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# EU Support to the Private Sector in the context of Association Agreements/DCFTAs

## Summary Report - Georgia

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## 1 INTRODUCTION

The European Neighbourhood Policy (ENP) provides a privileged relationship which promotes common EU values such as democracy and human rights, rule of law, good governance, market economy principles and sustainable development. Within the framework of this broader policy Association Agreements (AAs) incorporating Deep and Comprehensive Free Trade Areas (DCFTAs) represent a new generation FTA which provided the opportunity to negotiate regulatory and beyond-the-border issues that are not included in traditional FTAs.

Negotiations for AA/DCFTAs in Ukraine were effectively launched in 2009, followed by Moldova and Georgia in 2010. The AA, including the DCFTA, was signed between the EU and Georgia and, EU and Moldova on 27 June 2014 in Brussels. These apply provisionally as of 1 September 2014. This report details the findings of the study on EU Support to the Private Sector in the context of Association Agreements (AA) including the Deep and Comprehensive Free Trade Area (DCFTA) and covers the newly signed agreement in Georgia. It summarises the findings of the wider study on Georgia, Moldova and Ukraine. More detailed analysis can be found in the main report should be read in conjunction with this summary.

### 1.1 SME DEFINITIONS

The focus of support from the European Commission will be on small and medium enterprises (SME). Whilst during the survey and analysis stage, the EU definition will be used, it is not possible to differentiate national statistics between large firms as defined nationally, and medium firms as defined by the EU. As a consequence, throughout this report, when referring to national data, we necessarily have to use the national definition as follows:

**Table 1 Definition of SME in Georgia<sup>1</sup>**

Indicator	Employees	Turnover <sup>2</sup>
Large	>100	>€ 660,000
Medium	20-100	€ 220,000 – € 660,000
Small	<20	<€ 220,000

### 1.2 SME SECTOR IN GEORGIA

Georgia currently enjoys relatively high growth rates with average GDP growth since 2010 of 6.2% (although there was a decline in growth rate in 2013 to 3.3% compared to the high of 7.2% in 2011) and 4.8% in 2014 Forecast growth in 2015 is 2.0

In 2014, Following wholesale and retail sectors (17,4%), manufacturing is the largest sector of economic activity in the economy, representing 10,6% of GDP compared with agriculture of 9,2%. Other significant sectors are transport (7,7%), construction (7,3%), Real estate (6,0%), communications(2,9%),

<sup>1</sup> [http://geostat.ge/index.php?action=page&p\\_id=1490&lang=eng](http://geostat.ge/index.php?action=page&p_id=1490&lang=eng)

<sup>2</sup> 2014 annual average exchange rate used: 1 EUR – 2,34 GEL

**Table 2 Major sectors of the Georgian economy in 2014**

Sectors of the economy	Sector % contribution to GDP <sup>3</sup>
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	17,4
Trade	17,4
Manufacturing	10,6
Public administration	9,9
Agriculture	9,2
Transport	7,7
Construction	7,3
Real estate	6,0
Health and social work	5,7
Education	5,0
Other community, social and personal service activities	4,3

In IQ of 2015, total employment in business (excluding government) is 545,374 with 133,602 employed in wholesale and retail, 105,536 in Industry, 9,560 in agriculture, 57,340 in transport and communications and 54,211 in construction. In 2014, unemployment in Georgia is at approximately 12.4% of total labour force.

In 2014, Georgia has a significant trade deficit of €3.7 billion<sup>4</sup> (or 31% of GDP), with exports totally €2.15 billion and imports €6.46bn. The EU is Georgia's principal trading partner accounting for 21.7% of exports and 27.6% of imports.<sup>5</sup> Other trade partners include: Azerbaijan (19%), Armenia (10%), Russia (9.6%), Turkey (8.4%), United States (7.3%);Bulgaria (5.7%);Ukraine (4.9%) and; import sources Turkey (20%), China (8.5%), Azerbaijan (7.4%), Russia (6.7%), Ukraine (6.4%), Germany(5.4%); Japan (4.3%); Georgia's main exports (HS code 4 digit) are: motor cars (18.1%), ferro-alloys (10%), copper ores and concentrates (8.7%), nuts (6.4%), wine (6.3%), mineral or chemical fertilizers, nitrogenous (4.8%), waters, natural or artificial mineral and aerated waters (4.8%).<sup>6</sup> The main exports to the EU are<sup>7</sup>: Mineral fuels, oils, distillation products (31%), Ores, slag and ash (10%), Wine (30%), nuts (23%), Fruit and vegetable juices (11%), mineral waters (31%)In 2014,Exports to the EU have increased by 2% compares to the same period of 2013, and by 161.34% compared with 2009.

In 2014, Georgia's main imports (HS code 4 digit) are: Petroleum and petroleum oils (10.7%), motor cars (8.3%), petroleum gases and other gaseous (4.3%), medicaments (3,7%), telephones for cellular networks or for other wireless networks (2.3%), copper ores and concentrates (2%), Wheat (1,8%), Cigarettes (1,3%).

Table 3 shows the number of economically active enterprises by size, contribution to GDP and employment:

**Table 3 Profile of SME Sector in Georgia**

Indicator	Large	Medium	Small
No. of Enterprises (2014) <sup>8</sup>	3,593	5,427	50,539
Contribution to Output (2012) <sup>9</sup>	81%	8%	11%
Employment No.	321,185	71,199	98,715

<sup>3</sup> www.geostat.ge

<sup>4</sup> 1EUR- 1,33USD (<https://www.ecb.europa.eu/home/html/index.en.html>)

<sup>5</sup> In 2014

<sup>6</sup> In 2014

<sup>7</sup> 2013 data

<sup>8</sup> [http://www.geostat.ge/index.php?action=page&p\\_id=212&lang=eng](http://www.geostat.ge/index.php?action=page&p_id=212&lang=eng)

<sup>9</sup> [http://www.geostat.ge/index.php?action=page&p\\_id=212&lang=eng](http://www.geostat.ge/index.php?action=page&p_id=212&lang=eng)

Table 4 shows SME activity by sector and provides an indication of where SMEs participate in the economy. By value, SMEs are most active in industry/manufacturing (€348 million), real estate/business services (€145 million), wholesale/retail (€86 million and hotel/tourism (€ 78 million). By number of SMEs, the largest SME sectors are wholesale/retail, real estate and industry/manufacturing and; by employment wholesale/retail, real estate, industry/manufacturing and construction.

**Table 4 SME Activity by Sector**

	Value of Sector contributed by SMEs (€)	Contribution of SMEs to the total Sector (%)	No. of SMEs in sector	Employment in SMEs
Agriculture, hunting and forestry	106 637,37	31,9	532	4185
Fishing	3 739,61	100	71	230
Industry	2 559 265,97	13,6	5660	30566
Construction	316 949,98	14,7	3536	29464
Wholesale and retail trade; repair of motor vehicles and personal and household goods	385 470,79	22,2	19271	57615
Hotels and restaurants	162 250,32	48,1	2604	19524
Transport and communication	147 983,26	10	2314	12618
Real estate, renting and business activities	325 989,92	44,4	6372	35973
Education	31 773,17	40,5	873	11334
Health and social work	42 841,14	13	1413	12376
Community, social and personal service activities	76 868,27	11,9	1523	11507

The majority of registered SMEs are located in Tbilisi, Adjara and Imereti accounting for 75% of all SMEs in Georgia. However, it should be noted for the agricultural sector, There are 560,000<sup>10</sup> households in Georgia with at least one member being a farmer, of which it is estimated that 292,000 households sell to formal markets.<sup>11</sup> In addition, there are 680 agricultural cooperatives in Georgia.<sup>12</sup> When considering the impact on agricultural producers these should be added to the 532 registered SMEs in the agricultural sector.

**Table 5 Geographical Distribution of SMEs (number of SMEs)**

	Total	Large	Medium	Small
Tbilisi	30204	2407	3430	24367
Adjara	5513	315	576	4622
Guria	836	20	76	740
Imereti	5410	186	433	4791
Kakheti	2342	77	175	2090
Mtsketa-Mtianeti	670	41	57	572
Racha-Lachkhumi/Kvemo Svaneti	360	5	34	321
Samegreli-Zemo Svaneti	2866	142	286	2438
Samckhe-Javakheti	1139	52	114	973
Qvemo Qartli	3501	167	329	3005
Shida Qartli	1832	76	196	1560

<sup>10</sup> Data from GEOSTAT(2013)

<sup>11</sup> Ibid.

<sup>12</sup> According to Agricultural Cooperatives Development Agency ([www.acda.gov.ge](http://www.acda.gov.ge))

## 2 ISSUES AND SCOPE OF IMPACT

In this study, we have focused exclusively on the provisions that will have a direct impact on the day-to-day operations of a business. This section details those provisions. It also details the gap analysis between existing legislation in country and the requirements to align to the EU acquis relevant to SMEs as detailed in the AA/DCFTA.

### 2.1 IDENTIFICATION OF KEY PROVISIONS OF THE AA/DCFTA THAT WILL AFFECT BUSINESS

Based on our audit of the AA/DCFTA and its provisions that will have a direct effect on the business administration of SMEs, the following summarises these effects.

