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EESE Enabling Environment for Sustainable Enterprises

EESE Assessment of MSME trends and policies in Georgia

Georgian Employers Association

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GEORGIAN EMPLOYERS ASSOCIATION

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Foreword

The Georgian Employers Association (GEA), in line with its mandate to contribute to the development of a conducive environment for enterprises in Georgia, has called upon the ILO to assist the organization to assess the follow up analyses of the business environment in the country focusing on two specific topics – taxation system in Georgia and financing of SMEs.

The ILO commissioned a follow-up study in 2021, based on the findings of the 2016 ILO EESE assessment report, delving further into some of the priority areas identified in this first report. In particular, the follow-up study examined more in-depth major bottlenecks and possible solutions in selected policy areas (taxation and SMEs financing) which were jointly agreed by the GEA and ILO. At the same time, it was equally proposed that the follow-up study takes into account that, due to the COVID-19 pandemic, today's economic context is very different from that of 2016. As such, it was proposed that the first part of the follow-up study offer an overview of the impact of the COVID-19 pandemic on Georgian enterprises, based on existing data and surveys, as this preliminary analysis might also point to priority areas for intervention that did not come up in the previous assessment.

As in previous report, this report was developed in line with ILO methodology on the Enabling Environment for Sustainable Enterprises (EESE). For GEA, the analysis of two specific area of enabling environment provides starting point for further development of strategic documents and structured and evidence-based advocacy efforts.

This report provides an overview of the research findings of the EESE assessment. It identifies the relative strengths and weaknesses of the enabling environment for sustainable enterprises focusing on taxation system and financing of SMEs in Georgia. The purpose of the assessment is to stimulate debate and to provide an evidence base for policy reforms, leading to an environment that is more conducive to the promotion of sustainable enterprises.

This report has been written by external consultants Ricardo Arroja (taxation), Lois Stevenson (SMEs financing) and Sopho Chachanidze, national expert (Impact of COVID 19 on SMEs). It has also greatly benefited from the coordination and the technical inputs by Marco Marchese (Technical specialist, SME Enabling Environment) and Mirza Muleskovic (Technical Officer, Enterprise development) and the review from the ILO Moscow's Senior Employers' Specialist Vladimir Curovic, and Team Leader, Enabling Environ. for Sustainable Enterprises HQ ILO Severine Deboos.

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1. Introduction

The present report has been prepared by the ILO Enabling Environment for Sustainable Enterprise (EESE) Programme on request of Georgia Employers' Association (GEA), as a follow-up to the 2016 ILO EESE Assessment report of Georgia. The 2016 report had looked at main barriers and opportunities for enterprise development across a wide range of policy areas, from trade to fair competition, from access to financial services to education and training, based on an enterprise survey of 300 companies and 3 focus groups from 3 different sectors.

This report takes a more focused approach, looking closely into three policy areas which GEA flagged as priority: enterprise taxation; access to finance for micro, small and medium-sized enterprises (MSMEs); and main government incentives for enterprise development (i.e. covering business innovation and business internationalization). In addition, given the current context of the COVID-19 pandemic, the report includes an initial chapter that presents information on the impact of the pandemic on the performance of Georgian enterprises, especially MSMEs.

The methodology underlying this report has included desk research, covering both statistical and policy information; a policy questionnaire submitted to GEA to receive factual information on Georgia's main policies in the areas covered by the study; and online meetings between the ILO, on the one hand, and Georgian stakeholders and other international organizations supporting business development in Georgia, on the other.[1]

Main findings of the report

The rest of this introduction presents the main findings of the report, with more details available in the thematic chapters.

The impact of COVID-19 on Georgian enterprises

Georgia has an estimated GDP per capita of USD 4,275, which makes it an upper middle-income country in the World Bank's per capita income classification. Before the outbreak of COVID-19, Georgia was growing at a sustained pace; i.e. 5% per year between 2005 and 2019. The pandemic entailed a contraction of output by 6.1% in 2020, although the economy was expected to partially recover in 2021 (3.5%, according to IMF projections). The pandemic-induced recession has also taken a toll on employment, which dropped by 1.5% in 2020 (41%) and on unemployment, which rose by 0.9% in the same year (18.5%).

Similarly, to other countries, COVID-19 has affected Georgian enterprises through income and job losses. Companies involved in international markets have also seen demand for their products collapse and their business model questioned by supply chain disruptions. With respect to the policy response put in place by the national government to tackle the crisis, the most used measures have included tax and other payment deferrals, tax reductions and exemptions, and wage subsidies. Larger companies have benefited proportionally more than SMEs, while the informal sector, which is large in Georgia, has been largely unattended.

As emergency programmes are phased out, it will be important to encourage the adaptation of Georgian businesses, especially SMEs, to the post-COVID economy. This is likely to require greater support in the areas of digitalisation and digital skills, including the improvement of government digital services; technical assistance to overcome disruptions in supply chains; and supporting greener business models, as demand for more rigorous environmental standards become the norm in international markets.

1 Meetings took place online due to travel restrictions related to the COVID-19 pandemic during the second quarter of 2021. The full list of organizations that the ILO met is provided in Annex.

Enterprise taxation

Georgia combines an internationally competitive tax system with one that reveals robust tax capacity among countries in the Eastern Partnership region. The main tax rates are either in line or below median levels observed in the region, and yet total tax revenues amount to a relatively high share of GDP. The country is home to a flat-rate structure in personal and corporate income taxes that are closely, albeit not exactly, aligned among themselves. In doing so, growth disincentives are reduced and growth incentives are strengthened through lower tax rates applicable to capital and interest incomes.

Georgia's international competitiveness is especially noticeable in the domain of corporate income taxation, or the profit tax as it is known in Georgia. The profit tax framework, which came into effect in 2017 and is characterised by a flat 15% tax rate, follows the Estonian model of corporate taxation, whereby non-distributed earnings go entirely untaxed contributing to healthier balance sheets.

In recent years, tax policy in Georgia has also targeted economic informality. In the process, different preferential tax regimes have sprouted, targeting MSMEs, the exporting sector, and others. However, the multitude of special regimes has given rise to concerns that there are too many tax exceptions, which could negatively affect the general principles of tax equity and tax efficiency. As a result, the government could consider eliminating, reassessing or reforming certain tax preferences. For example, as regards tax preferences for MSMEs, eliminating the fixed taxpayer status and realigning the turnover tax's threshold with the minimum threshold for VAT registration would be recommended.

Access to finance for MSMEs

Georgia has made considerable progress in strengthening the financial sector through better regulation of the banking system and the microfinance sector. Banks are more responsive to SME lending and are currently the dominant source of external finance for SMEs. The microfinance sector also plays an important role in catering for underserved or unbankable clients, although it still makes up a very small share of overall lending activity and serves mostly the consumer market.

Access to finance is a core pillar of the national strategy for MSME development. Public support for MSME financing rests with Enterprise Georgia, which mostly draws on a credit guarantee scheme (CGS) and interest rate subsidies. The national CGS has a recent history, having been introduced only in April 2019. Some changes in the design of this programme could increase its impact, such as introducing legislation that defines its legal and regulatory framework, establishing a designated credit guarantee agency, providing the initial capitalisation of the agency, and setting minimum capital adequacy standards, which would reduce the dependence of the agency on an annual government budget.

With respect to equity finance, there is a modest amount of venture capital activity in the country and weak evidence of business angels. The government could make use of tax or other incentives to stimulate private sector investment in SMEs and/or invest directly with the private sector in promising early-stage ventures and growth-oriented SMEs, two approaches which have been common in other countries. Considering the small size of Georgia and the potential limitations in generating adequate deal flow and exit opportunities for investors, Georgia could consider partnering with other countries in a capital market union, as done for example by Croatia and Slovenia.

Government incentives for business development: innovation and internationalisation

Public policy for innovation in Georgia is still at an incipient stage, mostly assisted and jumpstarted by foreign donors through funding and technical support. Going forward, intellectual property (IP) could be better embedded in innovation programmes, for example through the set-up of IP offices at universities and research centres; public procurement could be used to stimulate market demand for innovation, including in areas related to the digital and green transition; and a stronger emphasis on open innovation programmes could foster collaboration not only between public and private sectors, but also between SMEs and larger companies.

With respect to business internationalisation, Georgia has made considerable progress in trade facilitation, thus easing cross-border procedures for exporting and importing enterprises. The major export development policy in Georgia consists in trade promotion (trade missions, exhibitions and fairs, business matching activity), while less is done to support existing or potential SME exporters through mentoring and coaching services. Going forward, SMEs could be better assisted in meeting international standard requirements, which are typically a main barrier to SME internationalisation. In addition, Georgia could do more to align and harmonise national standards with international and EU standards. Within the context of Georgia's cluster initiatives, participating SMEs could be supported to create export consortia to overcome the problem of lack of scale in developing export markets. Finally, there is scope for further encouraging digital trade by SMEs, for example through digital training and digital vouchers, and for incentivising SME exports through export-dedicated credit and insurance schemes.

