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# Investing in SMEs in the Eastern Partnership

## Georgia

COUNTRY REPORT  
JUNE 2018

# Table of contents



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<b>Introduction</b>	<b>1</b>
<b>SECTION 1:</b>	
<b>General economic overview of the country</b>	<b>2</b>
1.1 Macroeconomic indicators	2
1.2 Trade volume with the EU – exports	4
1.3 Business climate	4
<b>SECTION 2:</b>	
<b>Share of SMEs in the economy</b>	<b>6</b>
<b>SECTION 3:</b>	
<b>Overview of the EU4Business portfolio in Georgia</b>	<b>7</b>
<b>SECTION 4:</b>	
<b>Donor support to the SME sector in the country – looking beyond EU4Business</b>	<b>10</b>
<b>SECTION 5:</b>	
<b>SME survey results</b>	<b>12</b>
<b>SECTION 6:</b>	
<b>Highlights of the round table discussion</b>	<b>14</b>
6.1 Access to Finance	14
6.2 Access to skills and knowledge	14
6.3 Access to markets	15
6.4 Business regulation	15
6.5 Modernization and digitalization	15
6.6 Communication and visibility of EU4Business Programmes	16

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# Introduction

The EU4Business Secretariat is proud to present the third Country Report prepared under this initiative, following the first in late 2016, and second May 2017 publication. Country Reports analyse the developments and achievements of the EU4Business initiative in each of the Eastern Partnership countries (EaP). They offer a review of the SME sector in the country, as well as of the economic and business environment in which enterprises operate. In addition, the 2018 Country Reports add two major new elements, namely the results of an SME survey and the outcome of round tables of EU4Business stakeholders carried out in each EaP country.

The national round tables were held between late February and early April 2018, and involved all the EU4Business stakeholders in each country, as you will see in Section 6 of the Report. The conclusions offer a unique perspective arrived at following a detailed joint consideration of all the EU4Business pillars and initiatives.

The results of the survey of SMEs benefiting from the EU4Business finance facility are presented in Section 5. They provide an overview of the impact of EU4Business, as perceived by the beneficiary enterprises themselves, at least a year after the lending operation has been completed.

We have also conducted a thorough analysis of some 150 documents and discussed these with a multitude of stakeholders to arrive at the impact assessment of the EU4Business portfolio, as presented in Section 3.

Finally, the two opening sections provide an economic overview by country and the state of affairs of the SME sector.

The EU4Business Secretariat has received tremendous research assistance from our country teams, based in the EY offices throughout the Eastern Partnership region, while the EU Delegations provided substantial support and data for the publication. DG NEAR was closely involved in report editing and verification. To all of them we extend our sincere thanks.

We anticipate that the materials presented here will support the reform discourse in each of the six countries, contributing to further enhancement of the SME climate and regulatory framework. The Secretariat looks forward to facilitating new national-level discussions on how further to improve effectiveness and delivery of EU support to the EaP's SME development and to work on new and innovative support instruments.

Boris Divjak, SME Expert  
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# General economic overview of the country

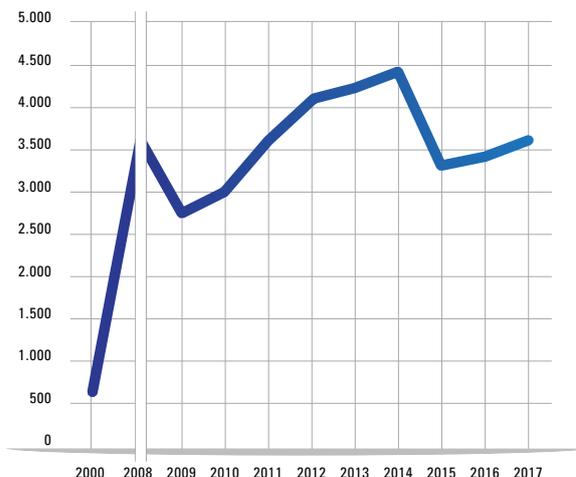


## 1.1 Macroeconomic indicators

Over the past decade, Georgia's economy has grown at an average annual rate of 5%. This was in spite of numerous shocks, including the global financial crisis of 2007–08, the conflict with Russia in 2008, and the regional economic headwinds of 2014.

The economy performed better in 2017 than earlier estimates had indicated. GDP growth improved markedly to 5% from 2.8% in 2016, led by the trade, construction, and transport sectors in an improved external environment. Exports of goods expanded by 24% led by strong demand from Russia, Azerbaijan, Ukraine, China, and the United States, while exports of services improved by 20%, led by a 27% spike in proceeds from tourism. According to available indicators, the economy continued to gain momentum throughout the first quarter, following a robust performance in 2017. Economic growth edged up to 5.6% on an annual basis in March, bringing average growth in the first quarter to 5.2%. The expansion was boosted by an improving external backdrop: merchandise exports jumped in the first quarter, and inbound tourism has been thriving.

Figure 1.1: Republic of Georgia's GDP per capita (current US\$)



Source: Macroeconomic indicators, World Bank

In addition, workers' remittances increased by 21% in 2017. Import growth was relatively lower, reflecting gradually firming oil prices. Gross foreign direct investment (FDI) inflows increased in 2017 to 12.3% of GDP, helping strengthen the international reserve position, which stood at four months of imports of goods and services. Meanwhile, the state budget recorded a surplus in all three months of the first quarter, with a considerable jump in the surplus in March. This could be a good sign of an improvement in the state of public finances in Georgia this year.

