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**Working Paper**

## Leveraging small and medium-sized enterprise finance through value chains in Georgia

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**ADB Working Paper Series**

**LEVERAGING SMALL AND  
MEDIUM-SIZED ENTERPRISE  
FINANCE THROUGH VALUE  
CHAINS IN GEORGIA**

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**Abstract**

A strong small and medium-sized enterprise (SME) sector can contribute much to a country's economy by fostering innovation, creating jobs, and reducing poverty. This paper examines the status of SME finance in Georgia and the involvement of Georgian SMEs in global value chains. The role of SMEs in Georgia's economy, SME funding, and the status of financial inclusion for SMEs are analyzed. Moreover, the level of financial literacy and skills of SME entrepreneurs is discussed. Furthermore, the paper analyzes the Georgian agricultural sector's value chain and the involvement of this sector in global value chains by discussing the case study of the hazelnut. An analysis of the agricultural sector's value chain financing in Georgia is carried out, its availability and development are discussed, and best practices of value chain financing are analyzed. Based on existing information, the paper identifies barriers to SME finance in Georgia and proposes policy recommendations and immediate actions with regard to existing government policies.

**Keywords:** SME sector, financial literacy, financing, global value chain, value chain financing, agriculture

**JEL Classification:** D53, G23, L26, Q13, Q14, Q17

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# 1. INTRODUCTION AND OVERVIEW OF ROLE OF SMES IN THE ECONOMY AND SME FINANCE

## 1.1 SMEs' Role in the Economy

In this chapter, various existing definitions of small and medium-sized enterprises (SMEs) in Georgia are introduced, while the trends of employment, value added, and average monthly remuneration in the SME sector in Georgia are also analyzed.

### 1.1.1 SME Definition

In Georgia, there is no universally accepted definition of SMEs. The definitions of SMEs differ in the National Statistics Office of Georgia, in the Law of Georgia on Accounting, Reporting, and Audit<sup>1</sup>, and in the Tax Code of Georgia.

The size of an enterprise determined by the National Statistics Office of Georgia is as follows:

- Small-sized enterprises refer to all enterprises of organizational-legal form where the annual average number of people employed does not exceed 50 and the annual average turnover is below GEL12 million (\$4.7 million<sup>2</sup>);
- Medium-sized enterprises refer to all enterprises of organizational-legal form where the annual average number of people employed ranges from 50 to 250 and the annual average turnover ranges from GEL12 million (\$4.7 million) to GEL60 million (\$12.5 million);
- Large-sized enterprises refer to all enterprises of organizational-legal form where the annual average number of people employed exceeds 249 and/or the annual average turnover exceeds GEL60 million (\$12.5 million).

Meanwhile, the size of enterprises according to the Law of Georgia on Accounting, Reporting, and Audit is determined as follows:

- Microenterprise (category IV) – an entity whose indicators, at the end of the reporting period, meet at least two of the following three criteria: (1) The total value of assets does not exceed GEL1 million (\$0.4 million); (2) The revenue does not exceed GEL2 million (\$0.8 million); and (3) The average number of persons employed during the reporting period does not exceed 10;
- Small enterprise (category III) – an entity that is not an enterprise falling under the fourth category and whose indicators, at the end of the reporting period, meet at least two of the following three criteria: (1) The total value of assets does not exceed GEL10 million (\$4 million); (2) The revenue does not exceed GEL20 million (\$8 million); and (3) The average number of persons employed during the reporting period does not exceed 50;
- Medium enterprise (category II) – an entity that is not an enterprise falling under the third or fourth categories, and whose indicators meet, at the end of the reporting period, at least two of the following three criteria: (1) The total value of assets does not exceed GEL50 million (\$20 million); (2) The revenue does not

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<sup>1</sup> <https://matsne.gov.ge/en/document/view/3311504?publication=4>.

<sup>2</sup> Throughout the text the annual nominal exchange rates GEL/USD are used. The data were taken from the National Bank of Georgia.

exceed GEL 100 million (\$40 million); and (3) The average number of persons employed during the reporting period does not exceed 250;

- Large enterprise (category I) – an entity whose indicators, at the end of the reporting period, meet at least two of the following three criteria: (1) The total value of assets exceeds GEL50 million (\$20 million); (2) The revenue exceeds GEL100 million (\$40 million); and (3) The average number of persons employed during the reporting period exceeds 250.

In the Tax Code of Georgia, another set of definitions for enterprise types are provided for which a preferential tax regime is in force. The size of enterprises is determined by the Tax Code of Georgia as follows:

- Microbusiness status – entrepreneurs (natural persons) who do not use hired labor, conduct economic activity independently, and have an annual gross income of up to GEL30,000 (\$12,000);
- Small enterprise status – entrepreneurs whose gross income from economic activity during a calendar year does not exceed GEL500,000 (\$200,000).

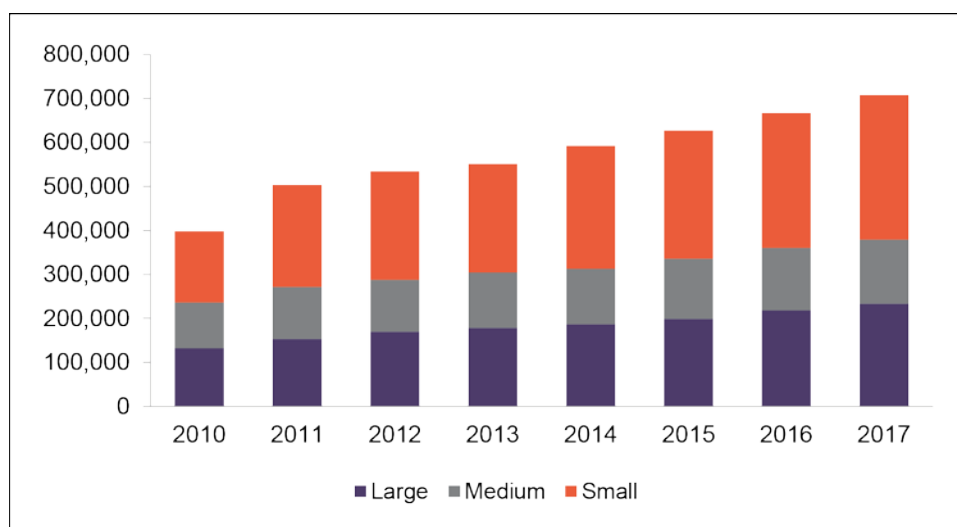
Moreover, financial institutions in Georgia also have different ways of determining an enterprise's size.

For this document, the definition and methodology given by the National Statistics Office of Georgia will be used when analyzing the statistical data.

### 1.1.2 SME Employment

In 2017, SMEs accounted for 67% of Georgia's total private sector employment – in total, 474,575 people (large enterprises accounted for 23%). During the period 2011–2017, SME employment increased, with the highest annual growth rate recorded in 2014 – 8.9%.<sup>3</sup>

**Figure 1: Employment in the Private Sector of Georgia**



Source: National Statistics Office of Georgia.

<sup>3</sup> Source: National Statistics Office of Georgia.

The largest proportion of employed people in SMEs were employed in the “wholesale and retail trade; repair of motor vehicles and motorcycles” sector<sup>4</sup> in 2017 with employment in this sector accounting for 29.2% of total SME employment (138,592 people). Between 2011 and 2017, the number of people employed in this sector increased, with the largest growth rate recorded in 2014, when the number of people employed in this sector rose by 14%.

**Table 1: SME Employment by Economic Sector 2017**

<b>Economic Sectors</b>	<b>SME Employment</b>	<b>Share of Sector in SME<sup>a</sup> Employment</b>
Agriculture, forestry, and fishing	8,546	1.8%
Mining and quarrying	4,385	0.9%
Manufacturing	59,469	12.5%
Electricity, gas, steam, and air-conditioning supply	2,172	0.5%
Water supply, sewerage, waste management and remediation	3,139	0.7%
Construction	58,446	12.3%
Wholesale and retail trade; repair of motor vehicles and motorcycles	138,592	29.2%
Transportation and storage	27,389	5.8%
Accommodation and food service activities	34,574	7.3%
Information and communication	13,430	2.8%
Real estate activities	14,341	3.0%
Professional, scientific, and technical activities	20,194	4.3%
Administrative and support service activities	14,181	3.0%
Education	19,582	4.1%
Human health and social work activities	30,959	6.5%
Arts, entertainment, and recreation	10,452	2.2%
Other service activities	7,458	1.6%
Sector is not specified	7,268	1.5%
<b>Total SME sector employment</b>	<b>474,576</b>	<b>100%</b>

<sup>a</sup> Based on the definition of the National Statistics Office of Georgia.

Source: National Statistics Office of Georgia, 2017.

The trade sector is followed by the “manufacturing” and “construction” sectors, as 12.5% and 12.3% of employed people in SMEs were employed in those sectors, respectively.

The “agriculture, forestry, and fishing” sector accounted for only 1.8% of SME employment.<sup>5</sup> However, it should be noted that during the period 2011–2017, in this sector the number of people employed increased, with the largest growth rate being recorded in 2012, when the number of people employed in this sector rose by 39.2%. Moreover, while the growth rate of SME employment in this sector increased between 2011 and 2017, the number of people employed in large enterprises in this sector

<sup>4</sup> Section – according to classification of economic activities NACE rev 2, later referred to as “trade.”

<sup>5</sup> According to the National Statistics Office of Georgia (Gesotat), the SME agriculture sector includes only primary production of agriculture. Therefore, the SME employment and SME value added in the agriculture sector given in the document include only primary production of agriculture.

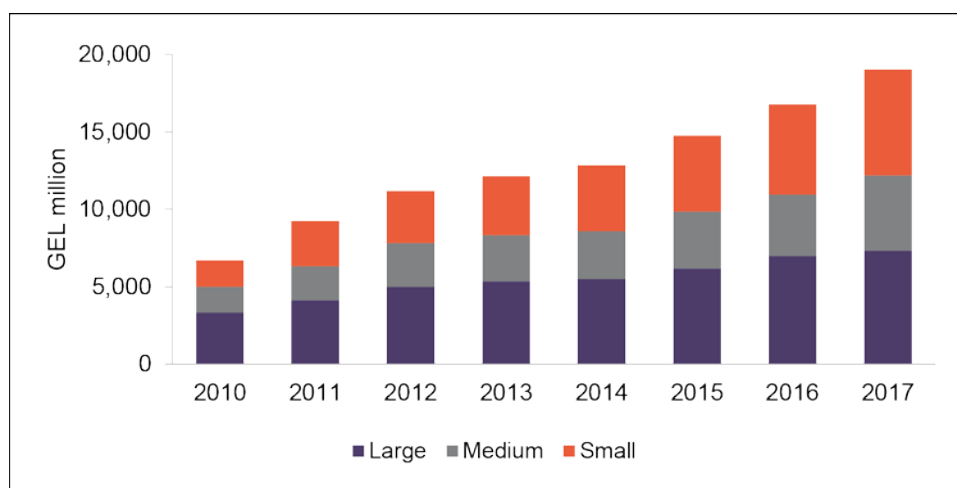


decreased in the period 2016–2017. Therefore, new businesses have been created in this sector; however, they struggle to become medium- or large-sized.<sup>6</sup>

### 1.1.3 SME Value Added

According to the latest statistics, in 2017, SMEs accounted for 61.6% of Georgia’s total value added in the private sector – in total, GEL11,722 million (\$4,673 million) (for large enterprises it accounted for 38.4%). The share of SMEs in total value added in the private sector has been increasing since 2012.<sup>7</sup> During the period 2011–2017, value added for SMEs increased, with the highest annual growth rate being recorded in 2012 – 20.7%.

**Figure 2: Value Added in the Private Sector of Georgia**



Source: National Statistics Office of Georgia.

The largest proportion of value added in SMEs was created in the “trade” sector in 2017, with this sector accounting for 24.3% of total value added of SMEs (GEL2,850 million (\$1,136 million)). Between 2011 and 2017, the value added in this sector increased, with the largest growth rate being recorded in 2017, when the value added in this sector rose by 16%.

The “trade” sector was followed by the “construction” and “manufacturing” sectors in 2017, with 19.4% and 12.3% of SMEs’ value added being created in those sectors, respectively. During the period 2011–2017, value added in those sectors increased.

The “agriculture, forestry, and fishing” sector accounted for only 1% of SMEs’ value added (GEL118 million (\$47 million)). Between 2011 and 2017, with the exception of 2014, in this sector value added created increased, with the largest growth rate being recorded in 2012, when the value added created in this sector rose by 80.9%.

<sup>6</sup> It should be noted that in 2017, 735,900 people (43% of employed people in Georgia) were employed in the “agriculture, forestry, and fishing” sector in Georgia, while SME employment in agriculture amounted only to 8546 people. That is because in Georgia there are a large number of small unregistered farms, and they are not included in SME statistics. According to the 2004 general population census, in Georgia there were 691,577 farms, and the size of the majority of them (67%) was 01.–1 ha (Source: National Agricultural Census of Georgia, 2004).

<sup>7</sup> In 2013, the share of SMEs in total value added in the private sector was 56%.

**Table 2: SMEs' Value Added by Economic Sector 2017**

<b>Sector</b>	<b>Value Added in Million GEL (in million \$)</b>	<b>Share of SMEs'<sup>a</sup> Value Added</b>
Agriculture, forestry, and fishing	118 (47)	1.0%
Mining and quarrying	147 (59)	1.3%
Manufacturing	1,445 (576)	12.3%
Electricity, gas, steam, and air-conditioning supply	270 (108)	2.3%
Water supply, sewerage, waste management and remediation	48 (19)	0.4%
Construction	2,273 (906)	19.4%
Wholesale and retail trade; repair of motor vehicles and motorcycles	2,850 (1,136)	24.3%
Transportation and storage	1,038 (414)	8.9%
Accommodation and food service activities	510 (203)	4.3%
Information and communication	322 (128)	2.7%
Real estate activities	587 (234)	5.0%
Professional, scientific, and technical activities	566 (226)	4.8%
Administrative and support service activities	329 (131)	2.8%
Education	193 (77)	1.6%
Human health and social work activities	437 (174)	3.7%
Arts, entertainment and recreation	154 (61)	1.3%
Other service activities	57 (23)	0.5%
Sector is not specified	381 (152)	3.2%
<b>SME value added</b>	<b>11,722 (4,673)</b>	<b>100%</b>

<sup>a</sup> Based on the definition of the National Statistics Office of Georgia.

Source: National Statistics Office of Georgia.