2. Impact of COVID-19 on Georgian Enterprises

2.1. Georgia's macroeconomic outlook and business sector

Georgia has a per capita GDP estimated at 4,275 US dollars and is therefore classified as an upper middle-income country. It is located at the intersection of Eastern Europe and Western Asia in the Caucasus region and is bound to the west by the Black Sea, to the north and east by Russia, to the south by Turkey and Armenia and to the southeast by Azerbaijan. It covers 69,700 square kilometres (26,911 square miles) and has a population of around 3.7 million. The country's total GDP is currently estimated at 15.9 billion US dollars.

Economic growth has been solid in recent years, averaging 5 percent per annum between 2005 and 2019. Poverty (by the national standard for it) declined rapidly to 19.5 per cent in 2019, almost half the 2007 figure. However, the economy has not created sufficient employment and many Georgians remain engaged in low-productivity agricultural activities. Georgia's small contraction in 2020, may indicate the reliance on tourism as a source of growth.

Much of Georgia's foreign trade is with its neighbours. Georgia's main export markets in 2019 were Azerbaijan (13%), Russia (13%), Armenia (10.9%), Bulgaria (7.5%), Ukraine (6.5%) and the EU, which accounted for 22% percent of total exports. Georgia's main sources of imported goods are Turkey (17%), Russia (10.8%), China (9.6%), Azerbaijan (6.2 %), and Germany (4.9%). The EU's share in total imports to Georgia was 25.6% in 2019. Georgia's main imports are petroleum products and natural gas, automobiles, copper ore, medicines, tobacco products, and wheat. After years of declining domestic manufacturing, most consumer goods are imported.

COVID-19 prevalence compared to neighbouring countries

Georgia was first in COVID-19 prevalence among the countries analysed in this report. From 1 March 2020 until early September 2021, cumulative total cases per 100,000 population stood at about 14,200. According to IMF projections, the Georgian economy will have a recovery of 3.5% in 2021, as it bounces back from the 6.1% decrease in GDP for 2020.

Table 1: COVID-19 total cases per 100,000 population from 1 March 2020 to 7 September 2021

Country	Cases - cumulative total per 100 000 population	2020	2021	2021/2020 recovery
Belarus	5210.95	-0.9	-0,4	-1.3
Ukraine	5260.25	-4.2	4	-0.2
Latvia	7581.58	-3.6	3.9	0.3
Armenia	8293.81	-7.6	3.4	-4.2
North Macedonia	8651.47	-4.5	3.8	-0.7
Croatia	9332.44	-9	4.7	-4.3
Georgia	14236.58	-6,1	3.5	-2.6

The economies of Georgia and Armenia need much stronger support in order to recover from the current impact of COVID-19. One of the findings from econometrics is that countries with a higher GDP per capita are more likely to have higher prevalence of COVID-19. It is also obvious from the scatter chart below (r = 0.41, p = 0.000002) that Georgia and Armenia are two outliers because they combine a low GDP per capita and a high rate of COVID-19 and are notable exceptions to the main trend.

Composition of the business sector

Although the number of active businesses did not dramatically decline in 2020, the previous upward trend in the number of active enterprises and especially in newly registered businesses has tapered off. According to the National Statistics Office of Georgia, in 2020 about 802,000 enterprises were registered in Georgia, 21% of which were business entities (around 172,000). Only about 21% of both registered businesses as well as organisations in general are active. Business registry data show that the number of registered organisations and businesses as well as the number of active entities in both groups had been steadily increasing in recent years until 2019.

Wholesale and retail trade is the leading sector in both registered and active businesses followed by manufacturing, construction, transportation, and storage. Although the share of businesses operating in wholesale and retail trade is much higher among active businesses compared to registered (39% and 21%, respectively).

The National Statistics Office of Georgia calculates statistics on the main indicators for enterprises according to their designation as small, medium, or large enterprises. Enterprises within the following limits for the number of employees and annual turnover are classified as small, medium or large business entities depending on the limits in shown in the table below:

► **Graph 2: COVID-19 and GDP per capita in 2020**

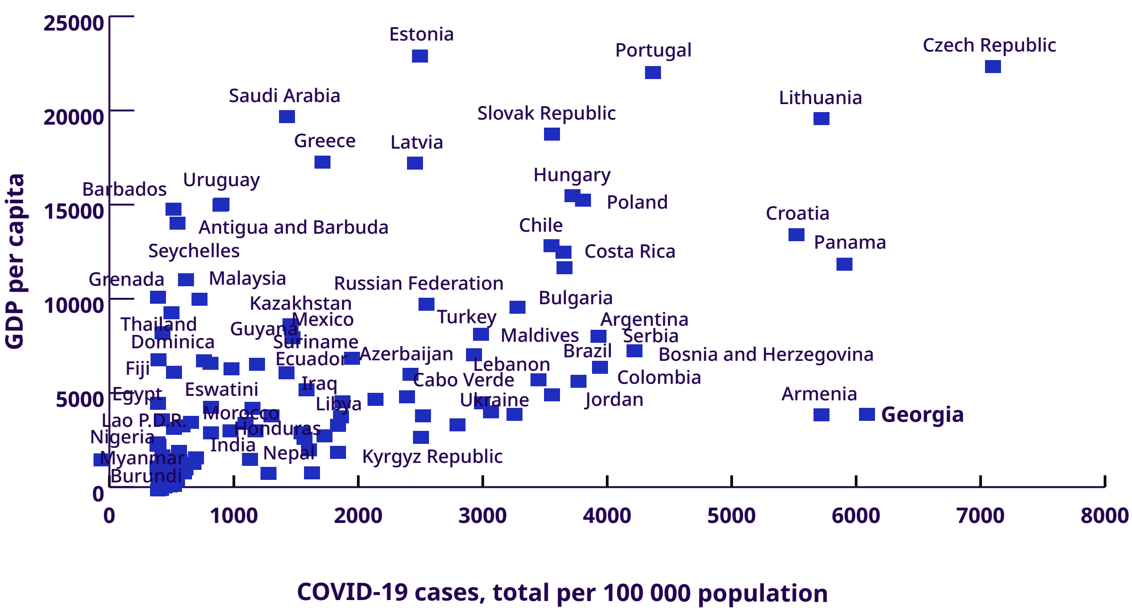


Table 2. Georgia's Business Sector (2012-2020)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Number of registered organizations by year - total cumulative, thousand	497.9	533.5	570.6	595.7	633.2	678.6	722.4	765	802
Number of active organizations, thousand	127.6	131	134.9	164.5	167.6	165.3	165.5	174.3	171.6
Number of registered business entities by year - total cumulative, thousand	472.8	506.7	542.2	565.6	600.3	643.2	685.8	727.5	763.3
Number of active business entities, thousand	121.8	124.9	128.6	158	160.9	158.7	158.9	167.9	165.3
Number of newly registered business entities, thousand	40.9	44.7	45.3	43.9	45.3	50	50.3	49.4	40.3

Source: National Statistics Office of Georgia

Table 3. Number of registered and active entities by kind of economic activity

	Registered entity		Active entity	
	Number	%	Number	%
Wholesale and retail trade	167 931	20.63	79 733	39.45
Manufacturing	37 518	4.61	17 043	8.43
Construction	24 000	2.95	12 441	6.86
Transportation and storage	23 943	2.94	13 866	6.16
Accommodation and food service activities	19 862	2.44	9 530	4.71
Professional, scientific, and technical activities	15 511	1.91	7 643	3.78
Real estate activities	9 439	1.16	6 056	3.00
Administrative and support service activities	9 172	1.13	4 975	2.46
Education	7 696	0.95	4 824	2.39
Agriculture, forestry and fishing	7 194	0.88	2 431	1.20

Source: National Statistics Office of Georgia

▶ Table 4. Definition of SMEs

	Criteria	
Category of enterprise by size	Average annual turnover	Average annual number of employees
Small enterprises	< 12 million GEL	< 49
Medium Enterprises	12 – 60 million GEL	50 – 249
Large enterprises	> 60 million GEL	> 250