Prudent macro-fiscal policies helped preserve fiscal space and supported price stability. With inflation above the ceiling of its target range in 2017 and the rapid growth of credit, the National Bank of Georgia (NBS) increased the policy rate by 0.75 basis points to 7.25% over 2017. The policy rate has remained tight so far in 2018.<sup>1</sup>

The banking sector is well capitalized and profitable and has a low number of nonperforming loans (NPLs). The sector yielded a return on assets of 2.8% and a return on equity of over 20% as of end-2017. Also, by December 2017, NPLs represented only 2.4% of gross loans, down from 3.6% as of end-2016. At the same time, systemic vulnerabilities persist, including the large market concentration of the top two banks, the high retail loan growth (including by non-bank financial institutions), and the elevated dollarization against the backdrop of deficient financial safety nets.<sup>2</sup> Banking sector lending to SMEs grew through the last five years from 14% to 21.1% and stands at 3790 million GEL as of 31 December 2017. The SME lending portfolio in the local currency amounted to 13.7% of total lending portfolio. There is a tendency of gradual decrease of interest rate both in local currency and foreign currency.<sup>3</sup>

1 Extracted from the World Bank in Georgia, <http://www.worldbank.org/en/country/georgia/overview>

2 Extracted from the World Bank's Georgia Overview - Economy, <http://www.worldbank.org/en/country/georgia/overview#3>

3 Last available data from the National Bank of Georgia



EU4Business

## GEORGIA: all roads lead to international trade



“

*Indico is raising standards in road engineering, by investing in environmental responsibility and contributing to the overall alignment of Georgian transport infrastructure with EU standards.*

”

Ioseb Gadelia is the founder of road construction company Indico, which invested in sand and gravel processors, wheel excavators, trucks, and other portable equipment, with help from the EU4Business-EBRD Credit Line. Through these investments, the company has been able to boost its productivity, replacing old technology with environmentally friendly updates and enhancing quality, as well as improving standards of health and safety, in line with the recommendations of project consultants.

Success stories:  
EU4Business-EBRD Credit Line



Georgia's economy is on track to being one of the fastest growing in the region over the medium term, on the back of robust export growth and a more stable monetary environment, which should support domestic demand. In comparison with the other Eastern Partnership countries, Georgia has rebounded after a couple of years of lower growth rates, although almost always the leader of the group. It has also traditionally had inflation rates well below the regional average and in 2016 it amounted to 2.13%. Among the six, it is in the group of smaller economies when it comes to export volumes in absolute terms and it stands at 43.6% of GDP, which has been below the EaP average (46%) and relatively unchanged over the past 5 years, all until this year. All this indicates there is a lot of room for expansion, which the economy seems to have acknowledged more recently. Crediting of the private sector has been on the permanent rise and well above the regional average with nearly 62% of GDP in 2016, according to the IMF, partly also because the lending interest rate is among the lowest in EaP and until this year dropping continuously - 11.5% in 2017, according to the WB. There has been no major exchange rate and local currency fluctuation in the past several years, so a Euro is worth 2.85 Georgian Lari (GEL) in mid-May 2018.<sup>4</sup>

## 1.2 Trade volume with the EU - exports

Georgia and the EU signed an Association Agreement which entered into force in 2016 with the scope of increasing market access between the two countries. Currently, the EU is Georgia's main trading partner and it accounts for almost 27% of its total trade (23.7% in exports and 27.5% in imports).<sup>5</sup>

This section focuses on exports from Georgia to the EU on selected trade categories which have high growth potential, especially for SMEs and excluding large-scale production. These exports to the EU in selected trade categories will be analysed in terms of size, economic impact and employment impact.<sup>6</sup> In general, the average impact of these selected trade flows in EaP countries amounts to 1.5% of GDP, and 1.3% of total employment. In comparison to other countries, the impact on the Georgian national economy is smaller, with a total impact of 0.9% of GDP and an employment impact of 0.6% of the total. The reason for a lower employment effect compared to GDP lies in the relatively high labour productivity of the sectors affected.

4 Macroeconomic data from <https://www.focus-economics.com/countries/georgia>

5 European Commission, DG for Trade, (2018), 'European Union, Trade in goods with Georgia 2017.'

6 Panteia, (2018), Study: Key sectors and BSOs - Step 1 selection of the sectors). Data on trade flows sourced from the International Trade Centre (ITC).

In the period 2010-2016, total exports in goods to the EU from Georgia reached an average of €367 million. In 2017, trade with the EU amounted to €2,374 million, an increase of 2% compared to the previous year. Exports amounted to €539.6 million (13.0% higher), while imports amounted to €1,834 million (0.8% lower)<sup>7</sup>. An in-depth assessment of these exports shows that a large portion is the result of large scale industrial outputs that are being exported to the EU, so SME exports alone total €233 million. Furthermore, when focusing only on the export categories with potential growth, the average amount of that trade comes to €150 million. The selected exports cover these categories:

- Edible fruits and nuts (categories in HS8)
- Fertilisers (categories in HS31)
- Beverages, spirits and vinegar (categories in HS22)

The main sectors that are directly affected are agriculture, forestry and fishing, food and beverages, and manufacturing of petroleum, chemical and non-metallic mineral products. The direct impact on value added amounts to €78 million, the direct effect on employment amounts to 3,000 jobs.

To produce these goods, additional inputs from other sectors of industry are required; hence, the total impact of these trade flows is larger than the direct impact. In terms of gross production, the total impact amounts to €204 million; in terms of value added, the total impact amounts to €104 million (or 0.9% of GDP), and the employment impact is 5,000 jobs (0.6% of total employment). The employment effect is less than the GDP impact; this is because the sectors affected are characterised by relatively high labour productivity.