#### 1.1.4 Average Monthly Remuneration

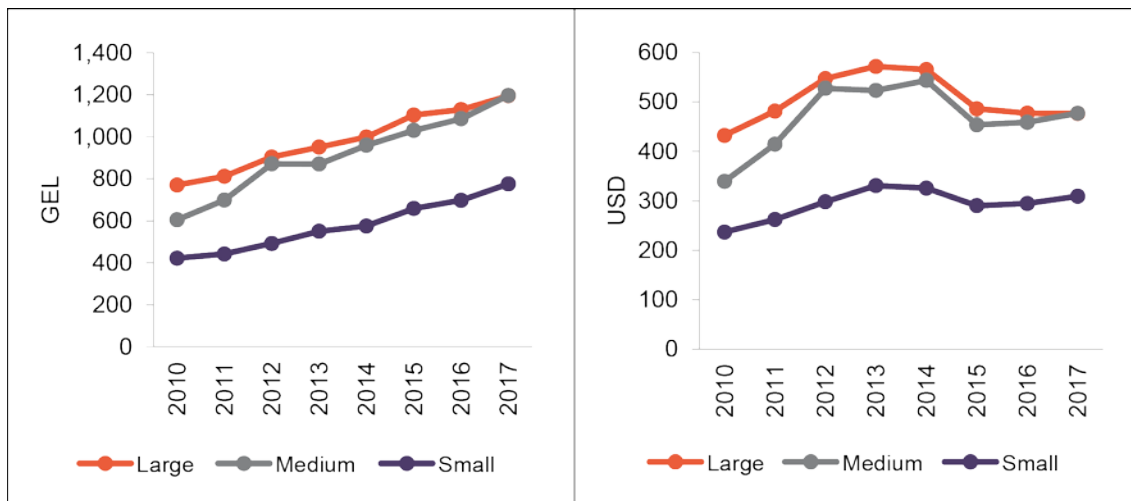
In 2017, in Georgia, the average monthly remuneration of employed persons in the private sector was GEL1,019.7 (\$404.7), which exceeded the overall average monthly salary of Georgia in 2017 – GEL999.1 (\$396.7). In small enterprises, monthly remuneration amounted to GEL776.1 (\$309.4), while in medium enterprises it was GEL1,196.9 (\$477.1) and in large enterprises it was GEL1,195.9 (\$476.7). During the period 2014–2017, the average monthly earnings in all kinds of private enterprises increased.

Between 2011 and 2017, the average growth rate of monthly remuneration in SMEs exceeded the average growth rate in large enterprises (small – 9.1%; medium – 10.5%; large – 6.5%).

The Georgian SME sector is concentrated in low value-added sectors<sup>8</sup>, such as the trade sector. Employment, as well as value added in the SME sector in Georgia, has increased, with the majority of SME employment and value added being in the trade sector. The proportion of people employed in this sector within total SME employment has increased since 2011, while the share of value added created in this sector has decreased since 2015.

<sup>8</sup> "Recommendations for Georgia's SME Development Strategy 2016–2020," OECD, 2016.

**Figure 3: Average Monthly Remuneration of Employed Persons by Enterprise Size**



Source: National Statistics Office of Georgia 2017.

The proportion of people employed and value added created in the manufacturing sector in the total SME sector has decreased since 2015.

In the agriculture sector, while the share of employed people in this sector in total SME employment has increased since 2015, its contribution in terms of value added created has not changed notably.

## 1.2 SME Funding

In order to respond to the challenges facing Georgian SMEs and to support their development, the Government of Georgia (GoG), donor organizations, and financial institutions all implement projects and create SME-oriented products and services. The GoG provides subsidies and implements projects to support SME development. Financial institutions, especially commercial banks and microfinance organizations, provide business loans and other services to SMEs. Donor organizations mainly provide grants for SMEs’ capacity building and development. Details regarding the activities of the listed stakeholders are discussed later in this chapter.

### 1.2.1 Government

The GoG supports SMEs’ development through several programs covering all economic sectors. The Ministry of Economy and Sustainable Development of Georgia and the Ministry of Environmental Protection and Agriculture of Georgia are the main implementers of programs supporting SMEs in the country. To support SMEs, the GoG provides subsidies and technical assistance. In addition, the GoG cooperates with financial institutions to subsidize bank interest payments in several government programs.

In 2017, the GOG spent GEL369 million (\$147 million) from the total state budget of GEL11.7 billion (\$4.7 billion) to support entrepreneurship, innovations, technologies, and agricultural development (3.1% of the total state budget).

**Table 3: Government Spending by SME Program Type**

	2015	
	Thousand GEL (thousand \$)	% of Total State Budget
Developing Entrepreneurship	22,959 (10,113)	0.2%
Development of Innovations and Technologies in Georgia	6,713 (2,957)	0.1%
Agricultural Development	306,052 (134,814)	3.2%
Total	335,724 (147,884)	3.5%
	2016	
	Thousand GEL (thousand \$)	% of Total State Budget
Developing Entrepreneurship	41,106 (17,368)	0.4%
Development of Innovations and Technologies in Georgia	9,362 (3,956)	0.1%
Agricultural Development	320,915 (135,595)	3.1%
Total	371,382 (156,919)	3.6%
	2017	
	Thousand GEL (thousand \$)	% of Total State Budget
Developing Entrepreneurship	39,348 (15,685)	0.3%
Development of Innovations and Technologies in Georgia	6,050 (2,412)	0.1%
Agricultural Development	324,061 (129,178)	2.8%
Total	369,459 (147,275)	3.1%

Source: The Ministry of Finance of Georgia 2018.

The Georgian government is involved in promoting and supporting SMEs through the following programs and initiatives:

- *Produce in Georgia*,<sup>9</sup> launched by the Ministry of Economy and Sustainable Development of Georgia and the Ministry of Environmental Protection and Agriculture of Georgia;
- *United Agroproject*,<sup>10</sup> launched by the Ministry of Environmental Protection and Agriculture of Georgia; and
- Supporting startups in the field of innovation and technology, launched by the Ministry of Economy and Sustainable Development of Georgia.

### **Produce in Georgia**

The program *Produce in Georgia*, implemented by the agency *Enterprise Georgia*, is designed to encourage the establishment of new businesses and/or the expansion of existing businesses. This program consists of three components: an industrial component, the hotel industry, and micro and small business support. These components were launched in 2014. As of 2017, the total number of supported projects had reached 5,563 and the total subsidies amounted to GEL81.5 million (\$32.5 million), which is 0.2% of Georgia's GDP. The micro- and small-business support component has the largest share in terms of number of projects (96% of all projects). The

<sup>9</sup> <http://www.enterprisegeorgia.gov.ge/ka>.

<sup>10</sup> <http://apma.ge/>.

micro- and small-business support component, together with the industrial component, took up the biggest share of total subsidies<sup>11</sup> (47% of total subsidies per component).

**Table 4: Results of the Program Produce in Georgia 2018**

	Number of Projects	Amount of Subsidies in GEL (in \$)	% of GDP
Industrial Component	213	38,568,616 (15,374,341)	0.10%
Hotel Industry	37	4,322,600 (1,723,088)	0.01%
Micro- and Small-Business Support	5,313	38,656,512 (15,409,379)	0.10%

Source: Agricultural Project's Management Agency 2018.

### United Agroproject

Under the program *United Agroproject*, several large-scale SME support programs are implemented, such as the program ***Plant the Future***, where entrepreneurs are assisted financially and technically to arrange perennial and nursery gardens. Financial assistance here entails co-financing the purchase of saplings and the installation of drip irrigation systems. As of 2017, the program had 658 beneficiaries and the total funding amounted to GEL22 million (\$9.3 million). Notably, the number of beneficiaries and the amount of funding have increased every year. Specifically, in 2016, the number of applications rose 2.4-fold and the funding amount almost doubled.

**Table 5: Results of the Program Plant the Future 2018**

	Number of Applications	Number of Beneficiaries	Amount of Funding in GEL (in \$)	% of GDP
2015	112	110	4,127,038 (1,817,935)	0.01%
2016	274	262	8,062,315 (3,406,541)	0.02%
2017	307	286	10,148,508 (4,045,430)	0.03%

Source: Agricultural Project's Management Agency 2018.

Through the program ***Preferential Agrocredit***, enterprises engaged in agricultural production, processing, and storage receive agrocredit and agroleasing from specific commercial banks and financial institutions. The program aims to support all participants of the agricultural sector (primary production, processing, storage, etc.) to establish new businesses or to expand existing ones. As of 2017, 27,685 loans had been issued in GEL, with total budgets of GEL1 billion (\$0.5 billion) and 2,283 in \$, with a total budget of \$223 million. The number of loans in GEL are quite volatile compared to the number of loans in \$. In 2017, compared to 2016, both the number of loans (+125%) and the total amount (+292%) in GEL increased, while the number of loans (-96%) and total amount (-91%) in \$ declined due to the larization<sup>12</sup> process.

<sup>11</sup> Total subsidies include direct financial assistance and subsidizing interest rate for credits.

<sup>12</sup> Larization/de-dollarization measures the usage of domestic currency in the Georgian economy. The larization strategy entails the promotion of Georgian lari and increasing public trust in the currency (National Bank of Georgia, 2018).

**Table 6: Preferential Agrocredit Program in Georgia**

	Local Currency			Foreign Currency		
	Number of Loans	Total amount in million GEL (in million \$)	Total Amount/GDP	Number of Loans	Total Amount (in million \$)	Total Amount/GDP
2013	5,818	158 (95)	0.59%	399	55	0.34%
2014	15,170	344 (195)	1.18%	437	62	0.38%
2015	3,266	185 (81)	0.58%	576	50	0.36%
2016	1,056	72 (30)	0.21%	835	52	0.36%
2017	2,375	281 (112)	0.74%	36	5	0.03%

Source: Agricultural Project's Management Agency 2018.

The **programs supporting agro-processing and storage** entail co-financing SMEs in agro-processing and storage. As of 2017, 10 projects were funded with a total budget of GEL3.4 million (\$1.4 million). The enterprises are co-financed in GEL as well as in \$. Since 2014, 42 enterprises have been co-financed with a total spend of \$9.4 million.

Through the **Agroinsurance program**, beneficiaries can insure agricultural land up to 5 hectares, and in the case of cereals up to 30 hectares. The aim of this program is to develop the insurance market in the agriculture sector and to reduce the risks in this sector. The Agroinsurance program covers the risks of hail, flood, storm, and autumn frost (only for citrus). Between 2014 and 2017, 68,879 insurance policies were purchased by program beneficiaries, and insurance premium subsidies carried out by the agency amounted to GEL29.3 million (\$13.9 million).

**Table 7: Agroinsurance Program in Georgia**

	Number of Insurance Policies	Insurance Premium in Million GEL (in million \$)	Insurance Premium Subsidies Carried Out by GoG in Million GEL (in million \$)	Insurance Premium Subsidies Carried Out by the Beneficiaries in Million GEL (in million \$)	Total Amount (Insurance Subsidies Carried Out by GoG)/GDP
2014	21,056	12.6 (7.1)	11.8 (6.7)	0.7 (0.4)	0.04%
2015	7,634	3.4 (1.5)	1.9 (0.9)	1.4 (0.6)	0.01%
2016	18,795	11.9 (5.1)	8.2 (3.5)	3.6 (1.6)	0.02%
2017	21,394	11.6 (4.6)	7.4 (2.9)	4.2 (1.7)	0.02%

Source: Agricultural Project's Management Agency 2018.

In addition, the Agricultural Project's Management Agency (APMA) supports the rehabilitation of tea plantations, thereby helping young entrepreneurs to increase their role and involvement in the sector.

### Other Sources of Funding

**Georgia's Innovation and Technology Agency (GITA)** provides products and services to entrepreneurs and startups oriented toward innovation and technology, with the aim of developing a strong startup ecosystem. As of October 2018, GITA had assisted 125 startups.

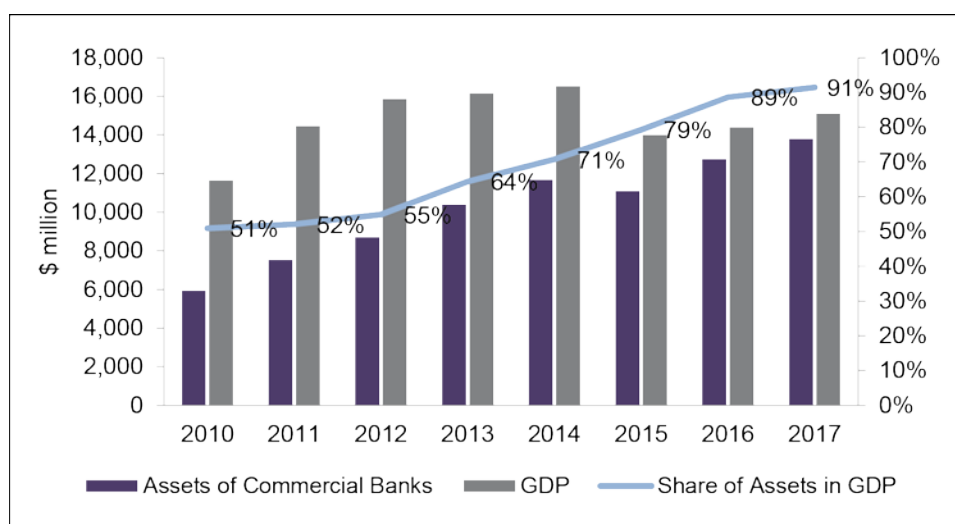
The state-owned investment fund the **Partnership Fund** supports the energy, real estate, agricultural, and manufacturing sectors.

### 1.2.2 Financial Institutions

Another source of funding for SMEs is loans and other services from financial institutions. During the period 2010–2017, the financial sector of Georgia grew significantly. In 2017, compared to 2010, the assets of financial institutions<sup>13</sup> in Georgia increased by 130% (accounting for \$14.7 billion) and the assets-to-GDP ratio increased to 96.7% in 2017, compared to 54.8% in 2010.<sup>14</sup>

Assets of commercial banks accounted for 94% of financial institutions’ assets in 2017. In 2017, 16 commercial banks were functioning in Georgia. Between 2010 and 2017, the number of commercial banks decreased from 19 to 16; however, the share of commercial banks’ assets in Georgia’s GDP has been increasing since 2010 (from 51% to 91%).<sup>15</sup> There is a duopoly in the banking sector. TBC Bank and the Bank of Georgia are the two major players with a 71% asset share in the total financial institutions’ assets in 2016.

**Figure 4: Commercial Banks’ Assets in Georgia**



Source: National Bank of Georgia 2017.

