossible 2" increased the number of tourists in Sydney national parks by 200%; filming of "Lord of the Rings" generated $7 billion in tourism revenues for the New Zealand economy; the screening of "Brave Heart" increased the number of tourists in Scotland the following year by 300%. This places even higher importance on attracting major film studios which are likely to become a box office success.

[43] 50% share includes actor fees which vary significantly.

[44] https://www.filmneweurope.com/news/georgia-news/item/118467-production-fast-and-furious-9-to-be-partially-shot-in-georgia

film companies come to shoot in Georgia, Georgia not only has an opportunity to take advantage of the growing market demand, but also has an imperative to deliver on existing contracts and not damage reputation with new higher value Hollywood buyers.

It is estimated that with support from Economic Security Program, the film production industry business activity segment could attract additional $30 million in qualified expenditures as part of the cash rebate program. Film production companies could generate additional $15 million in sale revenues and create between 100-150 FTE jobs for film professionals, and up to 200 additional FTE jobs in auxiliary services. There are potential opportunities to facilitate at least 2 PPPs with international film studios for workforce capacity building.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

The Georgian film industry is stretched to keep up with the increased demand during the high production season (May-September) and is lacking the required supply capacity to meet the growing demand. Lack of qualified technical and artistic crew, limited equipment base and limited capacity/number of local production companies - all put Georgia at risk of not meeting the expectations of international "buyers". This has already become apparent as both Universal, two large Indian and one UK production are set to be filmed at the same time in August 2019. The industry overall has the maximum capacity to service 2-3 film productions at the same time. Other constraints to long-term growth include:

- ***Insufficient supply of qualified technical crew:*** Most in demand skills include line producers (script supervisors), location scouts, and location managers. The technical skills of the "below-the-line"[45] crew are insufficient and they lack proper training in modern equipment. Georgia also lacks skilled heads of departments, production managers, production assistants, audio engineers, light technicians, gaffers, grips, makeup artists, and production designers.
- ***Lack of practical training options:*** Existing training programs focus on film directing and script writing and there are no vocational education programs that teach practical skills. According to industry stakeholders, Shota Rustaveli Georgian State University of Theater and Film and Ilia State University are not viable candidates for development of practical training programs. Skills building in this business activity requires practical on the set training.
- ***Limited access to finance options:*** Limited equipment base in the industry, with only four equipment rental companies, is going to constrain growth in the long term. The industry needs to grow the equipment base to be able to grow film production services. This is constrained by high interest rates and collateral requirements for bank business loans. Banks do not have equipment loan products and leasing products are not developed as there is limited secondary market for film equipment.
- ***Burdensome VAT taxation*:** The Georgian Film Cluster has extensively lobbied the government on an amendment to the VAT law that results in "double taxation" for the film industry. When purchasing local services, such as accommodation or catering, film production companies pay the 18% VAT tax and the 25% income tax on all services purchased.
- ***Delays in cash rebate reimbursement:*** According to the cash rebate program rules, rebates of up to 1 million GEL (approximately $400,000) are approved automatically, while projects requesting higher rebates need special approval from the Government of Georgia in order to receive

[45] In film/TV there are two categories of crew: "above the-line" refers to the product's creative influencers – the screenwriter, director, actors, cinematographer and the producer; while "below-the-line" refers to those responsible for making the product – project manager, gaffer (lighting), grip (holding, moving, elevating the camera operator), lighting, sound, set design, costume design, hair and make-up and a range or other skill sets.

reimbursement. Some companies have reported delays in getting approval for rebates exceeding 1 million GEL. As bigger budget movies come to Georgia, more companies might encounter this issue.

- ***Weak general business skills:*** Film businesses need to improve their understanding of international requirements of major film studios and marketing, as well as develop legal, accounting, financial management and contract negotiation skills.

PRIORITY INTERVENTIONS

To grow this business activity, Economic Security Program will facilitate catalytic investments in workforce training, create pathways to youth into entry level jobs in the film industry, facilitate investments into the sector and strengthen industry collaboration to address joint concerns. For example, the Program will:

- ***Facilitate partnerships with foreign film studios for on the job workforce training*** to allow local staff to observe and be trained during the shoot. In addition, work with Film in Georgia to build in a training requirement into agreements with future foreign film companies and/or adding training of local staff into the "cultural component" of the cash rebate program where film companies qualify for an additional 1-2 % rebate.
- ***Build pathways for youth into the sector*** targeting unemployed youth that may not see itself immediately associated with the film industry, but may have relevant non-technical skills that are suited for entry level jobs during production, such as set construction/carpentry, transportation, catering, design, etc. Work with film production companies to identify top entry level needs and look at potential options for increasing awareness of opportunities among youth, potentially in collaboration with the main online job portals.
- ***Improve access to finance options*** though various mechanisms, such as working with Enterprise Georgia *Film in Georgia* program to offer subsidized loans for the film industry for business upgrading and equipment purchases; developing leasing products for the film industry; working with commercial banks to develop equipment and other loan products or line of credit targeting the film industry; and exploring opportunities together with Start-up Georgia under the Partnership Fund to support start-up businesses interested in opening up equipment rental facilities.
- ***Strengthen industry collaboration around business services, marketing and advocacy*** through building capacity of the Georgian Film Cluster to develop and offer sustainable services for the film industry, such as marketing, training and advocacy. Support advocacy efforts and public-private dialogue around the changes for the VAT taxation regime and increasing threshold for automatic reimbursement under the cash rebate program.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

Contracts with major film studios present opportunities to leverage investment from these film studios who have an incentive in building the required workforce in Georgia. In the global film industry, skills building in film production can only take place on the set, so such a practical on set training from leading film studios is a unique opportunity for Georgia.

- **Universal Pictures:** The Program has already engaged in discussions with Universal Pictures, which is willing to allow "on the job training" during the *Fast and Furious 9* filming in August 2019 and is ready to co-finance the training costs because they believe this will be a long-term cost-saving for future shootings. A possibility also includes sponsoring training of Georgian post-production professionals abroad. 200 experienced crew members from Universal will arrive in Georgia and "learning by doing" alongside those professionals will be a once in a lifetime opportunity for aspiring film makers and crew members. The Economic Security Program is currently developing a concept note for partnership with Universal which will be focused on developing the country's workforce in film production and post-production value chains.

POST-PRODUCTION VALUE CHAIN (SOUND, VISUAL EFFECTS, ANIMATION, EDITING)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Georgia's post-production/audio-visual services value chain is nascent and currently its participation in the global market occurs on a rather small scale. The global market opportunities however are significant and the markets for post-production/audio-visual services are growing at a rapid pace. Globally the film, animation, video gaming and advertising industries are key markets for post-production/audio-visual services - video editing, sound and music composition, visual effects, color grading, and animation.

The global film market, particularly the film production segment, is expected to grow at 6% CAGR in 2019-2023. The global film box office revenues are forecasted to reach $50 billion in 2020[46], with the United States and China being the largest film markets in the world, followed by the UK, Japan and India. In 2018, 8,204 feature films and 496 original series were produced worldwide, representing a 10% and 86% growth rates between 2014 and 2018 respectively. According to conservative estimates[47], the value of international feature film production made outside of California was $4.6 billion in 2015.

Global animation and video gaming industry had grown to $254 billion in 2017 and is projected to reach $270 billion by 2020. The global animation industry is dominated by the US, where the animation industry is supported by the Hollywood film base. Video gaming market globally, as a segment of global animation industry, represents the largest consumer of audio-visual services and is projected to grow at 6% CAGR during 2019-2023. In 2018, video gaming market was worth approximately $115 billion, up from $78.6 billion in 2017, and is projected to surpass $138 billion by 2021. Asia Pacific is the largest gaming market with revenues of $51.2 billion in 2017.

Global advertising spending has been growing steadily and is estimated at $563 billion for 2019, an 4.6% increase compared to 2018. In particular, the internet advertising industry is projected to grow at 9% CAGR for 2019-2023 reaching a value of $160.8 billion. The United States remains the largest global internet advertising market, valued $107.5 billion in 2018. The Georgian domestic advertising market in 2017 was worth $48.4 million, where TV advertising was valued $35.3 million and digital online advertising - $5 million. The advertising market was forecasted to grow by 5 percent and reach $51 million in 2018. Georgia's online advertising market has doubled in 2017 compared to 2014 and was projected to grow at another 25 percent in 2018.

The post-production value chain in Georgia is currently very small and post-production companies are serving markets primarily outside of the film production industry, namely commercials and video games. The industry is mainly domestic market focused (estimated 90-95% of revenues) and serving mainly advertising companies and corporate clients, in addition to some limited post-production work for Georgian films. There is a small but fast-growing demand in export markets from advertising and video gaming companies both in the region (Azerbaijan, Kazakhstan, Russia) and internationally (US, UK, France), which accounts for 5-10% of current revenues. In addition, according to industry stakeholders there is an emerging demand from film post-production companies in Czech Republic, Germany, Belgium, UK, US, Canada, China that are looking to outsource post-production work to locations that

[46] https://www.statista.com/topics/964/film/

[47] "Global Film Production Incentives", White paper by Olsberg SPI, June 2019

offer a competitive combination of quality and price. According to industry interviews, currently such contracts account for no more than 1-2% of total post-production revenues.

Because of the spending requirements defined as part of co-production agreements, post-production for most Georgian films usually takes place abroad. Therefore, there is limited local demand for post-production of Georgian films. In addition, despite the fact that the cash rebate program, discussed in the previous section, includes post-production expenditures for the movies filmed in Georgia in the list of qualified expenditures, all post-production for these films is performed abroad, since there is no capacity locally to offer these services at the quality level required by international film studios. It is estimated that even over 70% of commercials are, at least in part, outsourced for international post-production.

Although the production media industry has been growing overall during 2013-2017 at the rate of 23% annually, reaching total revenues of $17.7 million in 2017, due to lack of disaggregated statistics and heavy use of freelancers by the industry, it is not possible to estimate the extent of the revenues generated by post-production activities. Industry stakeholders estimate that post-production accounts for no more than 2% of all film industry revenues in Georgia, which would make post-production revenues equal to only $350,000 in 2017. However, this likely does not include freelance work, which would make these numbers more significant as reportedly commercials present as much as 50% of revenues for local film production companies, who typically outsource part of the work to local post-production companies.

ECO-SYSTEM

The post-production business activity segment in Georgia is currently very small scale and represented by about 10 small companies, mostly start-ups that have been in existence for 2-3 years and have on average 3-5 full-time staff. These companies are specialized and include sound editing, computer-generated imagery and visual effects companies, color grading/correction companies/mostly individuals, and animation companies. In addition, there are estimated to be about 50 freelance post-production specialists (colographers, VFX, sound) and about 50 animation specialists (concert artists, drawers, animators, 3D modelers, composers, texturing artists, mapping typology artists, and story boarders). The eco-system for supporting growth in this value chains is still nascent, with the weakest elements being workforce, access to finance, low business capacity, and lack of international visibility/reputation. The range of stakeholders involved in the eco-system for post-production is the same as for film production, discussed in the previous section, as two are intrinsically linked.

Developing post-production services in Georgia is a priority for ***Enterprise Georgia*** and the ***Georgian Film Cluster*** included membership representing the most post-production companies. Creative industries is also one of priorities for ***GITA*** and several post-production start-ups received grants from GITA. Skills development in post-production is a significant gap, as there are no school in Georgia what trains post-production professionals or teach modern animation. ***Tbilisi State Academy of Arts*** and ***Ilia State University*** have programs in computer graphics, however only 5-10 students are interested in this field annually. The ***Georgian Film Studio*** is an old Soviet film studio which however is still in use by post-production companies. It has good foley studio but is lacking sound mixing stages.

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

Although currently the Georgian post-production industry is relying heavily on domestic advertising market demand, due to its small size and lower value, the local market does not represent a viable long-term market. industry stakeholders see growth potential in developing **post-production/audio-visual services for export markets in sound, color grading, VFX, and potentially animation,** if Georgia could develop the required capacity. Market demand and opportunities exist to 1) increase the volume of sales to high-value clients in export markets – namely the US and Europe - focusing on post-production services for film (sound, VFX) and video games (VFX, animation), and 2) capture a larger share of contracts in the advertising industry with clients in Europe and the region (Central Asia, Ukraine, Caucasus), as well as domestic contracts that are currently being outsourced abroad.

This market opportunity is supported by the following global market trends:

- Due to rising costs of film post-production globally, many post-production companies are outsourcing some tasks to cheaper destinations with good quality. Georgia appears to have growing capacity and some competitive advantages in sound editing. However, in visual effects (VFX) Georgia will face strong competition from India which has recently been attracting a lot of the VFX work globally.
- Global demand for VFX and animation is growing rapidly from both video gaming industry and animated movies. The growth in the animation industry globally is driven by high budget allocation to animated movies. Production costs per animation movie are estimated between $20 million and $300 million and as costs increase, animation studios are seeking strategic partnerships and outsourcing opportunities to lower production costs. According to industry stakeholders in Georgia there is growing global demand for animation services and one animation company already had contracts for outsourced production of animated videos for Walt Disney and Nickelodeon productions. Demand also grows from video gaming companies in the US and Europe for VFX. This opportunity however is largely aspirational at the moment, as Georgia lacks required capacity in animation and has only limited capacity in VFX at this time.
- Contracts with international advertising companies currently account for about 10% of Georgia's post-production revenues, which however are growing fast. For Georgian post-production companies already working for the domestic advertising industry there are opportunities to increase their export market share, either directly to export markets or via contracts with local production companies.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

Post-production represents a higher value segment of the film industry, which is relatively labor intensive (particularly VFX), with higher value technology-based jobs. The salaries are significantly higher than the current average salary of 1,124 GEL/month (approximately $410/month).[48] The industry has few constraints to employment of women. With sufficient volume of contracts this business activity could generate year-round full-time jobs. Currently, an estimated 45 people are employed full time, plus 50-100 freelancers. Companies believe that if they doubled their revenues, they would need to double their full-time staff and the number of freelancers they hire per project.

[48] Source: GeoStat: https://www.geostat.ge/en/modules/categories/39/wages

While the market demand is significant, the growth potential of this business activity at the moment is still aspirational due to lack of qualified professionals that are trained up to international standards and lack of modern technologies and facilities. There is however, a strong desire to grow from the industry from the private sector side. This work can be performed remotely for distant end markets and can create jobs quickly. Change in this industry will take time and will not yield large numbers on terms of jobs and sales. However, because this is higher value opportunity in a market that is growing globally, Economic Security Program will take an opportunistic approach and look for opportunities to draw catalytic investment in the sector business and skills development which can be a game changer. It is estimated that with support from Economic Security Program, Georgian post-production companies could generate additional $500,000 in sale revenues and create approximately 80 FTE jobs. There are potential opportunities to facilitate at least 2 PPPs with international film studios and animation companies with benefits to workforce capacity building.