Source: National Statistics Office of Georgia

▶ Table 5. Distribution of firms in Georgia, 2018 by firm size

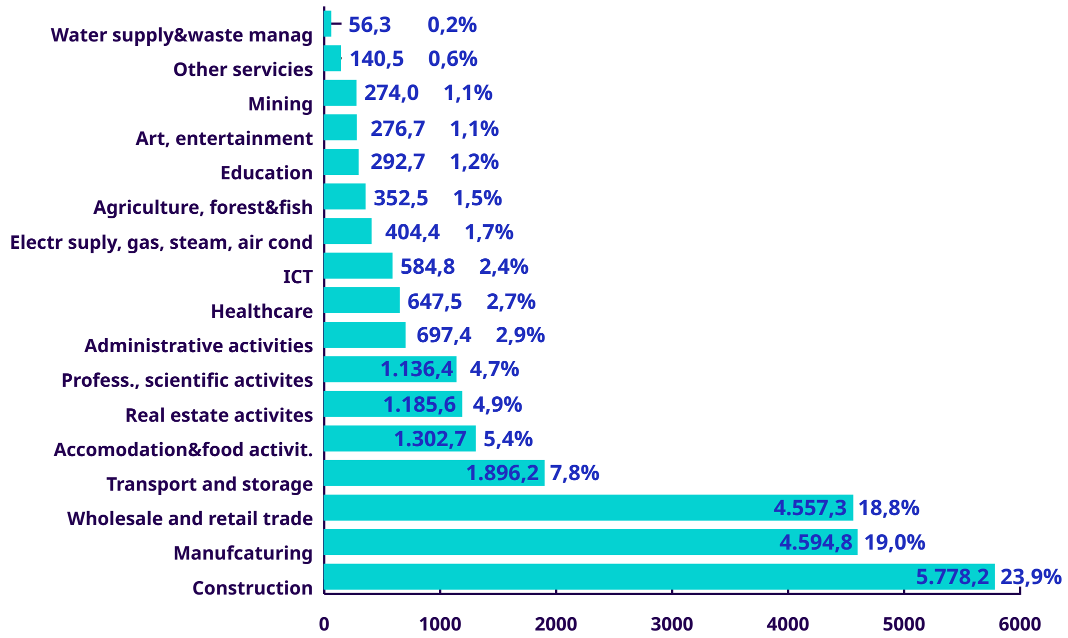
		By Size		
	Total	Small	Medium	Large
Number of enterprises (active)	127 219	125 100	1 735	384

Source: National Statistics Office of Georgia

The Georgian economy is dependent upon the small and medium-sized enterprises (SMEs) that constitute almost 99% of all businesses. However, a great many of them are in fact small and even micro companies (with between 1-19 employees). In 2018, there were 127,219 economic entities in Georgia, and most of them were categorized as small (98%). Nearly 1% were medium-sized entities, and large active enterprises constituted 0.3%. More than half of all SMEs are based in Tbilisi (the capital) followed by the Imereti and Ajara regions.

The SME sector is firmly entrenched in Georgia, and the sectoral structure of SME has become more diversified. SMEs play an important role in the development of the economy and are contributing significantly to sustainable growth with a reported 61% share of production and 64% of employment (2019). The leading sectors and the main contributors to GDP in 2018 were manufacturing (18.3%) and construction (12.6%). Georgia's economic growth in recent years has been driven by services with tourism acting as a catalyst that also boosted trade, construction, and other service sectors. In 2018 SMEs employed most of those engaged in trade (28.3%), manufacturing 12.8% and construction 12.6%.

▶ Figure 1. Output (in million GEL) and share of SMEs by Economic Activities, 2018



Source: National Statistics Office of Georgia

2.2. The performance of SMEs in Georgia

2.2.1. Labour productivity and distribution

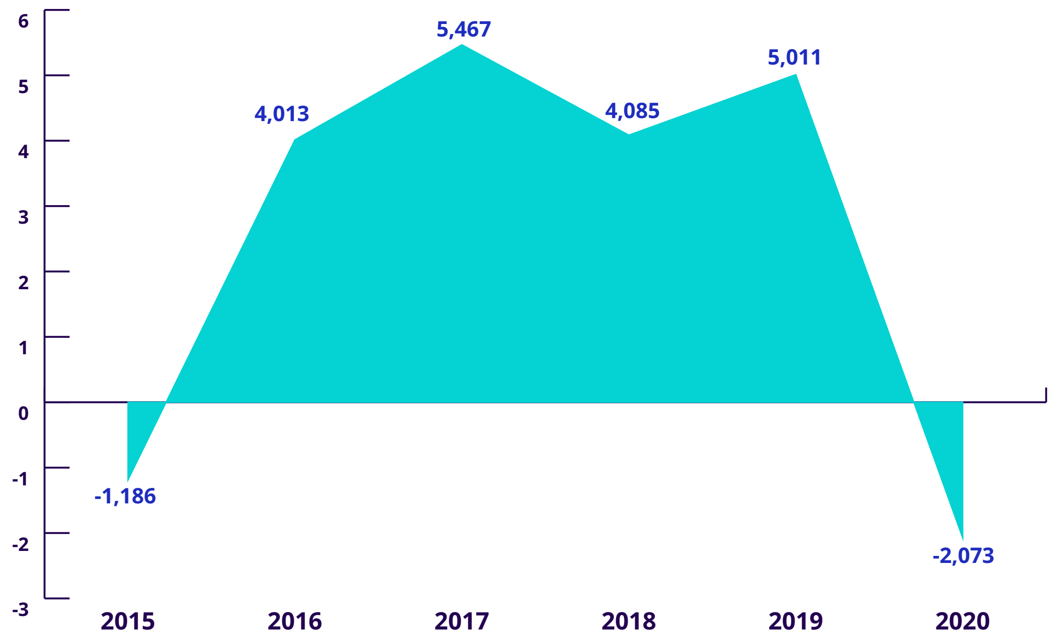
Georgia's main labour market challenges are substantial unemployment, mismatches between the skills available and demand for them, and informal employment. The National Statistics Office of Georgia reported the country's 2020 labour force participation (the ratio of people in the labour force to the population aged 15 and older) as 51% compared to an employment rate of 41%, and these are lower percentages, than in previous years. Labour force participation in 2020 was much higher in urban areas than in rural ones (54% versus 46%) and for men than for women (62% versus 40%). Employment is likewise significantly higher in urban areas than in rural ones (43% versus 39%) and for men than for women (50% versus 34%) (National Statistics Office of Georgia, 2020).

Self-employment is widespread, accounting for 32% of the employed population in 2020. Self-employment is markedly higher in rural areas than in urban ones (52% versus 18%) because Georgia is an agricultural country for the most part (National Statistics Office of Georgia, 2020).

Georgia's labour productivity dropped by 2.07 % in 2020 after a 5.01% increase in 2019 (CEIC, 2020) in a reversal of the positive trend that prevailed for the last four years. **The Census and Economic Information Centre (CEIC)[2] derives labour productivity from annual real GDP and annual employment figures that are provided by The National Statistics Office of Georgia.**

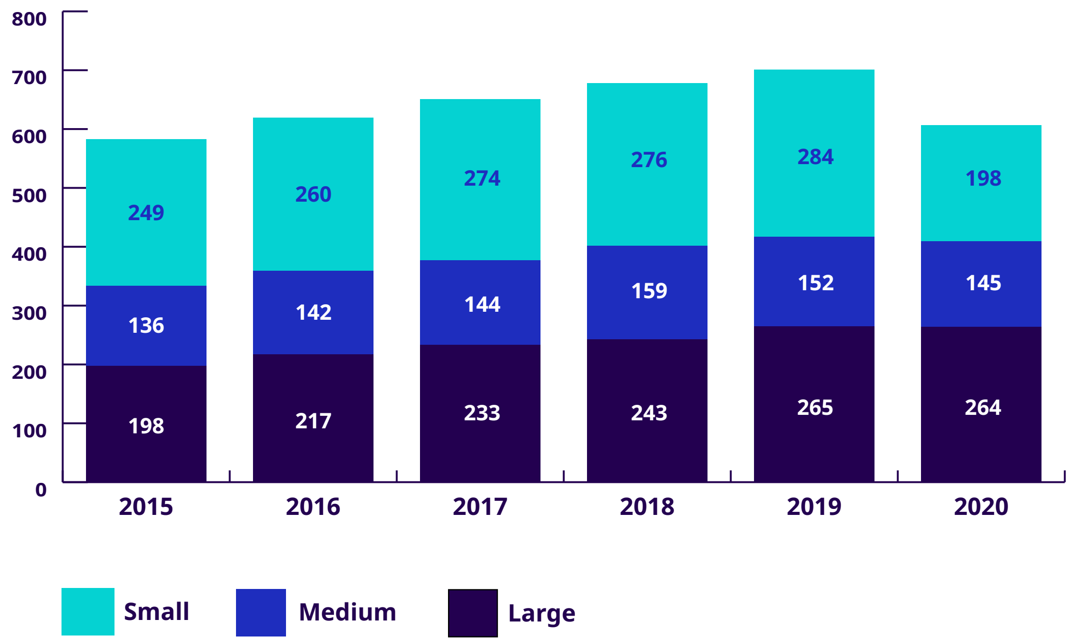
2 Source: https://www.ceicdata.com/en/country/georgia