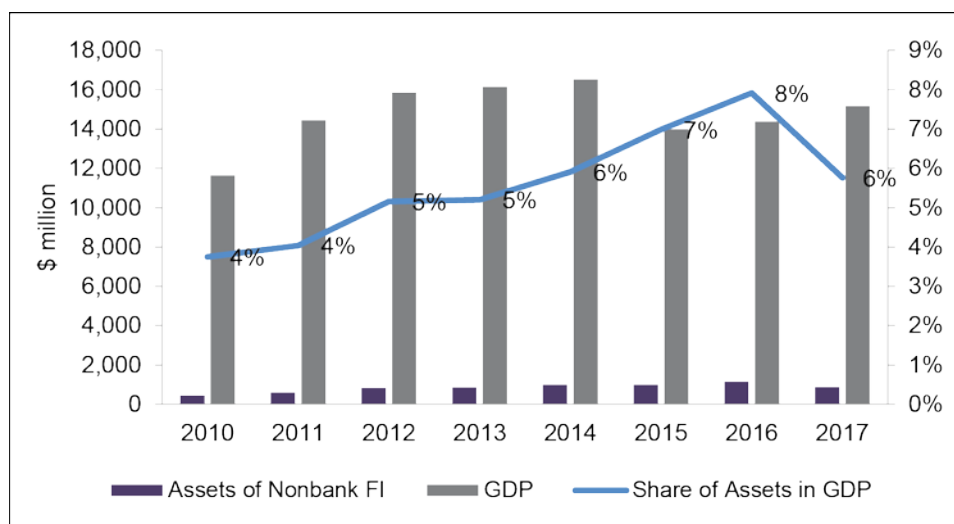
Assets of nonbank financial institutions accounted for 6% of financial institutions’ assets in 2017. The share of nonbank financial institutions’ assets in Georgia’s GDP increased between 2014 and 2016; however, in 2017 it decreased from 8% to 6%.

Between 2010 and 2017, the number of microfinance organizations in Georgia increased (by 26 units) and so did the value of their assets (by 249.9%). During this period, the number of nonbank depository institutions, exchange bureaus, and pension schemes decreased; however, the value of their assets increased.

<sup>13</sup> Financial institutions include: commercial banks, Nonbank depository institutions, microfinance organizations, exchange bureaus, stock exchanges, insurance companies, and pension schemes.

<sup>14</sup> Source: National Bank of Georgia.

<sup>15</sup> Source: National Bank of Georgia.

**Figure 5: Nonbank Financial Institutions' Assets in Georgia**

Source: National Bank of Georgia 2017

**Table 8: The Number of Financial Institutions in Georgia**

Financial Institutions	Number of Units (2010)	Number of Units (2017)	Assets (2017) (million \$)	Assets/GDP
Commercial Banks	19	16	13,790	90.9%
Nonbank Depository Institutions	18	8	3.3	0.02%
Microfinance Organizations	49	75	607.5	4%
Exchange Bureaus	1,627	1,126	29.7	0.2%
Stock Exchanges	1	1	1.4	0.01%
Insurance Companies	16	16	231.3	1.5%
Pension Schemes	6	3	13,790	0%

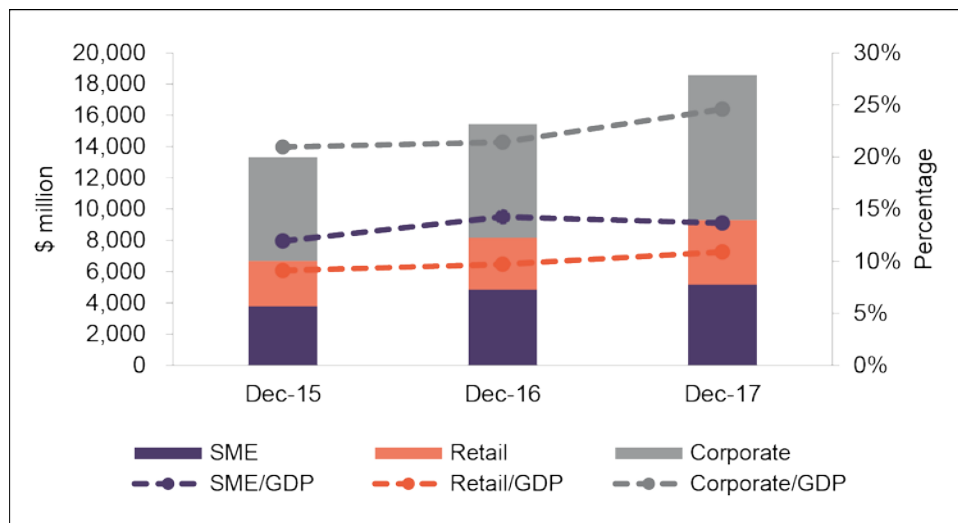
Source: National Bank of Georgia 2017.

Commercial banks and microfinance organizations are the major sources of SME finance. Commercial banks offer various products to SMEs, including current accounts, deposits, guarantees, and credits, although loans are the most popular product. Banks offer SMEs working capital financing, fixed assets financing, and trade financing. Commercial banks collaborate with the Georgian government and provide preferential credits to SMEs under several government programs. Microfinance organizations are not eligible to participate in government programs as sources of funding due to several restrictions being in place. First, the loan amounts suggested in the programs are higher than these organizations are capable of issuing. Second, government programs require that a document confirming the existence of a current account be given to their beneficiaries, and microfinance organizations are not able to provide such a document. However, microfinance organizations do still provide financial assistance to SMEs. According to the statistics, SME, retail, and corporate loans (issued by commercial banks) have undergone an increasing trend year on year. As of December 2017, GEL18.5 billion (\$7.4 billion) had been issued by commercial banks (+20% compared to 2016). Loans issued to SMEs amounted to GEL5.3 billion (\$2.1 billion) (+7% compared to 2016). During the last three years, the proportion of SME loans in total loans ranged between 28% and 31%.



Notably, in 2016, the increase in SME loans was higher (+28% compared to 2015) than that in retail (+14%) and corporate (+9%) loans. However, in 2017, the growth rate for SME loans was 7%, which was below corporate (+28%) and retail (+25%) loans.

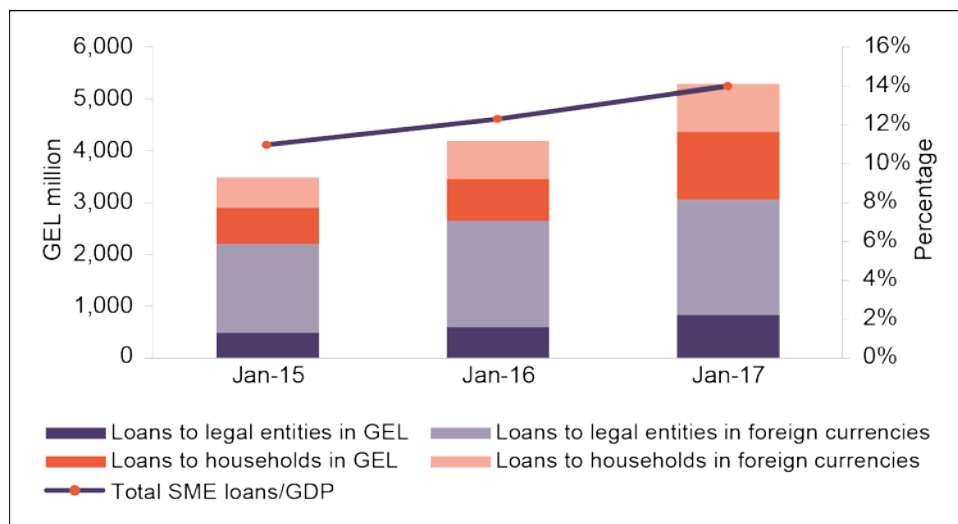
**Figure 6: Commercial Banks' Loans by Segments**



Source: National Bank of Georgia 2017.

According to the statistics of the National Bank of Georgia, as of 2017, 42% (GEL2.2 billion [\$0.9 billion]) of SME loans were loans to legal entities in foreign currencies and 25% (GEL1.3 billion [\$0.5 billion]) were loans to households in GEL. In recent years, the number of SME loans in Georgian currency have been increasing at a faster rate than those in foreign currency, which can be explained by the country's strategy of de-dollarization (larization). The proportion of total SME loans to GDP has increased since 2015. In 2017, the ratio of SME loans to GDP was 0.14.

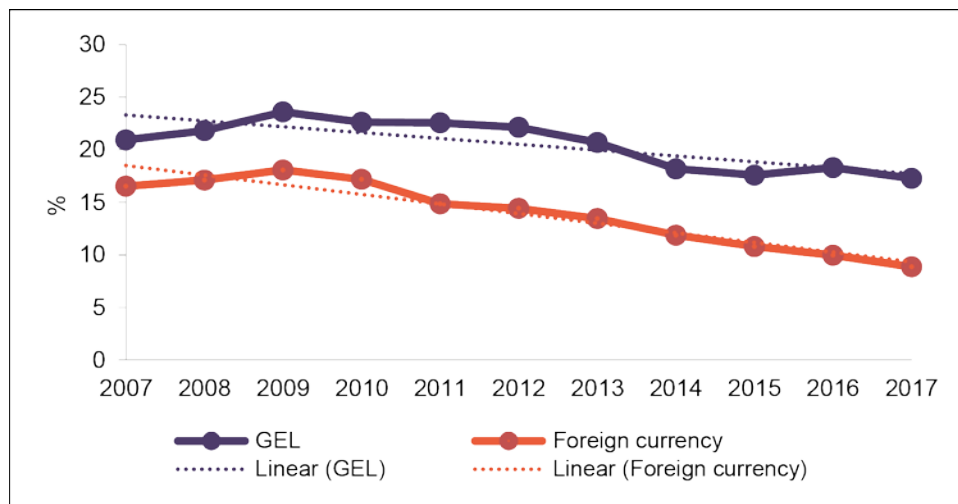
**Figure 7: Commercial Banks' Loans for SMEs (stocks)**



Source: National Bank of Georgia 2018.

Interest rates on commercial banks' loans have declined since 2007. In 2017, the annual interest rate in domestic currency was 17.3%, which was one percentage point lower than the same indicator in 2016. The annual interest rate in 2017 on loans in foreign currency equaled 8.9%, which represented a decline of 1.1 percentage points compared to 2016.

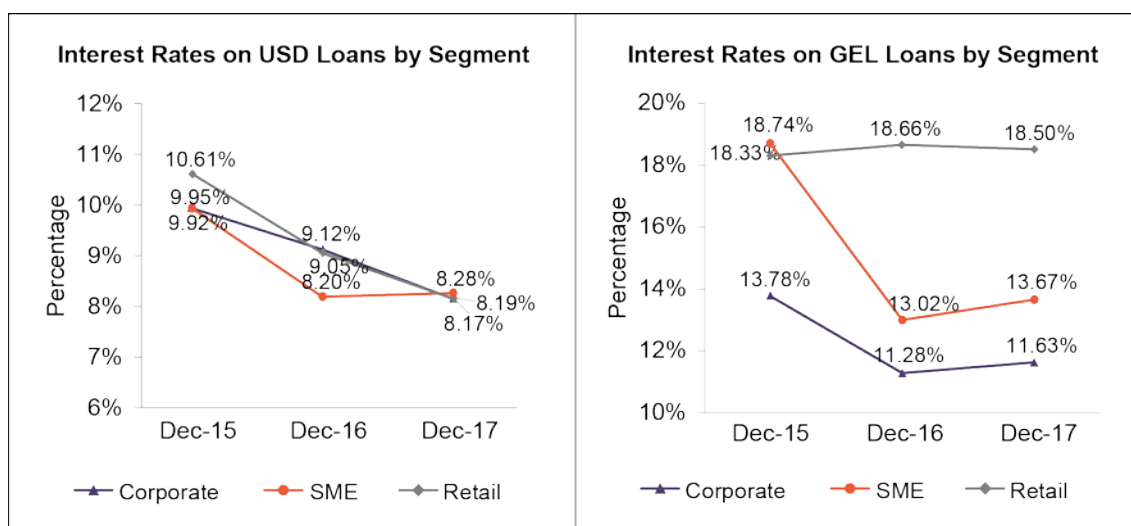
**Figure 8: Average Annual Interest Rate on Commercial Banks' Loans 2007–2017**



Source: National Bank of Georgia 2018.

In 2017, the average interest rate for SME loans in GEL was 13.67%. The average interest rate for SME loans in foreign currency was 8.28%. In this period, the interest rate for SMEs in foreign currency was almost the same as the average interest rate for commercial banks' total loans. However, the interest rate for SME loans in GEL was 3.63 percentage points lower than the average interest rate in GEL for aggregated commercial banks' loans.

**Figure 9: Interest Rates on GEL and on \$ Loans by Segment**



Source: National Bank of Georgia 2017.

The interest rate for SME loans in US dollars is higher than for retail and corporate loans. The interest rate for SME loans in GEL is lower than the interest rate for retail loans and higher than the rate for corporate loans.

Georgia's partner countries and international organizations support the country's economic and social development through different projects. Existing programs entail capacity-building and funding projects. Importantly, financial assistance alone for SMEs is not enough for their development, so donor organizations also provide technical assistance (training, information sharing) to increase SMEs' knowledge of business management, funding opportunities, accounting, etc. In particular, the European Union supports SMEs' development through the European Neighborhood Program for Agriculture and Rural Development (ENPARD) and the EU4Business program. Moreover, funding is also provided through the United Nations Development Programme (UNDP), the European Bank for Reconstruction and Development (EBRD), and the Food and Agricultural Organization of the United Nations (FAO). In addition, the United States Agency for International Development (USAID) implements programs for SMEs' development, such as Restoring Efficiency to Agriculture Production (REAP) and ZRDA Activity in Georgia. In addition, the Asian Development Bank (ADB), the Swiss Agency of Development and Cooperation (SDC), the Austrian Development Agency (ADA), the Danish International Development Agency (DANIDA), the International Fund for Agricultural Development (IFAD), and the US Department of Agriculture (USDA) are all involved in financing Georgian SMEs.

### 1.2.3 Donor Organizations

The total amount of funding for SMEs through the years is difficult to calculate, but below are some of the programs implemented to support SMEs in the agricultural sector<sup>16</sup>:

- Through ENPARD,<sup>17</sup> the European Union supports agricultural and rural development in the country. This program consists of three phases and is being implemented during the period 2013–2022 with a total budget of EUR 179.5 million. The first phase of ENPARD was implemented between 2013 and 2017 and concentrated on supporting the development of agricultural cooperatives in the country. Primarily, cooperatives were created in the following subsectors: apiculture, cereals, hazelnuts, viticulture, potatoes, vegetables, dairy, berries, etc. Although a significant amount of money (approximately GEL26 million) has been invested in the development of cooperative', according to the cooperative survey<sup>18</sup> conducted in four consecutive years (2014–2017), access to finance was still cited as the main constraint for such development.
- Under the program **EU4Business**, the European Union supports eastern neighbors, including Georgia, in the development of their SMEs. According to the annual report,<sup>19</sup> as of June 2018, the EU had contributed EUR 64.7 million. Access to finance programs cover 76% of its ongoing projects.