Area of Association Agreement	Likely Impact on business	Sectors potentially affected
Money laundering/crime & corruption	Requirement for increased financial reporting/controls	All
Market access	Market opportunities in EU and cheaper imported inputs	Depending on current structure of tariffs
Approximation of TR, standards, and CA and labelling	Adaption of production and CA.	Manufactures
Approximation of SPS	Compliance with EU SPS and animal welfare standards	Agriculture Agro processing sector of manufacturing
Approximation to EU customs law (customs code)	Procedures for customs administration	All importers and exporters
Approximate on public procurement	Opportunities to bid on EU contracts	Professional services Construction Manufacturers
Area of Association Agreement	Likely Impact on business	Sectors potentially affected
Approximation relating to energy cooperation	Product standards regarding energy and labelling thereof, of products and buildings	Manufacturing Construction Real Estate Professional services
Road transport	Road and vehicle safety	Transport Wholesale/retail Manufactures (of dangerous products in particular)
Company law, corp. governance, accounting and auditing	Changes in corporate governance	All
Environment	Control of industrial pollutions and hazards (vehicle emissions waste and waste water)	Transport Manufacturing (esp chemicals) Agriculture
Health and safety	Safety and health of workers at work,, use of work equipment, personal protective equipment	All sectors Especially construction Manufacturing (esp chemicals)

## 2.2 GAP ANALYSIS

A total of 23 organisations in Georgia were interviewed comprising government ministries, departments or agencies responsible for implementation or regulation and donor projects (mainly EU funded) assisting with implementation of the acquis.

The following analysis relates specifically to articles of the AA/DCFTA that will have a **direct** effect on the operations or opportunities for business as identified in the audit. It also reflects the understanding of those interviewed rather than any new analysis undertaken by the team. The following analysis presents the findings of both interviews and review of implementation plans and strategies along the relevant areas of the AA/DCFTA.

### **Money laundering and terrorism financing and Fight against crime and corruption**

Legislative Gap	Institutional Gap
<p>To be prepared, MoUs and Cooperation Agreements with FATF, MONEYVAL, Eurojust and authorities of EU Member States.</p> <p>Developing national legislation on prevention and counteraction against money laundering and financing terrorism.</p>	<p>Establish national mechanisms for cooperation and participation in international fora.</p>

### **Market access (reduction in tariffs, export duties, TRQS and reference prices)**

Legislative Gap	Institutional Gap
<p>Changes in the legislation already is on place</p>	<p>Training of the relevant customs staff related to the changing procedures is required</p>

### **Approximation of technical regulations, standards, and conformity assessment and EU standards and labelling**

Legislative Gap	Institutional Gap
<p>Approximation of Georgian legislation to EU directives according to AA/DCFTA time-table .</p> <p>Adoption of corresponding European Standards.</p>	<p>Need to establish market well-functioning surveillance system.</p>

### **Sanitary and phyto-sanitary, animal welfare and other legislative measures**

Legislative Gap	Institutional Gap
<p>Drafting/reviewing and adopting secondary legislation, in 5 priority areas fields.</p> <p>Listing the EU sanitary and phytosanitary, animal welfare and other legislative measures that will be approximated.</p>	<p>Need to develop capacity of National Food Agency based on approximation Programme.</p> <p>Need to set-up an early warning system for the food and feed, animal health and plant health safety.</p> <p>Need to build Infrastructure and provide proper equipment for BIPs.</p>

**Customs Law (Customs Code)**

Legislative Gap	Institutional Gap
<p>EU compliant primary customs provisions were drafted and adoption is expected in 2016.</p> <p>Legislation to be prepared and adopted for IPR enforcement by Customs, Common transit procedure and Authorized Economic Operator system.</p>	<p>Strengthen risk based customs control systems.</p> <p>Strengthening and further improvement of procedures for enforcement of IPR are needed</p>

**Approximation of legislation to the relevant EU acquis on public procurement**

Legislative Gap	Institutional Gap
<p>Repealing public procurement legislation to companies operating in utilities sector within the timeframes defined by the Annex XVI-B of AA/DCFTA</p>	<p>Strengthening capacity of procuring entities (Tender Committees and procurement officers)</p>

**Legislative and Institutional Gap on Enforcement of use of GIs**

Legislative Gap	Institutional Gap
<p>All necessary changes to the Law on appellations of origin and Geographical Indications of Goods, adopted in 1999.</p>	<p>Strengthening GI control system is required.</p>

**Approximation of legislation relevant relating to energy cooperation**

Legislative Gap	Institutional Gap
<p>Partially adopted legislation but still need to amend the law on 'Safety and Free Movement of Goods.</p>	<p>The requirements of already adopted legislation are not implemented.</p> <p>There are no available service providers able to conduct energy audits.</p>

**Approximation of legislation relevant relating to GMO monitoring**

	Institutional Gap
<p>Need to approximate legislation on GMO issues (plan to be submitted six months after EIF along with SPS)</p>	<p>There is no sufficient capacity or authorities for control of GMOs.</p>

**Approximation of legislation relevant relating to Road Transport**

Legislative Gap	Institutional Gap
Need to amend the Law on 'Safety Movement on Road Transport' and	Currently 22 accredited CAT testing centres operating but capacities of car testing centres need to be strengthen with modern system of management and monitoring. Also, a need to strengthen the existing controlling and audit structures.

**Approximation of legislation relevant relating to Company law, corporate governance, accounting and auditing**

Legislative Gap	Institutional Gap
The Law on Entrepreneurship and the Tax Code will need amending.	Develop administrative capacity of relevant state institutions.

**Approximation of legislation relevant relating to Environment**

**Legislative and Institutional Gap on Environment**

Legislative Gap	Institutional Gap
Continued harmonization of legislation.	Establishment of a new forest monitoring system.

**Approximation of legislation relevant relating to Health and Safety**

Legislative Gap	Institutional Gap
Legislation on safety and health of workers at work, minimum safety and health requirements for the workplace should be elaborated. Secondary legislation will then need to be prepared to enact the legislation.	Need to strengthen capacities of state bodies monitoring health and safety requirements.

### 3 SURVEY RESULTS

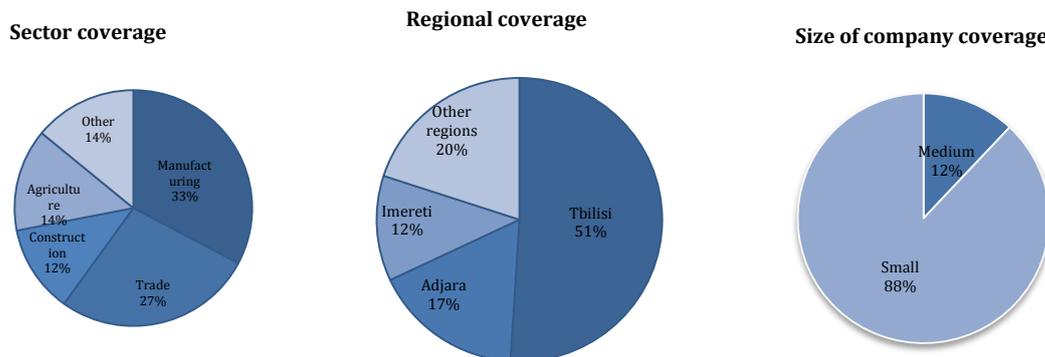
The following section presents the highlights of 3 surveys undertaken under this study: of SMEs, Business Support Organisations and Financial Institutions More details are provided in the Appendix to this report. This presents the results and should be used for reference only. An analysis of the implications of these results are presented in section 4 of this report.

#### 3.1 SME SURVEY RESULTS

##### Scope and Coverage of Survey

The SME survey was undertaken between October and December 2014 and 521 SMEs were surveyed.

A profile of the respondents is provided by sector, regional and size, as well as a breakdown of those currently exporting:



##### General Business Environment

###### **Top 5 Constraints Perceived by SMEs Surveyed**

- Cost of finance
- Availability of finance (willingness to lend)
- Tax rates
- Practices of competitors in the informal sector
- competition with large firms

##### Opportunities under the AA/DCFTA

###### **Firms who can sell or want to sell to EU**

- 27 %of the surveyed firms estimate that they can sell to EU now.
- 49% of the surveyed firms expressed their wish to sell to EU.

###### **Market Access to the EU market**

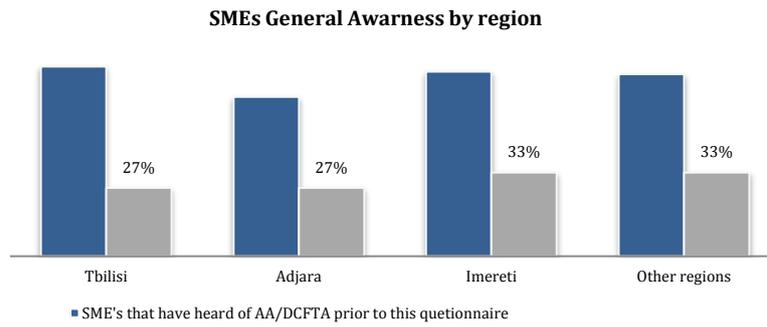
- There is very little knowledge amongst those that were surveyed of how to access the EU market and where to obtain information with less than 10% having the knowledge.
- Around 20% knew how to find information on exporting to the EU.