BUSINESS CASE

For film post-production, the market size is determined by the number of movies produced and their average budget. In 2018 8,204 feature films and 496 original series were produced worldwide, with film budgets ranging from $5-6 million for independent films to $70 - $300 million for a major film studio movie. The value of international feature film production made outside of California was $4.6 billion in 2015. Post-production that includes VFX, usually accounts for 20-30% of the film production budget. Production cost per animated film is estimated between $20 million and $300 million. The addressable market size for Georgia in the $254 billion global market for animation and video gaming and in the $160.8 billion internet advertising market is difficult to quantify, as Georgia's current revenues from post-production/audio-visual services, are estimated to be less than $1 million annually and few companies can secure steady steams of work. However, the growth in global market demand is evident.

Buyers for post-production/audio-visual services in higher value export markets, such as US, UK, France, are looking for a combination of quality and price. Quality is the first and foremost requirement, but buyers are also looking to outsource work to more cost-competitive locations. Georgia's key competitors in post-production and audio-visual services include Romania, Ukraine, Russia, and India (for VFX). According to industry interviews, the cost to do sound in Georgia is three times cheaper than in the US or Europe, and two times cheaper than regional competitors, like Romania. The quality of the post-production work in Georgia is considered good. It is not cheaper than India or China, but reportedly Georgia is considered culturally closer and more reliable by buyers. Costs are comparable to Ukraine, Russia, Poland. However, in VFX Georgia will face strong competition from India.

According to industry interviews, Georgia has the highest competitiveness potential in sound. Georgian professionals can perform music composition and record "foley" sound in an existing foley studio. However, the main competitive disadvantage is that only 80% of the work can be performed in Georgia at the moment, as there are no sound mixing studios. The sound editing work needs to be finished abroad, usually in the Czech Republic, Russia, Ukraine, Romania, Germany, France, Turkey. In addition, Georgia, does not have a Dolby Atmos studio, so the sound editing for major film studios cannot be performed in Georgia and the required level of sound quality. In visual effects, the scale of work is too limited to determine whether Georgia can compete with India. In animation, the industry stakeholders believe that Georgia is not yet cost competitive. The industry in general is not yet organized and has not realized the need to respond to global competitive pressures. While Georgians believe to offer better quality that Indian and Chinese animators, they charge higher prices and are not yet on the map of the animation industry globally.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

Georgia's main bottleneck in developing post-production capacity, is the sheer small number of companies and freelancers with the required skills to perform the work, as well as limited access to financing and limited scale of post-production companies. Industry stakeholders believe they would not be able to absorb significant amount of additional contract work due to lack of workforce.

- ***Lack of qualified workforce and modern skills:*** Most post-production professionals in Georgia are self-taught, are often not familiar with international standards and terminology, and lack proper training in modern digital techniques, processing software, and equipment. In addition, there is sheer lack of qualified post-production professionals, with an estimated 50-70 professionals in the entire country. Key skills missing include modern technical skills in sound editing, color correction, VFX and digital imaging. In animation, no modern animation is currently taught in Georgia, and key skills/professions missing include drawers, animators, 3D Modelers, texturing artists, mapping typology artists, story boarders.
- ***Limited investment in modern technologies and facilities:*** Post-production industry is lacking modern, digital technologies and facilities. About 70% of initial start-up expenses are for equipment and software; however, these are not affordable for many start-up companies. Internal cash flow is an issue as many start-ups have one off contracts and are struggling to secure continued flow of work. With regards to facilities, currently the post-production industry lacks specialized sound mixing studios, which cost from $100,000-500,000. As a result, only 80% of sound editing can be performed in Georgia and the work needs to be finalized abroad, usually in Eastern Europe (Prague, Bucharest, Warsaw).
- ***Weak market linkages and business scale:*** Georgian post-production industry is still lacking international reputation. Although post-production companies are starting to attract international clients, Georgia is not yet on the international map for post-production and animation work.
- ***Need for inclusion of post-production outsourcing services into the cash rebate incentive program:*** Post-production work is included in qualified expenditures within the cash rebate program. However, it only applies to the content shot in Georgia as part of the cash rebate program, and currently, the industry does not meet the quality requirements of these film productions. Post-production companies have been requesting the Government to extend the cash rebate program to include all post-production outsourcing services.
- ***Lack of enforcement of intellectual property rights:*** Currently, the majority of the companies and freelancers use pirated software. International buyers are concerned about security of their media content in Georgia.

PRIORITY INTERVENTIONS

To grow this business activity, improvements are needed in a range of capacity areas from investment in facilities and equipment, to creating a skilled workforce base, to international marketing and raising Georgia's reputation in post-production. This is a longer horizon investment for Georgia and Economic Security Program will take an opportunistic approach to support this business activity and will look for opportunities to draw in catalytic investment into the sector, rather than working to tackle individual constraints. Justification for working in this sector to the Program will be dependent on attracting catalytic investment into the sector workforce development which can be a game changer. Should a catalytic partnership be attracted into the sector, potential areas for Program assistance could include:

- ***Support private sector-led models for workforce training:*** Support development of internship and apprenticeship programs with Georgia post-production companies, who have already expressed interest in initiating own training programs for youth interested in audio-visual fields, particularly computer graphics and animation. Work with Tbilisi State Academy of Arts and Ilia State University to identify interested youth with computer graphic design and art background and incorporate practical training in curricula.

- ***Improve access to finance for investment in sector infrastructure:*** Approach banks (specifically ProCredit, TBC and Bank of Georgia) as well as Enterprise Georgia to co-finance asset loans (or leases depending on timing) to help companies access finance for needed investments in new equipment. Together with investment advisory groups like Galt & Taggart and Gazelle Finance, and possibly leading commercial banks, explore possibilities of attracting investors into sound mixing studios, upgrading for post-production studios and other larger scale facilities. Link post-production start-ups to microfinance institutions for small scale loans. Provide advice to post-production companies on banking finance and meeting requirements of financial institutions, either directly via the Program or via the EBRD Advice for Small Businesses program.
- ***Support international marketing:*** Provide cost-shared support for international marketing activities for post-production companies, integrated with the broader marketing initiatives for the film industry, via the Georgian Film Cluster and Enterprise Georgia Film In Georgia program.
- ***Expand cash rebate program to include post-production outsourcing work:*** Support Georgian Film Cluster to lobby Enterprise Georgia for inclusion of post-production outsourcing work into eligible expenditures under the cash rebate program.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

Two potential PPP opportunities are being evaluated by the Program:

- **Foreign direct investment in animation:** A potential partnership opportunity is being explored with an animation company in Jordan that is interested in developing a niche micro-site (50 employees or less) outside of Jordan and is considering Georgia as a potential location. The company will be looking for individuals with basic art/drawing skills and can teach them animation, graphics and storyboarding.
- **Universal Pictures:** The Program is in discussions with Universal Pictures, which is willing to allow "on the job training" during the *Fast and Furious 9* filming in August 2019 and is ready to co-finance the training costs. Initial discussions with Universal included potential sponsorship by the studio of training abroad for Georgian post-production professionals.

ARTISAN VALUE CHAIN[49]

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Georgia's artisans are among the best in the region, with significant skills in business activities such as fashion design, jewelry design, architectural design, woodcarving, painting, and stone carving among others. The business activities within the artisanal value chain are not home crafts or those that adorn most gift shops in tourist areas of Tbilisi, Batumi, and other sites in the country. Rather, artisanal business activities focus on high-end, custom creations that are designed by discerning customers.

The current global market for crafts produced by artisans is $38.96 billion and this amount is expected to grow $50.91 billion by the end of 2024. Demand for high-end, customized artisanal products is highest in the United States and Western Europe, but there is also significant demand within the GCC depending on the items. Discerning customers around are increasingly focused not just on the beauty and value of products produced by artisans, but also the story behind them. Socially-conscious programs featuring products produced by artisans have proliferated over the last several years, with initiatives

[49] Artisan is a term used to denote luxury, custom-made articles that are valued by high-end consumers. This is not to be confused with handicrafts, which likely do not have the potential outside of mass tourism to build the country's competitive positioning.

such as AfghanMark (www.afghanmark.com) and Far + Wide Collective (https://www.facebook.com/FarAndWideCollective/) receiving significant international acclaim.

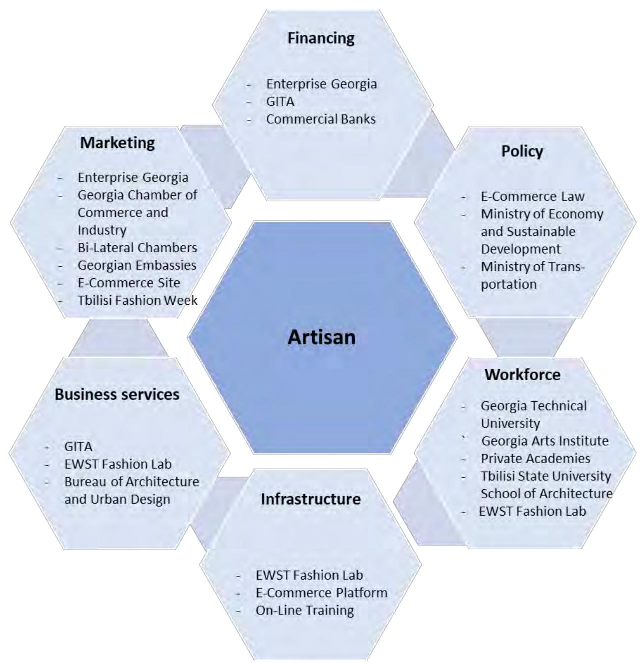
Programs such as these resonate with high-income customers who want handcrafted one-of-a-kind products, but also want to impact the social, educational, and/or economic welfare of the artisans and their communities. In addition, because items made by artisans are typically not "budgeted" or "staple" items, there is virtually unlimited demand among discerning customers. Unlike in many other value chains, artisan creations are unique and customized, so they are sold based on the customers' tastes and desire rather than on price, quantity, or delivery schedule.

While the preponderance of demand for artisan creations is on the international market, the domestic market for high-end, custom-made creations by Georgian artisans cannot be underestimated. Georgia's growing middle class, coupled with a growing number of well-heeled diaspora, have already made an impact in higher visibility areas of the value chain such as fashion and jewelry design. In addition, companies such as the Adjara Group's Rooms Hotel chain is sourcing Georgian-made art and design elements into its properties. This appears to be an emerging trend, as other hotel properties are now incorporating Georgian artisanal elements into their design and décor.

In short, Georgian artisans create products that are unique and that showcase their immense talent. Given the right sales and logistics platform, these artisans can use their collective talent to exponentially grow this value chain.

ECO-SYSTEM

The eco-system for the artisan value chain includes both traditional and non-traditional players. In recent years, private institutes have been developed for training in architecture and fashion-design, for instance, but are having difficulty with sustainability.



Gaps in the value chain exist in the area of marketing, sales, shipping/distribution, and finance, the latter being the inability of artisans to obtain contract or asset-based financing on a large scale.

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

The priority business activities within the artisan value chain are as follows:

- **Fashion Design:** Georgia's fashion design industry is emerging as a potential anchor for the entire value chain. Georgian brands such as Aznauri, Gola Damian, and Situationist recently gained significant notoriety at Mercedes Benz Fashion Week in Tbilisi and are also emerging on the international stage. Designers such as Irakli Rusadze, Alexander Arutyunov, Tamuna Ingorokva, George Keburia, and Alexandre Akhalkatsishvili are gaining recognition for their innovative approaches and collections. A number of designers, both known and as yet unknown, have opened shops in trendier areas are Tbilisi such as Vake and Old Town.
- **Jewelry Design:** Jewelry design in Georgia is not as visible as fashion design, but there are some artisans emerging on the national and regional scenes. Entrepreneurs like Maia Mikashavidze are gaining traction in this design space by focusing on creative uses of metals and gems. The specialty

niche for Georgian artisans in this space is the luxury jewelry market, as discerning buyers increasingly want one-of-a-kind and culturally important pieces.

- **Wood Carving:** Georgia has a long history in high-quality wood carving, both for home décor and in terms of art. Unfortunately, the number of carvers has receded over the years due to lack of opportunities. Many wood artisans are now focusing on home décor goods and high-end construction with a cultural flair.
- **Architectural Design:** Young architects like Nikoloz Lekveishvili are spurring the visibility and growth of this business activity. In October 2018, Georgia held its first architectural biennial which featured designs from local architects. At present, many Georgian architects are gaining experience by working as sub-contractors on international projects in the country, but a small core are emerging as prime contractors or lead designers.
- **Ceramics:** Georgia has a history of ceramics and pottery that dates back thousands of years, as pottery was used as receptacles for wine production. In modern times, however, Georgian artisans have introduced new techniques for the creation of high-end pottery for the home consumer market, as well as for discerning customers. Unlike other business activities within the artisan value chain, wood carving and pottery are those most linked to medium to upper-income buyers for home consumption, though specific pieces of ornamental pottery are interesting to high-income buyers.
- **Painting:** Georgian artists such as Alexander Berdysheff, Ana Chaduneli, Eka Abuladze, and Kote Jincharadze are part of group of emerging young contemporary painters that are positioning Georgia's art industry for growth. These painters are using different colors, textures and styles to create unique Georgian-centric art that is in demand throughout the country and the region. Most of this art is sold locally through their galleries, but there are opportunities for wider distribution that will create visibility and increase sales.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

There is moderate potential for growth within the artisan value chain as long as a) designers from different fields and genres can be persuaded to cooperate, b) there is a unified sales mechanism (e-commerce site) where Georgian creations can be offered to the world, c) significant marketing is conducted to brand the site, establish a socially-conscious sales strategy, and to promote the uniqueness of Georgian products, and d) a logistics/transportation platform is developed to facilitate delivery of artisanal pieces to customers around the world. If Georgian artisans could capture a small portion of the overall global demand for expensive, one-of-a-kind creations (.1%) it could generate more than $3.8 million per year in sales and catalyze the value chain. An important strategy in capturing market share will be to get Georgian artisans in front of major buyers and media outlets to promote their products and develop a band image.

BUSINESS CASE

The global demand for luxury, one-of-a-kind products is growing, with a CAGR of 9.2% annually through 2024. While the number of potential customers for high-end artisanal products from Georgia is relatively small, the revenue they could generate is significant. To capture a portion of the global market, however, Georgian artisans will have to cooperate to create enough mass to gain visibility under a unified brand.

Discerning customers are now looking for non-traditional markets for luxury, one-of-a-kind creations. Traditionally, in the European context, designers in Italy, France, Greece, and Spain controlled the market in certain areas of artistry, whether in fashion design or art. This trend is changing as the target demographic for luxury goods is getting younger and there are more sources of visibility and sales opportunities by artisans in emerging markets.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

- ***Lack of mass:*** The challenge for these artisans has been that none of these business activities is large enough on its own to move beyond one-off sales at local shops, exhibitions, or showrooms. Fashion and jewelry design have obtained assistance from some international donor organizations such as SIDA and some fashion and jewelry designers have shops in trendy areas of Tbilisi and Batumi. Even so, there is not enough visibility or mass among these or other artisanal business activities to establish a niche that could lead to competitiveness.
- ***Lack of sales platform:*** There is no e-commerce platform in Georgia that provides artisans in different field and genres the ability to market their goods to global customers. Most are existing on sales from the local/regional market or by focusing more on mass production than artisanal design. Georgia's regulatory environment allows for the development of e-commerce sites, so the way is paved to move forward in this area.
- ***Lack of logistics/distribution network:*** Even if an e-commerce existed, Georgian artisans do not have a way to get their creations to market on a global scale. A shipping network is needed that when linked to an e-commerce platform can provide artisans with both sales and shipping opportunities to target customers.
- ***Lack of visibility:*** Most Georgian artisans suffer from lack of visibility on a global scale and thus are forced to market one-off pieces at exhibitions and fairs throughout the region. Visibility is crucial to developing a global presence and ultimately a brand.