## 1.3 Business climate

Positioned 9th globally, the Republic of Georgia is not only the EaP leader in the Doing Business rankings of the WB by the ease and costs of business regulations, but one of the world's top ranks. Georgia remains well ahead of the other EaP countries, and in some regulatory aspects with only a couple of countries globally ahead. The business climate has steadily been improving over many years, due to a large number of regulatory simplifications, according to the indicator. Of the various topics Doing Business covers, Georgia is most advanced with protecting minority investors (2nd position globally), starting a business and registering property (both 4th in the world), while lagging behind with trading across borders and resolving insolvency, where it is ranked 62nd and 57th respectively of 190 countries ranked.

7 Official figures for 2017 from the National Statistics Office of Georgia, Statistical Yearbook 2017, <http://www.geostat.ge/index.php?action=wnews&lang=eng&npid=593>

Georgia has been addressing corruption in a variety of ways over the past decade, as shown also by the Transparency International's Corruption Perception Index: Georgia's score has been varying over the past five years between 49 and 57 (100 being best and 1 worst), placing it in 2017 in 46th position globally among 180 countries with the current score of 56. Despite being a leader among the post-Soviet republics, "limited enforcement of anti-corruption laws and regulations, as well as a serious lack of judicial independence hinder forward progress across the country," Transparency International finds<sup>8</sup>.

Georgia has a range of BSOs that actively engage in monitoring of the business environment, reporting on it and discussing progress with the public sector. Besides the official Chamber of Commerce and Industry, there are several other associations, including the foreign chambers and associations, such as: International Chamber of Commerce, American Chamber of Commerce, European Business Association and European Union Georgia Business Council to name the largest. The Georgian Small & Medium Enterprises Association was also established to highlight the importance of the SME sector and support them further. National business associations include: Georgian Entrepreneurs association, Georgian Business Association, in addition to a few associations supporting sector/industry specific activities that also play a role as a conduit for business environment improvement and propose improvements to the authorities. Even though the chambers typically work with larger companies, all of the identified associations actively support SME development and promote policies aimed at their strengthening.

The establishment and activity record of the two main SME support agencies operating under the auspices of Ministry of Economy and Sustainable Development, 'Enterprise Georgia' and the Georgian Agency for Technology and Innovation (GITA), provide a strong institutional basis for the delivery of SME policies and support services. The Ministry of Agriculture, through the Agricultural Project Management Agency (APMA), also supports SME development in agriculture by implementing more than ten projects under a single agribusiness programme umbrella. The Government of Georgia also made significant progress to institutionalise private-public dialogue through the creation of a Private Sector Development Advisory Council and regular consultations to monitor the implementation of the SME Development strategy. Also noteworthy is the planned establishment of Business Houses (one-stop-shop location to provide over 600 services to businesses).<sup>9</sup>

### **Textbox 1: Busy Georgian reform agenda**

The country's Socio-Economic Development Strategy titled "GEORGIA 2020" is a roadmap document for medium to long-term economic development, setting the strategy, priorities and action plan by sectors. The strategy identifies three main priorities areas: private sector competitiveness, developing human resources, improving the social safety net, and improving access to finance.

The SME development strategy 2017-20 and action plan was subsequently approved by the Ministry of Economy and Sustainable Development in 2016, which aims to increase SME output by 10%, increase employment by 15% and increase production by 7% by 2020. The report on the 2016-2017 action plan performance has been released and the next phase of the action plan (2018-2020) was approved in early 2018.

The key strategic directions of the strategy are:

- access to finance;
- improvement of the institutional, legal and entrepreneurial environment;
- SME skills and entrepreneurial culture development;
- export support and SME internationalization;
- Innovation and research development support.

Additionally, there are also the Strategy for Agricultural Development in Georgia 2015-20 and the Professional Education Reform Strategy 2013-20 supporting the SME development agenda. A draft of the Innovation Development Strategy 2020 has been prepared recently and is expected to be approved in the summer of 2018.

The National Statistics Office has developed a new methodology for determining the size of the enterprises now in compliance with EU standards, which came into the force from 2018. According to the changes, turnover and the number of employees will be set out as criteria using PPP and Eurostat recommendations.

A new Law on Entrepreneurs and Insolvency Law are expected to be approved by the end of 2018. From 1st of July 2018 a new initiative of the Ministry of Finance will come into the force, which foresees only 1% of corporate income tax payment for small enterprises.

<sup>8</sup> [https://www.transparency.org/news/feature/europe\\_and\\_central\\_asia\\_more\\_civil\\_engagement\\_needed\\_part\\_II](https://www.transparency.org/news/feature/europe_and_central_asia_more_civil_engagement_needed_part_II)

<sup>9</sup> OECD EU4Business: From Policies to Action, Monitoring Georgia's implementation of the SME Development Strategy, Concept note, 2017

# Share of SMEs in the economy

In 2017, the National Statistics Office of Georgia approved a new methodology for the SME registry aimed at the harmonisation of SME definition for statistical purposes to EU SME definition (Eurostat), which becomes effective from the start of 2018. This was envisaged by the Georgia SME strategy Action Plan 2016-2017 of the Government. The SME definition as per the new methodology was harmonised with that of the EU and the new turnover levels are set to bring the regulation in line with that of the EU.

According to the National Statistics Office of Georgia, the number of active enterprises in 2016 amounted to 598,947. For the last five years, the number of registered enterprises has increased by 126%.

