

MODA TEXTILE FACTORY

Bishkek, Kyrgyzstan

TEACHING NOTE

Abstract:

Sergei Ivanov and his wife Olga faced some important decisions regarding the future of their small sewing business in downtown Bishkek. The company, founded eight years earlier and now employing 15 people, produced made-to-order women's suits for sale to wholesalers in town who distributed them to retailers across the region. The founders wanted to expand the business into more fashionable clothing and reach external markets, but capital was limited and they were leery about finding trusted business partners in remote areas.

Course Usage

This case can be used in courses on International Entrepreneurship, International Development or Business in Transition Economies. The case examines the lives of people who previously held important factory jobs in the Soviet system but now operate their own textile and trading businesses. It provides a good look at life inside a transition economy.

Questions for Discussion

- (1) How have Sergei and Olga's lives changes since Soviet days? Are their lives better?
- (2) What is Moda Textile Factory's competitive advantage? How can they use it to expand the business?
- (3) How would you characterize Olga's management style? How was it shaped by the Soviet system?
- (4) What kind of person(s) should Sergei and Olga look for as a business partner(s) to help them expand their market outside Kyrgyzstan? How should they find a partner they can trust? What can they do to build trust with that person?
- (5) What steps can Sergei and Olga take to address the cash needs of their growing business?
- (6) How can Sergei and Olga begin producing fashionable women's cashmere coats in their factory? Is it feasible or should they give up this dream? Propose an action plan to move the business in this direction.

Answers to Questions for Discussion

- 1.How have Sergei and Olga's lives changes since Soviet days? Are their lives better?*

Sergei and Olga used to have a very stable life as members of the factory community. The state-owned light bulb production facility where they worked in their former town provided them with housing, health care, education, even vacation opportunities. They lived modestly, had to save for years to make big purchases, and they were unable to travel outside the country, but they felt comfortable and they played respected roles in their community.

Once the Soviet system fell, they moved to the big city of Bishkek fifteen hours away and began their own businesses and started a family. Their first business was importing finished clothing purchased on buying trips outside the country (India, Turkey). They later began producing their own goods in their own factory, filling orders from local wholesalers for distribution across the region.

They now face risks of volatility unknown under the Soviet system of Five Year Plans. They call the current system “wild capitalism,” a suitable label since they now depend on orders from a fickle marketplace, they must endure currency fluctuations when completing all international transactions and they face expensive demands from corrupt customs officials to move goods across the border. The legal framework applicable to business is still murky, offering limited protection and subjecting them to double taxation. And they have been burned by untrustworthy people.

But they are building their own enterprise. They can travel as they see fit. They can expand the business domestically and internationally and even introduce their own line of goods. They produce the goods they choose to make and possibly grow rich through their efforts.

2. What is Moda Textile Factory’s competitive advantage? How can they use it to expand the business?

Moda enjoys a stable workforce of loyal, productive people. There is a good work ethic and employees work as long as required to complete orders on time, even if that means working overtime and weekends. There is a warm family feeling in the workplace and the staff put in the extra effort whenever necessary. They produce quality products reliably, often improving on the fashion ideas of customers. Moda also has very stable links to its main customers, built on long-term relationships between Sergei and his wholesalers whom he has known for years.

Since Sergei is good at maintaining relationships, he can endeavor to grow the business by building new relationships with wholesalers and their overseas customers, turning each relationship into a continuing stream of orders for finished goods.

3. How would you characterize Olga’s management style? How was it shaped by the Soviet system?

Olga takes pride in the workplace she has created with her key lieutenants. She endeavors to create a family feeling in the workplace, celebrating birthdays and

holidays with gifts and treats. She offers personal counsel, emotional support and even financial resources to help her staff weather the unexpected challenges of life. She provides them with incentives to raise morale.

It seems that her maternal style of management reflects the complete caring and support offered workers in her old plant under the Soviet system. Her philosophy – to create a second home for her employees, where 3/4 of the company's success depends on the loyalty of the employees – sounds more reflective of Russian Communist idealism than a workplace operating under wild capitalism.