PRIORITY INTERVENTIONS

The USAID Economic Security Program can greatly enhance the competitiveness of the artisan value chain by:

- ***Facilitating cooperation:*** Georgian artisans in all genres must come together to develop an overall brand for their creations, as well as to cooperate on marketing, sales, and logistics. The Program can facilitate this developing an "Artisan Network" that links designers with potential markets and demographics. The Network will also provide training and support to assist designers in better understanding their customer base and they types of creations these customers desire.
- ***Facilitating the creation of an e-commerce platform:*** The Program will facilitate the creation of an e-commerce platform to showcase Georgian artisan creations under a unified, socially-conscious brand. The site will provide direct payment to artisans and will be sustained by a 3% fee assessed on every purchase, of which 1% will go into a marketing fund to create visibility for the site and the artisans. The Program will work with the local ICT community to identify a company(s) that can design and manage such a site. It will also explore linkage of Georgian artisan creations to existing global e-commerce sites as a bridge to launching and promoting one on the national level.
- ***Facilitating the development of shipping and payment platforms that links to the e-commerce site:*** The Program will work with the e-commerce site designer(s) to facilitate the creation of payment and shipping mechanisms to ensure timely delivery of goods and sustainability of the site.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

- **PPP:** Potential PPPs exist with both ICT companies that wish to develop an e-commerce platform for artisans, as well as with existing global sites that already have pricing and delivery mechanisms in place.
- **GDA:** Potential GDAs exist by linking promotion of Georgian artisan creations to high-visibility tourism initiatives such as the proposed GDA with Columbia Sportswear that will generate millions of followers on social media sites.

LIGHT MANUFACTURING SECTOR

FURNITURE VALUE CHAIN (CUSTOM, HIGH-END PRODUCTS, CONTRACT MANUFACTURING, CABINETS AND COUNTERS)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Georgia's furniture sector is established, but its progression over the decades is a complicated study in both market forces and human nature. Georgian furniture companies have been slow to change, reluctant to embrace new technology, and for the most part unwilling to invest in new processes and products that might make them more palatable for export. This being said, the VC Assessment Team's analysis highlights specific opportunities within specific business activities defined below, as there are a core group of companies/designers that are willing and able to pursue them. Continued focus on specific business activities within the furniture value chain makes sense when examining global market potential.

Global furniture imports amounted to more than $67 billion in 2018, with the United States generating more than a third of this total at $25 billion.[50] The United States and Germany imported more all wood furniture than any countries in the world at $6.3 billion and $2.1 billion in 2018, but the UK, France and the Netherlands are also significant importers. Georgian furniture producers captured virtually none of either the global or niche import markets.[51]

China is by far the largest furniture exporter, with over $28 billion in sales in 2018[52], but much of this is processed and low-end furniture for the mass consumer market. In terms of all wood furniture, China is still the largest exporter at $7.2 billion in 2018 but is at the low end of the consumer market.

Even though the numbers are small, there are three main export market segments of relevance to Georgian furniture producers. The export market segment that has historically been the most important is the regional export market—mainly to Caucasus countries and Central Asian countries like Kazakhstan. Until the last few years, Georgia exported cabinet pieces and individual furniture to supply mainly hotel construction and supply a few retail stores in Armenia, Azerbaijan and Kazakhstan.

The second main export market segment is what may be termed the international niche market. This market is for specific niche products other than the major high-volume market-leading mass-produced items that dominate in the high-volume consumer market. Niche products now being exported include reclaimed wood wall cladding and flooring, finger-joint boards, small volumes of wooden toys and some outdoor and children's furniture

The third international market segment is for contract furniture market. This segment consists of large-scale international retailers and designers/manufacturers that market their own brands of furniture.

[50] Source: Global Trade Atlas

[51] Ditto

[52] Source: Global Trade Atlas

These large-scale operators are increasingly looking to outsource manufacturing to firms in countries with lower costs that can produce to their required quality standards. More than 90 percent of exports are in the third, contract furniture segment—providing clear evidence of its potential.

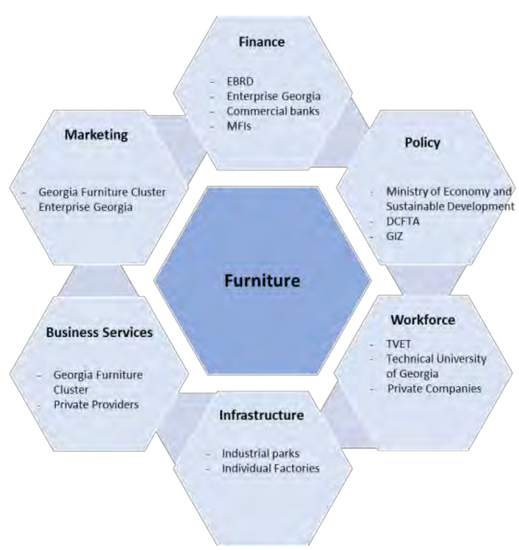
Georgia has significant potential for export to specific European Union countries such as Germany, France, Italy, and the United Kingdom in the areas of contract furniture production and high-value wood furniture. If Georgian furniture producers could capture just .01% of the German import market alone, it would generate approximately $21 million in annual sales. Clearly, the potential in niche business activities is significant, but for it to be so, local producers will have to change their production, marketing, and sales techniques to adapt to the demand.

Currently, much of the Georgian furniture value chain's mass comes from serving the domestic market. This market is comprised of three major segments. The first of these is the construction market, which made-up of both commercial and residential construction. This is the market that has fueled much of the growth in overall consumption, due to periodic peaks in construction activity, such as in 2013-2014, and an underlying strong investment in the domestic hotel industry. The second main domestic market segment is the mass market for individual furniture pieces. This is now being supplied mainly through imports consisting of two types: generally lower to medium quality furniture imported from China (or other low-price range producers) or second-hand European furniture. The last segment in the domestic market is what the study team is calling the "luxury market." This somewhat ambiguous label covers a variety of products spanning both individual furniture pieces and the flat-surface cabinetry and flooring from solid wood that predominates in the high-end of the construction market segment.

The challenge with furniture producers' strategy of focusing on the domestic market is that a) this market will likely slow significantly in the future, b) when this occurs, companies will not have developed significant export markets to capture lost revenue, because c) they have been content selling to the domestic market. As Jim Collins states in his seminal book on competitiveness, "Good to Great," this could create a "doom loop"[53] for furniture producers.

ECO-SYSTEM

While there are no obvious gaps in the furniture value chain eco-system, it is apparent from the country's lack of traction on the export market that there are issues beneath the surface with which both the Georgia Furniture Cluster and the companies themselves must deal. Most needed is a recalibration of strategy to focus on higher-value inputs and outputs within niche business activities.



In reviewing the eco-system, the continued progression of technical universities and TVETs is paramount to ensuring a pipeline of skilled labor. In addition, the Georgia Furniture Cluster, which operates like an association, needs continued capacity building to focus

[53] Collins reference to a doom loop denotes poor decisions compounding each other until a company (or in this case a value chain) spirals into a crash.

on a new reality for the value chain…one that will enhance exports in niche areas instead of focusing on past approaches.

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

Georgian furniture producers, while currently focused on low value added production, have some niches that can be explored:

- **Contract Furniture Production:** The example of GEOP shows the clear potential of the international contract furniture market. In only four years, once the market linkages were made with the key private label client and its production line established, GEOP was able to grow rapidly and now provides over 90 percent of Georgia's furniture export sales. This shows the potential of international contract work that is de-linked from the local market and its slower growing demand path. Previous consulting work commissioned by GIZ has identified possible market linkages for Georgian manufacturers with good products in such area as outdoor and children's furniture. To access these markets, Georgian manufacturers and designers will need substantial assistance in making market linkages, product development and testing, and in plant improvement and investment.
- **Custom, High-Value Wood Furniture:** While there is some original design work being done for individual furniture pieces, it is not yet linked to any sort of larger commercial strategy for product development and sales either into the domestic luxury market or, more realistically, into the international niche market for higher quality or original furniture pieces. Georgia has some of the key ingredients to succeed in the international niche furniture market. It has talented designers, a good supply of an emblematic local raw material (solid local wood), increasing international visibility from a thriving tourism industry with the potential to benefit from cross marketing between furniture and tourism,[54] and easy access to EU markets due to a free trade agreement and excellent shipment logistics. Obstacles exist in the form of a lack of strong collaboration between new product designers and furniture manufacturers, the long pipeline for product development, testing and market penetration, and the general low profile of design-oriented furniture in Georgia.
- **Cabinets and Counters:** While overall growth in the domestic furniture market is steadily trending upward at a slow pace, the market for hotel construction is growing at a much faster pace than the market as a whole. At least for the next two to three years, there is quite likely to be an exponential increase in construction firm demand for furniture and cabinets to fill new projects in the hotel sector. While some of this is likely to come through to the luxury market in the form of increased demand for high quality furniture and interior spaces, the largest part of this demand will be in the form of more basic and lower-cost flat-surface cabinetry and counters. This creates a clear opportunity for Georgian firms in both the low-cost cabinetry market and the higher-value luxury furniture market. To capitalize on this opportunity, it will be necessary to address serious capacity constraints at the level of smaller cabinet makers, as well as market organization challenges that will require new forms of cooperation between firms in the sector to respond to tenders and to handle increased volumes of work.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

The potential for growth in the furniture value chain is high in some business activities and not as much in others. Overall, the value chain will likely achieve a CAGR of 4.40% through 2024, which is not overly

[54] Some firms are already promoting "wine furniture" which consists of wine accessories, carts and buffets and special purpose tasting table/chair ensembles.

significant. Some business activities, like those highlighted as potential niches for Georgian producers, have a much higher CAGR, however, with estimates from 6.1-10.2%.

The takeaway in terms of growth potential, however, is that Georgia's current products and markets have relatively limited potential. Transition to lower volume, craftsmanship, and contract manufacturing, however, can lay the groundwork for sustained growth. Domestic sales are likely to slow over the coming years, so Georgian producers must improve their export potential by accessing new markets and focusing on new product offerings.

BUSINESS CASE

The business case for Georgia's furniture value chain is not clear-cut in terms of its traditional focus. The Program's analysis of the value chain reflects a future that has to be dramatically different from the past if furniture is to provide a competitive advantage for Georgia. The value chain's current positioning as the producer of lower-end furniture for mass-production, focus on assembly and fittings, and manufacturing for domestic consumption has left it vulnerable to market forces. Competitors in these business activities, namely China and Turkey, provide formidable and likely insurmountable competition for a demographic that is not consistent with the Georgia furniture sector's core competencies.

Regrettably, past studies and interventions within the sector have focused technical assistance, grants, and other support mechanisms on the same business activities that hold limited potential. After analyzing the market, three business activities emerged as potential differentiators for Georgian producers.

The contract furniture production market is growing exponentially and provides Georgian furniture companies with the opportunity to do custom and private label products for key retailers around the world, such as IKEA. This segment of the furniture value chain continues to expand and could allow Georgian manufacturers the maneuverability to take advantage of market niches. To do so, however, the value chain will need significant upgrades in equipment, marketing, and skills development. In the case of equipment, this will likely lead to contracting employment, but increased revenues and investment as precision manufacturing requires fewer people but has higher efficiency.

Custom, high-value wood furniture is a definite niche for Georgian manufacturers as it is a growing segment within the value chain within high net worth customers. This niche merges Georgian design with a high-value segment of the value chain that could provide low volume, but significant revenue per piece. The key in this business activity will be the ability of Georgian producers to position themselves in a way that promotes visibility and access to markets.

Cabinets and counters have been a core business for Georgian producers in the past, but mostly on the domestic market. This focus is finite in that it is dependent on a high rate of new construction that may not be sustainable. By focusing on wood-based treatments and high-quality custom cabinetry for high-value consumers as well as contract manufacturing, Georgian producers my generate fewer overall sales by volume, but increase revenues exponentially.

In short, the path for Georgian furniture producers is to focus on high-value niches and tap into a growing export market. By capturing 1% of the German furniture import market alone, the country's producers could eclipse their total exports over the past few years.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

Constraints to growth is the high potential business activities have been informed and prioritized based on market requirements and Georgia's competitive positioning discussed in the previous section.

The section below presents the main constraints to value creation in the furniture value chain. Rather than presenting an exhaustive list of constraints to the whole value chain, it is organized by the three

Business Activities so that constraints are mapped to specific business activities and specific actors in the value chain map.

Contract Furniture Production: The significant potential of international private label contract furniture sales has been amply demonstrated by the GEOP/Zoo Plus example. The challenge under this business activity will be to replicate this for other furniture product manufacturers and lines with other international clients such as IKEA and Habitat. Major constraints standing in the way of the realization of this business activity are:

- ***A lack of market knowledge and contacts in the international contract furniture market.*** Georgian furniture manufacturers lack both the marketing capacity and market knowledge to navigate through the complicated maze of international contact furniture relationships to identify both promising product lines and potential buyers at different market levels in target countries. Without assistance in this regard, there is little that they can do on their own to penetrate this market.
- ***Georgian furniture manufacturers lack experience in product development to fulfill international contracts.*** Once product and client opportunities have been identified, Georgian furniture manufacturers still face a long process of prototype development, testing and production planning for larger volumes of production than they are used to handling.
- ***Production facilities will require significant upgrading and investments in new production equipment.*** Moving to expanded contract manufacturing means that successful manufacturers will almost certainly need to expand into new factory space and open new production lines.[55] They will also likely need to attain international GMP and/or ISO certifications if required by buyers as well as re-engineer their process flows to accommodate larger volumes of production.

