



# Leveraging SME Finance through Value Chains in Georgia

November, 2018

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# Introduction - SME definition (1/2)

SMEs in Georgia are defined by the National Statistics Office of Georgia; the Law of Georgia on Accounting, Reporting and Audit; the Tax Code of Georgia.

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

	<b>Number of people employed</b>	<b>Annual average turnover</b>
Small	< 50 person	< GEL 12 million (USD 4.7 mln)
Medium	from 50 to 250 person	from GEL 12 million (USD 4.7 mln) to GEL 60 million (USD 12.5 mln)



# Introduction – Methodology (2/2)

## Desk research

- Literature review
- Statistical data analysis (National Statistics Office of Georgia, National Bank of Georgia, The Ministry of Finance of Georgia, The Ministry of Environmental Protection and Agriculture of Georgia, etc.)

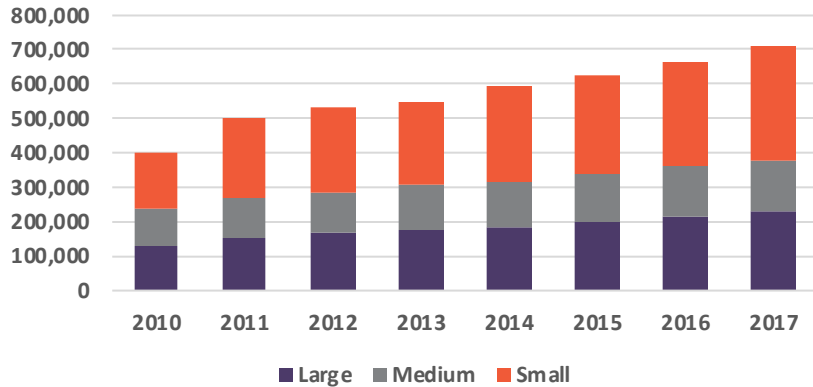
## Field research

- Interviews with relevant stakeholders, such as representatives of government, financial institutions, donor organizations and field experts.

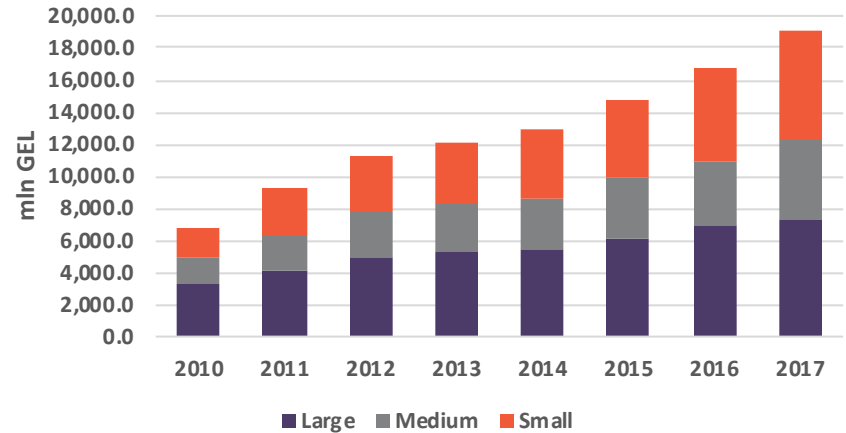


# SMEs' Role in the Economy

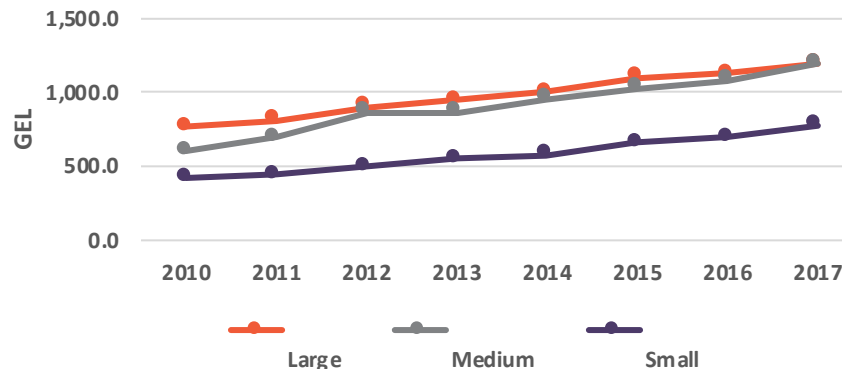
Employment in the Private Sector of Georgia



Value Added in Private Sector of Georgia



AVERAGE MONTHLY REMUNERATION OF EMPLOYED PERSONS BY ENTERPRISE SIZE



# Three main sources of SME funding (1/2)

- Government of Georgia;
- Financial institutions (mainly banks and microfinance organizations);
- Donor Organizations.