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<sup>16</sup> Source: The Ministry of Environmental Protection and Agriculture of Georgia, <http://mepa.gov.ge/Ge/InternationalProjects>.

<sup>17</sup> <http://enpard.ge>.

<sup>18</sup> ISET policy institute, <https://drive.google.com/file/d/1DTDNIZYHm5EAs-YwVr1yg-FDVr2c7jF3/view>.

<sup>19</sup> [http://www.eu4business.eu/files/community/pdf/annual\\_report\\_2018\\_6.pdf](http://www.eu4business.eu/files/community/pdf/annual_report_2018_6.pdf).

- Since 2013, USAID/Restoring Efficiency to Agricultural Production (REAP) has been implemented to help input suppliers and new agribusinesses enter the market with funding of \$22.5 million.<sup>20</sup>
- Since 2016, USAID's ZRDA Activity in Georgia has been implemented. It aims to stimulate Georgian MSMEs' growth through providing grants, technical support, and training, and giving assistance to improve market linkages and find investment opportunities. \$14.7 million is to be spent for these purposes.<sup>21</sup>
- The International Fund of Agricultural Development (IFAD) also provides support to Georgian agriculture. Their work in Georgia is directed toward increasing investments in the agricultural sector, increasing agribusiness participants' access to international markets, and promoting sustainable rural development in the country.

Donor organizations are implementing projects countrywide, covering most regions and municipalities. Donors are more oriented toward increasing SMEs' awareness and capacity in order to enter international markets, to adapt to new technologies, and to produce more competitive products on international markets.

### **1.3 Key Aspects of the Country's Financial Situation, Regulatory Framework, Tax Regime, and Financial Infrastructure**

#### **1.3.1 Financial Sector in Georgia**

Georgia was ranked 92nd among 183 countries in the International Monetary Fund's financial development index, 80th in its financial institutions index, and 98th in its financial markets index (2013).<sup>22</sup>

In the "Financial market development" pillar of the World Economic Forum's Global Competitiveness Index<sup>23</sup> 2017–2018, Georgia was ranked 63rd among 137 countries. Compared to 2010–2011, in 2017–2018 Georgia improved its position in every pillar of this index except for the "Financing through local equity market" pillar. During the period 2010–2018, Georgia's position improved most in the "Legal rights index" with a rise of 48 places.

The capital market in Georgia remains underdeveloped, as in 2016 the ratio of capital market assets<sup>24</sup> to GDP was 7%.<sup>25</sup>

#### **1.3.2 Georgia's Ranking in Ease of Doing Business**

Georgia was ranked 6th among 190 countries in the Ease of Doing Business ranking 2019. Among the 10 indicators of the Ease of Doing Business ranking 2019, Georgia's best result was in the "starting a business" indicator (2nd place) and "protecting minority

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<sup>20</sup> Source: The Ministry of Environmental Protection and Agriculture of Georgia, <http://mepa.gov.ge/Ge/InternationalProjects>.

<sup>21</sup> Source: The Ministry of Environmental Protection and Agriculture of Georgia, <http://mepa.gov.ge/Ge/InternationalProjects>.

<sup>22</sup> "Introducing a New Broad-based Index of Financial Development," IMF, Year 2016.

<sup>23</sup> <http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf>.

<sup>24</sup> Capital market assets include bond and equity markets.

<sup>25</sup> German Economic Team – Banking Sector Monitoring Georgia 2018.

investors” indicator (2nd place), while its lowest position was in the “resolving insolvency” indicator (60th place) and “trading across borders” indicator (43rd place).

**Table 9: Georgia’s Ranking in the “Financial Market Development” Pillar of the “Global Competitiveness Index”**

Indicator	Measure	Rank 2017–2018
Availability of financial services	The degree to which the financial sector provides the products and services that meet the needs of businesses	92
Affordability of financial services	The degree to which the cost of financial services (e.g., insurance, loans, trade finance) impedes business activity in Georgia	81
Financing through local equity market	The extent to which companies raise money by issuing shares and/or bonds on the capital market	131
Ease of access to loans	The degree of ease with which businesses obtain a bank loan	46
Venture capital availability	The degree of ease with which startup entrepreneurs with innovative but risky projects obtain equity funding	80
Soundness of banks	The assessment of banks by representatives of micro, small, medium-sized, and large enterprises	64
Regulation of securities exchanges	The extent to which regulators ensure the stability of the financial market	102
Legal rights index	The degree of legal protection of borrowers’ and lenders’ rights	12

Source: World Economic Forum’s Global Competitiveness Index 2017–2018.

Georgia’s unfavorable position in the resolving insolvency indicator could be linked to SMEs’ access to finance problem. This represents an institutional risk for the financial sector, resulting in higher interest rates and higher collateral requirements. In addition, Georgia’s 43rd place in “trading across borders” can be connected to the level of Georgian SMEs’ involvement in global value chains, which hinders SMEs’ access to finance.

### 1.3.3 Georgia’s Ranking in Logistics Performance Index

Georgia was ranked 124th among 167 countries in the Logistics Performance Index 2018. Among the six pillars of the index, Georgia’s best results were in the “Infrastructure” pillar (108th place) and “Customs” pillar (109th place), while its lowest positions were in the “Logistics quality and competence” (139th place) and “Tracking and tracing” (130th place) pillar.

### 1.3.4 Tax Regime in Georgia

In 2018, Georgia was ranked 22nd among 190 countries in the World Bank’s Ease of Doing Business index’s indicator “Paying Taxes,” representing a rise of 80 places since 2008 (102nd place). According to Forbes’ 2009 “Tax Misery and Reform Index,”<sup>26</sup> Georgia was ranked 4th, putting it among the countries with the lowest tax burden in the world.

<sup>26</sup> <https://www.forbes.com/global/2009/0413/034-tax-misery-reform-index.html#7111a0bd43b3>.

Georgia has implemented numerous reforms in this direction since 2004. The tax system has been simplified, types of tax were reduced from 21 to 6 with several types eliminated (e.g., social tax, vehicle tax, natural resource tax, environment tax, tax on gambling),<sup>27</sup> and an electronic tax filing system for tax reporting has been introduced.<sup>28</sup>

**Table 10: Types of Taxes in Georgia**

Type of Tax	2018
Income Tax	20%
Profit Tax	15%
VAT	18%
Excise	Various
Property Tax	1%
Customs Duties	Differentiated 0%, 5%, & 12%

Source: Revenue Service, Georgia.

Currently in Georgia there are six types of tax: income tax, profit tax, value added tax (VAT), excise tax, property tax, and customs tax.<sup>29</sup>

For micro- and small businesses (with businesses categorized according to the Tax Code of Georgia's definition of enterprise size), there is a preferential tax regime. Microbusinesses in Georgia<sup>30</sup> do not pay income tax; however, there are some activities (25 in total) in which enterprises are not able to attain microbusiness status. In the agricultural sector, such activities include agricultural production that is done by tractors and combines. Moreover, trade activity is not permitted for microbusinesses unless the treatment and delivery of produced or purchased goods are carried out by the businessperson.

According to the Tax Code of Georgia, for small businesses<sup>31</sup> income tax is 1%,<sup>32</sup> but where income exceeds GEL500,000 (\$200,000) a small business pays 3% income tax. If its income exceeds GEL500,000 (\$200,000) for two consecutive years, its small-business status expires.

For nearly 85% of products, Georgia has abolished import tariffs. From the previous 16 import tariff rates, only 3 remain (0%, 5%, and 16%). Import tariffs are set on 174 products, of which 119 are agricultural value chain products.

In 2017, the Estonian tax model was largely replicated in Georgia, according to which the existing profit tax was changed to tax on distributed profits. The rate of 15% remained; however, only the part of the profit that is distributed is taxable. These rules will not affect commercial banks, credit unions, insurance organizations, microfinance organizations, and pawnshops until January 2019.

<sup>27</sup> "Law of Georgia on Tax Code."

<sup>28</sup> Balancing Act – Managing the Public Purse, March 2018, IMF.

<sup>29</sup> "Law of Georgia on Tax Code."

<sup>30</sup> Microbusiness status – entrepreneurs (natural persons) who do not use hired labor, conduct economic activity independently, and have an annual gross income of up to GEL 30,000.

<sup>31</sup> Small-enterprise status – entrepreneurs whose gross income from economic activity during a calendar year does not exceed GEL 500,000.

<sup>32</sup> <http://www.rs.ge/5393#>.

"Law of Georgia on Tax Code".

\*From profit tax to distributed profit tax – retained profit tax is 0% from 2017.

In the agricultural sector there is a preferential VAT regime.<sup>33</sup> The following activities are exempt from VAT with the right of deduction:

- Supply of agricultural products produced in Georgia (other than eggs and chicken (*gallus domesticus*) that is uncut, fresh, or frozen), before their industrial processing; and
- Supply of products obtained from goods fully made in Georgia (including chopped/minced meat), as well as the supply of cheese made as a result of industrial processing of products obtained from animals living in Georgia and also the supply of shell-less nuts.

Agricultural cooperatives profit from primary production (produced in Georgia) supply before their industrial processing is exempt from profit tax before 1 January 2023. Moreover, dividends and property (apart from land) of cooperatives are not taxed.<sup>34</sup>

## 2. STATUS OF FINANCIAL INCLUSION FOR SMES

According to the World Bank definition, financial inclusion<sup>35</sup> for SMEs means having access to financial products and services that they need. This chapter analyzes the main indicators<sup>36</sup> that measure financial inclusion. According to the SME financial inclusion base set,<sup>37</sup> three dimensions measure financial inclusion for SMEs.

The first dimension measures SMEs' **access** to financial services through bank branches and payment services. According to the World Bank's Financial Access Survey, in 2015 the total number of branches of financial institutions (mainly commercial banks and microfinance organizations) amounted to 1,236 units. The number of commercial bank branches per 100,000 adults was around 32, and this indicator has increased every year. In 2017, the number of branches of banks and microfinance organizations per 1,000 enterprises was around 10.<sup>38</sup> The accessibility of financial services is also evaluated according to the number of automated teller machines (ATMs) in Georgia. In 2015, countrywide, there were 2,117 ATMs available in the country, which is around 70 machines per 100,000 adults.

The second dimension measures how SMEs **use**<sup>39</sup> financial services in terms of the frequency and duration of using such products. According to the data,<sup>40</sup> in 2015, 11,627 SMEs (12.9% of total number of SMEs) borrowed funding from commercial banks, microfinancing organizations, and other financial intermediaries. In the same period, SME deposits with commercial banks made up 3.5% of the country's GDP.

Data analysis shows that access to, and usage of, financial services has increased every year, which means that the level of financial inclusion is improving. The representatives

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<sup>33</sup> Source: "Law of Georgia on Tax Code."

<sup>34</sup> "Law of Georgia on Tax Code," Article 99.

<sup>35</sup> <https://www.worldbank.org/en/topic/financialinclusion>.

<sup>36</sup> <http://www.worldbank.org/en/topic/financialinclusion/brief/how-to-measure-financial-inclusion>.

<sup>37</sup> [https://www.afi-global.org/sites/default/files/publications/afi\\_smefwg\\_wg\\_guideline\\_note\\_stg2.pdf](https://www.afi-global.org/sites/default/files/publications/afi_smefwg_wg_guideline_note_stg2.pdf).

<sup>38</sup> Authors' calculations. Source: National Bank of Georgia, Georgian Statistics Office of Georgia, 2017.

In 2017, 124,614 small and medium-sized enterprises were operating in Georgia. The number of branches of commercial banks and microfinance organizations amounted to 1331. Per 1,000 enterprises, the number of branches =  $1331 * 1000 / 124614 = 10$ .

<sup>39</sup> [http://databank.worldbank.org/data/download/g20fidata/Indicators\\_note\\_formatted.pdf](http://databank.worldbank.org/data/download/g20fidata/Indicators_note_formatted.pdf).

<sup>40</sup> World Bank's Financial Access Survey.

of financial institutions admitted in the interviews<sup>41</sup> that they communicate with their clients and offer financial products, other than loans, that are more suitable for their businesses. Financial institution (FI) representatives admitted that awareness and usage of financial products increases every year.

### **3. FINANCIAL LITERACY AND SKILLS OF SMES' ENTREPRENEURS**

#### **3.1 Assessments of Financial Literacy in Georgia**

According to the European Investment Bank,<sup>42</sup> the level of financial literacy of Georgian SMEs hinders them from using financial products efficiently. In Georgia, an assessment of financial literacy for SMEs has not been conducted yet; however, in 2016, the National Bank of Georgia did an assessment of the financial literacy of Georgia's population by using OECD methodology.

Georgia was ranked 24th among 30 countries in the Financial Literacy ranking (2016).<sup>43</sup> The financial literacy score of the Georgian population (above the age of 18) was 12.3 out of 21 (58.8 on a 100-point scale).<sup>44</sup> This is lower than the OECD average – 13.7. This is an intermediate outcome, indicating that in Georgia there is a need to improve financial literacy. The financial literacy score is obtained through a combination of measuring knowledge, behavior, and attitude. In Georgia, the distribution of scores for these three components was as follows:

- Financial knowledge<sup>45</sup> – Georgia was ranked 17th among 30 countries, with a score of 4.5 out of 7 (OECD average – 4.9).
- Financial behavior<sup>46</sup> – Georgia was ranked 27th among 30 countries, with a score of 5 out of 9 (OECD average – 5.4).
- Financial attitude<sup>47</sup> – Georgia was ranked 27th among 30 countries, with a score of 2.8 out of 5 (OECD average – 3.4).

#### **Financial Literacy Scores by Employment**

Financial literacy scores vary according to employment status. Overall, employed people attained higher financial literacy scores than unemployed people. The highest financial literacy score was attained by students (13.4). An above average financial literacy score of 13.3 was also attained by self-employed people, which included people running their own businesses. Although the financial literacy score of self-employed people was high compared to the other groups, it is still not particularly high.

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<sup>41</sup> See Annex 1.

<sup>42</sup> European Investment Bank – Neighborhood SME Financing, Georgia, February 2016, p. 5.

<sup>43</sup> "International Survey of Adult Financial Literacy Competencies," 2016, commissioning body – National Bank of Georgia.