##### Understanding of the changes from implementation of the AA/DCFTA

###### **General Awareness of the AA/DCFTA**

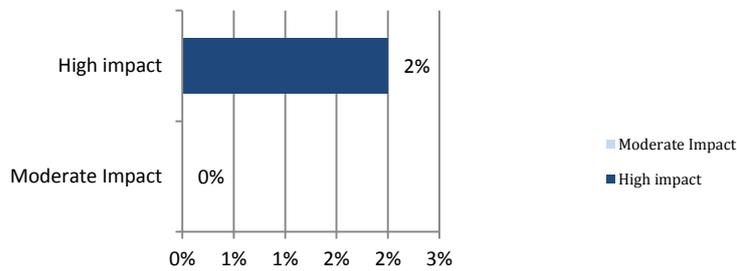
- 72%of the surveyed SME's heard of AA/DCFTA prior to the Questionnaire
- 30% of the surveyed SMEs thing that AA/ DCFTA will have an impact on all business in country

## Awareness of AA/DCFTA by Region

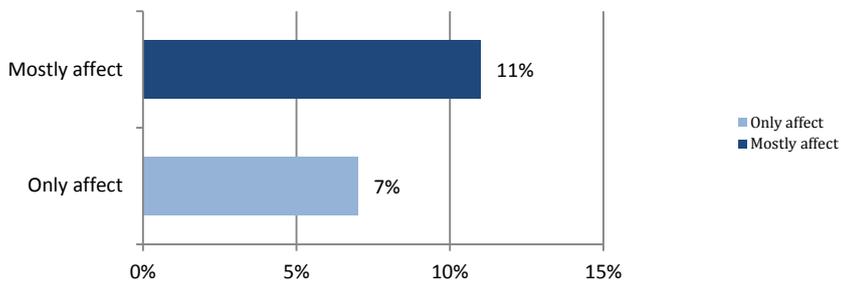


## Impact of AA/DCFTA on SMEs

### SMEs who think that AA/DCFTA will only or mostly affect only those exporting to the EU



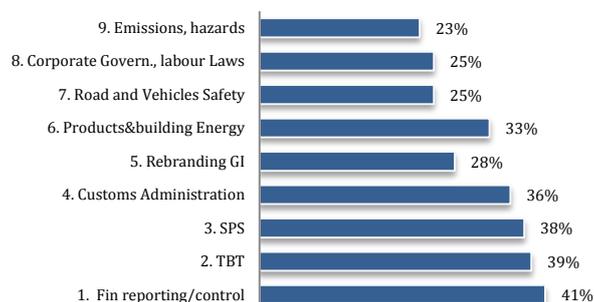
### SMEs who think that AA/DCFTA will only or mostly affect only those exporting to the EU



SMEs do not think that their business will be affected with very little impact as only 2% of the respondents think that they might be affected.

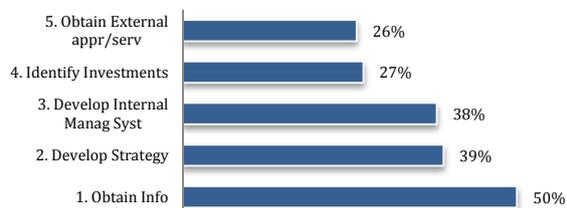
## Specific knowledge of Changes amongst SMEs

### SMEs that understand the changes to their business in specific areas

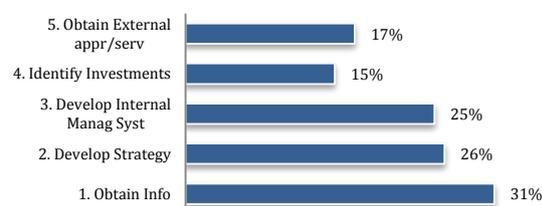


## Availability of resources for compliance with AA/DCFTA

### SMEs that have internal resources to make necessary changes



### SMEs that have financial resources to make necessary changes



### SMEs that can access external financial resources to make necessary changes



Around one third of SMEs stated they have the internal resources to manage the necessary changes to their business resulting from the AA/DCFTA, although only one quarter thought they would be able to manage identifications of investment and managing external certifications compared to 50% who could manage the identification of required information.

Around 25% of firms stated they would be able to fund changes from internal finances and a further 7% thought they could obtain external finance. Therefore, only 32% of SMEs stated they could finance the required changes resulting from the AA/DCFTA changes.

Similarly, around one third of firms thought that they would be able to access external finance to make necessary changes. This means that for example, around 50% of SMEs believe they can fund any necessary investments from own finance or loans.

## 3.2 SURVEY OF BUSINESS SUPPORT ORGANISATIONS AND BUSINESS SUPPORT PROJECTS

### Scope and coverage

A total of 63 organisations supporting SME development across the 3 countries were interviewed to gather data and information, these including 13 Ministries and state organisations responsible for

business support, 34 business support projects (BSPs), 3 think tanks focussing on SME needs and 14 business support organisations (BSOs).

**Table 6 Breakdown of BSOs and BSPs Surveyed**

	Georgia
Ministries Responsible for SME Development	3
State Business Support Institutions	2
Business Support Projects and Donors	10
Business Support Organisations	6
Think Tanks	1
	<b>22</b>

### **Awareness of the AA/DCFTA**

#### **Awareness of AA/DCFTA requirements/opportunities amongst BSOs interviewed**

- DCFTA is a popular topic, but the overall awareness, in particular in view of implications of DCFTA on firms is rather low
- SMEs are little aware of the implications of DCFTA on their firms, but export, export-ready and “better-off” firms in all countries are quite well aware
- SMEs are not really aware of how to benefit from DCFTA
- The awareness on DCFTA also differs between sectors; e.g. IT and manufacturing firms are better aware than most of the agricultural firms except for firms from the wine sector who are quite well aware
- the Government has taken steps to inform people on DCFTA, e.g. via web sites, awareness seminars/meetings (including regions)

#### **Management and marketing capacities of SMEs to comply/benefit DCFTA**

- In general, management and marketing skills are considered to be low.
- Many firms are not aware of what needs to be done to comply with DCFTA
- Export and export-ready firms in all countries possess the necessary skills to comply with DCFTA

#### **Technical capacities of SMEs to comply/benefit DCFTA**

- Technical capacities are better developed than the managerial and marketing ones, but still considered to have room for improvement
- Exporting, export-ready and “better-off” firms usually have better technical knowledge to comply with DCFTA than SMEs

#### **Financial capacities of SMEs to comply/benefit DCFTA**

- It is expected that compliance with DCFTA will require a lot of funds
- Many firms have difficulties to quantify their financial needs as they are not aware of the requirements for adapting to DCFTA
- Access to finance is difficult as interest rates are considered high; in all countries collaterals are an issue and prices for loans are considered too high
- Liquidity for SME lending is said to be no problem but banks mention a lack of bankable projects due to the lack of financial literacy and business planning skills
- Lending is the most used financial instrument; leasing and factoring is available, but trade finance is usually not used by SMEs; the demand for any other instrument than lending is low.
- SME lending is heavily collateralized
- Long-term local currency lending is practically not available for SMEs

- Similarly, significant efforts and creativity are often required to identify and exploit support mechanisms available for DCFTA implementation at the firm level.

### **Available support for AA/DCFTA Compliance and realising opportunities**

#### **Capacity to support SMEs in AA/DCFTA compliance and realising opportunities**

- BSOs have no capacities to offer services on DCFTA
- capacities seem to be concentrated in the capital cities with limited outreach to remote areas
- there seem to be international chambers leading the DCFTA process, but not really reaching SMEs
- there are some State Agencies, such as the Export Promotion Agency, the National Food Agency and the Enterprise Development Agency intending to offer services to SMEs on DCFTA with capacities to be developed

#### **Available services for AA/DCFTA compliance (e.g. for testing, certifying, auditing)**

- there are some facilities for testing and certification, but with limited capacities; only a few of them are internationally accredited
- there are State labs and a limited number of private labs, which are competing with each other
- many facilities are outdated and need upgrading and improvement
- international donors are supporting the setting up of testing and certification bodies
- There is a competition between State and private labs

### **3.3 SURVEY OF FINANCIAL INSTITUTIONS**

#### **Scope and coverage**

A survey of 5 financial institutions was undertaken in Georgia as well as interviews with EBRD and EIB.