▶ Figure 2. Georgia's Labor Productivity Growth, 2015-2020



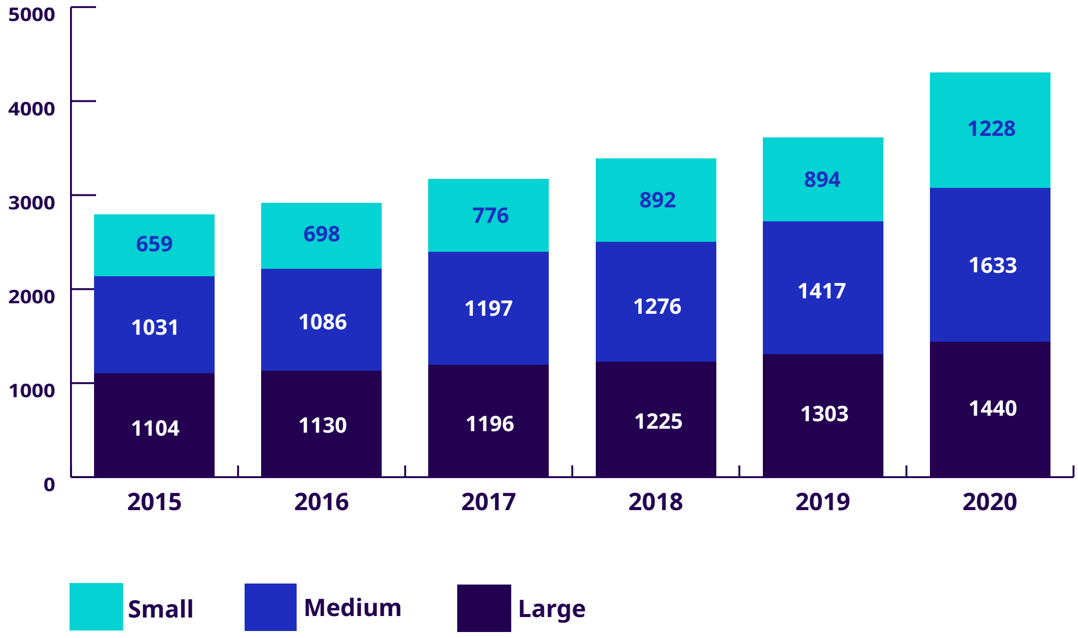
Source: Ceic Data (https://www.Ceicdata.Com/en/country/georgia)

▶ Figure 3. Business employment by the size of enterprises (thousand)



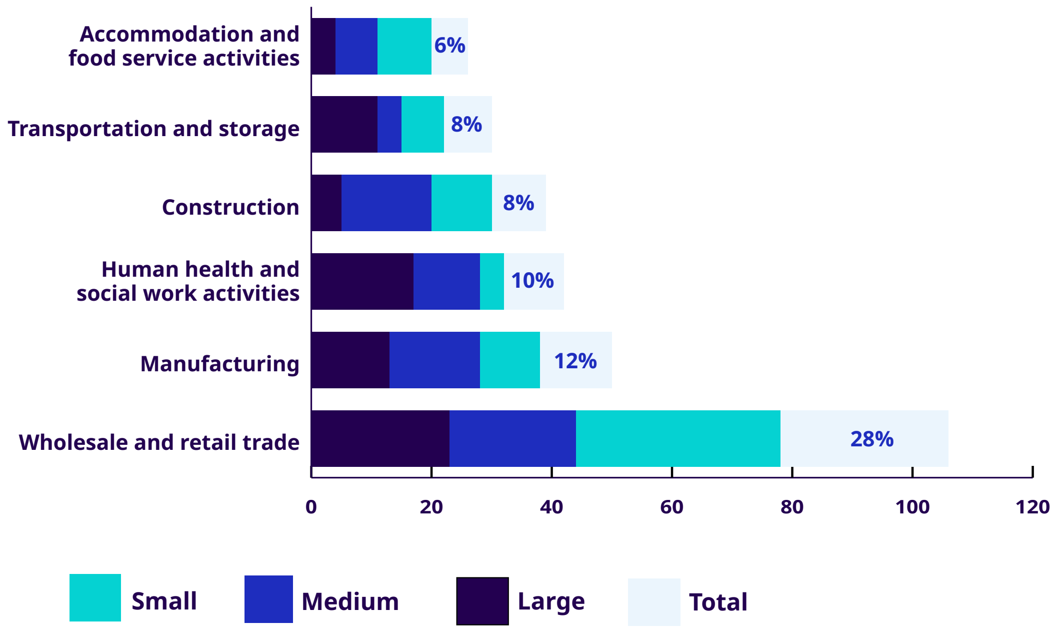
Source: National Statistics Office of Georgia

Figure 4. Average monthly remuneration of employed persons by enterprise size



Source: National Statistics Office of Georgia

Figure 5. Structure of employment by size of enterprises in 2019



Source: National Statistics Office of Georgia

The number of employees had been increasing by 1% from year to year until 2020 when there was a 3% decline in employment in the business sector. However, the majority of employees still work at small and medium-sized enterprises.

Workers' earnings in medium-sized enterprises are higher than the average monthly remuneration of persons employed in the business sector as a whole. Average monthly remuneration of employed persons has been increasing each year, and 2020 was no exception.

Wholesale and retail trade came first in the distribution of employment at 28% during 2019, then manufacturing at 12% followed by human health and social work activities at 10%. Employment in the wholesale and retail trade sector predominates in all three sizes of business. Large-sized firms employ 23% in wholesale and retail trade, 17% in human health and social work activities, and 11% in transportation and storage. Medium-sized enterprises have 21% employed in the wholesale and retail trade, 15% in manufacturing, and another 15% in construction. Some 34% of those employed in small-sized firms are in wholesale and retail trade, 10% in manufacturing, and another 10% in construction. Agriculture has the lowest share of employment (1.7%), which is due to high levels of self-employment (and informal employment) in this sector.

2.2.2. Innovation

Only 3% of enterprises in 2019 were involved in innovation for producing goods and another 3.2% in innovation for providing services according to the National Statistics Office of Georgia. Analysis of the data indicates that individual enterprises are

▶ Table 6. Developed innovation of goods or services by organisations or institutions (%)

	Innovation of goods	Innovation of services
Your enterprise alone	58.2%	41.7%
Your enterprise together with other enterprises or institutions*	12.8%	16.9%
Your enterprise by adapting or modifying goods or services originally developed by other enterprises or institutions	13.5%	27.7%
Other enterprises or institutions*	15.5%	13.7%
Total	**100.0%**	**100.0%**

** Institutions include universities, research institutes, non-profits, etc.*
Source: National Statistics Office of Georgia

▶ Table 7. The Global Innovation Index for Georgia, 2017-2019

	GII	Innovation Inputs	Innovation Outputs
2019	**48**	44	60
2018	**59**	53	62
2017	**68**	69	62

Source: Global Innovation Index 2019

the primary drivers of innovation, but cooperative arrangements are also common.

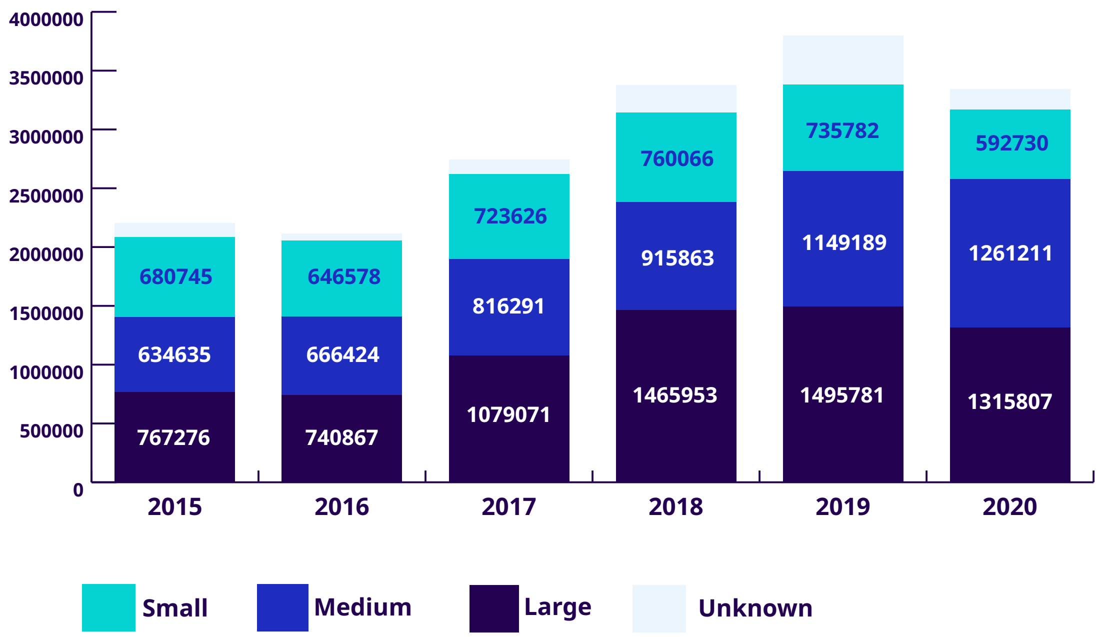
Innovations are mostly introduced by acquiring machinery, equipment and software (19.3%), training for innovative activities (13.1%) and in-house research and development (12.5%). Due to methodological limitations, the survey did not sort the data by sizes of firms or economic activities. Although national data on innovation in the Georgian economy is quite limited, the Global Innovation Index (GII) provides important findings about the country's efforts to innovate and about its environment and outputs. Georgia was ranked 48th in the GII for 2019 among 129 economies, and the following table shows the rankings of Georgia over the past three years. Georgia performed better in innovation inputs than outputs in 2019 ranking 44th in innovation inputs, which was better than in the previous two years. Georgia rose to 60th place for innovation outputs, which was slightly better than in the previous two