SMEs play a significant role in Georgia's economy, accounting for 94.1% of active enterprises, 67.7% of employment and 58.4% of value added in 2016, compared to the OECD averages of 99.8%, 70.7% and 66.7% respectively.

Looking at a longer timeline, employment has increased in last five years by 125%. The biggest contributor to employment are micro and small enterprises with 46%, followed by large enterprises with 32.7%, and medium enterprises with 21.4%.

In Georgia, SMEs are concentrated in low value-added activities, which in turn explains their limited contribution to the total value added. Namely, 40.8% of SMEs operate in the trade sector, followed by real estate (13.1%). Share of output by size of enterprises in 2016 was as follows: large – 41.6%; medium – 25.1%; small – 33.3%. Total output for the last five years has increased by 147%.<sup>10</sup>

Geographically, half (43%) of all SMEs were located in the capital, while the rest of them are distributed mainly in the three large regions of Georgia: Imereti (14%); Adjara (8.6%) and Samegrelo-Zemo Svaneti (8%).<sup>11</sup>

<sup>10</sup> Last available data from the National Statistics office of Georgia

<sup>11</sup> Last available data from the National Statistics office of Georgia



## SECTION 3:

# Overview of the EU4Business portfolio in Georgia

In Georgia, the EU4Business umbrella initiative supported in total 23 projects. Between 2009 and 2017, 4 projects have been concluded, while 19 are still ongoing. Across the four key objective areas, a total of 10 projects have been established to Improve access to finance, 3 to Strengthen policy and regulatory framework, 6 to Improve knowledge base and business skills, and 4 to Improve access to markets.

The table illustrates the distribution of projects in the different support areas, and which of those are ongoing and which are completed.

*Table 3.1: EU4Business project portfolio*

PROJECTS in GEORGIA				
Area of support	A: Improving Access to Finance	B: Strengthening policy and regulatory framework	C: Improving knowledge base and business skills	D: Improving access to markets
Ongoing projects	10	2	5	2
Closed projects	0	1	1	2
<b>Total projects</b>	<b>10</b>	<b>3</b>	<b>6</b>	<b>4</b>

Source: EU4Business database

With regard to the ongoing projects, the EU contributed a total of approximately €64,700,000, with most financial support addressing the area of Improving access to finance, followed by ongoing projects focusing on Improving knowledge base and business skills.

Projects aiming to improve access to finance have as main focus the provision of financial facilities to SMEs, mainly in the form of loans and grants. Two projects in particular add weight to the EU contribution in the overall EU4Business portfolio in Georgia: the DCFTA Initiative East has an EU contribution of €11.4 million in Georgia, and the EBRD credit line has an EU contribution of €13.6 million (see the story of the Indico road construction company<sup>12</sup>, as well as textbox 2 for examples of SME investments enabled by the credit line).

<sup>12</sup> For the related success story, please refer to page 3

In the area of improving knowledge base and business skills the DCFTA Adaptation Programme (DAP), focusing exclusively on Georgia, received the largest EU contribution of €4.5 million. The DAP programme is part of the larger Advice to Small Businesses programme of EBRD, which has mostly supported improving knowledge base and business skills in the EU4Business portfolio by organising trainings of local consultants and support of SMEs with advisory services from local and international advisors.

The portfolio for closed projects saw a total EU contribution of approximately €4,500,700, with most contribution targeting the action of improving access to markets, in which two projects have been completed, followed by the improvement of knowledge base and business skills with one closed project. An example of how EU4Business support has improved access to markets is shown by the success of Baia Abuladze in exporting Georgia wines to the European Union<sup>13</sup>.

The impact of this initiative and its enablement of projects had a positive impact on both enterprises and job creation in Georgia<sup>14</sup>. The table below summarises these key impacts in terms of enterprises supported, the number of enterprises that received loans, the total value of the loans provided via the programmes, and the number of jobs created through the programme support. Since its inception until 2017, the EU4Business umbrella supported 755 enterprises in Georgia, 37,008 enterprises received loans, accumulating to a total value of €882,153,323, and it contributed to the provision of 10,312 new jobs, with many more supported and sustained this way.

In general, mainly due to the relatively good business environment, EU4Business projects have been easier to implement in Georgia, compared to the other EaP countries. This has also contributed to the success of the EU4Business initiative in Georgia.

<sup>13</sup> For the related success story, please refer to page 9

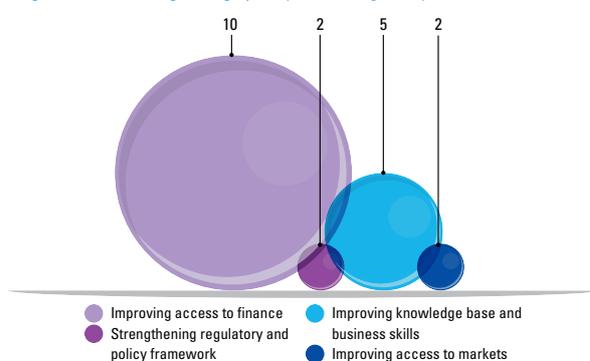
<sup>14</sup> Key impacts of the EU4Business portfolio are monitored through the analysis of the progress reports of the projects included in the portfolio. More detailed information can be found in the 2018 Annual Report.