#### **Major challenges in lending to SMEs**

##### **General Lending Environment**

- SME lending is an attractive market for banks, but it is difficult to find clients able to prepare bankable projects;
- banks considered themselves as “partners of SMEs”
- There is no real liquidity problem within banks for SME lending
- Financial literacy is low
- there is a lack of demand for SME lending noted by the banks
- Costs of loans are considered too high
- Many SMEs lack knowledge on banking products and do not understand the logic (and needs) of the banks
- Long-term, local currency loans are a problem
- In general, banks are rather risk-adverse and conservative in SME lending

##### **Loan Applications**

- Banks are supporting SMEs to prepare loan applications, but banks are complaining that the financials of most firms are sub-optimal and not well structured or opaque
- MFIs have less sophisticated loan applications than banks; often loan officers visit firms to prepare the loan application with the clients together on-site.
- Microfinance is done in many banks via retail banking; there are several MFIs active on the market

##### **Realisation of Collaterals**

- Georgia has a very bank-friendly legislation
- Credits are heavily collateralized.
- collaterals can be recovered with the help of the National Bureau of Enforcement, but difficult cases will require a court involvement;
- most costs from realization of collaterals can be recovered

- there is a buyer's market for collaterals, which makes the selling of collaterals difficult for banks
- The recovery via court systems is very time consuming in all countries (between 6-12 months)

### **Loan Performance**

- The overall NPL rate of banks are reported at between less than 1% to 3.9 NPL rates of smaller firms are lower than bigger firms as one default loan of millions of USD can bring down the NPL of a bank substantially;
- MFI NPL rates are much lower than NPL rates of banks
- The interest rate at banks ranges between 10-15% (many firms with good projects can get loans for less than 10%).
- MFIs charge from 12% up to 30%

### **Awareness of AA/DCFTA**

#### **Awareness of AA/DCFTA amongst Financial Institutions (FIs)**

- knowledge on DCFTA among financial institutions is rather limited
- some banks are aware that DCFTA will be a topic for SMEs – providing business opportunities – but the overall knowledge even in these banks remains rather limited
- banks and MFIs would be interested to receive further training on DCFTA as many of them have realized that there are a lot of opportunities upcoming for financial institutions

#### **Awareness of AA/DCFTA amongst SMEs**

- All financial institutions consider that the awareness, knowledge and management, technical and financial capacities of SMEs with respect to DCFTA are rather limited

#### **Support from FIs to SMEs on AA/DCFTA implementation**

- Most of the FIs were not really aware of DCFTA and its implication on firms; however, some of the banks conduct information and awareness creation events on DCFTA using external expertise;
- All banks interviewed in all countries would like to see some training on DCFTA for FIs.

## **4 MAIN FINDINGS**

### **4.1 NEEDS OF SMES TO COMPLY WITH CHANGING BUSINESS RULES DURING AA/DCFTA IMPLEMENTATION**

#### **Lack of Awareness of the Impact of the AA/DCFTA on business**

The scale of the tasks facing small and medium sized business in Georgia in order to both take advantage of the opportunities and to comply with the national reforms resulting from implementation of the AA/DCFTA cannot be underestimated. There are eleven areas of the AA/DCFTA that will have a direct impact on the operations of business, implementing over 500 new EU directives and introducing over 500 new harmonised standards. These will affect the majority of SMEs including the 170,000 economically active registered SMEs, 260,000 households estimated to be selling to formal agricultural markets and 580 agricultural cooperatives.

Moreover, the current level of knowledge and understanding of the changes required is little known within the country with only 72% of SMEs surveyed, having even heard of the AA/DCFTA, and only 30% of these believing that it will actually impact their business (no significant difference was observed across the various regions of Georgia). Therefore, the basic need is for the Government and donors to increase the general awareness amongst business of the AA/DCFTA. It should be recognised that efforts have been made over recent years to inform business and there have been a plethora of seminars relating to the AA/DCFTA provided by the Government, BSOs and donors. However, the survey of BSOs, donors, donor support projects and Government Ministries, Departments and Agencies highlighted a lack of knowledge and understanding of the actual impact of the AA/DCFTA which has been reflected in the lack of focus on the concrete effects on business noticeable during previous rounds of events and aforementioned seminars; they tend to concentrate on the overall benefits of integration with the Single European Market, rather than actual changes that will arise. Similar attitude is noticeable within government Ministries and Donor Support programmes for implementation of specific aspects of the AA/DCFTA, which tend to focus on regulatory compliance rather than on communicating and supporting business to adapt to the new reforms.

#### **Lack of knowledge of the scope and coverage of the changes to business operations**

There is a general lack of understanding of the scope of changes that will affect business. Of the SMEs surveyed, 18% stated that any changes under the AA/DCFTA would only or mostly affect exporters and only 2% thought that any impact on all SMEs would be high. Only around 33% of SMEs stated that they understood the changes that would arise from the AA/DCFTA across the various sectors, with the highest level, 41% of SMEs stating an understanding on changes to financial reporting requirements and lowest understanding, only 23% stating they understood the emissions and environmental requirements for business arising from legislative changes in implementation of the AA/DCFTA. It should be noted that these figures probably overestimate the actual understanding as for some firms interviewed, although they stated they understood, clearly did not.

#### **The needs of SMEs to take advantage of the provisions of the AA/DCFTA**

The majority of SMEs surveyed want to export to the EU, but only 27% of SMEs believe the AA/DCFTA provides business with an opportunity. In terms of SMEs by sector that want to export to the EU, the predominance is amongst agricultural producers.

However, there is a lack of knowledge amongst SMEs as to the changes in market access under the DCFTA, with only 21% of SMEs stating they know, or know where to obtain information on, exporting to the EU.

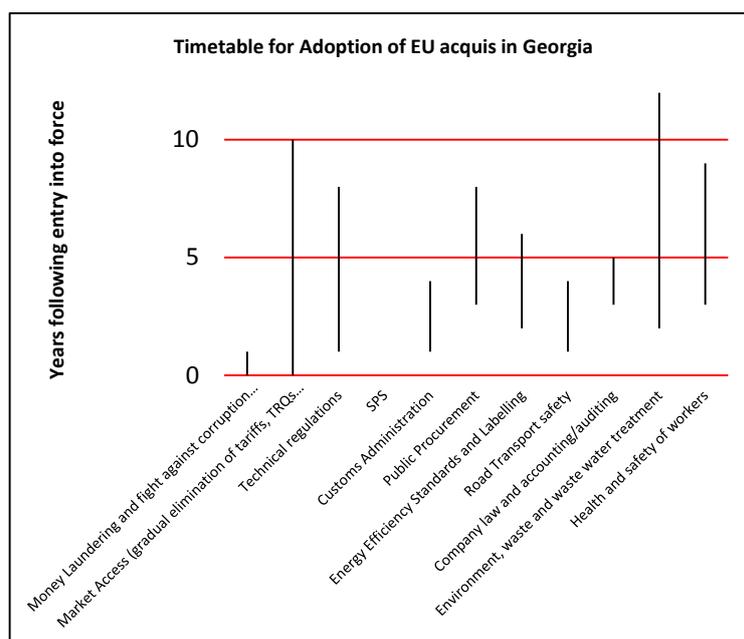
SMEs do not have the technical capacity to understand requirements with limited knowledge and understanding of where to find information on exporting and EU tender opportunities with only 5% of SMEs stating they know where to find information.

#### 4.2 SCALE AND SCOPE OF CHANGES

Not all areas will affect all business in the same way. There will be varying levels of scale of changes required, levels of investment and timing.

##### Timetable for adoption of the EU Acquis directly affecting business

It is important to recognise that implementation of the AA/DCFTA will be over a 10-12 year period and therefore, within each strategy it is necessary to prioritise not only sectors that are prominent in each country and will be affected most, but according to the timeframe for implementation.



**Note:** The timetable for adoption of regulations on SPS has yet to be determined and is in preparation by the Government of Georgia

The timetable indicates that initially (years 1-3), most of the changes affecting SMEs will focus on financial reporting (for money laundering and fight against corruption purposes), market access changes, changes in customs administration and adoption of road safety requirements and technical regulations. In the medium term (4-8 years), further adoption of technical regulations and adoption of energy efficiency regulations, environment and health and safety at the workplace.

##### Scope of changes for SMEs

Moreover, some of the changes that will affect business will not be too onerous, nor require high levels of investment.

Those areas that will require little investment will be:

- Money Laundering, Terrorism Financing and Fight Against Crime and Corruption: will lead to increased record keeping of financial transactions. The effect on SMEs will imply allocation of internal human resources to improve accounting and reporting of finances within the business, training, use of external BDS (accountants/book keepers) and some very minimal investment perhaps in accounting software, largely OTS packages.
- Market Access (reduction in tariffs, export duties, TRQS and reference prices): will mean that exporters will see administrative changes on issuance and confirmation of compliance with

rules of origin (EUR 1 certification by Customs). Whilst this will affect logistics management, it will not require any investment.

- Gradual Approximation to the Union's Customs Law (Customs Code) and some International Law, as well as the EU Law on Customs Enforcement of IPR: all importers and exporters will have to work with new customs procedures and rules. Again, whilst this will affect logistics management, it will not require any investment.
- Approximate National Legislation to the Relevant EU acquis on Public Procurement: developing open and transparent systems for government tendering will provide opportunities for SMEs to supply and work on government contracts. In order to do so, SMEs will need to understand the rules, monitor publications and exercise rights (transparency and disputes). This will not require investment.
- Company Law, Corporate Governance, Accounting and Auditing: largely this relates to the adoption of international standards on accounting practices, record keeping and financial reporting. For SMEs, improved accounting and reporting of finances within the business, training, use of external BDS (accountants/book keepers) and some very minimal investment perhaps in accounting software, largely OTS packages.
- Employment, Social Policy and Equal Opportunities: largely this relates to health and safety of workers and requires procedures put in place, signage and a small amount of investment in safety equipment but this would be small purchases of personal protective equipment such as safety shoes and fluorescent jackets.