Table 8. External Trade (million USD)

	2015	2016	2017	2018	2019	2020*
External Trade Turnover	9 508.40	9 459.00	10 802.90	12 741.50	13 317.60	11 396.30
Export (FOB)	2 204.20	2 117.10	2 745.70	3 379.70	3 798.40	3 343.40
Import (CIF)	7 304.20	7 341.90	8 057.20	9 361.80	9 519.20	8 052.90
Trade Balance	-5 100.00	-5 224.70	-5 311.40	-5 982.10	-5 720.80	-4 709.40
Domestic export	1 602.50	1 620.40	2 007.80	2 226.20	2 324.50	2 408.10

Source: National Statistics Office of Georgia

Figure 6. Exports of Georgia by size classes of traders, Thsd. USD



Source: National Statistics Office of Georgia

years. Georgia's improving rankings for 2018 and 2019 resulted from a combination of improved performance and new innovation data becoming available. It is noteworthy that Georgia ranks third among the 26 lower-middle-income economies and fourth among the 19 economies in Northern Africa and Western Asia (WIPO, 2019). The most notable gains in 2019 occurred in such indicators as patent families filed in two or more offices, high technology imports, exports of information and communication (ICT) services, and industrial designs by origin. Georgia ranks in the top 10 for several indicators such as ease of starting a business, ease of protecting minority investors, and labour productivity growth. Despite this progress, Georgia has a number of weak areas, among which are global R&D companies, high- and medium-high-tech manufacturers, and intellectual property receipts (WIPO, 2019).

2.2.3. External Trade

Georgia's external trade has mostly increased since 2016 and stood at US$11.4 billion for 2020, but there is a negative balance of trade with imports exceeding exports on average by US$4.7 billion during recent years.

Georgia exported a total of US$3.79 billion in 2019, making it number 94 (out of 127) exporters in the world (Global Edge, 2019), and more than half of the exports were from small and medium-sized enterprises. In 2020 there was a drop in exports by US$456 million (12%) compared to the previous year; however, during the last six reported years, Georgia's exports have risen from US$2.20 billion in 2015 to US$3.34 billion in 2020. The reduction in exports is mainly due to the less re-export as domestic export, which increased only slightly compared to 2019.

International trade has been in a positive trend since February 2021. In June 2021 exports reached US$349.3 million which is 30.1% higher than in June 2020 and 12.5% higher than the most recent pre-pandemic period (June 2019). For the first two quarters of 2021 exports increased by 25.2% (US$1.885 billion) and imports increased by 18.9% (US$4.325 billion) over the same period in 2020. Export growth was reinforced by increased domestic exports, which made up 73.1% of total exports (Current Economic Tendencies, 2021).

Georgia's exports rely on low value-added agriculture and mineral products. The most recent exports have been led by copper ore and concentrates (19%), motor cars (11%), ferro alloys (10%), wine (5%), spirituous beverages (4%). Georgia's main export partners are China (17%), Russia (13%), Azerbaijan (13%), Turkey (9%), and Ukraine (8%) (National Statistics Office of Georgia, 2020).

2.2.4. Access to finance

Access to financing is ranked second among the most problematic factors for doing business in Georgia. A well-functioning financial system is instrumental to the development of small and medium-sized enterprises, as these companies often need external capital for further expansion as well as for improving the qualifications of personnel and implementing innovations. Limited access to funds can be one of the greatest obstacles to investment according to the executive opinion survey conducted by the World Economic Forum (2017). The magnitude of the problem varies across the EaP countries. According to the survey, in Armenia and Azerbaijan, it is perceived as the greatest obstacle to doing business, whereas in Moldova and Ukraine it is ranked fourth and seventh, respectively, among obstacles.

Small and medium-sized enterprises cumulatively generated more than 59% of total added value for the economy of Georgia in 2019 (National Statistics Office of Georgia, n.d.); however, their access to financing remains relatively limited. According to the World Economic Forum (2019), Georgia scores 3.8 out of 7 in financing of SMEs and is consequently ranked 83rd out of the 141 countries observed, while Armenia and Azerbaijan have scores of 4.1 and 4.7, respectively, on the same scale; Moldova scored 3.6 and Ukraine scored 3.4, which places Georgia below the average score (3.92) among the Eastern Partner countries (excluding Belarus).

These results contradict the assessment offered by the OECD et al. (for 2020). Georgia was considered the best in access to finance among the EaP countries by scoring 4.02 out of 5, which was significantly higher than the EaP average of 3.57 points and in addition showed a 7% improvement in access to finance (or 8% using the 2016 methodology).

▶ Table 9. Business loans for Georgia, 2015-2018

	Business loans, SMEs (GEL million)	Business loans, total (GEL million)	Business loans, SMEs (% of total business loans)
2015	**3 621**	8 433	42.9
2016	**3 992**	10 500	38.0
2017	**5 176**	12 000	43.1
2018	**6 620**	14 687	45.1

Source: OECD iLibrary

▶ Table 10. Non-Performing Loans for Georgia, 2015-2018

	Non-performing loans, SMEs (GEL million)	Non-Performing loans, total (GEL million)	Non-performing loans, total (% of all business loans	Non-performing loans, SMEs (% of total SME loans)
2015	**161**	1 200	9.8	4.4
2016	**206**	1 380	10.1	5.2
2017	**221**	1 337	7.7	4.3
2018	**401**	1 480	6.6	6.1

Source: OECD iLibrary

A significant level of loan rejections persists in the Georgian market. In the bank lending survey conducted in 2018 by the European Investment Bank, banks reported that they reject loan applicants either on rare occasions (40%) or on an irregular basis (60%). The reasons given for rejecting applications can be grouped into four categories: lack of suitable collateral, lack of credit history, unmeasurable risks and poor business plans. The main specific reason cited for rejecting loan applications was the riskiness of either clients or projects (Conde & Gattini, 2019).

The EIB Bank Lending Survey also showed that use of credit is widespread in Georgia. Other instruments such as trade finance and leasing have progressively gained in importance unlike the equity market, which remains underdeveloped and is not seen as an instrument easily available to SMEs. The study also showed that 25% of all loans are provided to the SME segment and that the volume of the SME loan portfolio has increased almost fivefold since 2010 (Conde & Gattini, 2019).

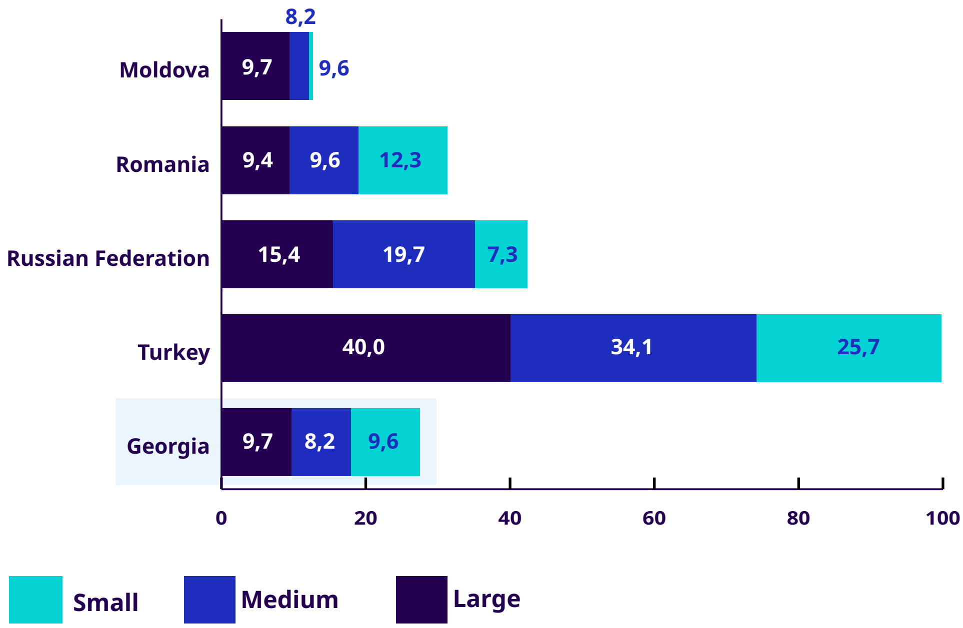
According to the OECD's SME Policy Index for Eastern Partner Countries 2016, Georgia has improved access to finance for SMEs since 2012 by strengthening its legal and regulatory framework. Overall, Georgian SMEs can access financing relatively easily at the regional level, and annual SME credit usage has accelerated in recent years due to declining interest rates on commercial bank loans and private sector development programmes introduced by the government (OECD iLibrary, 2020). Nonetheless, the overall share of SME lending remains low and access to finance is still considered a key obstacle to SME development. In 2018 outstanding business loans to SMEs rose significantly (by 28%, reaching GEL 6.6 billion), and the overall share of SMEs in business loan portfolios increased by 2 percentage points to 45.1%, its highest level since 2010.