Custom, High-Value Wood Furniture: This Business Activity seeks to create value by developing commercially viable projects built around designer-led high-quality individual furniture pieces. It targets lower volume international specialty niche retailers and direct-to-consumer international marketing, although sales into the Georgian luxury market are an important ancillary objective (and maybe even a first step in a phased implementation plan). This is basically an attempt to 'commercialize' and scale-up the existing limited-edition designer-transaction channels. Major constraints to achieving this include:

- ***Poor collaboration between designers and furniture manufacturers.*** Currently furniture manufacturers have a purely utilitarian view of design---they view it as a tool they use to replicate existing designs. Similarly, designers only collaborate with manufacturers to produce for very small orders or for prototypes for design exhibitions. There is no longer-vision of developing original designs for Georgian firm branded products that have a potential for larger-scale production runs backed-up by a longer-term marketing plan.
- ***Low appreciation and visibility for quality and original design furniture pieces in Georgia.*** One contributing factor to the lack of collaboration between designers and furniture manufacturers is the low level of appreciation for original design in Georgia. The lack of a solid 'home base' of support for design in Georgia makes it harder both to develop an export market for original furniture pieces and to interest manufacturers in investing in design-intensive higher quality production runs.
- ***A lack of Georgian solid wood suitable for high quality furniture use with appropriate certifications for sale into high-end environmentally-conscious international markets.***

[55] Furniture factories in Georgia are generally in quite poor condition and virtually all would require some rehabilitation to comply with expected international buyer standards for contract work and many would require moving to or building new production facilities altogether. This is detailed in J. Murray, "Regional Analysis of Furniture and Wood Processing Sector in Georgia," Ligna Group, 2018.

Georgia's natural advantage in original growth forest wood (particularly beechwood which is excellent for furniture uses) is under-exploited due to a lack of high quality treatment after harvesting and due to a lack of sustainable forest management certification, such as that available under the international Forest Stewardship Council guidelines.

- ***A Lack of international marketing expertise and buyer contacts in destination markets.*** Accessing international niche markets is especially challenging due to the highly fragmented and local nature of specialty retailers in different countries. The challenge is magnified by the fact that most Georgian furniture makers have little experience planning longer-term international marketing campaigns (even in Georgia) and have a complete lack of market understanding and language capacity to develop the needed market linkages for sales into specialty high quality retail networks in Europe and Asia.
- ***Inadequate production facilities for increased volumes of high quality exports.*** While most generalist furniture manufacturers and high-quality craftsmen have the capacity to produce the very small limited-edition production runs that design houses need to fulfil individual client orders, to scale such production to make large-sized production runs to overseas clients who will want to see the production process, most manufacturers will need to make sizeable new investments in upgraded factories and production lines and to obtain standard international certifications like those available through ISO.

Cabinets and Counters: The fundamental challenge in this business activity is to upgrade the capacity of small cabinet makers in terms of quantity and quality to allow them to handle an increased workflow. It will also be important to foster greater cooperation between smaller cabinet makers and the higher-capacity general furniture manufacturers and solid wood specialists who deal in flat surface panels, as the latter have much greater managerial and financial capacity to respond to construction firm tenders. They may also require punctual additions to capacity that can be provided by smaller firm subcontractors. Specific constraints that are relevant for this Business Activity include:

- ***Low technical skills among current employees and a lack of technically trained prospective employees available to small cabinet manufacturers.*** Many small cabinet makers have a small core of senior level trained employees with a larger circle of more junior occasional employees. Given the high labor requirements of furniture making to deal with increased volumes and possibly moving to two-shifts, firms will require new employees at both senior and junior levels.
- ***Low business skills among small cabinet makers.*** Most small cabinet maker firm owners are technicians and carpenters. Many are not comfortable with common administrative tasks and formal requirements for participating in competitive tenders. Even more rare are the business skills required to manage firms through a growth process.
- ***A lack of basic design services and skills available to small cabinet makers.*** To respond to formal tender offers, particularly the larger ones, cabinet makers need proper design drawings and product specifications. Some firm owners make use of standard software packages to attempt this, but there is a clear need for wider diffusion or competent basic design assistance for firms at this level.
- ***Difficulty accessing investment financing for firm-level upgrading.*** Small cabinet makers who are seeking to upgrade their quality levels and increase capacity will need to make substantial new investments—both in equipment and in plant facilities.
- ***Many small cabinet makers have difficulty in participating in formal construction procurements.*** Due to limited administrative capacity and size, many smaller cabinet makers are unable to submit responses to construction tenders. GIZ had foreseen a role for the Ligna Group in submitting for such tenders that would be subcontracted out to smaller cabinet makers in the GFC and Craftsmen City networks. With the recent cessation of GIZ support, no such plan now exists.

PRIORITY INTERVENTIONS

Contract Furniture Production: Interventions under this activity will be organized around an initial market assessment to determine the potential market demand and its requirements matched against Georgian manufacturers' capacities. Following this, detailed individual firm-specific action plans will be developed with phased steps and targets for firms judged to have the potential to access the international contract furniture market. This activity will be led by an international contract furniture market specialist, with a deep knowledge of the European market and contractual practices. Specific interventions appear below.

- ***Conduct a market assessment of the potential of Georgian furniture manufacturers to access the international contract furniture market.*** This business activity will commence by the engagement of an expert in the European contract furniture market—who must have an extensive knowledge of the procurement modes of such chain retailers as IKEA and international hotel chains.
- ***Develop and implement detailed firm-level action plans to guide needed steps to enter the international contract furniture market.*** Following the initial assessment, the contract furniture market expert will work with an array of five to seven firms to assist them in developing realistic action plans with phased implementation steps and target dates by which they should be accomplished.
- ***Provide financing assistance to furniture manufacturers for equipment and plant upgrades***. Few or no Georgian furniture manufacturers have production lines and facilities that will meet the quality standard of international contract buyers. They will require, at a minimum, line retooling and more likely, given the potential for large scale orders, relocation to or construction of new factories. Since these investments are likely to be downstream of many prior requirements in different firms' action plans, the Program can consider offering grants support to leverage other sources of funding only with firms that have demonstrated real potential by achieving a number of prior-benchmark actions. In addition, assistance can be given in identifying other sources of funding or, potentially, new investors.

Custom, High-Value Wood Furniture: This activity aims to create totally new original design-based high-quality export products for the international niche market. This is a process that will require time to achieve its end goal, since the base from which it is starting is not well developed. It will require a certain amount of work in Georgia to raise the visibility of the role of design and raise awareness of the commercial potential of original design furniture, along with an international discovery phase in which product development can take place. This will require work with manufacturer and designers coming together to develop prototypes with an eye to both international market receptivity and the scaling of manufacturing processes in Georgia to meet anticipated volumes. Underlying the whole process is the imperative to create fruitful modes of collaboration between Georgian designers and design houses and furniture manufacturers, which are sorely lacking. Interventions to achieve these goals are outlined below.

- ***Raise awareness of the potential for design-led furniture.*** Georgian furniture owners have, in general, little appreciation of the market potential for original design furniture. Much of this is due to the low visibility of original design furniture and general lack of public appreciation. To create a more fertile environment for design, and furniture design in particular, the Program can work with the newly created Design Georgia Association to publicize original design products more widely.
- ***Develop new original design furniture products with commercial potential.*** To spur the development of original design prototypes and start building a basis of collaboration between designers and manufacturers, the Program will engage an international furniture market specialist with a background in new product development, ideally with a specialty in wood products (given its importance in most furniture pieces). This marketing expert will work with the Association Design

Georgia, various higher education design schools, and the GFC to canvass manufacturers and furniture designers and work with them to develop viable prototypes of original design furniture with materials and production processes that will be amenable to scaled-up production runs.

- ***Provide market linkage support for new original design products in the pipeline.*** The Program will work with manufacturers/design houses to help them identify viable buyers and distributors in target markets. This effort, to which the international furniture market specialist identified above will contribute, will include the identification and prospection of interest of brokers and relevant niche retailers in key target markets and tailored preparation for sales visits that could be part of the awards offered to winners of the original design prototype contest mentioned above. The Program will also work with the Design Georgia Association and/or GFC to set up direct e-commerce links and social networking strategies to promote direct sales of designer furniture to individuals in Europe and elsewhere.
- ***Promote investment in necessary wood supply chain improvements.*** Georgian furniture manufacturers are unable to derive the full benefits from Georgia's considerable advantage in producing wood, particularly beechwood, from its original growth forests because of poor post-harvest treatment. To support improvements in wood quality, the Program will seek to promote investment in improved wood treatment facilities at saw mills and possibly furniture manufacturers (if appropriate).
- ***Provide financing assistance to furniture manufacturers for equipment and plant upgrades.*** As sales of original design pieces take-off, the furniture manufacturers engaged in their production will require new investment to expand or retool their production lines to ensure higher quality production. Also, in all likelihood, they will need to make improvements to their plants to qualify for international certification that are likely to be required by buyers. The Program will help such actors access financing and investment to fund these improvements. This could include possible grant support to reduce funding amounts and attract co-financing from donor or commercial sources.

Cabinets and Counters: The strategic focus of this business activity is mainly on strengthening the capacity of smaller cabinet maker firms to help them capture a large share of the anticipated increase in demand for furniture emanating from the expected increase in hotel construction. A secondary focus will be on supporting linkages between smaller cabinet makers and medium sized generalist manufacturers and solid wood specialist to form consortia for responding to hotel construction firm tenders. Interventions to achieve these objectives are listed below.

- ***Provide increased technical training for small cabinet firm staff and management training for firm owners/managers.*** To deal with increased workflows, small cabinet makers will need more trained staff who are familiar with different types of raw materials and who can operating CNC routers and edge banders and conduct required finishing operations. Such a training program will accelerate the process of on-boarding new workers.
- ***Initiate a design service center for small cabinet manufacturers.*** In tandem with the training activity cited above the Program could work with the Craftsmen City/GFC to open-up a designer window in the Craftsmen City complex to offer schematic design drawings and specification sheets as a service to small cabinet makers and other furniture manufacturers.
- ***Provide market linkage and contracting assistance to small cabinet manufacturers for the local construction market.*** Given the highly atomized nature of the construction contracting environment and the lack of preparation of many small cabinet making firms, some level of market-linkage assistance will be required to facilitate them taking a greater role in the expanding hotel construction market. To do this, the Program could provide technical assistance through an embedded advisor, with either the Craftsmen City or the GFC, who would be tasked with

developing 'consortia' of furniture firms and small cabinet craftsmen to respond to tenders from hotel construction firms (and others).

- ***Provide support to small cabinet makers in accessing loans.*** To aid small cabinet makers in the Craftsmen City and beyond in accessing loans from commercial banks and other lenders, the Program could work with Craftsmen City management and/or the GFC to link these firms and lenders with suitable loan products and credit approaches.
- ***Initiate a "star firm" accelerator program for small cabinet makers with high-growth potential.*** The whole body of interventions identified above will be building to a larger objective—raising a pool of high potential small cabinet makers that will transform themselves into larger, more structured furniture manufacturers. In support of this objective, the Program could put into place a specific accelerator initiative, in which high potential small cabinet manufacturers who are successful in expanding their output and showing an aptitude for growth, can receive tailored assistance in customized areas that will boost sales.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

The furniture value chain lends itself to a number of partnerships that will build its competitive positioning:

- **International Furniture Manufacturers:** There may be an opportunity to engage with international furniture manufacturers to provide equipment and technical support for Georgian furniture producers to increase standards and become certified suppliers/contractors. This could provide support for the integration of Georgian producers into the contract manufacturing space.
- **Hotel Partnerships:** A number of hotels have already expressed interest in partnering to source custom-made furniture from local producers that is both stylish and culturally significant. Such a partnership could link the creative industries, light manufacturing, and tourism sectors while providing highly-visible examples of Georgian craftsmanship.

PACKAGING VALUE CHAIN (CARDBOARD, PLASTIC, AND CRATES/CONTAINERS)

GLOBAL MARKET ANALYSIS AND GEORGIA'S CURRENT POSITION

Like the furniture value chain, the real potential in packaging comes at the business activity level (defined below). These activities primarily focus on industrial and logistics use for both domestic and global consumption, though the real opportunity comes from capturing even small segments of the international market. Agriculture packaging for local and regional consumption is a possible niche, but this is best explored by the USAID Agriculture Project. The critical mass in packaging can come through the willingness and ability of Georgian companies to capture segments of the global market which have either been vacated by big competitors or where local firms can gain cost/value advantage. The business activities outlined below are those where the VC Assessment Team believes this can occur since there would need to be a minimum of retooling and up-front investment. Market linkages is the key to gaining traction in these business activities. The upside of pursuing targeted interventions in packaging is its continued global appeal.

Packaging is an $164 billion industry globally, with the United States leading all importers with $24 billion in purchases in 2018. France, Germany, and the Netherlands follow the United States in terms of global imports of packaging. Georgia is capturing less than .00001% of the demand from these three countries alone.

China and the Germany are the largest exporters of paper/cardboard packaging at $4.5 billion and $3.4 billion in sales in 2018. With only $9 million in exports in 2018 from all packaging sources, Georgia's share of the global and regional markets is nascent. Virtually all of Georgia's packaging exports are plastics. A large majority of exports go to Armenia and Azerbaijan.

Exports of packaging materials have progressed greatly in the last few years, exceeding over $1 million for the first time ever in 2012 and growing to almost $9 million in 2018. Exports of plastics packaging grew by 31.2% from 2017 to 2018, largely because of increased regional demand.

Virtually all packaging exports are shipped to Georgia's two main regional neighbors—Armenia and Azerbaijan. This growth is the result of two similar trends in each country—a rapid growth in the local demand for plastic packaging materials and a growth in Georgia's market share. In Azerbaijan, overall imports of plastic packaging materials increased by 60% between 2013 and 2018 (over $12.2 million in absolute terms) with Georgia's market share growing from 7% to 17%. A similar trend is evident in Armenia with a 2013 to 2018 import growth of 55% (which corresponds to an absolute growth of $5.1 million) and a growth in Georgian plastic packaging exporters' market share from 9% to 14% of total imports.

For reaching these markets, Georgia possesses some important competitive advantages by virtue of its geographic location. A key factor in the competitiveness of packaging firms is their ability to access raw materials at a low cost and with easy logistical access so as to minimize the need for large quantities of raw plastic materials stocks that eat-up working capital and generate financial charges that raise product cost. With its easy access to Black Sea supply routes and European transport networks, Georgia possesses a considerable advantage in this regard compared to packaging manufacturers in Armenia and Azerbaijan. The small size of the Armenian market also tends to make it reliant on outside suppliers of capital intensive products such as packaging.

While the above analysis shows the potential for plastic packaging exports, Georgian manufacturers of paper-based packaging products may also enjoy similar advantages. The same fundamental supply route advantages exist for accessing the needed supplies of craft paper that are used to manufacture paper sacks, cups and corrugated cardboard boxes.

The demand for packaging products is dependent on the growth and structure of business that need these products. Domestic sales of packaging products have been quite strong with more the $62 million in domestic production. One indicator of the value chain's health is that GDP increased only from $ 15.8 billion to $16.2 billion in Georgia over the 2012 to 2018 period (2.5% total growth over six years).[56] Such an anemic pace of growth would not normally produce a significant growth in business demand for packaging. This does not account, however, for the structural changes that are underway in the Georgian economy. These changes are producing a much stronger demand for packaging than would be predicted from just looking at overall rates of GDP growth.

[56] Growth rates are much higher when measured in GEL. However, we have used USD measures throughout this report as a more accurate indication of real values, given depreciations in the value of the Lari.

ECO-SYSTEM

The packaging value chain's eco-system has no obvious gaps, but there are a number of areas where it can be strengthened. At present, the value chain is built for the regional and domestic markets, so it will likely have to recalibrated for the export market, which will include modernization of equipment, strengthening of supply chains, and increased workforce skills among others.