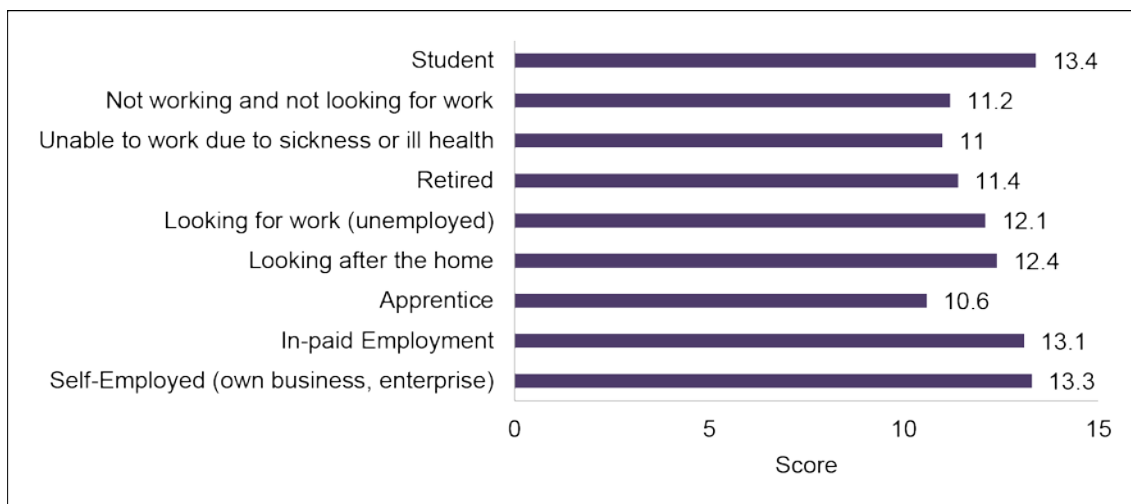
<sup>44</sup> "Financial Literacy and Financial Inclusion Study," National Bank of Georgia; research was done using OECD methodology.

<sup>45</sup> Financial knowledge measures populations' knowledge of financial concepts (e.g., simple and compound interest rates, risk, return, inflation) and ability to apply numeracy skills in financial situations.

<sup>46</sup> Financial behavior measures the extent to which people behave in financially literate ways, e.g., the decision-making process before buying, paying bills on time, long-term financial goals, saving, budgeting, shopping around for financial products, and making ends meet.

<sup>47</sup> Financial attitude assesses attitudes about money and planning for the future.



**Figure 10: Financial Literacy Scores by Employment**

Source: National Bank of Georgia.

The National Bank of Georgia's study<sup>48</sup> showed that only 11.7% of Georgia's population is business-minded, meaning that they distribute income, make savings, set long-term financial goals, and take rational risks. The problems of business-minded entrepreneurs were also outlined during the interviews.<sup>49</sup> Representatives of government and financial institutions admitted that some Georgian SMEs do not have long-term goals and concentrate on short-term investments, take irrational risks, and have unrealistic expectations. However, some interviewees mentioned that SMEs' financial literacy level is improving every year.

### 3.2 Financial Education Strategy in Georgia

Improving financial literacy among SMEs is one of the priorities of the SME Development Strategy of Georgia 2016–2020 under the strategic direction "Improvement of access to finance." To achieve this, educational programs based on market needs have to be elaborated and training has to be conducted. In this process, together with the Ministry of Economy and Sustainable Development of Georgia, the National Bank of Georgia is involved.

Although, in Georgia, a strategy for financial education for SMEs has not been created yet, the *National Strategy for Financial Literacy* in Georgia was elaborated by the National Bank of Georgia. The aim of the strategy is to improve the financial literacy levels of the Georgian population to enhance their financial well-being and to protect their rights.<sup>50</sup>

The main strategic focuses of the strategy are the following:

- Raising awareness of the benefits of financial education;
- Enhancing coordination and collaboration among stakeholders; and

<sup>48</sup> [https://www.nbg.gov.ge/uploads/2016finganat/Financial%20Literacy%20Study\\_ENG.pdf](https://www.nbg.gov.ge/uploads/2016finganat/Financial%20Literacy%20Study_ENG.pdf).

<sup>49</sup> Source: Field research.

<sup>50</sup> The information given in this chapter is based on the National Strategy for Financial Literacy in Georgia, [https://www.nbg.gov.ge/uploads/publications/financial\\_literacy\\_strategy/finlit\\_strategy\\_eng.pdf](https://www.nbg.gov.ge/uploads/publications/financial_literacy_strategy/finlit_strategy_eng.pdf).

- Extending opportunities to learn.

The strategy covers the whole population of Georgia, although the following higher-need target groups have been identified:

- The young generation – pupils and students;
- Unemployed people;
- People employed by large companies and organizations;
- Rural population; and
- People facing special life events.

Under this strategy, the National Bank of Georgia cooperates with the Ministry of Education, Science, Culture, and Sports of Georgia, the Administration of the President of Georgia, commercial banks, microfinance organizations, donor organizations, and educational institutions. Programs implemented under the National Strategy for Financial Literacy are as follows:

- “SchoolBank” Project
- Brochures and videos
- Financial football
- Training in Georgian armed forces
- Video and web banners about mortgage loans
- Financial literacy program for migrants

Among the target groups of this strategy, SMEs are not represented; however, recently the National Bank of Georgia has been focusing on **SMEs’ financial education**. The National Bank of Georgia has implemented the two following programs to increase SMEs’ level of financial literacy:

- Brochure: “Improve Your Financing Decisions<sup>51</sup>” – the National Bank of Georgia together with the European Fund for Southeast Europe (EFSE DF) produced brochures for small businesses, covering the following topics: how to assess the risks and opportunities of borrowing in foreign currency; ascertaining how much risk one can afford to take; the impact on their cash flow; and the impact on their profit, loss, and equity. These brochures are accompanied by the following practical tools: a cash flow tool, a debt service ratio tool, and a balance sheet tool. These practical tools were created to help small businesses when taking financial decisions. The brochures were distributed among financial institutions and universities to be accessed by small businesses.<sup>52</sup>
- Financial Education Program for micro- and small enterprises<sup>53</sup> – the National Bank of Georgia together with the EFSE DF and the Export Development Association (EDA) has implemented a financial education program for micro- and small enterprises. Books for micro- and small enterprises were created, which will help micro- and small businesses to take financial decisions, and to obtain information about sources of funding and financial services. Training was conducted with micro- and small enterprises in the Samtskhe-Javakheti and

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<sup>51</sup> [https://www.nbg.gov.ge/uploads/publications/efse/EFSE\\_broschure\\_eng.pdf](https://www.nbg.gov.ge/uploads/publications/efse/EFSE_broschure_eng.pdf).

<sup>52</sup> <https://www.nbg.gov.ge/cp/index.php?m=550&newsid=1564&lng=eng>.

<sup>53</sup> [https://www.nbg.gov.ge/uploads/fin\\_ganatl\\_mewarm/mikroda\\_mcire.pdf](https://www.nbg.gov.ge/uploads/fin_ganatl_mewarm/mikroda_mcire.pdf).

Kvemo Kartli regions. Approximately 80 micro- and small businesses were trained in total.<sup>54</sup> The representatives of micro- and small businesses were able to acquire both theoretical and practical knowledge. Moreover, training for trainers was also conducted. The National Bank of Georgia plans to continue this process and to cover other regions of Georgia.

Each program has its own evaluation methods. Primarily, the programs whose target groups were the young generation and SMEs have been evaluated based on pre- and posttest results. Videos and web banners have been evaluated based on number of views. The overall evaluation of the strategy is expected to be conducted after 2021.

## 4. BARRIERS TO SME FINANCE

The SME sector is increasing in Georgia; however, according to the SME Development Strategy of Georgia 2016–2020, limited access to finance is the main problem hindering SMEs' competitiveness.<sup>55</sup> According to the World Bank's Enterprise Survey 2013,<sup>56</sup> 20.9% of firms listed access to finance as the main obstacle for their operations. The Global Competitiveness Index also lists access to finance as the second most problematic factor with regard to doing business in Georgia.<sup>57</sup>

Barriers to finance can come from both the supply and the demand side. The regulatory framework, institutional aspects, and gender and cultural issues can also be barriers limiting access to finance. Barriers listed in this chapter are derived from existing studies and opinions of GoG representatives, financial institutions, donor organizations, and field experts.

### Barriers from the Supply Side

The supply side is represented by banks and microfinance organizations, the GoG, donor organizations, and other funds that provide finance for SMEs. In Georgia, one of the main sources of SMEs' finance is financial institutions, especially commercial banks and microfinance organizations, therefore supply-side barriers are related to financial institutions' loans and other services. Access to finance barriers related to financial institutions are listed below:

- **Limited financing channel other than banking.** The capital market is underdeveloped in Georgia. The main sources of financing for SMEs are commercial banks and microfinance organizations. Moreover, there is a duopoly in the banking sector. The lack of competition in the financial market results in unfavorable conditions (high interest rates, high collateral requirements, limited financing opportunities) for SMEs.
- **High collateral requirements.** In 2017, 58% of legal entities' loans were secured by collateral. According to the findings of the OECD report,<sup>58</sup> ENPARD

<sup>54</sup> The National Bank of Georgia plans to expand this number and cover more regions.

<sup>55</sup> SME Development Strategy of Georgia 2016–2020. [http://www.economy.ge/uploads/files/2017/ek\\_politika/eng\\_sme\\_development\\_strategy.pdf](http://www.economy.ge/uploads/files/2017/ek_politika/eng_sme_development_strategy.pdf).

<sup>56</sup> WB Enterprise Survey, Georgia 2013. <http://www.enterprisesurveys.org/data/exploreeconomies/2013/georgia>.

<sup>57</sup> <https://www.weforum.org/reports/the-global-competitiveness-report-2017–2018>.

<sup>58</sup> OECD. [http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Recommendations\\_for\\_Georgia\\_SME\\_strategy.pdf?fbclid=IwAR1uqtKC-hP2ZckyImGZ3H5M5xhabi-lq2MU5dqWF37zxFZj7a2VCnxF3k](http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Recommendations_for_Georgia_SME_strategy.pdf?fbclid=IwAR1uqtKC-hP2ZckyImGZ3H5M5xhabi-lq2MU5dqWF37zxFZj7a2VCnxF3k).

cooperative research,<sup>59</sup> and experts' opinion, financial institutions require high collateral for SME loans. According to one study,<sup>60</sup> Georgia was first among less developed countries (e.g., Albania, Kazakhstan, Hungary, Ukraine, Estonia, Azerbaijan, Moldova, Belarus, etc.) with a 228% average collateral-to-loan ratio.<sup>61</sup> However, high collateral requirements are problematic, especially in the agricultural sector, where real estate's contribution is insufficient because of its low and volatile price across rural areas of Georgia. However, representatives of financial institutions admit that collateral requirements are not the main drivers of decisions to fund SMEs. Some of the interviewed financial sector representatives claim that solvency, income/expenditure, a company's leverage, and quality of servicing loans are more important aspects. Another reason for high collateral requirements is insolvency and bankruptcy risks. Those risks increase expected costs for financial institutions, resulting in higher collateral requirements.

- **High interest rates.** According to the World Bank Enterprise Survey,<sup>62</sup> interest rates are one of the main factors leading Georgian SMEs not to apply for financial institutions' loans. In addition, in the recently conducted value chain analyses by the PMC Research Center,<sup>63</sup> value chain participants admitted that interest rates for financial products remain high. In 2016, the average interest rate charged to SMEs in OECD countries varied from 1.5% to 5.5%, except for three countries with an interest rate of around 9.5%,<sup>64</sup> while interest rates charged to SMEs in Georgia were 13% in GEL loans and 8% in \$ loans. From the perspective of financial institutions, interest rates correspond with the risks characterizing the sector. A volatile exchange rate, a lack of financial education among SMEs, and a lack of experience among SMEs all increase the risks that result in higher interest rates.
- **Limitations for startups.** Establishing a new business is associated with higher risks due to a lack of experience in the sector, higher dependence on cost-benefit projections, and the risk of the entrepreneur having unrealistic expectations. Therefore, financial institutions support startups more cautiously and financing covers only specific sectors. Some of the financial institutions support startups in the agricultural sector, but only for highly productive agricultural fields (such as animal breeding). Others support startups in the tourism sector (e.g., hotels). When financing startups, financial institutions study the experience of the startupper (the startupper might not have entrepreneurial experience in this sector but may have been employed in this sector for a long time) and require the startupper's financial contribution.
- **Insufficient knowledge of regional loan officers in agriculture.** According to the evaluation of the state program "Preferential agrocredit," farmers complain about a lack of agricultural professionals and knowledge of agricultural specifications in commercial banks' regional offices. According to the interviews conducted in our study, representatives of financial institutions do not deny the merits of these complaints. However, some respondents did claim they have

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<sup>59</sup> Association of Young Economists of Georgia.

<sup>60</sup> Hanedar et al.'s study, 2012, [http://155.185.68.2/campusone/web\\_dep/CefinPaper/CEFIN-WP34.pdf](http://155.185.68.2/campusone/web_dep/CefinPaper/CEFIN-WP34.pdf).

<sup>61</sup> While Turkey had the lowest (120%) average collateral-to-loan ratio. Real estate can be considered as collateral.

<sup>62</sup> World Bank Enterprise Survey, 2013.

<sup>63</sup> Broccoli and raspberry value chain analysis, PMC Research Center, 2018.

<sup>64</sup> <https://www.oecd.org/cfe/smes/Highlights-Financing-SMEs-and-Entrepreneurs-2018.pdf>.

agricultural experts in their branches, who are locals and know the agricultural potential of the region/village as well as the particular entrepreneur. In addition, the OECD report<sup>65</sup> states that regional loan officers are unable to assess SMEs' risks.

Supply-side barriers related to the government are as follows:

- **Access to information about government programs.** The government is implementing many programs supporting SMEs; however, according to the interviews, some potential beneficiaries do not have information about these programs. In addition, there is a lack of information about the existence of state programs that give SMEs the opportunity to combine resources of different programs in order to finance their businesses.
- **Land fragmentation.** Land fragmentation is a problematic issue for SMEs who apply for government programs, because some programs have minimum requirements for the size of the area.

Supply-side barriers from SMEs' service providers:

- **Consulting.** In order to apply for state projects or loans from financial institutions, SMEs should develop business plans. Entrepreneurs might have profitable business ideas but are unable to develop them and obtain financing. Therefore, consulting companies can help SMEs to develop business plans. Consulting services are not free of charge, however the expected benefit for the business could exceed the cost.

According to the interviews with government representatives and field experts, there are three main constraints in this regard. First, there is a lack of qualified consulting companies. Second, SMEs do not have information about consulting companies, so they develop business plans on their own, or do not apply for the projects at all. Third, the agency Enterprise Georgia provides assistance to the program beneficiaries in developing business plans; however, only a few beneficiaries use this service.

## Demand Side

The demand side refers to SMEs and the aspects that hinder their access to finance. Demand-side barriers are as follows:

- **Financial literacy.** According to the studies<sup>66</sup> and interviews, the level of financial literacy of Georgian SMEs hinders them from using financial products efficiently.<sup>67</sup>
- **Low management skills.** According to the interviews, a lack of management skills represents a problem that hinders SMEs' development in terms of accessing finance. Some Georgian SMEs are unable to manage resources (including financial resources) and stocks effectively. These cases are assessed as risky by financial institutions, resulting in requests for high collateral and higher interest rates. Low management skills become more problematic when businesses are expanding.