Table 3.2: EU4Business impact in Georgia

Impacts of EU4Business support	2009-2015	2016-2017	2009-2017
Number of enterprises supported with advisory services	335	420	755
Number of enterprises which received loans	30,577	6,431	37,008
Total value of loans disbursed (Euro)	504,867,523	395,256,960	882,153,323
Number of new jobs created	3,458	6,854	10,312
Number of jobs supported and sustained (advisory and financial projects)	15,717	14,765	30,482

Source: EU4Business database

Figure 3.1 Ongoing projects by objective



Source: EU4Business database

### Textbox 2 – Examples of successful DCFTA adjustments in Georgia

The DCFTA programmes in Georgia have already seen concrete achievements in individual firms that made investments leading to compliance with relevant EU directives, thus giving them the opportunity to open up markets in the EU. Examples of investments funded under the EU4Business-EBRD Credit Line include:

**Warehouse company** LLC Sakinvesti refurbished a cold storage warehouse with efficient sandwich panels, doors and accessories for refrigeration with a loan from the EU4Business-EBRD Credit Line, achieving improved environmental protection standards as well as significant energy savings, reduction of water drainage and improved occupational Health and Safety standards.

**Food processing company** Kumisi XXI financed the procurement and installation of an egg grading and packaging machine, which facilitates high quality sorting-packaging processes, ensures food safety and increased hygiene in production process, in compliance with EU and international production standards.

**Winemaker** Kvareli Cellar used an EU4Business-EBRD Credit Line loan to invest in a new production line and auxiliary equipment, which improve production quality, and health and safety at work, enabling the company to increase its export potential to EU countries.

**Dried fruit and herb producer** Geo Flower invested in a new production plant and specialised machinery, achieving compliance with EU and international product standards, giving access to a wider international customer base and, due to increased product quality, higher sales prices.

**Asphalt producer** GCG LTD invested in a new asphalt plant with upgraded electrical system and a wastewater treatment plant, as well as in improving health and safety standards for employees. With these investments, the company now has a modern production plant, reduced personnel safety risk, reduced pollutant emissions and increased product quality, making GCG LTD one of the cleanest asphalt production plants in Europe.



EU4Business

## GEORGIA: from family tradition to export business



“

*We bottled our first 5,000 bottles of wine this year. There are many barriers but we manage to overcome them – how to bottle in a proper way and meet standards, distribute the product on the market... Growing sales is now our key focus.*

”

24-year-old winemaker Baia Abuladze has transformed a family business into a successful enterprise, selling not only in Georgia but in the EU. Baia received entrepreneurial support from the East Invest project, in the areas of informal education, the improvement of contacts, sales and the promotion of products.

Success stories:  
East Invest

## SECTION 4:

# Donor support to the SME sector in the country - looking beyond EU4Business

36 projects have been identified that focus on strengthening the role of SMEs in Georgia beyond EU4Business. Of these 21 are managed or mostly funded by the Georgian government and its agencies while the others are donor-funded projects - bilateral and multilateral.

Eight among the 36 are dominantly in the form of loans to SMEs, often targeting SMEs directly or through the banking sector, similarly to the access to finance pillar of EU4Business; 23 provide various types of grants from a variety of bilateral and multilateral institutions; finally, 4 are subsidies or other forms of investment.

Grant programmes largely look at increasing the value added to SMEs in strategic sectors, such as agribusiness (particularly wine), hospitality and tourism, but also targeting certain niches with high growth potential: export-oriented industries, youth entrepreneurs, value chain development, high-tech and ICT sector, innovation etc. These are largely comparable to the EU4Business' Access to knowledge pillar.

Almost all the national public funds are channelled through: Enterprise Georgia, as the SME agency; Georgia's Innovation and Technology Agency; and Agricultural Projects Management Agency.



A range of instruments are being made available – from subsidies and grants to equity investment and loans. Grants rarely distort other market strengthening efforts and are mostly aimed at strengthening business capacities, educating and training (vocational, specialised, introduction of new technologies), insurance coverage, enabling the target audience to add value or engage in a new production niche or activity, developing intermediaries and consultants who can then work with the ultimate beneficiaries or enabling access to such consultants and know-how, or engaging with special groups such as women entrepreneurs or individuals with special needs to encourage their market entry.

The programme sizes vary – mostly multi-million in EUR terms, yet far less than the largest programme, the European Neighbourhood Programme for Agriculture and Rural Development (ENPARD), implemented in three phases until 2022, which builds capacity and supports government institutions in the reform of the agriculture and rural development sector, but also directly strengthens farmers' cooperation skills and access to resources (€52 million in EU contribution alone). There are various types of subsidies, partial guarantees and rebates that government agencies offer to investors (domestic and foreign) if they engage in closely selected niches, such as film industry, tea or hazelnut production – all of which promote Georgian products that are export oriented.

Loan programmes, which correspond to the Access to finance pillar of EU4Business, are less restrictive and target the most viable investments, as can be anticipated. However, a few sectors have been highlighted by donors: agribusiness and innovation by the very nature of the agencies dealing with these (GITA and Enterprise Georgia). Loans made available to rural communities, farmers, and agribusinesses are the largest share of all the access to finance support made available through local banks and other quasi-financial institutions. They are often combined with other instruments, such as guarantees, consultancy assistance and access to knowledge and markets, etc.

Venture capital and equity investment has gone further in Georgia than in any other EaP country. They look to co-invest with business owners into innovative solutions, aimed at the projects that have a market potential but lack investment and are open to private funds.

Comparing the interventions both inside and outside the EU4Business portfolio with the suggested gap assessment, as portrayed by the national round table and other analyses deployed by the EU4Business Secretariat, the main needs are being met. The key issue is speed of implementation and disbursement of aid, which in turn depends on the speed of reforms and local absorption capacity.

