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kaffeine: the nepalese café opportunity

Kevin Xo and Zach Hamel wrote this case under the supervision of Professor Eric Morse solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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It was early 2013, and the empty one-storey building nestled on a small street piqued the interest of Ajay Shrestha, Nishant Pradhan, and Mahendra Gurung; a team of young Nepalese entrepreneurs. The building was close to a bustling centre of malls, business offices, and hotels in Kathmandu, Nepal’s capital city. With the city’s fast-growing economy and appetite for coffee, Shrestha saw an opportunity to make this location the first of a large chain of cafés that he would call Kaffeine. He and his partners each had their own successful businesses. From money management to consumer packaged goods distribution to construction, the founders brought a great deal of knowledge and valuable relationships that would help them operate in the Nepalese business environment. They had many things to consider, such as location, competition, target market, and how to measure the feasibility of this new venture.

The KAFFEINE Team

Shrestha, Pradhan, and Gurung were each successful entrepreneurs in their own right. Shrestha and Pradhan met while studying business at Kathmandu University, one of the most prestigious institutes in the country. After graduation, Shrestha founded an investment company called iCAPITAL that researched and invested in private and publicly-traded Nepalese businesses. Pradhan took a different route after business school, choosing to become the exclusive distributor of Optimum Nutrition consumer healthcare products in Kathmandu. Gurung, whom Shrestha met at a social event in Kathmandu, owned and operated his own construction firm in Hong Kong. Overall, Shrestha was quite confident about pursuing a venture, given his group’s accomplishments.

ENTREPRENEURIAL CHALLENGES IN NEPAL

Nepal was a landlocked Asian country surrounded by China and India. Located in the Himalayas, the country was extremely mountainous and was the home of Mount Everest, the tallest mountain in the world. Being located between two of the biggest economies in the world was a great opportunity for aspiring Nepalese entrepreneurs, but also a big source of political tension. For example, in 1989, the Indian government imposed an economic blockade on Nepal because of its growing relationship with China and disputes over transit treaties.[[1]](#footnote-1) There were few places Nepal could turn for trade due to the Himalayan mountain range along its northern border and India in the south. The lack of oil and gasoline flowing to the country was one of the biggest challenges for the everyday population as well as entrepreneurs. Costs that were normally stable skyrocketed as people turned to the black market to fulfill their needs, which drastically raised the cost of doing business in Nepal. The results of the blockade were disastrous for Nepal’s economy, with gross domestic product (GDP) growth dropping from 17.92 per cent from 1987–1988 to just 1.09 per cent in 1988–1989.[[2]](#footnote-2) The threat of another blockade was very real if Nepal and India’s relations worsened again.

Beyond these political challenges, Nepal faced many developmental challenges that affected its population. Nepal was considered a least developed country by the United Nations, with low economic growth and subsistence farming. This designation was conferred through the consideration of per capita income, human assets and development, and economic vulnerability.[[3]](#footnote-3) The Nepalese government set forward plans to become eligible to graduate from a least developed country to a developing country by 2022. As of 2012, only 67 per cent of the population had access to electricity, 62 per cent had access to sanitation, and the adult literacy rate stood at 57 per cent. Some progress had been made, though, with the percentage of those living below the poverty line dropping from 42 per cent in 1995 to 24 per cent in 2013, and GDP growth at 4.9 per cent in 2012.[[4]](#footnote-4) The developmental challenges facing Nepal directly affected entrepreneurs attempting to start businesses in the country.

Major hurdles for entrepreneurs in Nepal included lack of funding and electricity deficiencies. It was nearly impossible to receive funding for a business without putting up significant collateral in the form of land or buildings. The concept of credit scores did not exist in Nepal, so there were few ways for young entrepreneurs to build up a reputation of paying back loans and becoming creditworthy. Most funding came from existing family business houses, causing large family conglomerates with holdings across diverse industries. Also, Nepal faced large energy deficiencies, which it managed through planned load shedding, also known as rolling blackouts. As a result, businesses had to cope without electricity for hours every day. To ensure smooth business operations, many businesses ran expensive generators to keep the lights on, which cut into operational margins. Overall, these challenges discouraged many keen, young entrepreneurs from entering the uncertain business market.