In order to increase its competitive positioning, segments of this eco-system, such a PMAG, will need capacity building to help firms embrace opportunities (both export and domestic).

PRIORITY BUSINESS ACTIVITIES FOR GEORGIA

As the above analysis shows, there are considerable opportunities to increase output and employment in the packaging value chain due to an expanding national and international market. Georgian manufacturers in both paper and plastic-based product segments enjoy important advantages in terms of factor costs, raw and final product logistics relative to suppliers in the main regional competitor, which is Turkey. They also benefit from the fact that the lead firms in the value chain are relatively new, outward-looking and led by younger dynamic owners. These market opportunities in both the domestic and export markets combine to drive a realistic business activity for the value chain that can be defined as follows:

- **Plastic Containers and Wrapping:** The main category of packaging products produced in Georgia are plastic containers that are used mainly for food packaging. These include: plastic bottles, tubs and cartons used for dairy products and beverages; molded plastic containers used for eggs, containers for chilled perishable fruits such as raspberries, blueberries and strawberries; and serving containers for use in the food service industry (restaurants, grocery store deli counters, caterers, et al). Like plastic cups, if used for food packing, these must be produced according to sanitary norms. In addition to plastic bottles and containers, one firm is specializing in the production of heavy-duty plastic shrink wrapping used to protect open pallets of such items as beverage bottles or cartons and another is reported to produce rigid plastic crates referred to in the United States as "milk crates."[57] The global plastic container and packaging industry continues to expand, with more than $45.2 billion in global exports last year. Of this total, the United States was the largest importer at $7.8 billion, with Germany, France, Mexico, Canada and the United Kingdom following ($3.9 billion, $3.1 billion, $2.8 billion, $2.4 billion, and $2.3 billion respectively. The global export market for plastic containers and wrapping is valued at $48.2 billion, with China, the United States and Germany being the largest sellers ($9.2 billion, $5.5 billion, and $5.2 billion respectively). In terms of exports, however, Georgia could gain an additional $39 million in plastic packaging exports by capturing just .01% of the German import market.
- **Paper/Cardboard Containers/Boxes:** These are produced mainly from imported craft paper, which are heated and combined with glue and starch to form corrugated cardboard panels with

[57] There is also one firm in Georgia that produces glass bottles and containers. This firm, which is owned by Turkish shareholders, is not a member of the newly formed Packaging Manufacturers Association of Georgia (discussed below in the value chain linkages section of the report). The study team was unable to gain information on the glass bottle segment of the market. It was also impossible to separate out glass bottles in the GEOSTAT production data from other types of glass products that have no packaging uses. The analysis in this report, therefore, excludes glass bottles.

different thicknesses and finishes. These can then be printed with designs and text as an option before being cut to size and pressed to create pre-marked folds to result in boxes of the desire shape and size. These boxes are put on pallets and shipped to clients in non-assembled form. The global carboard and paper packaging industry has contracted slightly over the last few years, with imports of more than $18.6 billion in 2017 versus $19.2 billion in 2013. Even so, the United States imports more than $2.7 billion in cardboard packaging per year followed by France, Germany, and the Netherlands at $1.9 billion, $1.6 billion, and $1.2 billion respectively. This represents a sizable opportunity for Georgian packaging producers if they can meet international standards. Simply capturing .01% of the French market for cardboard and paper packaging would bring in $19 million in export revenue annually.

- **Paper Cups/Bags:** These are also made from rolls of imported craft paper. Bags are simply heated and cut to form. Paper cups go through a molding process. A key part of the production process of these products is printing of the paper before it goes through the cutting and molding stage to produce custom printed cups and bags in response to client demands. Paper cups can be made from just paper, in which case they are used for cold drinks, or they can undergo a process that imparts a thin layer of plastic polyethylene on the interior surface that makes them suitable for hot drinks like tea and coffee. Paper cups need to be produced in a food-grade line with sanitary handling procedures and an automated process that keeps surfaces that touch food free from any human contact. The paper cup and bag business activity generates $1.7 billion in imports globally with the United States, Canada, and Germany being the largest importers of these goods at $380 million, $223 million, and $146 million respectively. Simply capturing .1% of the German import market for paper bags and cups would generate $14.6 million in annual revenue for Georgian producers.

To do this, the Program will need to work on both the firm and value chain levels to help manufacturers address constraints that are preventing them from expanding and accessing new market segments. A key focus of this will be on helping plastic and paper-based manufacturers to meet the market requirements of buyers in the food industry, in which demand is expanding most rapidly. This will include working on needed certifications to enter into procurement relationships with international chain restaurants and supermarkets with food service offerings who are operating in Georgia, in the region and even in the European Union. Constraints and interventions to achieve the objective of this business activity are outlined in the final two sections of this report.

POTENTIAL FOR GROWTH (INVESTMENT, HIGH(ER)-VALUE JOB CREATION, ENHANCED REVENUES)

The three main types of manufacturers shown in the value chain map fall into two major categories: plastic-based and paper-based manufacturers. The two types of paper based manufacturers both use imported craft paper rolls as their fundamental input.

Plastic packaging good manufacturers use a process that heats and forms the desired items out of different types of raw plastic inputs. Many use a two-step process in which raw plastic resin pellets are transformed in to sheets of desired thickness through a heating and pressing process. These sheets then are printed with desired labels and imagery (if required) and molded into the final products.

A key part of the production process for both plastic and paper-based packaging products is printing. The selection of the type of printing process used is a key element of firm-level specialization and business strategy. Historically, printing firms have used off-set printing using plates and rotary printers that produce high quality printing in large volumes.

Both plastic and paper based production processes are capital intensive. The larger and most efficient manufacturers in both categories have investments in plants and equipment that easily top $4.0 million in capital expenditure. At the lower end of the manufacturing size spectrum, there are smaller carboard box manufacturers with one or two lines for producing different gauges of cardboard and a single flexi-graphic printing station that are operating with fixed investment of less than $1.0 million.

The high capital intensity of packaging manufacturing means that is essential for firms to operate as efficiently as possible, with minimal plant downtime and low variable costs to maximize total gross margin in order to cover the significant fixed-costs of getting into the business. Thus key elements of firm level competitive advantage include: minimizing the wastage of raw materials; ensuring maximum capacity utilization (most firms operate on two production shifts) of equipment at which production bottlenecks occur; and offering an attractive range of final products (which often means investment in different production lines) to avoid over-dependence on a single product or client and increase attractivity to those clients who demand multiple products (such as fast-food chains).

BUSINESS CASE

The competitiveness positioning of Georgia's packaging value chain depends on a focus on differentiating business activities that provide the most direct path to investment, high(er)-value job creation, and/or revenue increases.

- **Retailer Needs:** Retailer packaging needs are mainly for providing and conditioning products for sale for customers. By far the largest such product is bags for grocery stores and other retailers that sell assorted small-sized items. Wrapping paper is another such product. Occasionally retailers will also need cardboard sheets for padding or stacking heavy products—such as furniture. The most common goods shipment product is simply corrugated carboard boxes, that are cut to order to reflect buyer size requirements and set to specific thickness levels depending on buyer durability requirements.
- **Food Packaging Needs:** Food packaging needs arise when manufacturers and food service outlets need to place food in some type of packaging in order to transfer it to a consumer. In these cases, the food comes in direct physical contact with the packaging, which means it is subject to regulations governing food safety and, in many cases, to stricter buyer requirements as a way of limiting firms' consumer liability exposure. Products in the food packaging category include paper-based products, mainly cups and individual serving containers mainly for fast-food restaurants. Plastic- based products include many types of retail containers used by dairy and other food manufacturers or suppliers that require some type of refrigeration and which must have good durability.
- **Goods Shipment:** Goods shipment in the packaging value chain has a broad connotation, as it encompasses everything from cold chain transport to shipping containers. The sheer volume of transportation mechanisms around the world creates space for manufacturers to produce a plethora of products that are conducive to ease of shipment.

KEY GAPS IN PRIORITY BUSINESS ACTIVITIES

The primary gaps/constraints to value creation in the packaging value chain, focusing on the key constraints that stand in the way of successful implementation of the business activities listed above.[58] Key individual constraints are listed below.

- ***Manufacturers require up-dated equipment, production lines and improved plants.*** Although there has been much investment and new market entry into the packaging business over the last five years, many firms have evolved to the point where they now understand the market and have acquired enough technical expertise to see what further investments are required to allow them to

[58] These constraints are not delineated by business activity because they are common to all of those listed.

grow and expand market share in specific segments—such as the food and beverage segment and with international chain supermarkets and restaurants.

- ***A lack of qualified machine operators and skilled packaging operations managers and supervisors hinders growth in output.*** As noted above, there is a very small base of skilled workers and managers who know both technical operational skills and who have sufficient understanding of the economics of production to maximize overall profitability. All the people who can do this already employed by the firms in the sector and there are no functional training programs to provide skills to new employees. Most firms have sought to enlist the help of international equipment vendors to overcome this obstacle, as mentioned above, although this is a strategy that is hit or miss and is more likely to produce good results at the skilled-worker level than at the production manager level.
- ***Many firms need to obtain international certifications.*** As noted above, the PMAG and UKAID had begun an effort to assist packaging firms with obtaining international certification needed to export. That effort has now come to a halt. Without such certifications, it will be hard for these companies to access international procurements with food and supermarket chains, as well as to even begin supplying chain outlets that are now active in Georgia.
- ***Firms will lack sufficient capital to make needed improvements in plants, equipment and operations.*** Improvements to plants and equipment will not only entail developing strategic and technical plans, it will require increases in investment and working capital. Manufacturers in the value chain have shown some ability to access long-term loans from banks and in some cases from Enterprise Georgia. However, the scale of the investment required to obtain international certifications will easily surpass $1 million and maybe even $2-4 million if a completely new factory building is required.

PRIORITY INTERVENTIONS

The Program will focus on the following interventions to build the packaging value chain's competitiveness:

- ***Assist individual firms in elaborating and implementing firm-level upgrading plans.*** The Program could recruit and-engage one or two international short-term experts in packaging to serve a continuing role as technical and strategic advisors to Georgian packaging firms who have realistic prospects for upgrading their operations and expanding their sales base.
- ***Develop a roster of qualified technical experts to assist Georgian packaging firms and provide cost-share support for needed training and technical assistance.*** As noted in the constraints section, firms have tended to link their needs for technical training with their choices of equipment suppliers. While not unreasonable, this strategy has its limitations in that it may not give firms as much exposure to a broader range of technical and strategic options. To help address this constraint, the Program could work with PMAG to identify and vet a cadre of international technical consultants in relevant fields who are available for training and advisory work for individual firms and who may also be engaged to provide common trainings for multiple firms on such topics as optimizing raw materials procurement and production planning, cost accounting approaches and software packages for managing plastic and paper-based production processes; waste management and good environmental practices; etc. The Program could coordinate with PMAG to implement this activity, with PMAG taking a role in developing and maintain the roster, collecting feedback on consultants, and even in contracting with consultants to provide common trainings to multiple firms.
- ***Provide assistance to Georgian firms to help them obtain international certifications.*** A key part of many firms' upgrading plans will be to obtain one or more of the major certifications required by buyers, particularly international food service chains (including supermarkets). These

certifications (including mainly different ISO and British Retail Council certifications) are very likely to require changes to plants and equipment lines as well as to operational procedures and procurement practices. To support this effort, the Program could contract with a qualified certification consultant or a firm to conduct initial pre-certification assessments of firms working on upgrading plans, as soon as a critical mass of firms have progressed to the point where they have fine-tuned their exact certification requirements based on their sales objectives.

- ***Assist packaging firms that are implementing upgrading plans with financing.*** As noted in the constraints section, virtually all firms implementing upgrading plans will need to make significant additions to plant and equipment. Although some firms may only require a few pieces of equipment for less than $1 million, many more firms will require investment in the $1 to $4 million range. Significant investments on this scale will likely require a mixture of different types of financing—from working capital, to longer-term debt and eventually even equity or pseudo-equity investments. To help packaging firms implementing upgrading plans to source the needed financing, the Program could engage a local financial advisor or management consultancy firm to work with each company to develop a tailored approach to funding that includes different levels of finance.

PUBLIC-PRIVATE PARTNERSHIP OPPORTUNITIES

- ***Partnership with Local Retail Firms:*** The Program will work with local retail firms (e.g. supermarkets) to better understand their packaging needs and to develop co-designed partnerships between them and Georgian packaging manufacturers.
- ***Research and Development:*** The Program will work with the Association of Packaging and Processing Technologies, a global representative of the packaging industry, to co-design market linkage and volunteer expert interventions that will enhance the knowledge and experience of Georgian packaging firms.

Partnerships will be explored in this value chain based on industry-led requirements for integration of standards, technology, and supply chains.

V. INVESTMENT ECO-SYSTEM, PUBLIC-PRIVATE PARTNERSHIPS AND INVESTMENT OPPORTUNITIES

OVERVIEW OF THE FINANCIAL SECTOR AND INVESTMENT ECO-SYSTEM

Georgia has become one of the most business-friendly countries in the world, rising up the ranks from 9th to 6th best country in the world in terms of economic development and ease of doing business among 190 countries in 2018[59]. This progress has come as a result of deep reforms across the economy that have fueled robust growth over the past decade averaging 4.5 percent. Among these reforms are the simplification of registration procedures to start a business, the improvement of process to make paying taxes easier and the improvement of contract enforcement. These reforms combined with improvements in governance have enabled Georgia to become an attractive market for investment.

Government of Georgia ministries and agencies, particularly the Ministry of Economy and Sustainable Development and its sub-agency, Enterprise Georgia, are motivated to affect change, particularly for SMEs and start-ups. They do this by proactively partnering with local and international investors and providing a variety of financial and other incentives to build new and expand business growth in key industries, with an emphasis on those industries located outside of Tbilisi including tourism, hospitality, and meetings, incentives and exhibitions (MICE), manufacturing, film, information and communication technologies/innovation, business process outsourcing and industries that enable the export of products from Georgia.

Indeed, Georgia boasts one of the most robust and stable financial sectors in the Eastern European region, albeit conservative, and heavily dominated by banks. In fact, banks account for 90 percent of all financial sector assets, with total banking sector assets at around 41 billion GEL (approximately $14.1 billion) as of May 2019[60]. The two largest banks, TBC Bank and Bank of Georgia (BOG), both partially foreign-owned, account for 75 percent of total banking sector assets. Both are listed on the London Stock Exchange and are part of the FTSE 250 Index. Given no legal limitations in Georgia that ring fence corporate and investment banking (as has been done in the US with the Glass-Steagall Act[61]), both TBC and BOG have both developed investment holding companies, TBC Group and BGEO Group, that expand beyond corporate and retail banking to include investment and advisory activities.

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[59] *Doing Business Rankings 2018*. World Bank.

[60] *Financial Sector Review: Analytical Tables and Charts*. National Bank of Georgia. July 2019.