<sup>65</sup> [http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Recommendations\\_for\\_Georgia\\_SME\\_strategy.pdf?fbclid=IwAR1uqtKC-hP2ZckyImGZ3H5M5xhabi-lq2MU5dqWF37zxFZj7a2VCnxmF3k](http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Recommendations_for_Georgia_SME_strategy.pdf?fbclid=IwAR1uqtKC-hP2ZckyImGZ3H5M5xhabi-lq2MU5dqWF37zxFZj7a2VCnxmF3k).

<sup>66</sup> Given in chapter 3.

<sup>67</sup> Detailed information is given in Section 3, pp. 23–24.

- **Lack of formal relationships** (e.g., contracts). A set of Georgian agricultural value chain researches conducted by the PMC Research Center<sup>68</sup> showed that value chain participants mainly have informal relationships with each other. This means that, when applying for a loan, SMEs are unable to prove their involvement in value chains. According to the interviews, representatives of financial institutions stated that formal relationships within a value chain can improve SMEs' access to finance.
- **Challenges in financial reporting.** One of the main constraints for SMEs in accessing finance is financial reporting. On the one hand, this makes financial services and products more expensive, because banks have to assess SMEs' finances themselves. On the other hand, a lack of financial reporting could be a reason for a loan application being rejected.
- **Lack of experience and knowledge.** According to the interviews, the following issues can be grouped under this barrier:
  - Farmers do not have information about new technologies, and therefore productivity stays low;
  - Lack of agricultural specialists. SMEs have to hire foreign experts to manage processing or other issues. This labor force is very expensive, resulting in higher costs; and
  - Farmers do not know about domestic and foreign market requirements. They do not have information about prices, demands on the markets, or standards and regulations of foreign markets.

Financial institutions consider SMEs' experience and knowledge when issuing loans, therefore shortcomings in this regard can reduce SMEs' access to finance.

### Other Barriers

Besides supply- and demand-side barriers, interviewees outlined some additional barriers, such as:

- **Infrastructural constraints.** Access to sources of communication, such as the Internet, represents a barrier for SMEs in obtaining information about government programs, or financial institutions' and donor organizations' products and services, or in finding possible partners within value chains.
- **Land registration.** Since 1992, agricultural land registration reform has been implemented periodically. However, according to a recent policy document,<sup>69</sup> land registration reform has not been implemented with a systemic approach, and the reform has faced many challenges, such as problems with documentation, controversy about land size and boundaries, infrastructural problems, and a lack of land measurement professionals. Unregistered land cannot be taken as collateral, therefore problems in land registration also hinder SMEs' access to finance.
- **Regulations in the financial sector.** To reduce the level of indebtedness in Georgia, and to protect borrowers' rights, the GoG has adopted several laws and regulations<sup>70</sup> relating to retail loans. The main principle of the regulations is that

<sup>68</sup> Tangerine, raspberry, onion, broccoli value chain analyses, PMC Research Center, 2018.

<sup>69</sup> Agricultural land registration reform in Georgia, ISET, 2018.

<sup>70</sup> For more details see: <http://research.pmcg-i.com/images/PPD%202018/Government%20Initiatives%20to%20Decrease%20Indebtedness%20and%20their%20Possible%20Implications.pdf>.

a financial institution shall not issue a consumer loan without undertaking detailed analysis of the consumer's solvency. The thresholds for maximum payment-to-income ratios and maximum loan-to-value ratios have been set. Moreover, the maximum annual effective interest rate on consumer loans has been reduced from 100% to 50%.<sup>71</sup> The above-mentioned laws and regulations are expected to decrease the financial sector's retail loan portfolio. Although these regulations are being imposed on retail loans, they could affect the SME sector, especially SMEs in the agriculture sector. In the agriculture sector, the majority of farmers are not registered as legal entities and, when demanding finance, they apply for retail loans. As their businesses are not registered, they are not able to declare their income, making it difficult for them to get financing. Impact assessments of these regulations have not been conducted.

- **Restrictions of microfinance organizations.** As microfinance organizations are not eligible to participate in government programs, commercial banks are the only source that can enable SMEs to participate in programs the government offers in collaboration with financial institutions.
- **Regulations for the owning of agricultural land by foreign citizens.** According to the new state constitution, from 16 December 2018, foreigners cannot own agricultural land in Georgia.<sup>72</sup> These new regulations are expected to have a negative effect on the agriculture sector's development in Georgia, and foreign direct investments in the agriculture sector and the price of agricultural land are expected to decline. When applying for loans in financial institutions, SMEs in the agriculture sector use agricultural land as collateral, and often the value of land is insufficient to cover the demanded collateral requirements. Due to the new regulations, the value of agricultural land is expected to decline even more and, therefore, the problems faced by SMEs in trying to access finance are expected to worsen. An impact assessment of this regulation on the SME sector has not been conducted.

According to field research, in Georgia, there are no gender-related barriers obstructing access to finance.<sup>73</sup> Both genders have equal opportunities to obtain loans from financial institutions and to get finance from government-initiated programs.

## 5. STATUS OF AGRICULTURAL SECTOR'S VALUE CHAIN IN GEORGIA

### 5.1 Current Situation Analysis

In 2017, Georgia exported agricultural products<sup>74</sup> worth \$783 million.<sup>75</sup> During the period 2010–2017, with the exception of 2015, the export of agricultural products increased.

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<sup>71</sup> Civil Code of Georgia, 625.

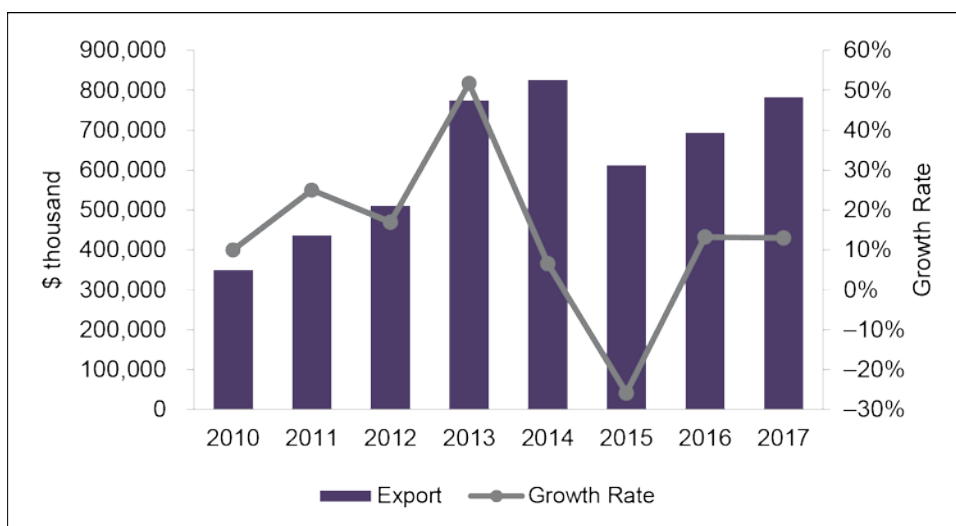
<sup>72</sup> <https://matsne.gov.ge/en/document/view/30346?publication=35>, Article 19.

<sup>73</sup> Source: Field research.

<sup>74</sup> According to HS commodity codes 01–24.

<sup>75</sup> According to commodity groups – Animal and animal products; Vegetable products; and Foodstuffs.

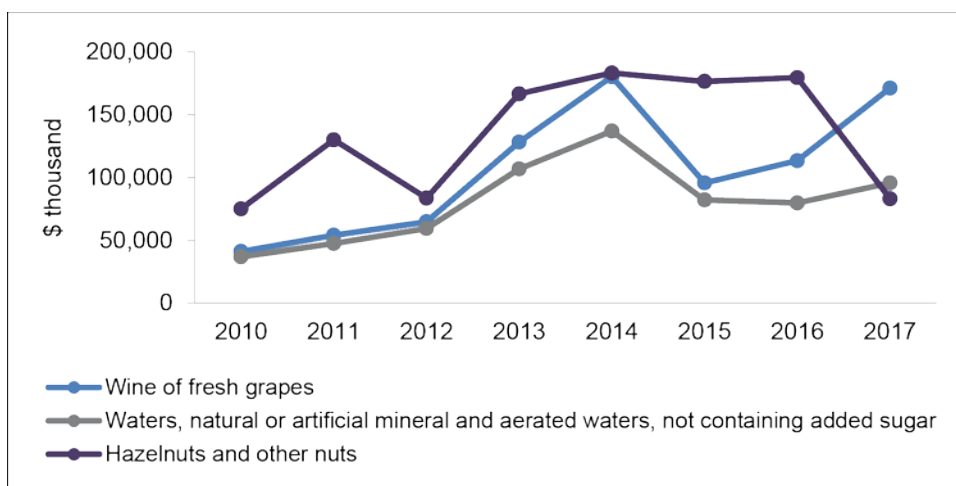
**Figure 11: Export in Agricultural Sector in Georgia**



Source: National Statistics Office of Georgia.

In 2017, according to commodity codes,<sup>76</sup> the majority of exported goods were in the following categories: beverages, spirits and vinegars (53.3% of agricultural products' export); and edible fruits and nuts, citrus or lemon peel (13.7% of agricultural products' export); and tobacco, manufactured tobacco (6.6% of agricultural products' exports).

**Figure 12: Georgia's Exported Products**



Source: National Statistics Office of Georgia.

<sup>76</sup> HS commodity codes.



### Box 1: Hazelnut sector in Georgia

The Ferrero Hazelnut Company's (AgriGeorgia) entry into the Georgian market in 2007 boosted the development of the hazelnut sector in the country and enabled its inclusion into the global value chain. Ferrero purchased land in Samegrelo-Zemo Svaneti for hazelnut tree plantations and built manufacturing facilities, thereby becoming one of the largest employers in the Samegrelo-Zemo Svaneti region. The company brought to Georgia expertise on the growing of hazelnuts as well as modern manufacturing methods and technologies. New technologies and expertise helped local farmers to improve the quality of production, which led to Ferrero purchasing hazelnuts from local, Georgian producers. AgriGeorgia provides support through consultations, training, machinery, and seedlings to enterprises that wish to improve their hazelnut production.

It can be concluded that Ferrero's entry into Georgia made local hazelnut production profitable and placed the Georgian hazelnut production into the global value chain. Therefore, this addition to the Georgian market reduced the risks for local financial institutions in supporting this sector and thereby increased hazelnut producers' access to financing.

Before Ferrero entered the country, Georgia exported hazelnuts in very small amounts – in 2006, the value was \$56.6 million, while in 2016, export value reached \$179.7 million.

Currently, in Georgia, along with large enterprises, SMEs are actively involved in the global hazelnut value chain. Relationships among value chain participants are mainly formal. Georgian producers' exports are not limited to primary production of hazelnut and include manufactured production as well, such as hazelnut flour and butter.

Wine, water, and hazelnuts are the three main agricultural products that Georgia exports in large volumes (13% of all exports and 45% of agricultural value chain products exported in 2017). The share of these products in agricultural value chain products exported ranged between 50% and 60% during the period 2013–2016; however, in 2017 the share amounted to 45%, mainly due to the decreased volume of exported hazelnuts. While the volume of exported wine and water increased in 2017 compared to 2016 (by 50.9% and 20%, respectively), the volume of exported hazelnuts decreased by 53.7%.<sup>77</sup>

Besides the main exported agricultural products, in their interviews field experts outlined several products that have the potential to penetrate domestic and global value chains in the near future. The products they named included berries, almonds, and kiwi fruit. According to recent research,<sup>78</sup> tea, fresh and processed fruit and vegetables, honey, flavorings, dried fruits, water, and alcoholic and nonalcoholic beverages were identified as being competitive on international markets.

According to the "Global Competitiveness Index 2017–2018," in Georgia, companies' presence in value chains is low as Georgia was ranked 75th among 137 countries in the "value chain breadth" indicator. According to the index, the quantity and quality of local suppliers are also low and clusters have not been developed.

The structure of the value chain can vary across sectors. The general structure of the agricultural value chain in Georgia can be seen as follows<sup>79</sup>:

<sup>77</sup> This decrease can be explained by Asian Parosana and fungal diseases, which decreased the quantity and quality of Georgian hazelnuts.

<sup>78</sup> [http://www.economy.ge/uploads/files/2017/ek\\_\\_politika/eng\\_sme\\_annual\\_report\\_2016.pdf](http://www.economy.ge/uploads/files/2017/ek__politika/eng_sme_annual_report_2016.pdf).

<sup>79</sup> A Toolbook of Value Chain Analysis – "Making Value Chains Work Better for the Poor," 2008.

**Main participants:**

- Input suppliers (intermediate goods)
- Primary production
- Distribution
- Storage
- Processing
- Retailers
- Exporters

**Supporting actors:**

- The GoG (e.g., the Ministry of Environmental Protection and Agriculture of Georgia, The Ministry of Economy of Georgia)
- Financial institutions (banks, microfinance organizations, insurance companies)
- Extension and educational institutions
- Associations (farmers, processors, etc.)
- Donors and other nongovernmental organizations
- Export logistics (transport, documentation, etc.)

To assess the status of domestic and global value chains for agricultural products, this chapter reviews the status of each value chain participant in Georgia.

**Input suppliers:** Inputs for primary production are supplied by agromarkets or nurseries. According to research conducted by the PMC Research Center,<sup>80</sup> the quality of supplied inputs is quite low, which results in low productivity and low product quality. Inputs are imported for some agricultural products<sup>81</sup> for two main reasons. First, local production of inputs is not developed<sup>82</sup> in the country, and second, local farmers prefer to buy imported raw materials, because of their higher quality. Crucially, there is a lack of certified nurseries in Georgia.

**Primary production:** Due to land fragmentation<sup>83</sup> there are many small producers in Georgia. According to the interviews, Georgian farmers mainly sell their products in local markets, directly or through intermediaries (e.g., collectors, distributors, processing enterprises). Relationships between farmers and intermediaries are mainly informal.

**Storage and processing:** There is a lack of storage and processing enterprises in Georgia.<sup>84</sup> The products are mainly sold fresh. Respondents admitted that the existing storage and processing enterprises are unsatisfied with the quality and price of products offered by farmers. In addition, there is a lack of specialists in the management of storage and processing enterprises.

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<sup>80</sup> Mandarin VCA, PMC Research Center, 2018.

<sup>81</sup> [http://research.pmcg-i.com/images/Policy\\_Papers/PIN%20VCAs/VCA%20Raspberry.pdf](http://research.pmcg-i.com/images/Policy_Papers/PIN%20VCAs/VCA%20Raspberry.pdf).

<sup>82</sup> Only two beneficiaries used the state program “Plant the future” for nursery gardens during the period 2015–2017.