The implementers have highlighted multiple times that EU4Business has finally reached high visibility and high expectations, which is a momentum that needs to be sustained. The agribusiness sector appears somewhat saturated, so EU4Business could perhaps focus on the high-growth sectors such as ICT industry, or other products and services where the current GIZ project has been making advances in clustering and value chain development. A range of instruments is needed for this development: from the actual funds to support business development, to specialised training and business handholding in form of know-how and consultancy work, etc.

There is a shortage of guarantee funds, particularly as many of the entrepreneurs are young with little starting capital, etc. These can complement a range of other opportunities that could be used hand in hand. Enabling easier access to the EU market through business matching, participation in fairs and accessing specialised online facilities might be a relatively small investment yielding comparatively high growth. Generally, it appears that the ongoing GIZ-implemented project SME Development and DCFTA in Georgia is rather spot-on in servicing and developing further the SME needs in the country, but the demand for this type of support far outnumbers what the project alone can cover and effectively manage. Therefore, a simple continuation or even expansion of this project and the likes would greatly support the SME cause and the DCFTA implementation.

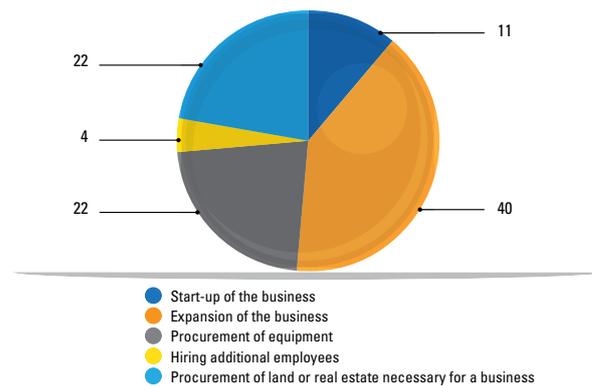
# SME survey results

Thirty SMEs – beneficiaries of the financial products of EU4Business were surveyed in Georgia in the period of March-April 2018<sup>15</sup>: 73% of those were limited liability companies, 20% were individual entrepreneurs and 7% cooperatives. Statistically, there was an even representation of the retail sector, manufacturing, services and agriculture. There is a wide range of SMEs’ years of operation prior to taking the loan: from less than a year to more than 25 years, and the employee size also varies – 39% of them have less than 10 staff and it goes up to 250 staff, with one company even exceeding 250. All these respondents borrowed in 2016 through EBRD and EIB run projects.

Georgia has one of the highest levels of awareness of the origins of funding: 59% of respondents know that the funds originate from the EU4Business programme or from the EU. 89% of them learned about the funding opportunity from the bank from which they borrowed. Borrowing in local currency through EU4Business is indeed paying off, as 54% of respondents have borrowed in GEL, and 88% obtained the full amount applied for. 55% of the respondents believe the terms and conditions were better than the otherwise market terms (45% see them as being no different and not one respondent as being worse).

In the case of Georgia, 40% of respondents needed the funds for business expansion, but as the chart below illustrates, also for a variety of other purposes, with none using the loan dominantly for working capital.

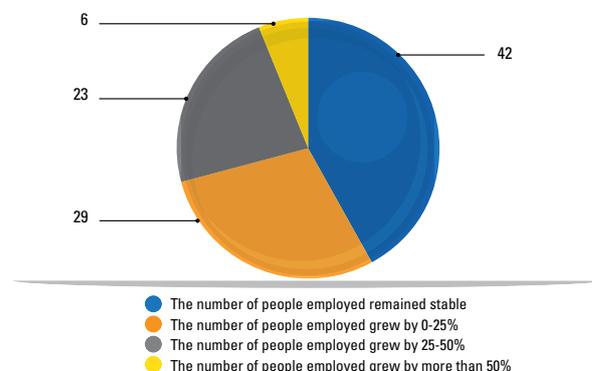
Figure 5.1: Loan purposes



Source: EU4Business database

However, as a result of this expansion, the majority increased its workforce as much as up to 50%, and two companies even more than that. Interestingly, more than half of the respondents acknowledge that women represented up to 15% of the new employees, and only 15% of the respondents hired more than 50% women among the new staff. The loan has played a very important or crucial role in increasing employment for 60% of those who hired, while for the others it was less critical or not at all important in generating jobs.

Figure 5.2: Impact of loan on employment



Source: EU4Business database

As many as 86% of the SMEs in the survey export abroad, mostly to the EU and EaP (27% of exporters to each; others to Russia, Turkey etc.), but all of them export less than 25% of their total output.

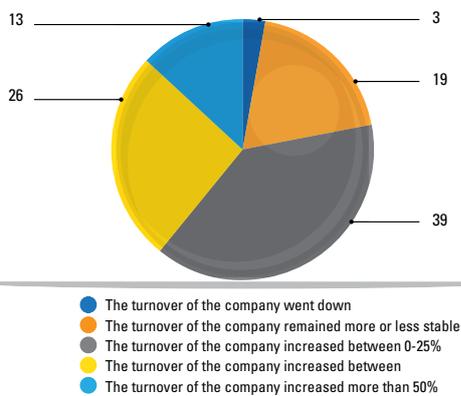
<sup>15</sup> A total of 130 SMEs were surveyed in five countries of EaP (Armenia, Belarus, Georgia, Moldova, Ukraine): 30 companies in the three countries with DCFTA status and 20 in the other two. Initially, the key implementers provided twice as many SMEs, from which firms were contacted until the target number of interviews has been completed. The firms were chosen randomly, but a precondition was that they had taken an EU4Business financed loan at least one year before the beneficiaries’ lists were prepared. In the countries where different projects were being run, the SMEs approached were from a proportional mix of such projects (provided via EBRD, EIB and KfW).