[61] The US Glass Steagall Act prohibited commercial banks from participating in the investment banking business and vice versa. Glass-Steagall lost its power in recent decades and was partially repealed in 1999. Recent financial crises have led to talk in political and economic circles of reviving the act.

In addition to the banking market, there is a small non-bank financial sector which includes microfinance organizations (MFOs) and credit unions that provides small loans to microenterprises and individuals which make up the majority of businesses, particularly outside of the capital. As of the end of 2018, total assets for the microfinance sector totaled 1.5 billion GEL[62]. There are also insurance companies and leasing companies, neither of which is regulated by the central bank; both segments have legal and regulatory limitations that limit their ability to invest and lease to businesses.

Outside of banking, the Georgian investment ecosystem is small. Georgian capital markets are not well developed, comprised only of two stock exchanges, one central securities deposit, eight brokerage companies and securities registrars that are licensed to carry out activities in the securities market. There is little to no trading happening on the stock exchanges. The National Bank of Georgia (NBG) serves as the mega-regulator of the financial sector, regulating and supervising the banking sector, the non-bank financial sector and capital markets; it does not regulate the insurance sector[63]. Given its primary focus on banking, it has been more measured and gradual in developing capital markets' instruments. These steps have included developing money and interbank markets, then government paper/treasuries, and then local currency bonds, the first of which was issued by the European Bank for Reconstruction and Development in 2014. More recently, other international financial institutions (IFIs) including the Asian Development Bank (ADB), the International Finance Corporation (IFC)[64] and commercial banks have issued Euro bonds, and some larger companies have begun issuing corporate bonds, all in local currency. That said, Georgian bond issuances have been quite limited to date, although use of these instruments is expected to grow as has been the trend in the rest of Central and Eastern Europe. The World Bank continues to support the Government and the NBG to develop other fixed income securities for the local market.

Georgian equity markets also remain small and relatively illiquid. Securing financing for start-ups is severely limited. There are only a handful of local equity investors, including a small number of internationally affiliated investment groups, bank-affiliated investment groups, and others associated with wealthy and politically connected individuals. Institutional investing from pension funds and insurance companies remains limited given the nascent legal frameworks. On the pension side, the Georgian parliament passed legislation enabling a mandatory accumulating pension system in July 2018 (Pillar II under the European system) and much work is now being done to set up the enabling regulations and structures. With respect to insurance, there is no institutional investment happening from the insurance sector in part due to a limited roll out of motor third party liability (MTPL) insurance to only transit vehicles (and thereby limited premiums collected, only 30 million GEL in the year and a half since the law was implemented.) The Georgian Insurance Association is currently lobbying on behalf of industry for a full implementation of the Motor Third Party Obligatory Insurance Law in Georgia, a draft of which currently sits in the parliament. Passage of this law could open up a new source of investment capital as well as need for long term investment mechanisms. However, passage of this law in the short term is highly uncertain.

It is important to recognize that development finance institutions, donor projects and public-sector support institutions and programs have increased focus on finance and investment in Georgia, notably for tourism and hospitality. Table 12 below highlights some of the idiosyncrasies of these investors, their preferences with respect to return versus impact, risk appetite and investment outlook.

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[62] *Georgia's Microfinance Sector*. Galt & Taggart. January 2019. Note: since the publication of the research, total assets have fallen given new regulations that set interest rate caps and has required more comprehensive borrower indebtedness analysis, thereby pushing several MFOs out of the market.

[63] Note: since 2013 the Insurance State Supervision Service of Georgia (ISSSG) has taken over the regulation of insurance companies and pension funds.

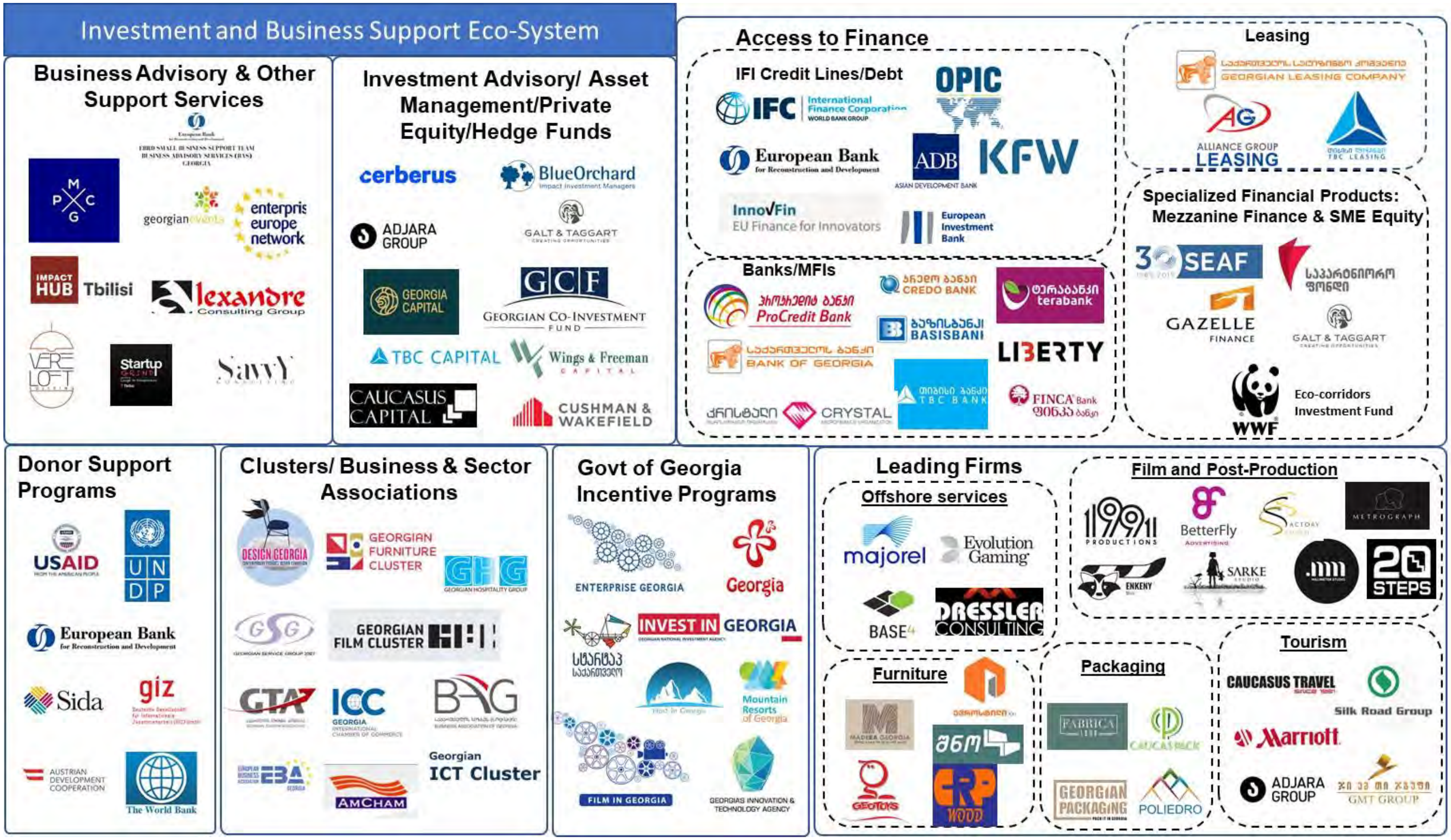
[64] Gattini, Luca Gattini, and Tamar Baiashvili. *Neighbourhood SME Financing in Georgia*. European Investment Bank. February 2016.

TABLE 13: CATEGORIES OF INVESTORS AND THEIR INVESTMENT PROFILES

Investor Category	Return vs Impact	Risk Appetite	Investment Structure Preference	Time Horizon & Currency
Informal Investors (High net worth private individuals)	Impact: ++ Finance: +	Medium/High	Equity mostly $5,000-$500,000 per deal (may syndicate multiple investors with average of $40,000 per investor)	Patient capital & USD/ EUR mostly
Regional Institutional Funds	Impact: +/- Finance: +	Medium	Comfortable with debt and equity instruments Venture $100,000-$5 million, PE > $5 million	Patient capital & USD/ EUR preferred
International Institutional Funds	Impact: + Finance: +	Low/medium	Comfortable with any investment instrument Venture $500,000-$5 million, PE > $5 million	Patient capital & USD/ EUR only
Local Lenders (Banks)	Impact: +/- Finance: +	Low	Mostly Straight Debt	Less patient, mostly local currency given lari-ization
Public Sector Investment Funds	Impact +	Medium	• Micro Grants for innovative start-ups up 5,000 GEL • Grants up to 100,000 GEL with 10% co-financing • Cash rebates (film) of 2-25 percent • Leasing interest rate rebates of 12 percent on leases between 100,000 and 5 million GEL • Guarantee schemes covering loans between 50,000-2 million GEL • Equity up to 49 percent on construction of infrastructure in core sectors	Patient capital

The section below provides an overview of the investment ecosystem, including more specifics about the Georgian banking sector and products available to SMEs including non-financial business support that might support selected sector. It also discusses in greater detail the nascent investment funds and advisory services that the USAID Georgia Economic Security Program could collaborate with to support opportunities that align with the project's development, investment and public-private partnership objectives. Figure 7 provides an overview of the Georgian investment and business support ecosystem.

FIGURE 7: INVESTMENT AND BUSINESS SUPPORT ECOSYSTEM



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BANKING SECTOR

Banking is one of the fastest growing sectors of the Georgian economy, as illustrated by the 20.4 percent growth in assets annually and 20 percent growth in deposits[65]. Sixteen commercial banks operate in Georgia, eight of them fully foreign-owned and five with a majority participation from foreign investors. However, as noted above, the sector is concentrated in two banks, TBC and BOG, which dominate the landscape and compete heavily across all areas of lending including increasingly for the SME sector. Of the two, TBC currently has the largest share of the SME market, but BOG is aggressively targeting SMEs (they currently have more than 90,000 microenterprise borrowers and feel this is a base from which to grow), particularly outside of Tbilisi, Kutaisi and Batumi. A third largest bank, ProCredit, a German bank focused predominantly on SME lending, captures a much smaller percentage of the market but is viewed as an emerging player, particularly for SMEs. ProCredit lacks the branch network of TBC and BOG utilizing its digital platform to expand its market share. Additionally, two banks, FINCA and CREDO, are former microfinance organizations that restructured and became licensed as full-fledged banks, though continue to target more down-market lending and often work in coordination with donors and IFIs to promote sector specific lending aimed at growing smaller or women-owned enterprises. More extensive description of several of the largest banks and those lending to microenterprises and SMEs can be found in Annex 6.

In the past five years, bank lending has expanded substantially. Credit to GDP ratios which have grown from 45 to 59 percent from 2014 to 2017[66]. 2019 has seen increase in lending (3.9 percent) particularly in GEL loans. In recent years, however, a substantial part of this growth was in retail (consumer) lending including substantial growth in this segment by non-banks (see microfinance below). Regulatory changes imposed by the NBG including interest rate caps (first at 100 percent in 2017, then to 50 percent in 2018) and then in 2019, requiring lenders to ensure that loan sizes do not exceed a threshold ratio of the individual's total indebtedness measured against income and that retail loans of less than 100,000 GEL must be made in local currency. These changes have had a significant impact on the market in two ways: it reduced lending for mortgages (which were classified as retail loans) and also impacted the portfolios of banks and MFOs, shrinking the number of retail loans made as well as having some portfolio impacts on those retail shops (particularly those in the consumer electronics space) who saw a decline in business as a result. Also, in 2016, the GoG and the NBG jointly created a 10-point lari-ization plan with the aim of increasing access to local currency loans, minimizing foreign exchange risks and adjusting lari pricing in the market.

In terms of interest rates, there has been a downward decline in interest rates for both dollar and GEL-denominated loans and the sense that banks are passing on efficiencies to the end client over the past five years. Interest rates have declined from a high of 21.7 percent on GEL loans in 2013 to 12 percent in 2019. In general, all the banks beyond the big two have limited access to local currency because they do not attract deposits like TBC and BOG. As a result. their cost of funds and therefore interest rates are slightly higher. There are efforts afloat to issue local currency bonds that would raise capital for these banks.

On the collateral side, there is no secured transaction law that would allow enterprises to pledge assets other than real estate collateral. Work on a draft law has been slow. However, its passage could open up opportunities particularly for smaller banks.

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[65] *Doing Business in Georgia: Commercial Guide for Investors*. Grant Thornton. 2018.

[66] Giucci, Ricardo, Alexander Lehmann, Giorgi Mzhavanadze, and Anne Mdinaradze. *Banking Sector Monitoring Georgia 2018*. German Economic Team Georgia. March 2018.

SME Lending

Although definitions for SMEs differ from institution to institution (and are not consistent from financial institutions to the NBG), SME lending has grown substantially over the past decade given the competitive pressures of the banking system, and access to credit facilities and credit enhancements from IFIs. Credit extended to SMEs has grown from 21 percent of all credit extended in 2016 to 23 percent in 2017[67]. Also, with the NBG's lari-ization program, more local currency loans are available to SMEs, reducing the currency mismatch that many faced back in 2014 and earlier when banks lent largely in foreign currencies[68].

Of the two largest banks, SMEs make up a core part of new lending. Below are brief descriptions of the products and terms they offer, as well as specific strategies and priority areas for the coming years:

- TBC provides a range of products for SMEs including trade finance, letters of credit, guarantees, and factoring products. TBC staff noted their interest in geographic expansion outside of Tbilisi as well as into neighboring markets. One of TBC's differentiators is its interest and focus on start-ups, particularly greenfield investment, including start-ups outside the technology/innovation space. They also provide a "maternity/paternity" cover for employees who wish to take time off to start-up tech related businesses. It has numerous clients in the tourism and hospitality sectors, particularly travel agents. TBC offers competitive interest rates on lari, USD and Euro loans, ranging in cost between 10-12 percent, 7-10 percent and 5+ percent for each currency, respectively. With assessing the business and its assets/collateral, TBC does take into consideration other assets including grants coming into a potential SME client for specific projects.
- BOG provides a range of products for SMEs similar to those of TBC. The Bank has taken a keen interest in the tourism and hospitality sector and is currently evaluating several technology-based platforms that allow hotels and guest houses to manage client services as well as a real estate platform that integrates developers and investors interested in financing new tourism properties. Also, since 2015 the bank has been a co-sponsor with the Georgia National Tourism Administration of the Welcome to Georgia National Tourism Awards. This program has brought together national and local authorities, hotels, restaurants, tour operators, travel agencies, wine companies and more, many of which have gone on to become clients of the bank. BOG noted that last year it financed more than 150 million GEL in tourism, largely to SMEs and this market segment is growing. As a result of the bank's growing interest in tourism, it has launched a special start-up hotel loan with a 15-year term (and two-year grace period), providing financing of between 40-50 million GEL. This is particularly attractive to investors who also take advantage of the GOG program, Host in Georgia's interest rate subsidies for properties outside Tbilisi.