Despite this good performance in comparison with other Eastern partnership countries, access to finance remains a persistent problem for Georgian SMEs. Compared to OECD countries, financial literacy is still limited, and the enforcement of creditors' rights could be improved. The promotion of greater competitiveness in the banking sector is also necessary to facilitate more sustainable access to finance for SMEs (OECD iLibrary, 2020).

Total non-performing SME loans exceeded GEL 407 million in 2018, the highest level since 2010, and 6.1% of SME loans are currently non-performing. The lowest level was reached in 2014 when non-performing SMEs loans stood at 4.2%. Over the past year, the volume of non-performing SME loans increased by 84%, amounting to a 1.8% increase in its share of all SME loans.

Access to non-bank financing in Georgia remains limited. The assets of the non-banking financial sector reached 2 billion GEL in 2019 (4% of total assets in the financial sector), of which 1.4 billion GEL were assets held by microfinance organizations (National Bank of Georgia, 2020b); however, the microfinance sector mainly focuses on issuing consumer loans to individuals: loans issued for agricultural, trade, and service-related purposes make up only 25% (299 million GEL) of the gross loan portfolio; during 2020 growth was observed only in consumer loans mostly due to a 20% increase in pawn shop lending, which can be attributed to the effects of the COVID-19 pandemic (National Bank of Georgia, 2020a).

▶ Figure 7. Share of establishments that fired workers in the last 30 days

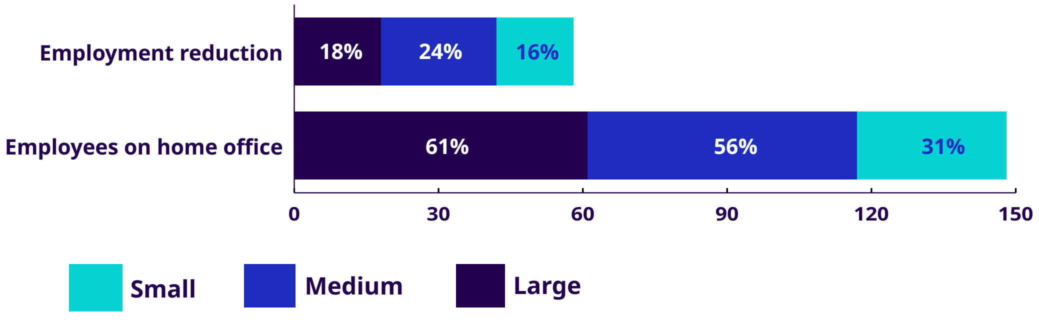


Source: World Bank Business Pulse Survey

▶ Figure 8. Share of employees working remotely at the time of the interview

Source: World Bank Business Pulse Survey

▶ Figure 9. Share of entities with remote working and entities with a reduction of employment, 2020



Source: PwC Survey

2.3. The impact of the COVID-19 crisis on Georgian SMEs

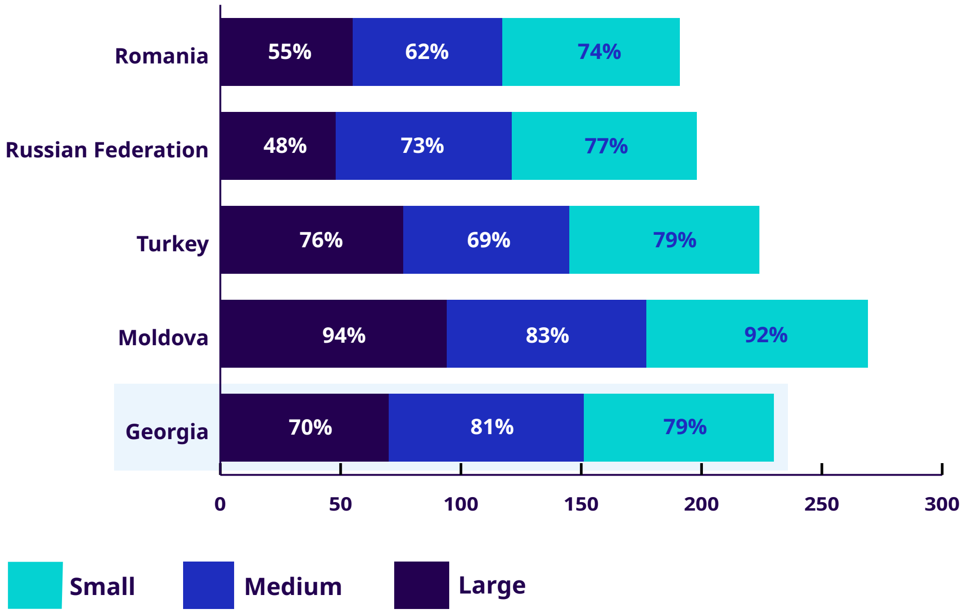
2.3.1. Impact on workers

Compared to 2019, number employed decreased by 54,100 in 2020 and reached a total of 1,241,800; this amounted to a 1.5% decrease that brought total employment to 41.1%. The reciprocal increase in unemployment by 0.9 percentage points brought total unemployment to 18.5%, and the trend is same in firs two quarters of 2021[3] (22.1% at the end of 2nd quartal 2021) (National Statistics Office of Georgia, 2021). Unemployment has continued to increase during the first two quarters of 2021. As reported by the Ministry of Economy and Sustainable Development of Georgia, employment was decreasing from January to March 2021 and fell to 37.7%

According to findings from the first wave (2020) of the World Bank Business Pulse Survey for Georgia (designed to capture the fallout from the COVID-19 pandemic on the universe of enterprises), the

3 https://www.geostat.ge/en/modules/categories/683/Employment-Unemployment

Figure 10. Percentage of establishments with decreased monthly sales compared to the year before the interview



Source: World Bank Business Pulse Survey

establishments that reported firing the most workers were large and small-sized entities. ***Large firms made up 9.7% of establishments that had fired workers in the last 30 days before the survey, and small firms accounted for 9.6% (World Bank, 2021).[4] Large firms (at 11.9%) and small firms (at 9.7%) also had the higher percentages of employees working remotely in Georgia.***

In 2020 PwC together with the Investors' Council developed a survey to study the impact of COVID-19 on the Georgian economy and business sector. The main purpose of the study was to properly assess the impact on companies from the pandemic (PwC, 2020). The survey of businesses revealed that employees of large and medium-sized companies more often than others could telework or work remotely, and their business operations could move online. The survey found that the reduction in employment was not very severe. Even though medium-sized entities were affected the most, only a quarter of them (24%) responded that they had to reduce the number of employees.

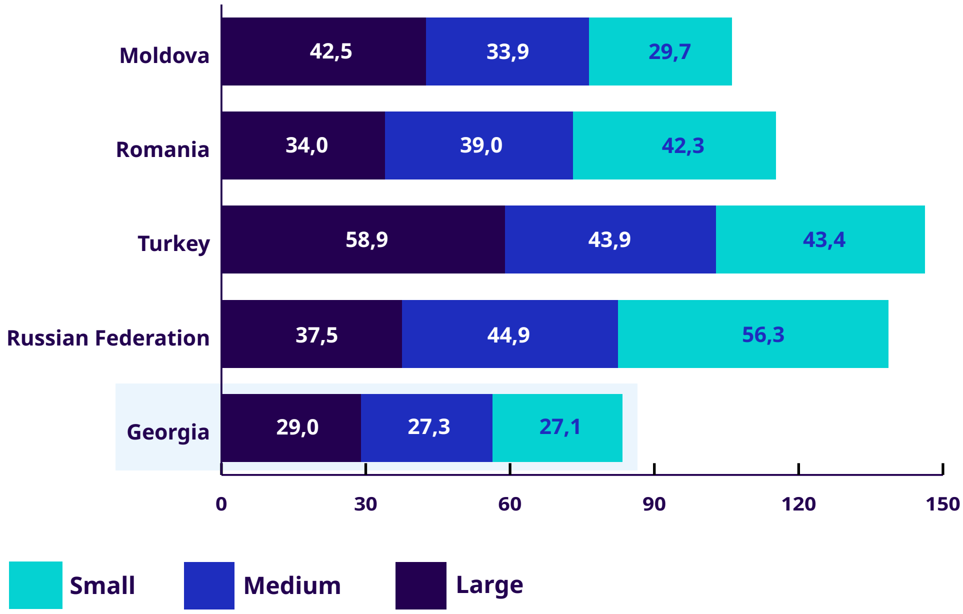
2.3.2. Impact on sales

Based on the data from the World Bank Business Pulse Survey for Georgia, more than half of the establishments in each size category saw a decline in monthly sales. Specifically, 70% of large firms, 81% of medium-sized and 79% of small-sized firms had a drop in sales. Among the other Eastern Partnership countries, the worst deterioration in sales occurred in Moldova, where more than 90% of firms reported a decrease in sales. Romania fared somewhat better with only 67% of firms experiencing a decline in sales.