<sup>83</sup> The average area of land plots is 1.4 ha (geostat.ge).

<sup>84</sup> Peach value chain analysis, raspberry value chain analysis. PMC Research Center, 2018.

**Retailers and exporters:** Agricultural products are mainly sold in agrarian markets and in supermarkets in Georgia and in foreign countries. The relationships between farmers and local agrarian markets are direct or through intermediaries, while local supermarkets are mainly connected with intermediaries. Intermediaries export products on their own or through exporters.

According to the field research results, the level of communication between different participants of the agricultural value chains in Georgia is low and the level of participation of SMEs in the value chains also remains low. In Georgia, large firms are trying to create their own chains, which could be classified as supply chains. The relationships between value chain participants are mainly informal.<sup>85</sup>

Furthermore, the PMC Research Center conducted a set of value chain analyses<sup>86</sup> on agricultural products, such as mandarins, raspberries, broccoli, tomatoes, peaches, walnuts, onions, laurels, potatoes, trout, blackberries, and carrots. These products were chosen based on their potential in domestic and international markets. The analyses showed that the value chains are not fully functional for these products. According to the studies, value chain participants face challenges that prevent them from increasing the value added in the chain and reduce products' competitiveness. These challenges include a lack of qualified workforce, a lack of processing facilities, a lack of industry specialists, a lack of coordination among value chain participants, underdeveloped nurseries, a lack of refrigeration facilities and technologies, a low diversity of the export markets, and a lack of knowledge and motivation among farmers to adopt innovations.

To sum up, the Georgian agricultural sector's value chains face many challenges. By strengthening each actor of the value chain, the productivity of products might improve.

## 6. VALUE CHAIN FINANCING ANALYSIS

Value chain finance refers to the flow of financial resources within the chain to provide chain participants with the necessary funds for efficient production, for the reduction of risks, and to develop the chain.<sup>87</sup>

### 6.1 Availability and Development of Value Chain Financing in Georgia

Links between value chain participants can be direct or indirect, depending on the length of the chain. Programs implemented by the GoG, donor organizations, and financial institutions finance different value chain actors. The table below lists value chain actors with relevant institutions' programs that are financially and technically supporting their development.

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<sup>85</sup> "Business environment and enterprise performance surveys – Georgia country profile," WB, EBRD, 2013.

<sup>86</sup> [http://research.pmcg-i.com/index.php?option=com\\_k2&view=itemlist&layout=category&task=category&id=37&Itemid=137&lang=eng](http://research.pmcg-i.com/index.php?option=com_k2&view=itemlist&layout=category&task=category&id=37&Itemid=137&lang=eng).

<sup>87</sup> <http://www.fao.org/docrep/017/i0846e/i0846e.pdf>.

**Table 11: Value Chain Actors and Relevant Financing Programs**

<b>Value Chain Participant</b>	<b>Supporting Program</b>
Input suppliers	Government program “ <i>Plant the Future</i> ” Financial institutions
Primary production	Government program “ <i>Plant the Future</i> ” Government program “ <i>Program of Agro-production Promotion</i> ” Government program “ <i>Agroinsurance</i> ” Financial institutions
Distribution	Financial institutions
Storage (warehouses, coolers, dryers)	Government program “ <i>Preferential Agrocredit</i> ” Government program “ <i>Co-financing of Agro Processing and Storage Enterprises</i> ” Government program “ <i>Program of Agro-production Promotion</i> ” Financial institutions
Processing	Government program “ <i>Preferential Agrocredit</i> ” Government program “ <i>Co-financing of Agro Processing and Storage Enterprises</i> ” Government program “ <i>Program of Agro-production Promotion</i> ” Government program “ <i>Produce in Georgia</i> ” Financial institutions
Retailers	Financial institutions
Exporters	Enterprise Georgia – <i>Export support</i> Financial institutions

Source: Agricultural Projects’ Management Agency (APMA), Enterprise Georgia.

**Input suppliers:**<sup>88</sup> The government program “*Plant the Future*” co-finances, and provides technical assistance<sup>89</sup> to, beneficiaries making nursery gardens.<sup>90</sup> Financial assistance here entails co-financing 50% of the total project to make a nursery garden, but the amount should not exceed GEL150,000 (\$59,790) for each beneficiary.

**Primary production:**<sup>91</sup> The government program “*Plant the Future*” provides financial and technical assistance in arranging perennial gardens. The program provides 70% co-financing in purchasing seeds and saplings, and no more than 50% (not more than GEL2,500 [\$997] per hectare) co-financing for installing drip irrigation systems. This program is mainly focused on fruits, nuts, and berries. This component is much more popular than the nursery gardens component. During the period 2015–2017, 658 projects were financed by GEL22.3 million (\$8.9 million) and the number of beneficiaries is increasing every year.

Another APMA program, “*Program of Agro-production Promotion*,” co-finances smallholder farmers and agricultural cooperatives operating in primary production with 40% of the total project amount, while the other 60% is co-financed by the beneficiary. Smallholder farmers can get funding up to \$15,000 equivalent in GEL. In the case of co-

<sup>88</sup> Agricultural projects’ management agency of MEPA, 2016.

<sup>89</sup> Technical assistance means conducting training for beneficiaries in plant propagation, and certification of planting material.

<sup>90</sup> According to the APMA data, this component is not popular with beneficiaries. Since 2015, only two beneficiaries were financed in the Samegrelo-Zemo Svaneti region.

<sup>91</sup> Agricultural projects’ management agency of MEPA, 2016.

financing cooperatives, the amount depends on the number of members (no more than \$15,000 equivalent in GEL for each member).

The government program “*Agroinsurance*” covers the risks of hail, flood, storm, and autumn frost (only for citrus crops). Program beneficiaries can insure up to 5 hectares of agricultural land and in the case of cereals up to 30 hectares. Beneficiaries receive 70% co-financing for each crop under this program but in the case of wine only 50%. Currently the program does not cover all agricultural products, e.g., honey production and livestock are not insured. Moreover, the program does not cover risks other than climate risks in agriculture, such as biological, price, and institutional risks.

**Distribution:** Logistics is not financed under government programs. However, according to the interviews, commercial banks and microfinancing organizations provide loans to distribution companies.

**Storage (warehouses, coolers, dryers):**<sup>92</sup> APMA implements several projects with regard to developing storage enterprises. One of these projects entails 40% co-financing of storages, on the condition that co-financing of legal entities (including cooperatives) must be a maximum of \$ 100,000 equivalent in GEL. Co-financing can be applied to modernize acting storages, to arrange new ones, to purchase new equipment, and to implement modern standards for certification.

The agency implements another project co-financing the development of storage enterprises through three sources: first, 40% co-financing, up to GEL600,000 (\$239,174); second, preferential credit or leasing, co-financing up to 50% (maximum GEL1,500,000 (\$597,934)); and third, a contribution of at least 10% from the beneficiary in enterprise capital. Notably, every entrepreneur who qualifies for the required scheme and provides the necessary information to the agency gets funding without competition from other applicants. Meanwhile, storages can be financed by preferential agrocredit for fixed assets. The amount of funding ranges between GEL20,000 (\$7972) and GEL1,500,000 (\$597,935). The agency subsidizes loan interest rates for up to 66 months, at 11% of the total amount annually. This program includes agroleasing as well.

**Processing:**<sup>93</sup> Processed goods accumulate a higher value within the country. APMA finances agroproduction through three programs: preferential agrocredit, promotion of agroproduction; and co-financing of agroprocessing enterprises. These projects mainly entail the establishment of processing enterprises through co-financing. Co-financing of agroprocessing enterprises provides financial and technical assistance to establish new enterprises. Promoting agroproduction includes 40% co-financing of no more than \$100,000 equivalent in GEL per project. Preferential agrocredit provides co-financing under several components of the project.

The Government program “*Produce in Georgia*” provides credit and leasing to establish new enterprises and to expand existing ones. The amount of credit in the program varies between GEL150,000 (\$597,935) and GEL5,000,000 (\$1,993,116). For the first 24 months of the program, interest rates are co-financed by the government.

**Retailers:** APMA is not aiding this part of the value chain; however, financial institutions are providing services for retailers. A representative of one of the leading financial institutions admitted in the interview that retail is one of the leading sectors that this financial institution is financing.

**Exporters:** This part of the value chain is one of the least developed in the agricultural sector. Leading commercial banks are financing trade and export through several

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<sup>92</sup> Agricultural projects’ management agency of MEPA, 2016.

<sup>93</sup> Agricultural projects’ management agency of MEPA, 2016.

products (**loans, factoring, letters of credit and guarantees**); however, SMEs' knowledge of these products is very low and they are consequently unpopular. Donors and international organizations consider trade financing to be an important tool for SMEs' development. For example, the EBRD launched a new project, "*Trade Ready*" to support SMEs' trade finance<sup>94</sup> and to provide business advice in the process.

Enterprise Georgia also supports SMEs involved in exports. The agency works in two directions – export promotion and export development. Export promotion entails the organization of international exhibitions and trade missions and connecting Georgian producers with foreign partners. Meanwhile, export development means providing information about customs tariffs in international markets and export procedures in Georgia, and providing training for export managers.<sup>95</sup>

Since 2012, agriculture has been identified as one of Georgia's priority sectors<sup>96</sup> and agricultural value chain development has been earmarked as one of the priority actions for the country. The set of agricultural programs implemented during the last six years reflects the sector's importance. However, links between value chain actors are not strong yet. Financial institutions are also involved in value chain creation and, according to the interviews, financial institutions connect their clients to each other to promote communication and partnership within value chains. For example, they connect input suppliers with producers, or processing companies with logistics, and, additionally, they allocate finances to develop these linkages and value chains.

## 6.2 Comparison with Best Practices

The Food and Agricultural Organization of the United Nations (FAO) suggests two methods of value chain financing<sup>97</sup>:

- Internal value chain financing;
- External value chain financing.

Internal value chain finance takes place within the value chain. Each value chain participant provides credit to the other participants within the chain. Forms of internal value chain finance can include input supplier credit, credit issued by a marketing company, or credit issued by the leading company in the chain.<sup>98</sup> For example, in Myanmar, input suppliers provide credit with a postponed payment structure for farmers.<sup>99</sup>

Internal value chain financing is not yet developed in Georgia. Primarily, Georgian SMEs involved in value chains have informal relationships with their partners. Few of them have contracts or other elements of formal cooperation (e.g., contract farming) with other chain

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<sup>94</sup> The project will equip SMEs with knowledge of international markets, financial products used for trade financing and attracting investments through improved financial accounting, preparing business plans, etc. They developed a tool, *trade passport*, to identify strengths and weaknesses of enterprises and to provide training/assistance to develop a company's capacity. Financial support for the project is provided by the European Commission. Notably, this project does not directly increase SMEs' access to finance; however, it does provide knowledge and tools to improve SMEs' access to finance.

<sup>95</sup> <http://www.enterprisegeorgia.gov.ge/en/export-support>.

<sup>96</sup> Georgia's Agricultural Development Strategy 2015–2020. The Ministry of Environmental Protection and Agriculture of Georgia, 2018.

<sup>97</sup> <http://www.fao.org/docrep/017/i0846e/i0846e.pdf>.

<sup>98</sup> <http://www.inclusivefinanceplatform.nl/documents/bankers%20guide%20to%20avcf.pdf>.

<sup>99</sup> <https://www.adb.org/sites/default/files/project-document/180599/46082-001-tacr-01.pdf> (case of Myanmar).

participants. In most cases, they have verbal agreements. In order to develop an internal value chain financing method, first SMEs should formalize their partnerships within the value chain. According to the interviews, this problem is more acute for small-sized farmers than it is for medium-sized enterprises. Although internal financing is not prevalent in Georgia, according to a recent study,<sup>100</sup> farmers prefer to get loans from input suppliers, rather than from financial institutions. Therefore, introducing methods for internal value chain financing could contribute to further development of value chains.

External value chain financing takes place beyond the value chain. Financial institutions issue loans to value chain participants if those participants have contracts with other members of the chain.

This type of financing is more common in Georgia; however, contract farming remains unpopular. Banks usually do not require contracts from their beneficiary SMEs, but they study their clients' income and expenditure, and then provide credit on their terms. Some farmers are willing to consider this type of financing. For example, one of the Georgian input suppliers<sup>101</sup> has an agreement with farmers and retailers. The input supplier provides inputs for the farmer (all kinds of input needed for production) and, when the good is produced, the retailer takes it from the farmer and sells it on the market. The financial flow of the agreement is as follows: The financial institution issues a loan to the farmer, but the money is transferred to the input supplier SME, which is responsible for supplying all necessary inputs to the farmer; the farmer then produces the good and delivers it to the retailer; the retailer sells the product and covers the loan (with interest) from the financial institution. Each chain participant has a written agreement with the others. This model is a good example of how external financing can develop a value chain. When the system works, it is much easier to expand the chain and increase production.

External value chain financing is more common in Georgia than the internal alternative, and this type of financing is usually associated with getting loans from financial institutions. However, there are several other sources of finance,<sup>102</sup> which can be cheaper<sup>103</sup> than taking out such a loan. These products include:

- **Factoring:** A farmer delivers a product to the buyer and prepares an invoice for it. The buyer does not pay the farmer directly. Instead, the farmer sells the invoice to a financial institution and gets paid for the sold product. Afterwards, the financial institution delivers the invoice to the buyer for the final transaction.
- **Leasing:** The leasing company provides the SME with equipment/machinery for a certain period defined in the contract. The SME covers the agreement in installments. When all duties are fulfilled, the leasing company can repossess or sell the equipment/machinery to the SME. In this case, the risk is lowered compared to taking out a loan.
- **Repo Finance:**<sup>104</sup> Repurchase agreement. A commercial bank buys the product from the seller and signs a contract to sell it back to the seller within an agreed time.

<sup>100</sup> <http://alcp.ge/pdfs/10fc006f0cba20f5dbed959a7bd5e778.pdf>.

<sup>101</sup> [http://iset-pi.ge/images/Projects\\_of\\_APRC/LivestockFarmEnterpriseModelsInKakhetiRegion.pdf](http://iset-pi.ge/images/Projects_of_APRC/LivestockFarmEnterpriseModelsInKakhetiRegion.pdf).

<sup>102</sup> <https://knowledge.hivos.org/sites/default/files/publications/pdfvaluechainfinance.pdf> p.43, 2010.

<sup>103</sup> Depending on the market conditions and costs to credit risks.

<sup>104</sup> <http://www.fao.org/docrep/017/i0846e/i0846e.pdf>.

- **Private equity:** A bank (investor) may buy shares in a company to provide capital for investments.
- **Warehouse receipt:** When farmers deliver their product to a warehouse, they get a receipt. This receipt can be used as collateral for loans.

Some of these products, such as factoring and leasing, are available in Georgia.