Several IFIs including EBRD, the European Investment Bank (EIB) and the ADB have made lines of credit available to commercial banks for onlending as well as credit guarantees to reduce risk. TBC and BOG have been the primary recipients of these credit lines and guarantees, although ProCredit, CREDO and FINCA have also utilized these facilities to reach SMEs, firms exporting to the EU under the Deep and Comprehensive Free Trade Area (DCFTA) and women-owned firms. Unfortunately, most SME loans (an estimated 80 percent by one industry expert) are provided to businesses in Tbilisi.

Credit Guarantees

In Georgia there are several partial credit guarantees (usually portfolio guarantees) offered by IFIs, USAID and the government aimed at helping local entrepreneurs access financing by sharing the risk of lending with the local bank. Longer term aim of these guarantees is to demonstrate the commercial

[67] *Annual Report*. National Bank of Georgia. 2017. Note. More current statistics are not available in English.

[68] Gattini, Luca Gattini, and Tamar Baiashvili. *Neighbourhood SME Financing in Georgia*. European Investment Bank. February 2016.

viability of lending to underserved markets and sectors. In Georgia, there are several credit guarantee schemes available for local SMEs and entrepreneurs through the banking sector.

- USAID through the Office of Development Credit has extended a Development Credit Authority (DCA) portfolio guarantee to TBC Bank to expand lending to SMEs, microenterprises and agricultural businesses. The guarantee provides 50 percent coverage of realized loss of principal. The facility extends until 2022. Other banks in Georgia have had DCA guarantees in the past including Crystal Microfinance, Basis Bank and Oikocredit. BOG has expressed interest in accessing the guarantee, as has the investment firm, Gazelle Finance[69].
- The EIB has provided portfolio guarantees to stimulate SME lending to TBC and Procredit banks. The guarantee which covers up to 80 percent of a maximum loan of Euros 100 million. Through the InnovFin program, EIB also provides a 50 percent first loss guarantee to innovative start-up engaged in research and innovation activities.
- Under the Government of Georgia, Enterprise Georgia launched a new guarantee facility which will provide a 70 percent first loss coverage for loans to a variety of sectors including hospitality, manufacturing, process, education, export, high tech, medical and service. The guarantee facility had in theory been available in the past, but banks did not utilize it in the past due to concerns over its payout. Enterprise Georgia has now provided participating banks with a 10 million GEL liquidity facility. The cost of the facility will add an additional percentage point to the loan. As of late July, a majority of banks had signed up for the program including BOG, Procredit and Liberty banks.

Microenterprise lending

Until 2010 Georgian MFOs were focused on the provision of credit to informal micro businesses and agricultural enterprises, bolstered in part by the 2006 law that required their licensing and supervision by the NBG. MFOs are limited to making loans up to 100,000 GEL in local currency. Interest rates currently hover around 26 percent on average.

The microfinance market changed substantially around 2010 when several foreign commercial MFOs came into the market and started up new online operations providing expensive, rapidly disbursed retail/consumer finance to low income individuals. This trend has been seen throughout Eastern Europe and in some cases, has driven business credit providers out of the market and driven up household indebtedness, particularly for lower income clients. Another big shift in the microfinance sector has been the transformation of some MFOs to commercial banks. CREDO, the largest MFO, for example, applied for and received a banking license in 2017; before CREDO, FINCA transformed into a bank in 2013. Finally, the market has also been impacted by the entrance of banks lending to businesses in this market. For example, BOG has begun issuing loans for microenterprises, and given its capital base, faces fewer liquidity constraints. As a result, the number of MFOs in the market has gone down from a high of 72 to 55[70]. Also, "classical microfinance institutions" have also begun to rebrand themselves as responsible finance providers, advertising their adoption of high consumer protection standards in line with international standards set by the SMART Campaign and re-emphasizing their interests to extend credit to businesses.

In terms of lending to target markets identified in this value chain prioritization and gaps assessment report, some MFOs, such as Crystal Microfinance, see tourism and hospitality as an important sector, hiring and training loan officers with specific knowledge of the sector. Some also lend to furniture manufacturers and are open to opportunities in other sectors, particularly creative industries. Their portfolios are geographically more diverse and dispersed than banks as they have branch networks that

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[69] Note: the DCA guarantee facility is the process of being shifted to the new US Development Finance Corporation which will be created out of the current Overseas Private Investment Corporation (OPIC).

[70] Statistics from conversation with CEO of Crystal Microfinance.

serve micro and small enterprises and entrepreneurs across the country. MFOs also appear to be flexible, and more apt to address other constraints of their microenterprise borrowers. For example, Crystal Microfinance is partnering with USAID's Young Entrepreneur School (YES) to build up the capabilities of young entrepreneurs. Some of the IFIs have extended lines of credit to MFOs. Similarly, they have developed green financing loans in partnership with FMO to deliver finance for boilers, heaters, energy efficient briquettes and other energy-saving equipment. Crystal Microfinance has also issued a corporate bond to raise financing women owned microenterprises. The ADB is also currently working on a line of credit for Crystal Microfinance.

Leasing and Factoring

Both leasing and factoring/receivables finance as products and sectors are underdeveloped in Georgia; neither has a legal framework to address their operations nor is licensed or regulated by the central bank.

Leasing is broadly covered under the Civil Code. According to the Georgian Leasing Association, without a proper legal framework, the sector currently faces several legal and implementation challenges including:

- An interest rate cap of 50 percent that includes insurance and fees;
- Confusion in the law with respect to language that equates leasing with lending. This translates into a number of challenges including how companies source capital as well as how judges make rulings (often inaccurate ones) due to lack of knowledge of the product;
- Leases larger than 200,000 GEL can only be made in local currency, irrespective if the lessor is an individual or a legal entity; and
- Dubious clauses in the law regarding penalties and fine for cars/drivers of leased vehicles which puts lessors at a greater disadvantage than owners[71].

Currently, there are only three leasing companies focused on the corporate and SME market: TBC Leasing, Georgia Leasing Company and Alliance Group Leasing; two of these are affiliated with BOG and TBC Bank. Several other smaller companies focused on retail leasing, and Crystal Microfinance has plans to create a leasing subsidiary which they believe will be an important source of asset financing. Of the three, TBC Leasing captures 74 percent of the market. In general, the companies are limited in their ability to raise capital because they cannot borrow from the banking sector. The head of the Leasing Association also noted that banks often compete with their leasing subsidiaries.

In terms of interest rates on leases, leasing is about 3-5 points higher than commercial bank loans. However, clients are uneducated about the product, not knowing that VAT is not charged on the lease of an asset, only its purchase. Also, leases are not treated as leverage, enabling a company to borrow funds for other purposes including working capital.

In addition to the few companies, Enterprise Georgia has offered leasing finance for up to 5 million GEL for two years with co-financing that covers 12 percent of the interest rate for the first 24 months for leases from 100,000 GEL up to 5 million GEL. However, the program has not been particularly popular given higher interest rates on the product.

According to the Leasing Association, the estimated size of the market is currently about $200 million, up 100 percent since 2017[72]. According to the association, it should be a $3 billion industry if its legislation and financing terms could improve. To date, leasing companies have largely focused on large

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[71] *Georgia Leasing Market Overview.* Georgia Leasing Association. 2017.

[72] Ibid

economic sector such as construction and real estate, transport, medicine and power engineering. A few industry experts noted great potential in the market, particularly in light of a new law under development by the Ministry of Finance that would allow a more appropriate legal framework and tax incentives, and shift licensing and supervision to the NBG. Moreover, it could help businesses in tourism (including medical tourism), the healthcare sector and manufacturing source more modern equipment and further build out fleets for tour companies who engage in operational leasing of rental cars, yachts, and scooters.

Like leasing, factoring does not have a separate legal framework but is covered in the Civil Code and Law No. 121 on Activities of Commercial Banks (written in the mid-1990s). There are no licensing nor capital adequacy requirements under the law. Moreover, Georgia is not a member of the UNIDROIT Convention on International Factoring or United Nations Convention on Assignment of Receivables in International Trade[73]. There are no special foreign exchange rules applicable to factoring transactions and thus, export receivables denominated in foreign currency can be factored between Georgian firms across border without any restrictions. Factoring is also exempt from VAT like other types of financial services. That said, without an explicit framework, there is limited factoring taking place in Georgia and largely within the confines of commercial banking.

EBRD is helping to support the new leasing and factoring laws. Passage of new legal frameworks for leasing and factoring might also enable the Program to engage leasing companies around the development of leasing products for light manufacturing companies in furniture making and packaging as well as in the film and post-production industry. Similarly, access to factoring products for SMEs who have regular receivables from lead firms in their value chains, for example, packaging firms or suppliers to the hospitality sector, could benefit from this product in the long term.

INVESTMENT FUNDS, PRIVATE EQUITY AND VENTURE CAPITAL

In 2013, the **GOG** established a new **Law of Investment Funds,** which now provides a stronger ability to fund local businesses. The current legislation provides for the creation of different **types of investment funds** and **investor classes** who can register**.** Despite a framework, there are few Georgian private equity, investment management or venture capital firms in Georgia in part due to the very small size of the market. The Program Team met with several private and public sector firms as part of the mapping, including Wings & Freeman, Galt & Taggart (G&T), the Partnership Fund, the Caucasus Growth Fund/SEAF, Enterprise Georgia and the Georgia Innovation and Technology Agency (GITA). Each of these firms/funds and others are described in greater detail in Annex 6. Several firms confirmed interest in working with the Program. Already one firm, Wings & Freeman, is collaborating with the Program as the lead investor on its first deal note through the Partnership Development Fund.

The Team was also unable to locate many angel investors, although noted on social media the Georgian Business Angels Associations formed in March 2017 with the aim of raising public awareness about the business angel market and the success stories of investments, addressing the problem of information asymmetry, to make it easy for entrepreneurs and investors to find each other and providing training and coaching to entrepreneurs and investors. The organization now appears to be defunct.

Foreign Investment and Export Promotion

According to the Georgian National Statistics Office, Georgia received $1.346 billion in foreign direct investment. Investments were made largely in transport, communication and construction[74]. Enterprise Georgia is the lead agency for investment promotion (it took over the Invest in Georgia program) as well as for export promotion. On export promotion, Enterprise Georgia is helping companies to

[73] *Factoring Survey in EBRD Countries of Operation*. European Bank for Reconstruction and Development. Third Edition. September 2018.

[74] Karelidze, Tamara. “Investing in Georgia.” *Emerging Europe*. March 2, 2018.

improve export readiness and attend exhibitions by providing access to subsidies for space/exhibitions at trade fairs and by providing technical assistance. Last year they supported more than 500 companies to attend 50 exhibitions which yield more than 66 million GEL in revenue for their 7 million GEL investment. Among the exhibition attended were the Gulfoods (the world's largest food and beverage expo which takes place annually in Dubai), Paris Fashion Week and China Import and Export. Current priority sectors include tourism and hospitality, creative industries, manufacturing and BPO.

There are opportunities to expand visibility to outside investors through other venues, although not all investment fora have been successful in doing so in the past. One opportunity for further consideration in the future is the Welcome Challenge. Last year Georgia hosted this global competition focused on identifying innovative ideas in the hospitality sector. The final event was held in Tbilisi and brought in investors/angels to meet with start-ups and innovators from all over. Georgian companies could make a bigger play at the next event as well as use the event to position Georgian in global tourism.

Private Equity

Of the few equity providers, most have been formed in the past 8-10 years. As noted earlier, two of the largest are affiliated with the two big banking groups. The other prominent players, namely Gazelle Finance and Caucasus Growth Fund, were formed with equity provided by IFIs and other concessional finance providers/donors to serve as a demonstration effect to the market. Indeed, these organizations have had an important role to play in building the investment market. The two latter firms make investments largely in SMEs in the range of $200,000- $3 million across a range of sectors including tourism and hospitality, healthcare, construction, light industry/manufacturing, agricultural processing, education and supermarkets[75]. Average investments have been around $1.5 million. Several of the larger funds have focused largely on real estate investments; in some instances, they are tied to current and former politicians.

The GOG's Partnership Fund, a state-owned investment fund, established in 2011, is one of the larger equity investors in Georgia, providing co-financing equity, mezzanine, etc. to projects at their initial stage of development. The majority of its investments have been in large scale infrastructure development (energy, transport). More recently, they have invested in hotels and other types of light and heavy industry manufacturing. Partnership Fund participation is limited to minority share (up to 50 percent) but has the added benefit of enabling projects to attract senior financing from commercial sources or IFIs.

Mezzanine Finance[76]

Although the product is not well known or utilized in the market, a small handful of firms and state companies offer mezzanine finance in Georgia including Gazelle Finance, G&T and the Partnership Fund. In mid-2015, G&T announced the launch of a $50 million fund that targets high potential, growth companies seeking $2-8 million in investment. However, marketing of the firm was curtailed until recently and now seems to be picking up steam.

Institutional Investment

As noted earlier, institutional investment is very nascent but could grow in the coming years with the stand-up and expansion of the Georgian accumulating pension fund. The system requires mandatory enrollment for legally employed people under 40, and will work based on a 2+2+2 scheme, where employees contribute two per cent of their salaries towards their pension, matched by employers and

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[75] Note: Caucasus Growth Fund makes only equity investments while Gazelle also uses debt and mezzanine instruments.

[76] Mezzanine financing is a hybrid of *debt* and equity *financing* that gives the lender the right to convert to an equity interest in the company in case of default, generally, after venture capital companies and other senior lenders are paid.
https://www.investopedia.com/terms/m/mezzaninefinancing.asp

the government with an additional two percent each[77]. As of July 2019, an accumulating fund had been set up with more than 750 million GEL collected and on deposit in commercial banks. The board has been selected but the pension fund was still recruiting for a Chief Investment Officer and Chief Risk Officer. Next steps include finalizing its investment strategy (by the end of 2019). Similarly, changes in the insurance market with the expansion of MTPL insurance to all citizens (not just tourists) and revisions to the law could open up a market for institutional investment that could include longer term capital for larger businesses and SMEs.

Capital Markets

Georgian capital markets have been and will likely continue their nascent development for some time. Bond markets may be the one area where there are further opportunities to raise capital for SMEs. Crystal Microfinance's issuance of a bond to raise financing for women entrepreneurs and those raised by other IFIs offer an innovative example to expand financing, particularly for specific sectors or classes of businesses, particularly in light of limited opportunities for SMEs to list and raise funding on local stock exchanges.

BUSINESS SUPPORT SERVICES

Several donors including the European Union through EBRD and the Swedish International Development Agency (SIDA) are providing advisory services for SMEs including women owned firms. These programs offer access to a network of specialized firms that provide support across a wide range of business topics including marketing, finance, financial reporting including IFRS, human resources, quality assurance, investment readiness and legal among others. The EBRD Advisory Services for Business (ASB) program has operated since 2003 and provides two types of cost-shared advisory services to SMEs and larger corporates. These include:

- Access to a network of local consultancies co-financed up to 50 percent and capped at Euro 10,000;
- Access to international sectoral experts from developed economies who provide targeted technical assistance over a 12-18 month period though 10-12 one-week trips during which experts work with C-suite executives in the Georgian company to address everything from engineering, supplier and buyer markets. For this latter service, EBRD provides a larger cost share with the firms covering 12-16 percent of the total cost.