Only one company exports the majority of its products. However, most of them saw the export levels unchanged since they engaged with EU4Business, except for one firm that actually increased exports by up to 50% as a direct result of the financial package from EU4Business. This is why the majority of the surveyed exporters indeed see the loan as less relevant for their exports, as other market factors were seen as more important. When asked what is hampering the increase of their exports into the EU, they mostly cite lack of awareness and lack of knowledge of the procedures, standards, but also the difficulty of identifying their potential trading partners.

39% of the companies saw their turnover increase by up to 25% and just as many of them even more than that, as the chart below details. 29% of respondents said that the loan was crucial to increase turnover, 55% important and only 16% of companies found that the loan did not significantly interplay with their turnover.

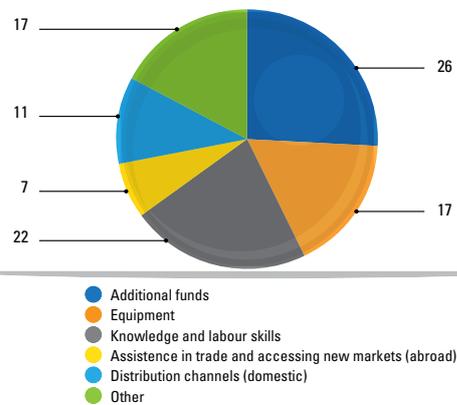
If they would borrow again, most are looking to boost their working capital. Next in line is investment in knowledge followed by more equipment. For that, a majority would turn to the commercial banks or non-bank institutions where they are seeking loans under favourable conditions, primarily meaning lower interest rates than presently available. A quarter is looking to reinvest their profits into business expansion.

Figure 5.2: Impact of loan on turnover



Source: EU4Business database

Figure 5.4: Company's current needs



Source: EU4Business database

# Highlights of the round table discussion

The round table held in Tbilisi on 1 March 2018 resulted in a dynamic discussion, during which 40 EU4Business stakeholders present in Georgia highlighted important achievements of the EU4Business initiative. The participants jointly concluded that the funding, support and training provided to the SMEs in the framework of the EU4Business programmes, have had a significant impact on the further development and growth of SMEs in the country. A number of key points have been identified for a possible follow-up as a way to further strengthen the EU4Business impact. They follow the logic of the four pillars of EU4Business.<sup>16</sup>

## 6.1 Access to finance



Even though increasing support is available to SMEs, as facilitated by the international finance institutions under the EU4Business umbrella, access to finance is critical for Georgian SMEs. The financial market remains insufficiently attractive for investment, with high interest rates, low maturity periods and high collateral requirements. SMEs do not have equal access to finance across the country, with the situation in Tbilisi being significantly better than in the regions.

Georgian SMEs would like to see the following instruments developed or increased in scope:

- In the short to medium run, revision of eligibility criteria for credit lines. Currently, eligibility criteria use EU SME definitions, which hinders many SMEs from being eligible for access to finance projects. The EU definition examines total revenue, total assets and total number of employees. Georgian companies, for traditional reasons of how operations are organized, are more labour intensive.

<sup>16</sup> The national round tables were held in the capitals of all six EaP countries between late February and early April 2017, and engaged all the EU4Business stakeholders in each country: the EU Delegations, the IFIs involved, national counterpart- SME agencies and Ministries of Economy, commercial banks involved, business associations, key implementers and any other related party, totalling between 25 and 45 persons per round table. The discussions focused on the ongoing achievements across all four pillars of EU4Business, but the content was tailored to the priorities of each country. The discussants were specifically guided to address the forthcoming challenges anticipated and to propose solutions for the way forward.

Sometimes they qualify as SMEs by the revenue and asset definition, but not for employment. Adjusting the SME definition to the EU definition used for tax purposes, would lower the bar and more entities would be allowed to access EU4Business finance programmes. In addition, to increase the speed of SMEs' access to finance, loan agreement between IFI's and banks should be more clear and detailed.

- In the medium to long run, alternative financial instruments should be developed for SMEs:
  - Equity funds (for startups or to scale up) especially those that have leverage problems;
  - Retro financing made available;
  - Leasing;
  - Microfinance;
  - Startup seed funding incl. other sources of finance such as crowdfunding;
  - Guarantees to support collateral requirements and specifically blending guarantees (first loss guarantee, partial guarantees) and combining them with other tools and loan schemes - risk sharing;
  - Finally, if more loans are made available in local currency, the demand for these is very strong.

## 6.2 Access to knowledge and skills



Generally, SMEs still lack appropriate education and entrepreneurial skills, understanding of HR remains low, digitalisation and modernisation of operations is still lagging. Most SMEs find it difficult to navigate through the market triangle of SMEs-labour-education. While clusters add tremendous value, as shown by the breakthrough of 20 Steps Production with the help of the film cluster supported by GIZ<sup>17</sup>, there is a shortage of cluster facilitators and leaders. Value chains are still weak and unattainable for smaller companies.

- In the short to medium run, certain skills can be upgraded based on existing programmes, such as women entrepreneurship or business incubators. Value chains and SME linkages need to be studied further and subsequently identified, developed, led and trained.