The responses to the PwC survey highlighted the difficulty that companies faced from a decrease in demand. Demand fell by 70% for large

4 WBES and WB Pulse Surveys define small companies as having 5 to 19 employees, medium companies as having 20 to 99 employees, and large companies as having 100+ employees.

Figure 11. Share of firms that started or increased the use of digital platforms



Source: World Bank Business Pulse Survey

firms, by 69% for medium-sized firms and by 60% for small firms and sharply reduced the revenues of the companies surveyed.

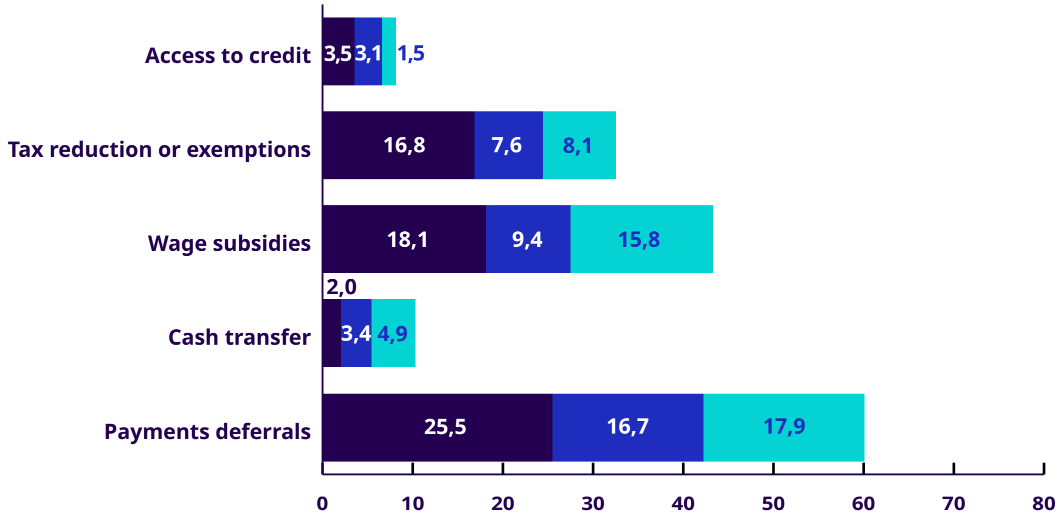
The Regional Study on the Impact of COVID-19 Pandemic on SMEs found that COVID-19 had a severe effect on a company's revenues in Georgia. Some 91% of the respondents noticed a drop in revenues to varying degrees. Furthermore, a sizable majority of 60% experienced revenues declining by more than 50%. The impact of the pandemic on revenues was most harmful to the tourism sector; 93% of tourism businesses responded that their income decreased by more than 50%. Light manufacturing was also among the sectors hit by a reduction in sales due to COVID-19. Among the sectors where little revenue decline was observed, the ICT sector suffered the least with 16% of ICT firms seeing no decline in income.

Impact on digitalization of enterprises

The World Bank Business Pulse Survey for Georgia found that 29% of large firms that began using or increased the use of digital platforms; among medium-sized and small firms around 27% did so. The Russian Federation relied more heavily on a shift to digitalization with 53% of Russian firms starting or increasing the use of digital platforms; in Turkey 46% of firms did the same. According to the PwC survey, 13% of firms moved their business activity online (launched or increased e-commerce activity). More specifically, 13% of small firms, 24% of medium-sized firms, and 23% of large firms launched or increased e-commerce activity.

The Regional Study on the Impact of COVID-19 Pandemic on SMEs revealed that e-commerce is one of the most widespread tools for remote working in the target value chains. Even though the pandemic forced many of the companies surveyed to digitalize their business processes to a greater extent, 52% of the businesses did not use e-commerce before COVID-19 and did not introduce it afterward; and only 5% did not use e-commerce before COVID-19 but introduced its use afterward. In most cases, firms in the light manufacturing sector (57%) did not use e-commerce before COVID-19 and did not introduce its

Figure 12. Received/Expected support: share of firms that received support



Source: World Bank Business Pulse Survey

use afterward. Some 37% of tourism firms used e-commerce before COVID-19 but did not increase its use afterward.

2.3.3. Access to government support

According to the World Bank Business Pulse Survey for Georgia, government support for firms mostly took the form of deferred payments and wage subsidies, and most of that relief went to large firms. Specifically, the proportion of large firms that have received payments deferrals is 26%, and wage subsidies were received by 18%. The Regional Study on the Impact of COVID-19 Pandemic on SMEs indicated that most business owners benefited from relief measures (67%). One of the most popular government policies was reduction or deferral of taxes (48% of firms), 29% benefited from interest-free loans, while 17% received a subsidy for their employees' salaries. About 43% of tourism firms reported reduction or deferral of taxes, while 30% of light manufacturing firms took out interest-free loans.

2.4. Key Takeaways and Recommendations

The economic impact of the COVID-19 pandemic crisis on the country has already been severe. Limited intra-regional and international mobility became a heavy burden for economic activities in the major value chains and had a pronounced impact on small and medium-sized enterprises. It is extremely difficult to quantify the impact of the crisis in such a rapidly changing environment; however, it is evident that sharp contractions in output, revenues, and employment are among the immediate effects. An overview of the major economic trends and reports from international financial institutions reveal that an absolute majority of SMEs have suffered significant drops in revenue and limitations on their operations to varying degrees during the pandemic. Reductions in orders followed by problems with cash flow were the main challenges faced by SMEs.

The immediate impact on employment has not been as severe for SMEs because most of the companies managed to retain employees, albeit with salary reductions. However, remote work capabilities are especially limited among the small enterprises operating in the regions; they usually lack the experience and skills required for using digital platforms to facilitate remote work. The World Bank Business Pulse Survey has established that Georgia is among the least advanced in using digital platforms as a response to the pandemic.

Analysis of the support measures introduced by the government shows that deferred payments, wage subsidies and tax reductions or exemptions were the relief measures most used, although the proportion of companies that benefited from the support programmes is greater for large businesses than for SMEs.

The COVID-19 pandemic has major implications for international trade. Businesses will require support through technical assistance programmes to overcome disruptions in global value chains .

Financial aid needs to be accompanied by technical assistance to ensure sustainability and to leverage the results of efforts by the state or other actors. The majority of SMEs in the country did not have strategic readiness and were both ill-equipped to handle the crisis and challenged by the obstacles presented. Most SMEs attempted to offset their cash flow shortages by borrowing or reducing operating costs. The institutional financial climate is not favourable for SMEs, and access to financing remains a major challenge for the SME sector. The financial resources available, including the programmes launched by the government, have been used mostly to meet current liabilities rather than to introduce sustainable and long-term solutions for business recovery, product development, or market innovations in all value chains. Thus, government subsidies can be considered only as a short-term measure to limit immediate job losses.

3. The Business Tax System in Georgia

3.1. Introduction.

Georgia's tax system is generally regarded as competitive. The country compares well against international benchmarks in tax competitiveness, and in overall economic performance. According to The Heritage Foundation's 2021 Economic Freedom index, the country is ranked 12th out of 184 nations, placing Georgia ahead of the median (85th) rank observed amongst remaining Eastern Partnership countries (Armenia, Azerbaijan, Belarus, Moldova, and Ukraine). The World Bank's 2020 Doing Business index also ranks the Georgian business environment highly favourably, assessing Georgia's business environment as the world's 7th best, ahead of many countries well-known for economic prowess. As regards tax rates, headline rates in corporate income taxation and value-added tax (VAT) are low compared to regional peers. In personal income tax, the headline rate is just slightly higher than the median rate elsewhere in the Eastern Partnership region (Table 11). Georgia has undergone significant tax reform over the past decade, including a 2017 novel corporate income tax framework. The country had also previously introduced a preferential tax regime for micro, small, and medium-sized enterprises (MSMEs) in 2011, which was reassessed in 2018.