Those areas that will require higher levels of investment will be:

- Approximation of Technical Regulations, Standards, and Conformity Assessment and EU Standards and Labelling: compliance with one or more technical regulations will require understanding of the requirements (key characteristics), review of available standards that confer presumption of conformity, product redesign and adaption of production processes, industrial metrology, testing and analysis, certification of conformity assessment. To comply with these technical regulations and associated standards, SMEs may need (depending on the product) to invest in new technologies and equipment. In addition, some SMEs will have to either purchase testing equipment or outsource testing to laboratories, as well as certification to designated conformity assessment bodies. This will apply to domestic production as well as imported products for distribution and sale domestically).
- Gradual Approximation of Sanitary and Phytosanitary, Animal Welfare and Other Legislative Measures: Compliance with EU SPS measures nationally will mean agricultural producers and agro processors will need to comply with risk, hygiene and food safety standards. This will involve understanding requirements, putting controls in place, testing and monitoring throughout production and in batches and certification and external approvals. It will also mean checking standards throughout the supply chain and verifying compliance of suppliers (farm to fork). This will affect record keeping, production processes and hygiene (procedures, training and facilities) as well as in-house or external testing and control verification. This will require investments in both facilities (adapting buildings, product & production quality and standards) and technologies and equipment.
- Road Transport: adopting EU road safety acquis will affect any business that operates commercial vehicles and transport of goods, whether logistics/transport firms or producers with own vehicles. Compliance with road safety provisions will include regular testing of roadworthiness, maintenance records and procedures. For commercial transporters, either having weigh bridges or access to external facilities would be required as well investments and retro fitting of required equipment such as speed limiters, driving log meters, GPS systems etc.).
- Approximation Relating to Energy Efficiency: compliance with legislation on energy efficiency and labelling of buildings and household goods would require manufacturers of household goods and building materials to adapt production, to measure and rate products for energy efficiency and certify such. Investments would be needed in new equipment and technologies for manufacturers, as well as testing facilities; building materials manufacturers may also require new technologies and equipment although this applies only to new buildings.
- Environmental Protection: compliance with air quality and waste management (including waste water) directives will require SMEs that are involved in sectors that produce potentially hazardous waste to understand requirements, monitor waste and install systems to control, limit and treat their commercial waste, or have it disposed of by external commercial providers. This may require investments in monitoring and treatment facilities and equipment.

### **4.3 RESOURCES AND CAPACITY TO ADAPT AND COMPLY WITH THE REQUIREMENTS OF THE AA/DCFTA**

#### **Resources of SMEs**

SMEs do not have the resources to comply with AA/DCFTA requirements with around 40% of firms with internal capacity to manage and implement the necessary changes resulting from implementation of the AA/DCFTA. Although it is likely that firms have under-estimated the complexity of the changes necessary and these figures are therefore overstated.

Based on case studies and experiences of other countries there are 5 generic steps which SMEs will need to undertake to comply with, or take advantage of, the AA/DCFTA:

- Step 1: Information and knowledge of changes required
- Step 2: Strategy for implementation and compliance
- Step 3: Internal management and process changes
- Step 4: Investment in plant and equipment
- Step 5: External certification (as necessary)

Whilst 50% of SMEs stated they had internal capacity to obtain information and knowledge, only around 39% stated they would be able to develop the necessary strategy, 38% make management changes, 27% identify investments needed and 26% be able to qualify for external certification. This identifies a big gap for BSOs to provide support to SMEs.

Moreover, these SMEs stated that even with capacity, they do not have their own financial resources nor can they obtain external finance for these steps with 31% stating they had financial resources for obtaining information, 25% for developing a strategy and making management changes and 16% for necessary investments and external certifications. Only 6-7% of SMEs believe they will be able to obtain financial resources to fund these steps. Again, there is a needed role to provide such funding.

#### **Capacity of BSOs**

Notwithstanding the need identified above for BSOs to provide business development services to SMEs to support compliance with AA/DCFTA requirements, the ability and capacity of existing BSOs (public and private sector), government departments and donor SME support programmes is limited and needs to be strengthened.

Few SMEs (only 9% of those surveyed) use business development services and of those using BDS, 42% were unsatisfied with the services provided, 42% wanted a broader range of services and 56% think such services are unaffordable.

There are few BSOs with knowledge of AA/DCFTA in both the private and public sector. The BDS market is very weak and concentration of both governments and donors is in legal compliance and none of the actors has so far been seriously involved with ensuring SMEs are supported.

#### **Finance**

External finance to fund compliance with the AA/DCFTA and taking advantage of the opportunities is an extremely important factor identified above. The majority of firms (57% of those surveyed) had experience of obtaining loans from financial institutions and only 38% reported these loans were difficult to obtain, but 67% reported the interest rate was unaffordable and most financial institutions report that SMEs have inadequate financial literacy.

#### **General Constraints to Business**

It should be borne in mind that the general business and finance environment will affect the ability of SMEs to comply, as well as affecting their ability to survive and develop in the short to medium term. Whilst we do not address these factors in this report (as we concentrate on direct effects of AA/DCFTA) these should be addressed within the wider PSD development framework. These include:

- SMEs face major constraints: Cost and access to finance; Taxation rates and drawback; Geopolitical instability caused by Russia,;
- Finance and enforcement of new regulations by government were cited by BSOs as a concern in all countries for compliance with AA/DCFTA. Other constraints listed by SMEs, BSOs and FIs were not related to the business environment but rather BDS such as availability of information on AA/DCFTA.

## **5 RECOMMENDATIONS**

The scale of the task for SMEs to understand the changes resulting from AA/DCFTA compliance and to adapt their administration procedures, production processes and facilities cannot be underestimated. In order that business in each of the countries can be better prepared to comply with changing national legislation, as well as take advantage of the opportunities, a full range of support and “hand holding” is required through a comprehensive programme of targeted and very specific support. The following summarises the recommendations. Full details of these are elaborated in the main report.

### **STRATEGY 1: AWARENESS**

To improve the understanding of the actual effects of the AA/DCFTA on business and the opportunities it provides. Current and future planned awareness across all countries is based on high level political statements rather than concrete information, so all information in this programme will be specifically oriented to business.

Awareness of AA/DCFTA to business must be more than current “headline” approach and be specific as to the ‘effects’ (as well as impact) on SMEs business operations. The specific objectives will be:

- to ensure that all SMEs understand how the agreements affect business;
- to stimulate SMEs to consider and incorporate AA/DCFTA implications into their corporate planning;
- to ensure FIs and BSOs understand the needs of SMEs;
- to encourage government broaden communication on changes to business.

In order to achieve these objectives, the following programmes could be developed in each country:

1. National Business Awareness Campaign
2. Outreach Programme for and through Financial Institutions, BSOs and Government MDAs (Ministries, Departments and Agencies)

### **STRATEGY 2: KNOW HOW**

The overall objective of this strategy is to enable SMEs to comply with the requirements of the AA/DCFTA as they are adopted nationally and take advantage of the opportunities it provides. To provide SMEs with assistance and tools to make all the necessary changes within their business operations to enable them to adapt and prepare for the AA/DCFTA.

The specific objectives of this strategy will be:

- Increase the cadre of skills and knowledge of how to operate and adapt business under the AA/DCFTA
- To create and make available adequate and available BDS for AA/DCFTA compliance

In order to achieve these objectives, the following programmes could be developed in each country:

1. Availability of BDS for AA/DCFTA strategy and planning
2. Thematic Specific BDS (new and existing)
3. Business Linkages Approach
4. Establishment of National AA/DCFTA Centre (creator and keeper of knowledge)

### **STRATEGY 3: INVESTMENT FINANCE**

The changes that will occur as a result of implementation of the AA/DCFTA, as well as taking advantage of the opportunities, will require investments. However, not all these changes will affect all businesses, not all will apply to all sectors and not all will require financial investment. Therefore, the objective of the AA/DCFTA financial strategy is to fund activities and investments targeted to those enterprises that will be most affected so as to enable them to comply and take advantage. These

recommendations relate exclusively to the financing needs for compliance with AA/DCFTA requirements. However, as detailed in the analysis, there are a number of underlying access to finance issues that need to be addressed in parallel including financial literacy, systems for realisation of collateral, cost of finance and local currency lending, amongst others. Without such actions, the reach and effect of these other suggestions will be limited (for example, access to finance is limited by financial literacy of SMEs, so unless this is addressed, SMEs will not be able to access the suggested facilities).

The general approach to providing finance to SMEs to assist in compliance with the requirements arising from national implementation of the AA/DCFTA must have the following considerations:

- SMEs in Georgia need investment for upgrading to meet market requirements and to ensure competitiveness. Whilst this investment is needed, it is not necessarily linked to the needs arising from compliance with the rules to be adopted as a result of the AA/DCFTA. Therefore, it is important that the facilities offered provide a direct link to effects of AA/DCFTA compliance.
- It should be recognised that the focus should not just be on compliance but for taking advantage of the resulting opportunities. So although existing exporters already comply with the EU acquis, facilities should also be made available to potential exporters to the EU. Therefore, the principle focus should be on SMEs supplying structured domestic markets and potential exporters.

In order to achieve these objectives, the following programmes could be developed in Georgia:

- Credit Lines for compliance with technical regulations and SPS measures
- Credit Lines for Approved Technologies for transport, energy efficiency and environmental protection
- Credit Lines for Equipment for testing

#### **STRATEGY 4: SUPPORTING CERTIFICATION AND APPROVALS**

Adoption of EU legislation in each of the 3 countries under the AA/DCFTA or compliance with EU requirements in order to export, necessitate changes in businesses operations and processes. SMEs will not only be required to adapt but must also verify those changes through verification systems such as inspection by national authorities or independent certification and approvals. However, the availability and cost of certification is often a major constraint to growth and compliance and will be addressed within Strategy 4.