<sup>17</sup> For the related success story, please refer to page 17

- In the medium to long run, specific industry or cluster hard skills, as well as entrepreneurial skills, digitalization and modernization skills need much greater resources. Implementing alternative instruments to bring EU skills to Georgia might be of interest, e.g. Mobility partnership (signed in 2009) with a simple migration possibility for the temporary employment of Georgian citizens abroad. This would contribute to VET and bringing knowledge and skills from the EU. Capacity building and awareness campaign for civil servants is also a major component to facilitate understanding and to support businesses development from the public sector side.

### 6.3 Access to market



Georgian SMEs find trade with EU member states increasingly important, despite an already high share of local exports going to the EU. However, large companies still dominate foreign trade. SMEs acknowledge the value that specialized experts bring to them, primarily in finding partners in the EU and matching them with possible importers. As they look to export and internationalise, SMEs typically add value and increase the quality of products and services. Again, all these appear simpler for the companies based in the capital than in the regions.

- In the short to medium run, SPS food security issues, new rules and regulations of DCFTA requirements need to be brought closer to the SMEs and their introduction facilitated by the regulators. This will often require one-on-one expert work with the SMEs and handholding. High added value cluster identification and linking Georgian SMEs to European SMEs are essential. Greater inclusion of disadvantaged groups (young, disabled) is highly desirable. Regulating dumping prices, hypermarkets and to some extent import tariffs might support the growth of SMEs.
- In the medium to long run, as SMEs compete with one another to take a larger portion of the domestic market, there is a need to better regulate competition and distribution rights. The country would benefit from faster and improved operations of commercial courts, but also alternative dispute resolution mechanisms such as mediation or arbitration. Further development of free industrial zones might benefit from EU expertise.

### 6.4 Policy and regulation



Despite very significant advances in smart regulation of the market, a number of regulatory issues still require attention for the benefit of Georgian SMEs. In addition to the definition issue, raised under Access to finance, 90% of Georgian companies are SMEs, yet contributing to 40% of employment – more than in most EaP countries, but still lagging well behind EU indicators. Civil servants are not always aware of the importance of SMEs for the national economy, despite the extraordinary efforts of Enterprise Georgia and GITA. In order to make SMEs more resistant and structured, the following is important:

- In the short to medium run, the SME Policy index provides specific recommendations to strengthen the regulatory environment. Review and assessment of the existing and planned incentives and exemptions for SMEs must be ongoing and flexible, ensuring there are no market distortions.
- In the medium to long run, a reformed SME insolvency procedure and legislation needs to be adopted, and generally the judiciary system is in the need of modernization and strengthening, incl. the aforementioned alternative disputes mechanisms. Even though this is not strictly a part of EU4Business, in order to enhance the efficiency of the public sector, capacity building for civil servants is needed, specifically in how to support businesses – such curricula should be integrated in the Public Administration Reform (PAR).

### 6.5 Modernization and digitalization

As SMEs do not have the same access to technology, especially in regions, there are a number of areas for the regulators to take into consideration in the long run:

- Making broadband internet available much more broadly, especially in villages and remote areas;
- Develop innovation tools and support innovative SMEs;
- ICT absorption, internalisation and E-commerce fostering.

## 6.6 Communication and visibility of EU4Business Programmes

The round table acknowledged a much greater need for timely information exchange and access to information. The Government supports a more open flow of information and assessment of impact. Very often and particularly outside the capital, SMEs are not aware of the EU support available and what sectors and businesses it covers. Therefore, more transparency and visibility will benefit all the stakeholders. With the more recent DCFTA credit line, demand is far greater than supply, which is why the banks are not keen to further promote this programme. The lack of practical communication tools to better reach the end users can be improved as follows:

- In the short to medium run, more promotion and direct engagement with SMEs is needed, particularly in the regions. This can be done by the specialised SME agencies, government representatives, but also commercial banks and other EU4Business stakeholders that can distribute relevant information to SMEs, ideally in a coordinated fashion. This can go hand in hand with simple education on EU integration and how Georgia benefits from the DCFTA process. Showing success stories in the regions would have a major communication benefit for the entrepreneurs who potentially have access to the programmes. Some of this can be simplified to product-based communication understandable to all, by means of simple messages.

- In the medium to long run, an appropriate communication strategy should address the following issues: modification to a user-friendly website or social media interactions with potential users, other channels for information dissemination, integration of various stakeholders, horizontal linkages and experience sharing, creation of regional knowledge hubs and information sharing (incl. on DCFTA).

The round table finally concluded that a follow-up to the initial event is highly desirable. A Steering Committee or Taskforce can be set up that will provide regular updates and sharing of such a matrix among the round table participants, as a means of stocktaking. Such a taskforce can also provide highlights of the achievements/impact and the current challenges and priorities for review. Tools and other recommendations can be made for assessment of all the stakeholders and further discussion. Regular meetings at the same level can then be facilitated e.g. once a year, or as agreed.

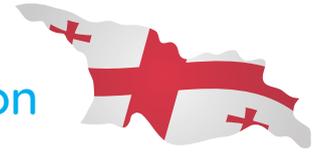




EU4Business

## GEORGIA:

putting Georgian film production  
on the international map



“

*Georgia has to present its works in the international film market if it wants to attract more foreign producers.*

”

Vladimer Katcharava is the founder of '20 Steps Production', a Georgia-based independent production company that is part of the Georgian Film Cluster, established in 2017 and supported by GIZ in the framework of the EU4Business initiative. Cluster members took part in the Marché du Film in Cannes last year, as a result of which 20 Steps Production collaborated on the Georgia-France-Belgium co-production *Girls of the Sun*, which was selected to compete for the Palme d'Or at the 2018 Cannes Film Festival.

**Success stories:**  
SME Development  
and DCFTA in Georgia



17



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