4. What kind of person(s) should Sergei and Olga look for as a business partner(s) to help them expand their market outside Kyrgyzstan? How should they find a partner they can trust? What can they do to build trust with that person?

After their bad experience with former business partner Igor, Sergei was concerned about finding a person who could be trusted. Interestingly enough, Sergei's ability to form long term relationships did not by itself guarantee finding a suitable candidate. Game theory predicts that honesty is the best policy when dealings between parties recur, such as in an ongoing business relationship. However, Igor, an old acquaintance, worked *inside* the company as factory supervisor – yet he still felt the need and justification to steal money from the business.

Sergei took a course on the psychological aspects of business and that helped him identify some steps he might take to insure he works with reputable partners overseas. He learned to check into the person's background and track record, check references and bring a lawyer to safeguard specific transactions. Building trusted relationships can take time and money. Failed efforts are a cost of doing business in the region.

Leave class time to brainstorm steps Sergei might take to build a trusted relationship. Though this note will not prescribe specific techniques to build trust, it is important to sensitize students to the need to devote attention to this important dimension of business life. Fostering trust is a key ability for a viable business. An important factor is to examine the person's reputation for reliability and their time in the market. He can use a prepayment system and work with a lawyer.

This takes on special relevance due to the limited legal enforcement in the country. There is no contract enforcement. The court system is very weak and it can take months to deal with a default on loans. There are no credit bureaus to provide an objective assessment of people's financial reliability. It is difficult to assess character. Many lenders demand 250% collateral, sometimes accepting an apartment, horse, car or container as collateral.

5. What steps can Sergei and Olga take to address the cash needs of their growing business?

Moda has been working with a series of cash loans from a microfinance organization. They have developed a good track record repaying their loans on time. Unless some other financial institutions begin extending larger loans to the business or consider making a long term investment in the business, Sergei and Olga can continue to work with these limited, periodic loans. They may want to earmark a portion of these loans for the area of business they now want to grow: fashionable cashmere coats.

A challenge to cash management is the uncertainty surrounding cross-border transactions. People move cash in person, making borders and downtown areas especially dangerous.

6. How can Sergei and Olga begin producing fashionable women's cashmere coats in their factory? Is it feasible or should they give up this dream? Propose an action plan to move their business in this direction. Should they develop their own label?

Sergei and Olga can begin producing cashmere goods now. However, sewing polyester and acetate is a lot different than sewing cashmere, so they will need to gain experience working with this soft wool and find quality sources for the fabric, most likely in Italy. Thus far they have built a solid reputation for producing quality goods with the distributors who know them. Through them they can gain experience making cashmere wear for export to Russia.

They can also develop their own label of clothing. They can introduce their own trademark and ship it to overseas markets on consignment. In 2003 a consignment of cashmere coats made of Italian cashmere with trademark *Diamond* was sent to New York. The importer there now has interest in Moda's goods, and Sergei has more perspective on the market potential for their products.

The main challenges to producing cashmere clothing under their own trademark is the shortage of time and resources to build a line of goods and market it effectively. All trademarks must be registered in export markets to protect their uniqueness.

Update

Sergei closed the jeans trading business a few years later because the business became unprofitable due to increased competition. Olga and he now run the sewing shop together. Sergei primarily devotes himself to developing and producing the company's own label merchandise for export.

The company has continued to grow. Total employment at the time of the case was 17 but since grew to 21 people in 2002 and 24 in 2005. Sales grew 58% in the past two years, where 75% was for contract sewing work and 25% was for their own label goods. They now work with cashmere to produce coats, but these goods are still made to order, not their own trademark.

The company is signing a legal services agreement with a law firm in Bishkek.

They have established relationships and work with 3 trade centers in Moscow.

Financing continues smoothly, though it is still inadequate to fund large scale expansion. The company signed its 10th loan for \$5,000. Half the money was used for working capital and the other half was used to expand their export-oriented label business.

Regarding facilities, they continue to operate above the bank. They negotiated an extension of their rental agreement largely because their rent payments were always on time. They are considering moving to a new facility to provide better working conditions for their workers (better heat in winter) and they plan to move to such a facility in the near future.