The specific objectives of this strategy will be:

- to ensure that certification and approval processes do not become a barrier to compliance with national legislation adopted within the context of AA/DCFTA implementation or access to the EU market;
- to reduce the cost of certification for SMEs;
- to improve access to competitive market for certification and approvals.

It should be noted that the development of the required quality infrastructure in each country for compliance approvals is necessary for implementation of the commitments under the AA/DCFTA. However, it is considered that this role will be undertaken within other programmes such as EU legal approximation and thematic programmes. Therefore, the activities within this strategy focus on “access” to the required quality infrastructure, not creating or strengthening the existing or planned structures.

In order to achieve these objectives, the following programmes could be developed in each country:

1. Financing Certification Costs
2. Facilitating Access to Certification Bodies

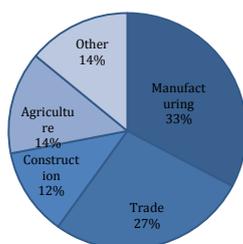
## Appendix 1: SME Survey Results

### Scope and Coverage of Survey

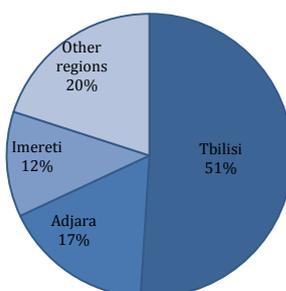
The SME survey was undertaken between October and December 2014 and 521 SMEs were surveyed.

A profile of the respondents is provided by sector, regional and size, as well as a breakdown of those currently exporting:

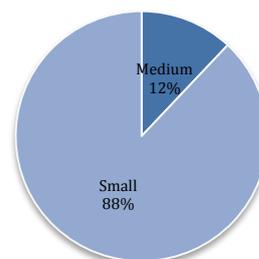
**Sector coverage**



**Regional coverage**



**Size of company coverage**



### General Business Environment

#### **Top 5 Constraints Perceived by SMEs Surveyed**

- Cost of finance
- Availability of finance (willingness to lend)
- Tax rates
- Practices of competitors in the informal sector
- Monopoly power anti competition of large firms

#### **Views on Business Prospects**

- 53% of firms surveyed think they can grow in the current business climate
- 25% of the surveyed firms state they are able to invest in the current climate

### Opportunities under the AA/DCFTA

#### **Firms who can sell or want to sell to EU**

- 27 %of the surveyed firms estimate that they can sell to EU now.
- 49% of the surveyed firms expressed their wish to sell to EU.

#### **Market Access to the EU market**

- There is very little knowledge amongst those that were surveyed of how to access the EU market and where to obtain information with less than 10% having the knowledge.
- Around 20% knew how to find information on exporting to the EU.

#### **Understanding of the Changes to EU market access under the DCFTA**

There was little understanding amongst those surveyed of the changes in market access resulting from the DCFTA:

- 11% knew about the changes affecting tariffs;
- 5% about TRQ's; and
- Only 8% about Certificates of Origin.

#### **Preparedness of SMEs for changes under AA/DCFTA**

Although the vast majority of SMEs surveyed intend to develop a marketing plan to access the EU market, few believe they have the internal resources or can gain access to external resources to implement it properly.

- 70% of the surveyed companies stated they will develop a marketing plan to access the EU Market;
- 37% confirmed they have access to external financial to implement the plan; and
- 45% stated they have internal resources to implement it.

The reported support needed to implement an EU marketing strategy: grants; liberalisation of legislation; financial assistance; information on EU tariffs and quotas and how to export in the EU; contacts.

### Opportunities to Participate in EU Government Tenders

There is reasonable knowledge of the EU public procurement opportunities with SMEs interested in participating in tenders. However, there is virtually no knowledge of where to get information on tender notices and the rules of tendering.

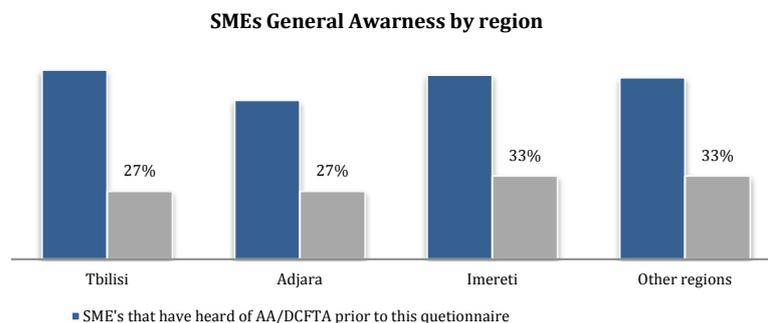
- 52% SMEs state they are aware of ability to participate in EU Government tenders;
- 17 % confirmed they interest to participate in the EU government tenders;
- 63% SMEs state they know where to find information about the rules for tendering in the EU;
- 5% SMEs surveyed know where to find information about calls for tender in EU.

### Understanding of the changes from implementation of the AA/DCFTA

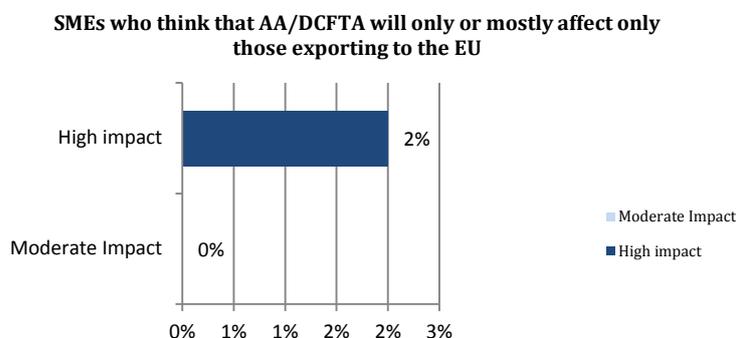
#### General Awareness of the AA/DCFTA

- 72%of the surveyed SME's heard of AA/DCFTA prior to the Questionnaire
- 30% of the surveyed SMEs thing that AA/ DCFTA will have an impact on all business in country

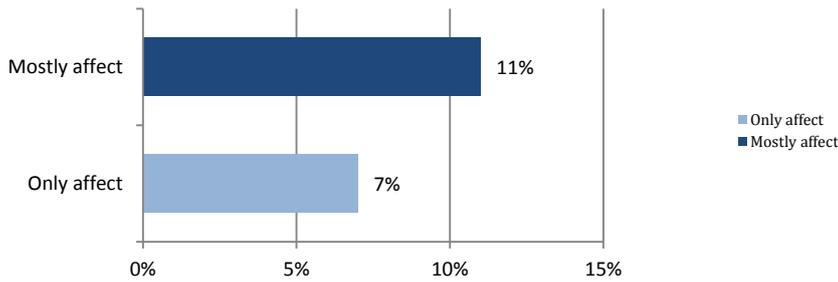
#### Awareness of AA/DCFTA by Region



#### Impact of AA/DCFTA on SMEs



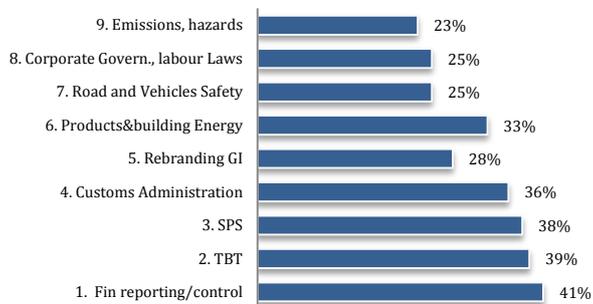
**SMEs who think that AA/DCFTA will only or mostly affect only those exporting to the EU**



SMEs do not think that their business will be affected with very little impact as only 2% of the respondents think that they might be affected.

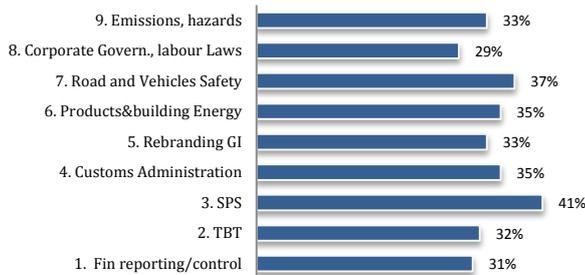
**Specific knowledge of Changes amongst SMEs**

**SMEs that understand the changes to their business in specific areas**



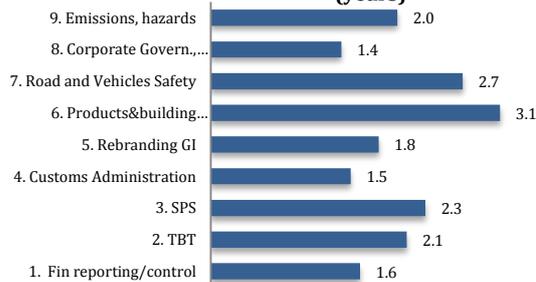
**Business who know where to find information on each area affected**