In addition to donor funded programs, Gazelle Finance has a limited technical assistance (TA) budget which can help finance ISO certification. Also, Enterprise Georgia's Produce in Georgia program provides entrepreneurs and business owners with technical assistance to grow and optimize their businesses. Companies can take advantage of these services for a value up to 10,000 GEL with an expectation of 10 percent co-financing.

PRIORITY INTERVENTIONS FOR THE PROJECT

Going forward, the Program will consider support to a few key sector investments in the financial sector including:

- ***Support to the development of leasing and factoring legislation*** (in alignment with EBRD). With an improved legal framework for both leasing and factoring, the Program could support initiatives that educate SMEs on these products and services and support smaller banks to roll out the products to SMEs in furniture, packaging and film/production companies (for leasing) and to MSME suppliers to the tourism and hospitality sector (factoring).

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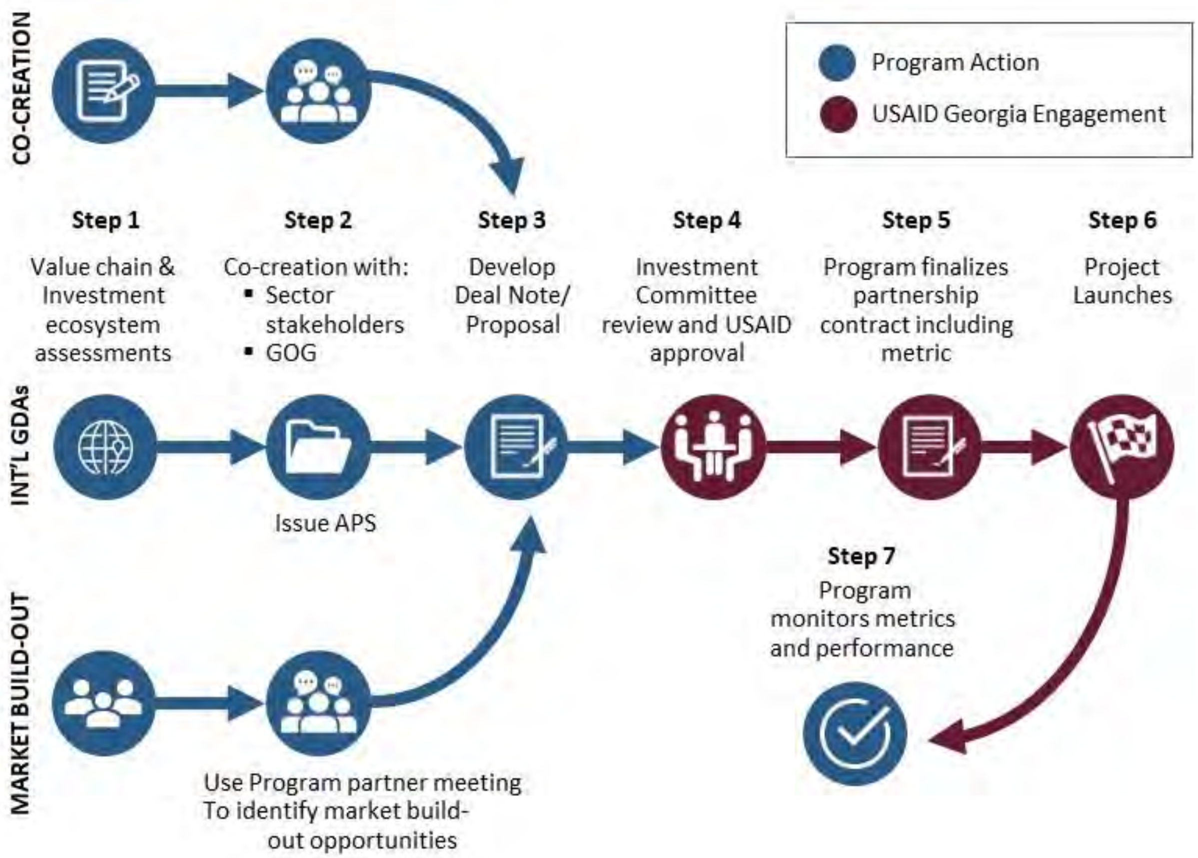
[77] "Georgian Parliament Approves Law on Accumulative Pension." Agenda.ge. July 22, 2018 https://agenda.ge/en/news/2018/1553

- ***Serve as a co-sponsor for the Welcome Challenge*** with the aim of also introducing international investors to Georgia's tourism sector. This support will be well-coordinated with the Georgian National Tourism Administration.
- ***Continue to engage with investment advisory firms,*** Wings & Freeman, Gazelle Finance, G&T and others as well as the GOG's Partnership Fund on specific opportunities across Program's core sectors. Already these firms have been engaged by Program management on new opportunities, some of which are highlighted in Table 13 in the coming section.
- ***Starting in 2020, work with new US Development Finance Company*** (formerly OPIC) to extend a new DCA facility to other banks or debt providers such as BOG and Gazelle Finance. A guarantee mechanism would enable Gazelle or new banks to mitigate some risk to newer SME target firm borrowers.
- ***Monitor the development of institutional investment possibilities*** with the Georgian Fund or MTLP. Where feasible, the Program will help the GOG develop investment criteria and regulations which might include a percentage (up to 10 or 15 percent) for investment in SMEs.

PUBLIC-PRIVATE PARTNERSHIPS AND INVESTMENT OPPORTUNITIES

Against the backdrop of Georgia's investment climate and financial landscape, the Georgia Economic Security Program is expected harness the country's growing market dynamism and catalyze problem-solving and co-investment from a variety of private and public sector partners to drive the country's competitiveness, improve productivity and the availability of industry required skills. Program partnerships will leverage $15 million in investments through at least 14 PPPs and GDAs; the program broadly must also catalyze $50 million in new sales and create 4,000 full-time jobs. Through the value chain assessments and initial start-up activities, the Program has already identified a variety of potential partnerships that it will consider for program investment through the Partnership Development Fund (PDF). Already one deal note has been presented and approved during the start-up phase. We anticipate that future partnerships may also be identified through the issuance of an annual program statement (APS) and through co-creation with private sector and government stakeholders and will follow the PDF Funding and Implementation Cycle as illustrated in Figure 8.

FIGURE 8: PDF FUNDING AND IMPLEMENTATION CYCLE



FITNESS TEST[78]

In order for partnership projects to be considered, opportunities must be evaluated against a fitness test which was developed to enable the Program to determine whether an opportunity supports the Program's intended development outcomes. We propose the below fitness test made up of 9 criteria by which program management will evaluate each opportunity. Each criterion will be evaluated on a 0-5 scale with the maximum composite score of 100 percent and a minimum threshold of 75 percent. Only opportunities scoring 75 percent or above will qualify for project support. The following caveats however apply:

- The first three proposed criteria should be evaluated on a yes/no filter. A 'no' to any of these criteria automatically disqualifies the opportunity, while each 'yes' will score a maximum of 5 points.
- The "geography" criterion will be weighted toward opportunities outside Tbilisi providing up to 10 points for those in other cities/regions and a maximum of 5 points for strong opportunities within the Tbilisi region.

Fitness Test Criteria are as follows:

- **Sector Fit.** Does the partnership drive investments in the project's priority value chains where significant employment, investment and revenue to vertically or horizontally integrated SMEs can be expected? Yes/no filter.

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[78] This will be formalized in the Program's Year One Workplan (October 1, 2019-September 30, 2020)

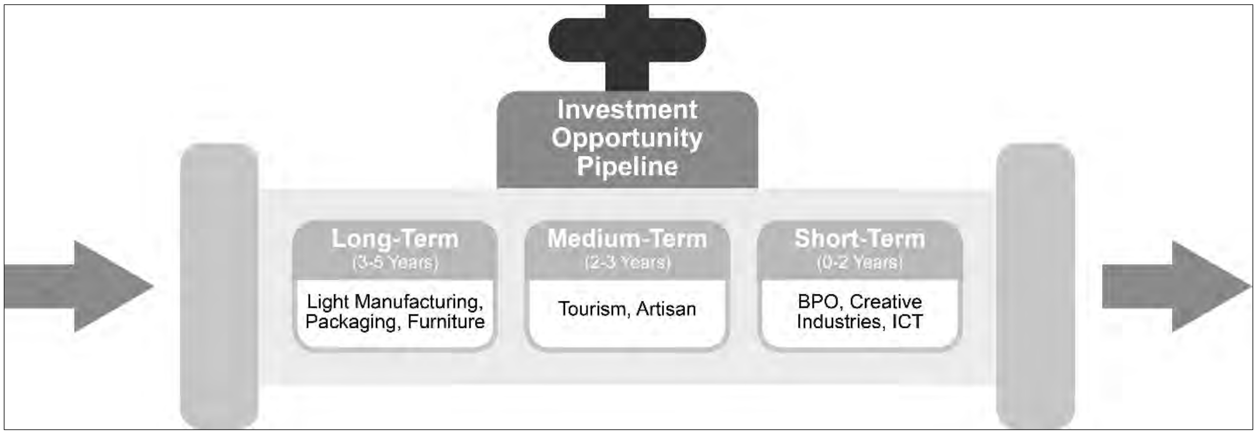
- **Financing structure.** Does the investment from the partner/partners meet or exceed the expected 1:1 match of the project's investment? Yes/no filter.
- **Timing**. Will the partnership be realized and demonstrate measurable benefits within the five years of the project's life cycle? Yes/no filter.
- **Geography.** Does the opportunity consider create economic opportunities outside of Tbilisi?
- **Gender, Youth, and Social Inclusion.** Does the opportunity positively empower female stakeholders, youth, and other vulnerable populations as entrepreneurs, employees, or individuals/groups benefitting from investments?
- **Impact/Feasibility.** Is there a likelihood of success, the potential for transformative developmental impact in terms of job creation (on direct and indirect beneficiaries), increased external investment and increased revenues to impacted MSMEs?
- **Resources versus Results**. Are the funds and/or staff time allocated to this partnership sufficient to unlock or leverage additional jobs, investment, or revenues for MSMEs? Will the results of the project's investment result in significant contributions to project targets?
- **Positive Economic Externalities.** Will investment mobilized contribute to great indirect economic impact including indirect jobs, SME growth, exports and other development impacts generated? Does the opportunity offer the potential for scale and crowding in or catalyzing additional investments? Does the opportunity expand the potential for on-lending to SMEs by new financial institution partners?
- **Environmental Best Practice** (crosscutting requirement). Does the opportunity ensure compliance with U.S. Government environmental procedures? In addition to standard USAID compliance, will the opportunity align with other Environmental, Social and Governance criteria recognized in the investment community?

We recommend that the Program review the weight of each criterion and adjust over time based on learning and a review of data generated by the Monitoring, Evaluation and Learning Plan (MELP).

TIMING

The Program's management recognizes that not all projects will start, be implemented and end within the same time horizon and that timing is critical given the Program's five-year duration. Some partnerships will begin, be completed and show results within a short time horizon but others will require as much as two or three years to show results. The project will seek to balance partnership opportunities that show results in the short, medium and long term, as outlined in Figure 9.

FIGURE 9: INVESTMENT OPPORTUNITY TIMELINE



Based on the value chain assessments the Team has concretely identified the following potential partnerships over the short, medium and long term, shown in Table 13.

TABLE 14: POTENTIAL PROJECT OPPORTUNITIES OVER THE LONG, MEDIUM AND SHORT TERM.

Long Term	Medium Term	Short Term
Business Hotel in Poti. Support workforce training and MSME sourcing for food and beverages and other needs for first hotel in Poti aimed at business travelers.	**Far + Wide Collectables.** Integrate Georgian artisans with Far + Wide's e-commerce platform and utilizing joint marketing, shipping, and sales platforms.	**Airbnb.** Work with local providers and Airbnb to develop a "guest experience platform" that highlights high-end Georgian properties for top-tier consumers. Airbnb would provide the platform and marketing, while the Program would work with local providers to build capacity and increase standards.
Hotel Partnerships. Work with a number to source custom-made furniture from local producers that is both stylish and culturally significant and an opportunity to bring visibility to Georgia craftsmanship.	**FDI in Animation:** Explore potential opportunity with Jordanian animation company interested in developing a niche micro-site (50 employees or less) outside of Jordan. The company will be looking for individuals with basic art/drawing skills and can teach them animation, graphics and storyboarding.	**Universal Pictures.** Work with/co-finance the studio to provide "on the job training" with Universal's 200 experienced crew members during the *Fast and Furious 9* filming in August 2019. This partnership could include sponsoring training of Georgian post-production professionals abroad.
	Online retailer and Majorel. Set up German language call center in Telavi (alongside the location of a German language school) and support workforce training.	**US Sportswear GDA**. Collaborate with sportswear company (possibly Columbia) and an airline to bring social media influencers to Georgia to post and blog about Georgia tourism experience.
	International Furniture Manufacturers. Engage with international furniture manufacturers to provide equipment and technical support for Georgian furniture producers to increase standards and become certified suppliers/contractors and first step to contract manufacturing.	**Local Retailers.** Engage with local retailers (e.g. supermarkets) to better understand their packaging needs and to develop co-designed partnerships between them and Georgian packaging manufacturers.
	Business & Institutional Furniture Manufacturers Association. Work with this global representative of the packaging industry to co-design standards and certification programs that will	

Long Term	Medium Term	Short Term
	enhance the knowledge and experience of Georgian packaging firms.	

VI. CONCLUSIONS

The Program's Value Chain Assessment Team spent months in the preparation of this document, attending dozens of meetings, conducting countless hours of research and meeting with hundreds of stakeholders. Even after its comprehensive analysis, however, the Program's leadership realizes the inexact nature of competitiveness in general. While its assumptions in this report are based on solid data, fluidity in global markets, unwillingness of countries to change course, government actions (or inaction) and the inability of the private sector to adapt to new realities are just a few of the challenges that might prove insurmountable to competitiveness in some of the sectors and value chains. For this reason, the Program will continually monitor indicators within each and will launch practical interventions to provide each with the opportunity to become game-changers for Georgia.

Each quarter, the Program will report on indicators specific to each sector and value chain and will at such a time as it may be necessary, advise the client to either increase or decrease focus on certain ones. It is important to note, however, that building competitive sectors and value chains takes time, resources, and coordinated actions. It will be important for the Program, and USAID, to have the patience and willingness to "take the journey" with these sectors and value chains in order to provide them the best chance to succeed. It will also be important for the Program and USAID to identify and take advantage of emerging trends in these and other sectors and to move swiftly and strategically into and out of sectors and value chains based on these trends.

Virtually every country that has succeeded in building competitiveness through the development of sectors and value chains that are direct links to investment, high(er)-value job creation, and revenue increases have done so by linking all elements of the value chain. This requires being willing to do the "heavy lifting" in terms of strategy, policy, skills development, marketing, et al in order to lay the foundation for success. It is for this reason that competitiveness for Georgia's priority sectors and value chains will be a journey, not a destination.