Besides financial institutions, there are other sources of value chain financing, such as credit cooperatives, revolving funds, and credit associations, however currently these kinds of financing sources are not available in Georgia:

- **Credit cooperatives:** A financial organization established on the basis of cooperation and providing financial support to households and businesses – for example, Credit Agricole<sup>105</sup> or Navy Federal Credit Union. Credit Agricole was established in 1885 and was owned by the members of farmers' unions. It issued credit to rural populations and businesses. The institution played an important role in the development and modernization of French agriculture.
- **Revolving funds:** These institutions are set up to provide business with finance that is available due to continuous replenishment from investments.<sup>106</sup> Revolving funds provide financial assistance with lower interest rates<sup>107</sup> than other commercial loans.
- **Credit associations:**<sup>108</sup> Institutions eligible to provide short, intermediate, and long-term farm credits in the agricultural sector. The institutions are cooperatively owned and require a lower effective interest rate from customers.

Both external and internal value chain financing need to be developed in Georgia. External financing suggests more diverse financial services and products. Therefore, raising awareness about these products and about internal value chain financing could be important for value chain development.

## 7. POLICIES TO PROMOTE SME FINANCE

Recognizing the important role of SMEs, the GoG developed the “SME Development Strategy of Georgia 2016–2020.” The aim of the strategy is to create a favorable environment for SMEs, and to increase their competitiveness, which in turn will result in increased income and job creation.

The Ministry of Economy and Sustainable Development of Georgia is the main implementer of the strategic actions. The national institutions involved in the promotion of SME creation are the Entrepreneurship Development Agency (Enterprise Georgia) and the Innovation and Technology Agency (GITA). Business associations such as the Georgian Chamber of Commerce and Industry (GCCCI), the Georgian Employers' Association (GEA), and the Georgian Small and Medium Enterprises Association provide support to SMEs as well.

<sup>105</sup> [http://iset-pi.ge/images/Policy\\_Briefs/HistoryOfCr%C3%A9ditAgricole.pdf](http://iset-pi.ge/images/Policy_Briefs/HistoryOfCr%C3%A9ditAgricole.pdf).

<sup>106</sup> <https://www.collinsdictionary.com/dictionary/english/revolving-fund>.  
<http://www.businessdictionary.com/definition/revolving-fund.html>.

<sup>107</sup> <http://documents.worldbank.org/curated/en/513501475845545082/pdf/108847-GEORGIAN-ESM-P157135-PUBLIC-EE-Options-Paper-Georgia-final.pdf>.

<sup>108</sup> <https://www.capitalfarmcredit.com/abol/faq#b>.



The five strategic directions outlined in the strategy<sup>109</sup> are as follows:

- Further improvement of legislative and institutional framework, as well as operational environment for SMEs;
- Improvement of access to finance;
- SMEs' skills development and promotion of entrepreneurial culture;
- Export promotion and SMEs' internationalization; and
- Facilitation of innovation and R&D in SMEs.

In the strategy,<sup>110</sup> under each direction, priority actions were established. Improving access to finance and increasing SMEs' involvement in global value chains are the two most important strategic directions. For the former, the following priority actions were planned, and relevant activities were implemented:

**Table 12: Priority Actions and Activities under Strategic Direction  
– Improvement of Access to Finance**

Priority Action	Activity
Improvement of financial literacy among SMEs	<ul style="list-style-type: none"> <li>• Training course for Enterprise Georgia's beneficiaries within the micro- and small-business support program component</li> <li>• Educational brochures and video clips for SMEs</li> <li>• Informing SMEs about amendments to Tax Code</li> <li>• Workshops related to Estonian model of taxation</li> </ul>
Supporting SMEs in the implementation of IFRS in accounting	<ul style="list-style-type: none"> <li>• IFRS for SME awareness-raising materials were developed and IFRS for SME awareness-raising training were conducted in 2017</li> </ul>
Increasing knowledge about fundraising among SMEs	<ul style="list-style-type: none"> <li>• Information meetings on fundraising issues were held for businessmen and the participants of 19 teams from business incubators were trained on fundraising topics</li> </ul>
Attraction of SME-oriented private equity funds and venture capital funds for startup financing	<ul style="list-style-type: none"> <li>• Venture funds and startups were identified for future cooperation</li> </ul>
Helping SMEs to increase access to finance through commercial banks and microfinance organizations (MFIs)	<ul style="list-style-type: none"> <li>• Enterprise Georgia added two new incentive programs for the hotel industry and the film industry</li> <li>• Discussions were held between different parties to identify obstacles to SMEs' access to finance</li> </ul>
Improvement of SMEs' finance through grants	<ul style="list-style-type: none"> <li>• Amendments to the law of grants have been elaborated and adopted</li> </ul>

Source: SME Development Strategy of Georgia 2016–2020.

According to the annual progress report<sup>111</sup> of the SME development strategy action plan 2016–2017, all six priority actions of the second strategic direction were fulfilled. At the same time, according to the “Midterm evaluation of Georgia's SME Development Strategy 2016–2020,” although some activities aimed at increasing SMEs' financial literacy have been carried out, no strategic framework indicating SMEs' financial literacy

<sup>109</sup> [http://www.economy.ge/uploads/files/2017/ek\\_politika/eng\\_sme\\_development\\_strategy.pdf](http://www.economy.ge/uploads/files/2017/ek_politika/eng_sme_development_strategy.pdf).

<sup>110</sup> [http://www.economy.ge/uploads/files/2017/ek\\_politika/eng\\_sme\\_development\\_strategy.pdf](http://www.economy.ge/uploads/files/2017/ek_politika/eng_sme_development_strategy.pdf).

<sup>111</sup> [http://www.economy.ge/uploads/files/2017/ek\\_politika/eng\\_sme\\_development\\_strategy\\_ap\\_annual\\_pr\\_2017.pdf](http://www.economy.ge/uploads/files/2017/ek_politika/eng_sme_development_strategy_ap_annual_pr_2017.pdf).

exists. Moreover, more activities to inform SMEs about the advantages of IFRS and about the alternative financing tools are considered to be the important actions government has to take.

The second direction is export promotion and SMEs' internationalization. To fulfill this goal the following priority actions were planned and relevant activities were implemented:

**Table 13: Priority Actions and Activities under Strategic Direction  
– Export Promotion and SMEs' Internationalization**

Priority Action	Activity
Raising awareness of prospects offered by the Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union and its requirements	<ul style="list-style-type: none"> <li>• Establishment of information centers to increase access to information about the DCFTA</li> <li>• Training and awareness-raising events</li> <li>• International exhibitions, international trade missions, and business forums were conducted</li> <li>• Seminar in standardization and metrology was conducted for SMEs</li> <li>• Meetings with farmers and entrepreneurs were held, where the DCFTA obligations and challenges towards them were discussed</li> <li>• The export managers of "Enterprise Georgia" beneficiaries were trained; the objective of the training was to diversify export markets</li> </ul>
Support businesses to adapt to DCFTA requirements	<ul style="list-style-type: none"> <li>• Identifying competitive products for export markets</li> <li>• Consulting with representatives of private sector</li> <li>• Introduction of international food safety standards</li> <li>• Support businesses to implement ISO 22000 standards and gain ISO 22000 certificate</li> <li>• Identifying needs and problems of the enterprises according to export readiness</li> <li>• DCFTA information centers were opened</li> </ul>
Promotion of export of SMEs	<ul style="list-style-type: none"> <li>• Identifying top-priority markets</li> <li>• Identifying top-priority products for export market</li> <li>• Developing export readiness tests to assess companies' export readiness</li> <li>• Organize trade sessions and trade missions</li> <li>• Supported beneficiaries for stimulating exports</li> </ul>
Help SMEs to establish international trade relations	<ul style="list-style-type: none"> <li>• Organize an event: networking opportunities for SMEs under EEN and Horizon 2020</li> </ul>
Responsible Business Conduct (RBC) promotion	<ul style="list-style-type: none"> <li>• Conducted research on business and human rights</li> <li>• Discussions on "Business partnership for gender equality" were carried out</li> <li>• Masterclasses on "Employing people with disabilities in business sector" were organized</li> </ul>
Support the establishment of FDI–SME linkages <sup>112</sup>	<ul style="list-style-type: none"> <li>• Business forums were organized</li> <li>• Foreign investors were identified for future cooperation</li> <li>• Georgian enterprises and foreign investors were connected</li> <li>• Foreign investors were informed about Georgian companies</li> </ul>

Source: SME Development Strategy of Georgia 2016–2020.

<sup>112</sup> We are in active communication with the Ministry of Economy and Sustainable Development and will have an in-depth discussion about this topic soon.

According to the annual progress report<sup>113</sup> of the SME development strategy action plan 2016–2017, all six priority actions of the fourth strategic direction were fulfilled. At the same time, according to the “Midterm evaluation of Georgia’s SME Development Strategy 2016–2020,” trade barriers for SMEs related to financing still exist and there is a need to identify trade barriers and for further SME internationalization.

To increase SMEs’ access to finance, the Ministry of Economy and Sustainable Development of Georgia is going to set up a credit guarantee mechanism, which is a guarantee fund that will be a guarantor for loans for SMEs to be received from commercial banks.<sup>114</sup> The credit guarantee will be a risk-sharing mechanism between banks, SMEs, and the state. The credit guarantee mechanism will be enforced in the first quarter of 2019.<sup>115</sup>

## 8. RECOMMENDATIONS

Based on the research outcomes, it can be concluded that the economic activity of SMEs is increasing in Georgia. However, a major barrier to SMEs’ development is access to finance. The study analyzed the current situation regarding SMEs’ access to finance and we propose the following *policy recommendations* and *immediate actions* with regard to existing government policies.

**The Government** can improve SMEs’ access to finance through heeding the following policy recommendations:

- **Land market liberalization:** The restriction on foreign ownership and management of agricultural land should be abandoned. In addition, a land registration process should be finalized and the process of privatization of state agricultural land should be accelerated (in Georgia, the state owns 75.1% of cultivable agricultural land).
- **Establishment of a well-functioning monitoring and evaluation system:** The GoG has a wide range of programs to support SMEs’ development and to increase their access to finance. However, no monitoring and evaluation system of these programs exists. In order to increase the efficiency of government programs, the GoG should establish such a system.
- **Regulatory impact assessment (RIA):** A regulatory impact assessment (RIA) system has not been established in Georgia. In order to develop a sustainable SME policy, impact assessments of new regulations for the private sector should be conducted.

**The government could improve access to finance through the following immediate actions regarding existing government policies:**

- **Insurance:** The government, in cooperation with insurance companies, should expand the coverage of agroinsurance in two directions. First, insurance should cover all agricultural products (currently, honey production and livestock are not insured). Second, the program should cover biological, price, and institutional risks. This will ensure the stability of farmers’ income and will improve the

<sup>113</sup> [http://www.economy.ge/uploads/files/2017/ek\\_\\_politika/eng\\_sme\\_development\\_strategy\\_ap\\_annual\\_pr\\_2017.pdf](http://www.economy.ge/uploads/files/2017/ek__politika/eng_sme_development_strategy_ap_annual_pr_2017.pdf).

<sup>114</sup> <http://agenda.ge/en/news/2018/1095>.

<sup>115</sup> [http://gov.ge/print.php?gg=1&sec\\_id=526&info\\_id=69911&lang\\_id=ENG](http://gov.ge/print.php?gg=1&sec_id=526&info_id=69911&lang_id=ENG).

relationship between farmers and financial institutions, resulting in improved access to finance for farmers.

- **Inclusion of financial institutions, other than commercial banks, in government programs:** Currently, microfinance organizations are not eligible to participate in GoG-initiated programs. These programs require financial institutions to have a current account and microfinance organizations do not have these.
- **Assess financial literacy of SMEs:** There has been no research analyzing SMEs' level of financial literacy in Georgia. In order to achieve the goals set out in the "SME development strategy," first the Government should assess SMEs' financial literacy, identify major challenges, and provide necessary actions based on the assessment.
- **Promote formal relationships, such as contract farming:** In order to increase SMEs' involvement in value chains and to promote formal relationships between chain participants, government programs should require contracts or consider them an advantage for granting beneficiaries.
- **Training for farmers:** The government could support SMEs by conducting training aimed at increasing SMEs' awareness of market requirements, government programs, and financial products and services such as factoring, leasing, and private equity to increase sources of value chain financing.
- **Trade (export) financing:** Government programs finance almost all parts of the value chain, except trade. The GoG promotes export through only technical assistance and helps SMEs to participate in international exhibitions and develop connections with foreign partners. In order to increase Georgian SMEs' involvement in global value chains, the government should elaborate a trade financing program.
- **Support entrance of international companies into Georgia:** Involvement of Georgian SMEs in global value chains increases their capacity and access to finance. The entrance of international companies into Georgia will help SMEs to get involved in global value chains. For example, the development of the hazelnut sector was boosted by opening the Ferrero Hazelnut Company in Georgia.

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## ANNEX 1: METHODOLOGY

In this document, SMEs' access to finance barriers and involvement in domestic and global value chains were assessed using desk and field research tools. Desk research included a literature review and statistical data analysis. Field research considered interviews with relevant stakeholders. Interviewees included representatives of government, financial institutions, donor organizations, and field experts.

### Field Research – Conducted Interviews

Respondent	Organization	Position
Mariam Guniava	National Bank of Georgia (NBG)	Head of financial education division, consumer protection and financial education department
Diana Togoevi	National Bank of Georgia (NBG)	Specialist, financial education division, consumer protection and financial education department
Lasha Gzirishvili	National Bank of Georgia (NBG)	Head of department, consumer protection and financial education department
Nikoloz Kavtaradze	Agricultural Projects' Management Agency (APMA)	Project: Co-financing of agro processing and storage enterprises
Severian Gvinepadze	European Bank for Reconstruction and Development (EBRD)	Principal manager, advice for small businesses, Georgia
Sandro Museridze	European Bank for Reconstruction and Development (EBRD)	Associate banker, SME F&D regional network
Kateryna Poberezhna	European Bank for Reconstruction and Development (EBRD)	Coordinator of advisory services for local agribusinesses in Georgia/DCFTA adaptation program
David Kapanadze	Bank of Georgia	Head of SME business banking department
Shota Gongladze	TBC Bank	Agro business development coordinator
Kakha Gabeskiria	Crystal (Microfinance Organization)	Chief business officer
Keti Gogotchuri	Georgian Farmers' Association	Project manager
Shalva Japaridze	Georgian Farmers Distribution Company	Deputy director
Rati Kochlamazashvili	ISET Policy Institute	Deputy head of agricultural policy research center
Mikheil Skhiereli	Policy and Management Consulting Group (PMCG)	Associated consultant governance, innovation, and investment policy
Irakli Barbakadze	ISET Policy Institute	Researcher