Coffee in Nepal

Britain’s heavy influence on Nepal contributed to the Asian country’s large tea-drinking culture.[[5]](#footnote-5) The Nepal-Britain Treaty of 1923 was the first to declare Nepal a sovereign international state.[[6]](#footnote-6) It was not until 1938 that coffee was introduced in Nepal, and it remained a niche product that was primarily consumed by expatriates throughout the 20th century.[[7]](#footnote-7) Nepal’s mountainous terrain provided the potential for its coffee farmers to produce a top-quality product; however, farmers often had trouble maintaining consistency in harvests each year. Up until the 21st century, the limited amount of coffee that was grown in Nepal was mostly exported.

However, in the 2000s, farmers had noticed an increase in both international and domestic demand for Nepalese coffee.[[8]](#footnote-8) Although exports had declined since a peak in 2008, export demand for coffee was supplanted by growing local interest (see Exhibit 1). This movement toward consumption of coffee was largely driven by Gagan Pradhan, founder of Nepal’s largest coffee chain, Himalayan Java Coffee (Himalayan Java).[[9]](#footnote-9) Prior to the founding of Himalayan Java, Nepalese primarily purchased instant coffee, a form of coffee that was inexpensive and consumed at home. Gagan Pradhan was able to achieve success in changing Nepal’s coffee culture by placing great emphasis on the location of his cafés. His first café was opened in an upscale region of Kathmandu called Thamel, after which, he was able to expand his chain to other booming regions in the fast-growing city.

Potential Customers

The prospective Kaffeine building was located one block away from Durbar Marg, one of Kathmandu’s busiest streets. Durbar Marg contained offices for many large companies, large malls, upscale hotels, restaurants, and bars, thus attracting a wide variety of people. Shrestha divided his potential customer base into three distinct groups.

The first group Shrestha considered targeting was the business people working at large companies, such as the Nepal Investment Bank and Nabil Bank. Many of these businesses had coffee canteens for their employees, and Shrestha wondered whether the appeal of his café would be enough to attract these wealthy customers. Not only did they come to the area for work, but they would also shopped in the upscale stores and restaurants around Durbar Marg.

Another group Shrestha considered targeting was tourists. Durbar Marg contained many shops and restaurants that were popular tourist spots. The café’s location was about a 25-minute walk from Thamel, the largest tourist hub in Kathmandu. This district was highly popular with tourists, a segment that had grown from 736,215 in 2011 to 803,092 in 2012.[[10]](#footnote-10) It was also a five-minute walk from Hotel Yak & Yeti, a five-star deluxe hotel for affluent travellers. One concern that Shrestha had with targeting this group was that the vast majority of tourists were interested in trekking in nearby mountains as opposed to shopping in Kathmandu. Without being centrally located, it would take a lot of marketing and online presence to attract tourists.

A third group Shrestha considered targeting was domestic students. Durbar Marg contained many of Kathmandu’s most popular malls, restaurants, and bars, which would attract students to the area. The café location was a 10 to 15 minute motorcycle ride from many of Kathmandu’s large universities, such as King’s College. Students frequented cafés and enjoyed using them as quiet study spots, with a steady stream of coffee to keep them awake through long study sessions. Although they had relatively low disposable income compared to the other groups, students were more often willing to try new products and brands.

Shrestha considered these three types of people the most easily distinguishable groups in the area. Although there were people who frequented the area but did not fall into these groups, Shrestha found it difficult to categorize them into an addressable market.

SUPPLY CHAIN

In starting Kaffeine, the founders needed to decide where to source their coffee from, weighing considerations such as price, quality, consistency, and branding.