**Level of understanding of the changes required in areas affected**



**Timetable for adoption of EU acquis**

**SMEs view on timetable to become national legislation (years)**

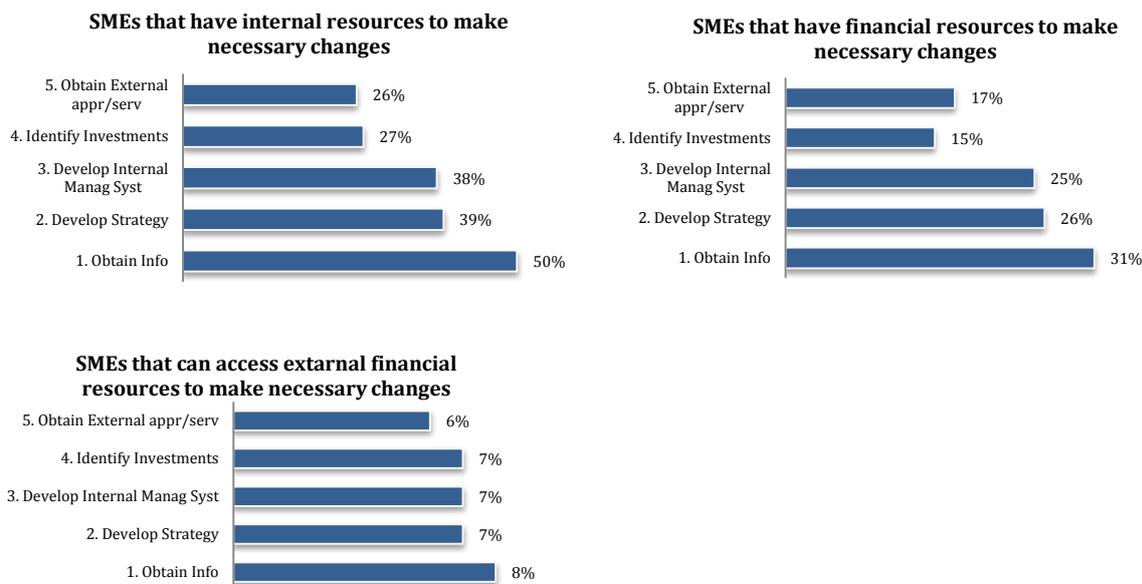


In general, SMEs have only very general and poor knowledge of the time table for the implementation of the legislation.

Most of the respondents didn't know the answer to this question and in most cases answers were made up

**Availability of resources for compliance with AA/DCFTA**

Similarly, around one third of firms thought that they would be able to access external finance to make necessary changes. This means that for example, around 50% of SMEs believe they can fund any necessary investments from own finance or loans.



Around one third of SMEs stated they have the internal resources to manage the necessary changes to their business resulting from the AA/DCFTA, although only one quarter thought they would be able to manage identifications of investment and managing external certifications compared to 50% who could manage the identification of required information.

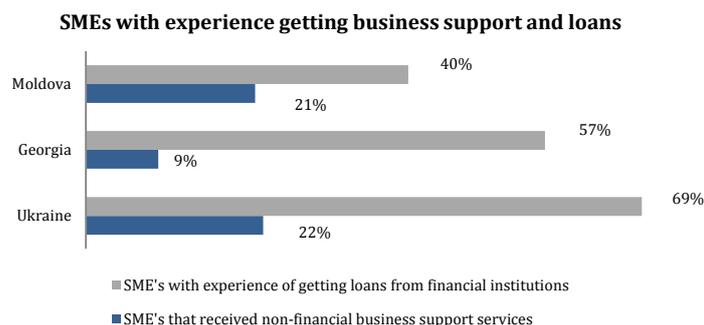
Around 25% of firms stated they would be able to fund changes from internal finances and a further 7% thought they could obtain external finance. Therefore, only 32% of SMEs stated they could finance the required changes resulting from the AA/DCFTA changes.

**Support required for compliance with AA/DCFTA**

Support suggested by Participants: Finances; Information; Training; Awareness creation, Human resources and New technologies

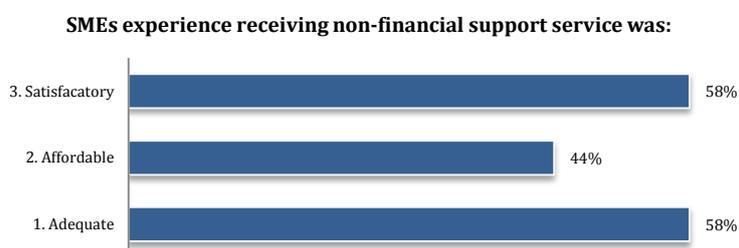
## Adequacy of available business development services

### Experience of BDS



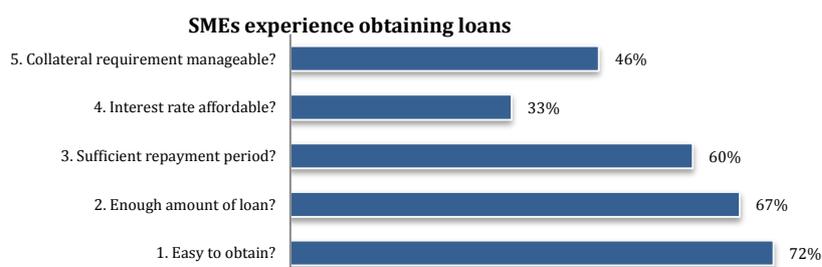
The majority of firms have received loans but few have received BDS.

### Adequacy of Business Development Services



Of those companies with experience of BDS, 58% of SMEs were satisfied with the services they received and thought that the range of BDS was adequate. Regarding cost of BDS, 44% of SMEs who received BDS thought it was affordable. However, it should be noted that the experience of using BDS was low at only 9% and so use of BDS is very small.

### Experience of loans



- In general, SMEs reported favourable experiences with lending, with 72% reporting that loans were relatively easy to obtain, two thirds reporting loans were sufficient and over a sufficient repayment period.
- SMEs reported interest rates unaffordable with around 67% of SMEs stating unaffordable interest rates.
- Collateral requirements were problematic for 54% of SMEs.

## Appendix 2: Survey of Business Support Organisations and Business Support Projects

### Scope and coverage

A total of 63 organisations supporting SME development across the 3 countries were interviewed to gather data and information, these including 13 Ministries and state organisations responsible for business support, 34 business support projects (BSPs), 3 think tanks focussing on SME needs and 14 business support organisations (BSOs).

**Table 7 Breakdown of BSOs and BSPs Surveyed**

	Georgia
Ministries Responsible for SME Development	3
State Business Support Institutions	2
Business Support Projects and Donors	10
Business Support Organisations	6
Think Tanks	1
	<b>22</b>

### Awareness of the AA/DCFTA

#### **Awareness of AA/DCFTA requirements/opportunities amongst BSOs interviewed**

- DCFTA is a popular topic, but the overall awareness, in particular in view of implications of DCFTA on firms is rather low
- SMEs are little aware of the implications of DCFTA on their firms, but export, export-ready and “better-off” firms in all countries are quite well aware
- SMEs are not really aware of how to benefit from DCFTA
- The awareness on DCFTA also differs between sectors; e.g. IT and manufacturing firms are better aware than most of the agricultural firms except for firms from the wine sector who are quite well aware
- the Government has taken steps to inform people on DCFTA, e.g. via web sites and awareness seminars (including regions)

#### **Management and marketing capacities of SMEs to comply/benefit DCFTA**

- In general, management and marketing skills are considered to be low.
- Many firms are not aware of what needs to be done to comply with DCFTA
- Export and export-ready firms in Georgia possess the necessary skills to comply with DCFTA

#### **Technical capacities of SMEs to comply/benefit DCFTA**

- Technical capacities are better developed than the managerial and marketing ones, but still considered to have room for improvement
- Exporting, export-ready and “better-off” firms usually have better technical knowledge to comply with DCFTA than SMEs

#### **Financial capacities of SMEs to comply/benefit DCFTA**

- It is expected that compliance with DCFTA will require a lot of funds
- Many firms have difficulties to quantify their financial needs as they are not aware of the requirements for adapting to DCFTA
- Access to finance is difficult as interest rates are considered high; collaterals are an issue and prices for loans are considered too high

- Liquidity for SME lending is said to be no problem but banks mention a lack of bankable projects due to the lack of financial literacy and business planning skills
- Lending is the most used financial instrument; leasing and factoring is available, but trade finance is usually not used by SMEs; the demand for any other instrument than lending is low.
- SME lending is heavily collateralized
- Long-term local currency lending is practically not available for SMEs
- Similarly, significant efforts and creativity are often required to identify and exploit support mechanisms available for DCFTA implementation at the firm level.

### **Type of support needed by SMEs to comply with AA/DCFTA**

**Table 8 Support Needs of SMEs as Perceived by BSOs Interviewed**

	Georgia	Rank
Management	1,80	1
Marketing / Labelling	3,10	4
Technology / Product Development	2,75	3
Finance (Financial Literacy)	2,35	2

The relevance of support needs is rather close, but a ranking can be made according to which, the major need for support is management, followed finance / financial literacy, technology / product development and marketing, incl. labelling.