## Government of Georgia

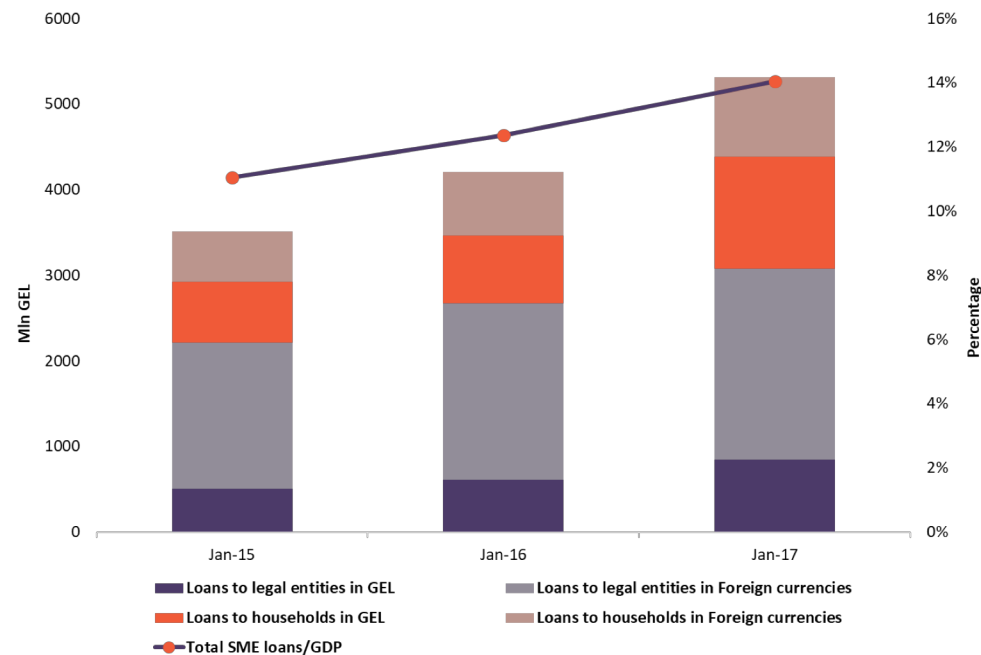
	2015		2016		2017	
	Thousand GEL	% of total state budget	Thousand GEL	% of total state budget	Thousand GEL	% of total state budget
<b>Developing Entrepreneurship</b>	22,959	0.2%	41,106	0.4%	39,348	0.3%
<b>Development of Innovations and Technologies in Georgia</b>	6,713	0.1%	9,362	0.1%	6,050	0.1%
<b>Agricultural Development</b>	306,052	3.2%	320,915	3.1%	324,061	2.8%
<b>TOTAL</b>	335,724	3.5%	371,382	3.6%	369,459	3.1%



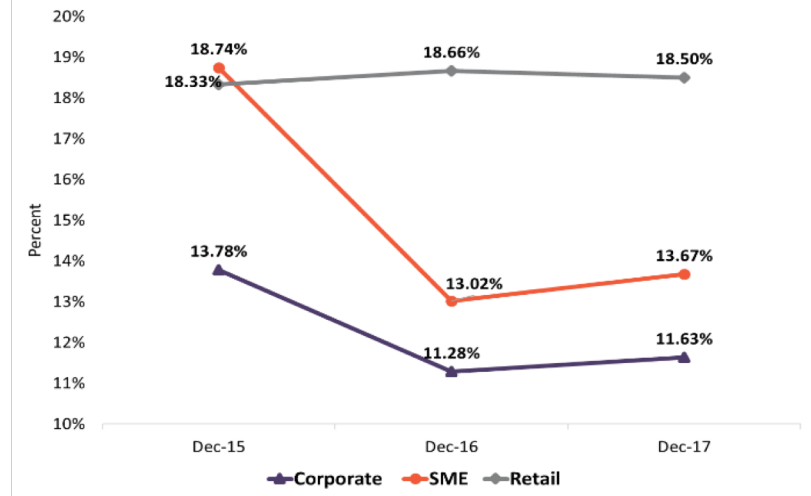
# Three main sources of SME funding (2/2)

## Financial institutions

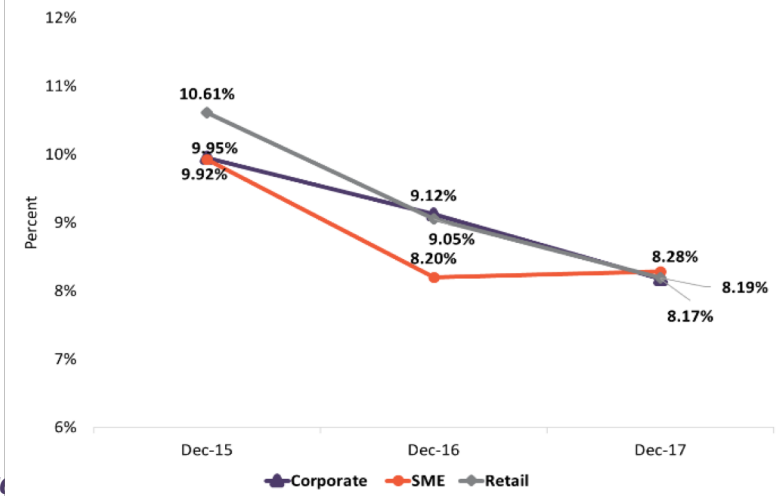
Commercial banks' loans for SMEs (stocks)



Interest Rates on GEL Loans by Segment



Interest Rates on USD Loans by Segment



# Georgia's Financial Development

- Ease of Doing Business 2019 rank – 6<sup>th</sup>.
- International Monetary Fund's financial development rank – 92<sup>nd</sup>.
- In 2017, the assets of financial institutions in Georgia increased by 223.6% compared to 2010; Assets to GDP ratio resulted to 96.7%.
- In 2017, assets of commercial banks accounted for 94% of financial institutions' assets.