Nepalese Beans

Nepal’s unique high-altitude Himalayan environment made it ideal for growing specialty coffee.[[11]](#footnote-11) Coffee grown in Nepal included the Bourbon and Typica varieties of the *C. arabica* species.[[12]](#footnote-12) The Nepalese coffee production market was highly fragmented, with most coffee grown on small plots by independent farmers. This made the Nepalese coffee market a somewhat niche market, with mass production to the scale needed by international brands not possible.[[13]](#footnote-13) Segmentation was also a problem for quality control. Because batches of beans came from many different plots and growers, quality across shipments could vary greatly. Despite the quality issues, there was a pride in showcasing locally grown products. Of all the options, locally-sourced coffee was the most affordable, costing between Rs1,300[[14]](#footnote-14) and Rs1,600 per kilogram.

Imported Beans

The second option was to import beans from popular growing regions around the world, such as Ethiopia, Colombia, and India. Importing beans without branding would allow Kaffeine to brand and label them however it wanted while gaining the consistency of larger farm operations. However, the company would lose the “locally grown” appeal and marketing power of a larger brand. Imported beans would provide quality consistency but would cost Kaffeine Rs2,500 per kilogram.

Branded Imports

Finally, Kaffeine could purchase imported, branded coffee from international brands. Two popular options worldwide were Illy and Lavazza—Italian brands with operations spanning the globe. The benefit of going with a branded option was that Kaffeine would be able to advertise with the supplier’s logo on shop and advertising materials, leveraging the international brand. Additionally, these brands underwent extensive quality control on their coffee beans. At Illy, a coffee batch could be quality tested as many as eight times before being incorporated in the Illy blend.[[15]](#footnote-15) However, using a branded option might take away from the core Kaffeine brand and came at a premium; importing Illy cost Rs3,950 per kilogram, and Lavazza’s international beans cost as much as Rs4,500 per kilogram.

COMPETITION

Since 2003, there was a large increase in the number of coffee shops in Kathmandu. Within a three-minute walk of the location, there were four established coffee locations that Kaffeine would be competing with, the largest of the four being Himalayan Java Coffee.

Himalayan Java Coffee

Himalayan Java Coffee was founded in 1999 and proudly advertised its sourcing of Nepalese coffee. It targeted tourists heavily and the upper middle-class in the Thamel area, and priced its coffee between Rs200 and Rs300. The company used Facebook and TripAdvisor to advertise to tourists and spread its growing brand. Due to its backstory and heavy social media presence, Himalayan Java Coffee would be Kaffeine’s toughest competition in the Nepalese market.

The Coffee Shop

The Coffee Shop was a high-end restaurant in Hotel Annapurna, a 50-year-old, 5-star hotel in Kathmandu. The shop was very formal rather than relaxed like a café, with coffee being offered at prices between Rs200 and Rs400. The Coffee Shop’s customers mainly consisted of wealthy tourists staying at the Hotel Annapurna and well-off local businessmen who used it as a venue to meet clients.

Magic Beans

Magic Beans was a mid-range coffee shop located in Sherpa Mall, on Durbar Marg. It mostly targeted local shoppers with prices between Rs150 and Rs250. It had some social media presence but did not have the same brand strength as Himalayan Java coffee. While Himalayan Java coffee had the potential to be a national brand, Magic Beans was more of a local one-off shop.

Coffee Express

Coffee Express was a coffee kiosk located on Durbar Marg, catering to on-the-go customers with lower prices. Coffee started at Rs100. Coffee Express did not have much of a retail presence and lacked the feel of a modern coffee shop. It was not a place that people would convene to socialize or have meetings.

FINANCIALS

Market Size

Shrestha estimated that 250,000 to 350,000 cups of coffee were sold in cafés around Kathmandu annually. This figure was growing quickly at approximately 5 per cent year-over-year. It was driven by new customers becoming avid coffee drinkers and by increasing economic prosperity, which made café-sold coffee more accessible. Given Shrestha’s relatively large marketing budget, he believed he could capture 2 to 4 per cent of the Nepalese coffee market in his first year. Shrestha believed that the market share captured would depend on his price point, which ultimately depended on the quality of beans his café would use. As a relatively discretionary good, a more expensive coffee would likely lead to lower market penetration. As his business grew and he opened up more locations, Shrestha projected that his market share would increase to 10 per cent in five years.