### **The General Business Environment**

#### **Major constraints to business development**

##### **Constraints listed by all BSOs and BSPS:**

- The implementation of rules and regulations was considered sub-optimal and reform processes are considered as taking too long
- The implementation of political decisions and the institutional framework for policy implementation is considered to be problematic
- The general geo-political situation (with Russia) is considered as a major challenge for the business environment
- Some reluctance to organize in associations could be found
- The statistics related to SMEs could be improved
- Access to foreign markets was considered difficult
- Access to finance was mentioned as a major impediment for firms
- Access to innovation and new technologies, incl. technology infrastructure, was considered sub-optimal
- Business and entrepreneurial skills were said to be sub-optimal
- FDI attraction is considered sub-optimal though because of the economic situation
- Finding strategic EU partners was considered difficult
- A lack of skilled labour was mentioned
- The size of the market was considered too small
- There is no coherent SME policy in place yet, but it is currently under elaboration and state support to SMEs is operational
- There is no lobbying on Government level for SMEs
- A Georgia, a lack of competitiveness and productive logistics was stated

#### **General Business Prospects**

- Several sectors are considered as having good potential for international trade
- There are opportunities to attract foreign investment
- There are good human, natural and material resources to be exploited

- The introduction of e-governance systems is seen as positive
- It is felt that the general business environment is improving
- The general business environment was considered positive, good and corruption free facilitating doing business
- The banking system is considered good and supportive to SMEs

#### **Effect of BEE constraints on AA/DCFTA compliance (all countries)**

- There is a lack of understanding what SMEs will require to comply with DCFTA
- Access to information and knowledge on DCFTA was considered sub-optimal
- There is some fear on the investment requirements to comply with DCFTA
- There are fears that there will be tougher competition, also in the country, and that some of the less competitive firms will not survive the DCFTA harmonisation
- The adaptation to the food safety standards are considered a particular problem
- Lack of appropriate testing and certification infrastructure was noted
- Firms were traditionally targeting the Russian market and there is a fear that the EU market will have no demand for CIS products
- There is resistance among firms as it is expected that DCFTA will make doing business more expensive as there will be new rules, regulations and inspections on DCFTA compliance within the national legislation

#### **Effect of BEE constraints on opportunities under the AA/DCFTA**

- DCFTA is expected to have a positive impact on the country's competitiveness, product standards, environmental standards, food safety, etc.
- There is hope that DCFTA will bring more opportunities for SMEs and will improve firm competitiveness
- There is expectation for DCFTA to bring more export opportunities
- There is expectation that DCFTA will allow more FDI

#### **Available support for AA/DCFTA Compliance and realising opportunities**

##### **Capacity to support SMEs in AA/DCFTA compliance and realising opportunities**

- BSOs have limited capacities to offer services on DCFTA
- capacities seem to be concentrated in the capital cities with limited outreach to remote areas
- there seem to be international chambers leading the DCFTA process, but not really reaching SMEs
- there are some State Agencies, such as the, the National Food Agency and the entrepreneurship Development Agency intending to offer services to SMEs on DCFTA with capacities to be developed

##### **Available services for AA/DCFTA compliance (e.g. for testing, certifying, auditing)**

- there are some facilities for testing and certification, but with limited capacities; only a few of them are internationally accredited
- there are State labs and a limited number of private labs, which are competing with each other
- many facilities are outdated and need upgrading and improvement
- international donors are supporting the setting up of testing and certification bodies
- There is a competition between State and private labs

#### **Needed Support for AA/DCFTA compliance**

##### **Support needed to improve policy and regulatory framework**

- A basic quality system for regulatory reforms should be established
- Policy making should include Regulatory Impact Assessments for business and ex-ante assessments of policy actions
- Personnel to be trained should have capacity and long-term institutional commitment
- Stakeholder dialogue should form part of the policy making process
- Donors should coordinate actions and challenge good policy making

### **Awareness and Information Needs**

- Awareness campaign must be smart
- Information channels & materials must be appropriate
- Materials for campaigns must be easy to understand

### **Needs for improved Business Development Services and business linkages**

- Awareness must be created to make firms aware of the benefits of BDS
- A BDS market needs to be further developed and strengthened
- BSOs/BSPs need to be trained to provide first-class services
- Georgian consultants should be trained and coached by / matched with EU consultants
- Business partnering must be beneficial for all parties
- Export to EU is not yet seen as an option for many firms

### **Training Needs for AA/DCFTA compliance**

- Training should be targeted
- Local trainers should be trained and coached by EU experts
- Training should be fee-based as it works well in Georgia
- An awareness campaign on the benefits of BDS is needed
- Local, well trained trainers from established institutions should be used
- Training should be adapted to the capacity of participants
- DCFTA training program should be initiated

### **Technical Service Needs (Testing, Certification)**

- There should be more testing/certification and related facilities
- Such facilities where they already exist should be upgraded
- Facilities should be internationally accredited

### **Financial Needs for AA/DCFTA compliance and realising Opportunities**

- Training on financial literacy is needed
- There should be capacity building programs on DCFTA in banks and MFIs
- Monitoring of any grant implementation is essential to ensure sustainability
- Debt Guarantee Scheme is needed
- There should be technical assistance to support the Government to solve the systemic problems of the banking sector, incl. NBM regulations
- Grants could be matched with consulting to achieve better results
- Sustainability of grants should be carefully monitored
- Guarantee Scheme should be revised

## **Appendix 3: Survey of Financial Institutions**

### **Scope and coverage**

A survey of 5 financial institutions was undertaken in Georgia as well as interviews with EBRD and EIB.

### **Major challenges in lending to SMEs**

#### **General Lending Environment**

- SME lending is an attractive market for banks, but it is difficult to find clients able to prepare bankable projects;
- banks considered themselves as “partners of SMEs”
- There is no real liquidity problem within banks for SME lending
- Financial literacy is countries low in all
- there is a lack of demand for SME lending noted by the banks
- Costs of loans are considered too high
- Many SMEs lack knowledge on banking products and do not understand the logic (and needs) of the banks
- Long-term, local currency loans are a problem
- In general, banks are rather risk-adverse and conservative in SME lending

#### **Loan Applications**

- Banks are supporting SMEs to prepare loan applications, but banks are complaining that the financials of most firms are sub-optimal and not well structured or opaque
- MFIs have less sophisticated loan applications than banks; often loan officers visit firms to prepare the loan application with the clients together on-site.
- Microfinance is done in many banks via retail banking; there are several MFIs active on the market

#### **Realisation of Collaterals**

- Georgia has a very bank-friendly legislation
- Credits are heavily collateralized.
- collaterals can be recovered with the help of the National Bureau of Enforcement, but difficult cases will require a court involvement;
- most costs from realization of collaterals can be recovered
- there is a buyer’s market for collaterals, which makes the selling of collaterals difficult for banks
- The recovery via court systems is very time consuming (between 6-12 months)

#### **Loan Performance**

- The overall NPL rate of banks are reported at between less than 1% to 3.9 NPL rates of smaller firms are lower than bigger firms as one default loan of millions of USD can bring down the NPL of a bank substantially;
- MFI NPL rates are much lower than NPL rates of banks
- The interest rate at banks ranges between 10-15% (many firms with good projects can get loans for less than 10%).
- MFIs charge from 12% up to 30%

### **Awareness of AA/DCFTA**

#### **Awareness of AA/DCFTA amongst Financial Institutions (FIs)**

- knowledge on DCFTA among financial institutions is rather limited
- some banks are aware that DCFTA will be a topic for SMEs – providing business opportunities – but the overall knowledge even in these banks remains rather limited
- banks and MFIs would be interested to receive further training on DCFTA as many of them have realized that there are a lot of opportunities upcoming for financial institutions

### **Awareness of AA/DCFTA amongst SMEs**

- All financial institutions consider that the awareness, knowledge and management, technical and financial capacities of SMEs with respect to DCFTA are rather limited

### **Support from FIs to SMEs on AA/DCFTA implementation**

- Most of the FIs were not really aware of DCFTA and its implication on firms; however, some of the banks conduct information and awareness creation events on DCFTA using external expertise;
- All banks interviewed would like to see some training on DCFTA for FIs.

### **The General Business Environment**

#### **Major constraints to business development**

- the general geo-political situation – and the Ukrainian-Russian conflict – is considered as a major challenge for business environment
- possible political instability and possible Russian embargo are seen as problems
- the implementation of political decisions and the institutional framework for policy implementation is considered problematic
- there is room for improvement was mentioned for law enforcement
- the regulatory framework for SMEs was considered sub-optimal; , it was more the lack of SME policy as such,
- access to finance was considered a shortcoming, but often it was said that it is the access to rather than the availability of actual funds
- the size of the market is seen as a problem
- the grey economy was mentioned as problem
- the lack of business and financial skills among SMEs were often mentioned as challenging constraints
- there is no lobbying on Government level for SMEs

#### **General Business Prospects**

- it is felt that the general business environment is improving
- the general business environment was considered positive, good and corruption free facilitating doing business

#### **Effect of BEE constraints on AA/DCFTA compliance**

- it was mentioned that most of the SMEs are not yet aware of the implications of DCFTA on their firms
- it is expected that firms will have high costs expected to comply with DCFTA as a lot of investments will be required to adapt to the EU standards

#### **Effect of BEE constraints on opportunities under the AA/DCFTA**

- it is expected that DCFTA will have a positive impact on the business environment
- it is expected that DCFTA will be conducive for the modernization of the country
- it is expected that DCFTA will open new market opportunities
- it is expected that DCFTA will open firms' access to new technologies and innovations