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# Tax regimes in Georgia

- The World Bank's Ease of Doing Business index's indicator "Paying Taxes" rank – 16<sup>nd</sup>.
- Currently, in Georgia there are six types of tax: income tax, profit tax, value added tax (VAT), excise tax, property tax and customs tax.
- Micro businesses in Georgia do not pay income tax.
- Small businesses in Georgia pay income tax - 1%.
- Preferential VAT regime in Agriculture sector.
- Preferential tax regime for Cooperatives.



# Status of financial inclusion for SMEs

## Three dimensions of financial inclusion:

- **Access:**

- Total number of branches of financial institutions - 1236 units.
- Number of branches per 1000 enterprise – 8 units.

Source: World Bank's Financial Access Survey, 2015.

- **Use (frequency and duration):**

- In 2015, 11627 SMEs borrowed funding from financial intermediaries.
- In the same period, SME deposits with commercial banks made up 3.5% of the country's GDP.

Source: World Bank's Financial Access Survey, 2015.

- **Quality:**

- In 2013, 35.8% of SMEs had bank loans, while 59.8% of SMEs did not need loans.
- Overall, 22% of SMEs used banks to finance investments and 27.6% of SMEs used banks to finance working capital.
- In 2013, 4.6% of SMEs had their most recent loan applications rejected.

Source: World Bank Enterprise Survey, 2013.



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# Financial literacy and skills of SMEs' entrepreneurs

- Financial Literacy ranking (2016) – 24<sup>th</sup>.
- Improvement of financial literacy among SMEs is one of the priorities of the “SME Development Strategy of Georgia 2016-2020”.
- National Strategy for Financial Literacy in Georgia was elaborated by National Bank of Georgia.
- The National Bank of Georgia has implemented two programs to increase SMEs' level of financial literacy under the strategy:
  - Brochure - “Improve Your Financing Decisions”;
  - Financial Education Program for micro and small enterprises.



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# Barriers to SME finance from supply side (1/2)

## Barriers related to financial institutions:

- Limited financing channel other than banking;
- High collateral requirements;
- High interest rates;
- Limitations for startups;
- Insufficient knowledge of regional loan officers in agriculture.

## Barriers related to the Government:

- Access to information about government programs.

## Barriers from SMEs' service providers:

- Consulting.



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# Barriers to SME finance from demand side (2/2)

- Financial literacy;
- Low management skills;
- Lack of formal relationships;
- Challenges in financial reporting;
- Lack of experience and knowledge;
- Land fragmentation.

## Other barriers

- Infrastructural constraints;
- Land registration.



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# Status of agricultural sector's value chain in Georgia

Products actually involved in global value chains:

- Hazelnut;
- Wine;
- Water.

Products potentially involved in global value chains:

- Berries;
- Almonds;
- Kiwi;
- Tea;
- Fresh and processed fruit and vegetables;
- Honey.



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# Value chain financing analysis (1/2)

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



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# Value chain financing analysis (2/2)

Two methods of value chain financing:

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

Sources of financing other than bank loans:

- Leasing;
- Repo Finance;
- Private equity;
- Warehouse receipt;
- Credit cooperatives;
- Credit associations.



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# Policies to promote SME's finance

- SME Development Strategy of Georgia 2016-2010.
- The five strategic directions outlined in the strategy:
  - Improvement of legislative and institutional framework;
  - 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.
- Institutions involved:
  - Entrepreneurship Development Agency (Enterprise Georgia);
  - The Innovation and Technology Agency (GITA);
  - Georgian Chamber of Commerce and Industry (GCCI);
  - Georgian Employers' Association (GEA);
  - Georgian Small and Medium enterprises Association.



# Recommendations – Government (1/3)

- Regulatory Impact Assessment (RIA);
- Land registration;
- Land market development;
- Insurance;
- Inclusion of financial institutions, other than commercial banks, in government programs;
- Increase financial literacy of SMEs;
- Increase awareness of SMEs about government programs;
- Promote formal relationships, such as contract farming;
- Trade (export) financing;
- Support entrance of international companies in Georgia.



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# Recommendations – Donor Organizations (2/3)

- Participation in activities in order to increase financial literacy of SMEs;
- Promotion of formal relationships, such as contract farming;
- Promote internal value chain financing schemes;
- Promote establishment of associations supporting communication between value chain participants.



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# Recommendations – Financial Institutions (3/3)

- Insurance;
- Increase awareness of SMEs about financial services and products, other than loans;
- Changes in collateral requirements.

## Recommendations - SMEs

- Improve financial reporting;
- Seek partners to create value chains.



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