Costs and Investments

Shrestha recognized that his direct costs would vary depending on how he sourced his coffee beans. Direct costs would make up 35 per cent, 40 per cent, or 45 per cent of revenues if he used local beans, branded beans, or imported beans, respectively. Shrestha also predicted all of the indirect operating costs of operating his first store (see Exhibit 2). Finally, Shrestha expected that the initial investment in his café would be Rs4,800,000, which would be enough to cover a rent deposit, renovations, and fixtures. He believed it was reasonable to assume that renovations and fixtures would last 10 years before having to be replaced.

The Decision

Shrestha and his team planned to meet the next day to discuss the many decisions and questions facing them. Was the location they were considering the right place to establish operations? Which target market would Kaffeine cater to, and how would it price and source its coffee to differentiate itself from the competition? Would the Rs4,800,000 required to occupy and modify the space pay off as an investment? Finally, what quantitative metrics should the partners use to measure the feasibility of this venture?

Exhibit 1: Nepal Coffee Export and Production since 2008

Source: Created by case authors using data from “Summary Table of Area and Production of Coffee (FY2012/13),” National Tea and Coffee Development Board of Nepal, accessed June 23, 2016, www.teacoffee.gov.np/images/gallery/Coffee%20data%20english.pdf.

**Exhibit 2: List of Operating Expenses (IN Rs)**

|  |  |
| --- | --- |
| **Indirect Expense List** |  |
| Rent | 1,082,400 |
| Salary/Training Expense | 460,000 |
| Utilities | 50,000 |
| Marketing Expense | 100,000 |
| Transportation | 50,000 |
| Total | 1,742,400 |

Source: Company files.

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2. The World Bank, “Nepal,” 2016, accessed June 23, 2016, http://data.worldbank.org/country/nepal. [↑](#footnote-ref-2)
3. Government of Nepal, National Planning Commission*, An Approach to the Graduation from the Least Developed Country by 2022*, March 2014, accessed June 23, 2016, https://web.archive.org/web/20140630125739/http://npc.gov.np:80/new/uploaded

   Files/allFiles/LDC\_Final\_draft.pdf. [↑](#footnote-ref-3)
4. Ibid. [↑](#footnote-ref-4)
5. “Tea from Nepal,” Paper and Tea, accessed June 23, 2016, https://www.paperandtea.com/tea/nepali-tea/. [↑](#footnote-ref-5)
6. Andy Sparkes, “Two Hundred Years of Nepal-Britain Relations: A Way Forward,” September 25, 2013, accessed June 23, 2016, www.gov.uk/government/speeches/two-hundred-years-of-nepal-britain-relations-a-way-forward. [↑](#footnote-ref-6)
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8. Ishwar Rauniyar and Jason Burke, “Nepalese Farmers Tap into Global Thirst for Coffee,” *The Guardian*, December 18, 2012, accessed April 4, 2017, www.theguardian.com/world/2012/dec/18/nepal-farmers-coffee-industry-booming. [↑](#footnote-ref-8)
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10. Government of Nepal, Ministry of Culture, Tourism and Civil Aviation, *Nepal Tourism Statistics 2012,* June 2013, accessed June 23, 2016, www.tourismdepartment.gov.np/files/download/79d87e69dc74cd7. [↑](#footnote-ref-10)
11. Himalayan Java Coffee, “Nepali Coffee Industry,” accessed June 23, 2016, www.himalayanjava.com/nepali-coffee-industry/. [↑](#footnote-ref-11)
12. Ibid. [↑](#footnote-ref-12)
13. Anbarasan Ethirajan, “Nepal Farmers Brew success with Coffee Cultivation,” BCC News, February 27, 2013, accessed June 23, 2016, www.bbc.com/news/business-21583681. [↑](#footnote-ref-13)
14. Rs = NPR = Nepalese rupees; all currency amounts are in Rs unless otherwise specified; CA$1 = Rs88.3 on January 1, 2013. [↑](#footnote-ref-14)
15. “Only the Best Will Do,” Illy, accessed June 23, 2016, www.illy.com/wps/wcm/connect/en/coffee/only-the-best-will-do. [↑](#footnote-ref-15)