Tax administration compares favourably against Eastern Partnership countries on most accounts. Georgia is ranked 14th worldwide in the "Paying Taxes" subindex of the World Bank's Doing Business index (Table 12). In particular, the number of taxes that need to be paid during a calendar year is very low: five only (i.e., corporate income tax, property tax, land tax, personal income tax, and value-added tax), whereas in other countries in the region the median number is nine. The burden of taxes and mandatory contributions is also low as a percentage of business profits. Yet, administrative deficiencies are evident in the data as well. Not only is Georgia's performance in paying taxes less stellar than its overall ranking in the Doing Business index, but the time needed to complete, file, and pay taxes is not perfect either. Indeed, it is quite paradoxical that a country exhibiting the least number of taxes is also a country exhibiting relatively lengthier processes vis-à-vis median levels observed in Eastern Partnership countries. A closer look at the data (see section 3) indicates that VAT is where administrative delay (and complexity) is most striking. Already, some reforms have been implemented, such as an automatic system for VAT refunds available since 2019, but feedback from local interviewees suggests that it remains an area of taxpayer concern.

Value-added tax (VAT) is the biggest contributor to tax revenues. In fiscal year 2020, VAT accounted for 44.1% of total tax revenues (Table 13). Income tax receipts accounted for 30.3% of total, with profit tax (which corresponds to the corporate tax, 8.4% of total) making a relatively minor

▶ Table 11: Main Headline Tax Rates in Eastern Partnership Countries

Main Taxes: Headline Rates	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Personal income tax	22%	25%	13%	12%	18%	18%	20%
Corporate income tax	18%	20%	18%	12%	18%	18%	15%
Value-added tax	20%	18%	20%	20%	20%	20%	18%

Source: PwC Worldwide Summaries
Note: The 'EPs (ex-Georgia)' measure represents the median level considering levels observed in Eastern Partnership countries bar Georgia. This measure is used throughout the report.

▶ Table 12: Tax Administration Efficiency in Eastern Partnership countries.

Paying Taxes	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Overall index, DB 2020 Rank	47,0	34,0	49,0	48,0	64,0	48,0	7,0
Paying taxes subindex, DB 202 rank	52,0	40,0	99,0	33,0	65,0	52,0	14,0
Payments (number per year)	15,0	9,0	7,0	10,	5,0	9,0	5,0
Time (hours per year)	15,0	9,0	7,0	10,0	5,0	9,0	5,0
Total tax and contribution rate (% of profit)	22,6%	40,7%	53,3%	38,7%	45,2%	40,7%	9,9%
Postfilling index (0-100)	79,4	83,8	50,0	90,8	86,0	83,8	85,9

Source: Doing Business 2020

contribution to government coffers. Excise taxes, on the other hand, representing 14.8% of overall tax revenues, remained a significant contributor to the country's fiscal balance. In 2020, tax revenues amounted to 88.4% of total government revenues. The government ran a fiscal deficit of 9% of GDP, and public debt ended the year at 60% of GDP. While the country's fiscal balance is beyond this section's scope, in coming years the government will likely be pressured into reducing deficit and debt levels, with taxation being one of possible levers of adjustment. Already, the government has committed to reducing the public debt level during the next four years (GoG, 2021). That will test not only the coherence of tax policy in Georgia, but perhaps most importantly the resolve of government in addressing current shortcomings in tax administration. Still, Georgia's tax revenues-to-GDP ratio, standing at 22.2% of GDP in 2020, suggests that there is a fair degree of tax capacity in the country compared to other nations in the region. (In 2019, the tax revenues-to-GDP ratio in all other Eastern Partnership countries, bar Armenia, was lower than in Georgia. Elsewhere in Eastern Europe, for instance in the V4 countries – Czech Republic, Hungary, Poland, and Slovakia – the mean tax revenues-to-GDP ratio was 18.3% in 2019, also lower than in Georgia.)

Tax revenue growth has subsided in recent years. Between 2015 and 2020, tax revenues grew below the growth rate of nominal GDP, while before, between 2010 and 2015, they had grown above GDP growth rates (Table 14). This trend of decelerating revenues has been observed in all main taxes, bar excise and customs duties. While a less than proportional tax revenue growth bodes well for the overall tax burden, which becomes lower in the process, it may also reflect the fact that government is not making the most of the economy's existent tax capacity (i.e., the capacity of taxpayers to absorb increased taxation). Nonetheless, value-added tax revenues, the biggest contributor to tax receipts, are still growing marginally ahead of overall revenues. Growth in income tax revenues have also slowed down significantly, yet it is still greater than growth in both overall revenues and nominal GDP. However, declining tax receipts are nowhere most evident than in corporate taxation (i.e., the profit tax as it is known in Georgia). Indeed, corporate income tax revenues in 2020 were lower than in 2015, declining to GEL 919

Table 13: Tax Revenues in Georgia.

Tax Revenues	Tax Revenues	Value-added	Income	Excise	Profit	Property	Custom	Other
Fiscal ear 220 (GEL, million)	10 964	4 837	3 327	1 619	919	434	74	-246
% of total	100,0%	44,1%	30,3%	14,8%	8,4%	4,0%	0,7%	-2,2%
% of GDP	22,2%	9,8%	6,7%	3,3%	1,9%	0,9%	0,2%	-0,5%

Source: GEOSTAT

Table 14: Tax Revenues' Compound Annual Growth Rates (CAGR) in Georgia.

Tax Revenues	GDP	Tax revenues	Value-added	Income	Excise	Profit	Property	Custom
CAGR 2010-2015	9,2%	10,5%	9,7%	13,1%	9,2%	12,2%	8,6%	-0,3%
CAGR 2015-2020	7,8%	6,5%	6,7%	8,4%	13,2%	-2,2%	8,4%	1,5%

Source: GEOSTAT

million from GEL 1 025 million.[5] The 2017 corporate income tax reform (see section 2) contributed to that change by decreasing the tax base and pivoting the burden of taxation away from corporate taxes. In contrast, excise revenues have increased substantially, growing at a compound annual growth rate of 13.2% between the end of 2015 and 2020, almost doubling the amount collected, and comfortably surpassing the profit tax in total tax revenues. The rise of excise duties has seemingly led to discontent amongst the business community (Bukia, 2019).

There is room for improvement in Georgian taxation. Improvements can be achieved not only in tax policy, but also in tax administration. In a previous ILO assessment, 86% of respondents had characterised the tax collection process as cumbersome (ILO, 2016). Five years later, there are still gaps in policy, and administrative efficiency remains sub-optimal. This report is concerned about the quality of business taxation in Georgia, with a special focus on MSMEs and its preferential tax regime. According to data from GEOSTAT (Georgia's statistical office), individual entrepreneurs (i.e. also called self-employed or own-account workers) represented 60% of active Georgian enterprises at the end of 2019, and SMEs accounted for 65% of total employment amongst registered entities. However, a large proportion of employment is still held outside of the formal economy, which is typically populated by micro and small businesses. Estimates for labour informality tend to vary widely, but local official statistics indicate that informal labour in 2020 was equal to 31.7% of total non-agricultural employment. The ILO, for its part, had previously estimated informality as high as 44.3% (2019), but has since revised its data to 26.0% (2020). The tax-related challenges that policymakers face in Georgia are

5 As of 12 September, 2021, Georgian Lari (GEL) were exchangeable in international currency markets at a rate of 1 GEL for 0.27 Euros (EUR) and 1 GEL for 0.32 US dollars (USD), respectively.

therefore twofold: policies and administrative requirements must incentivise business registration and growth simultaneously. The rest of this chapter report is structured as follows. In sections 2 and 3, we address the general system of taxation in Georgia, and how different tax preferences shape existing incentives and policy directions. We then conclude by discussing policy gaps and recommendations in section 4.

3.2. The General Tax System of Georgia and How It Affects Taxpayers

The existing tax code in Georgia entered into force in 2011 and has since undergone multiple amendments. At the time of preparation of this report (last quarter of 2021) the latest online version is dated 22 July 2021 (in Georgian language only). An English translation, dated 16 October 2019, is also available online. The most relevant institutions in the domain of taxation are the Ministry of Finance and the Revenue Service. This section contains a description of the taxes encountered in Georgia, which are related to business activity, as well as the main features of tax administration.

3.2.1. Personal income taxation

Georgia applies a 20% flat tax on personal income earned by resident taxpayers. A resident is a natural person who has spent 183 days or more in the territory of Georgia, during any 12-calendar month period ending in a tax year. The statutory rate on salary income in Georgia is above the median 18% personal income tax observed in other Eastern Partnership countries. Dividend and interest incomes are taxed at 5%. Rental incomes are taxed at 5% as well, under a simplified, no-deduction regime (or otherwise at 20%), and the same rate applies to the capital gains tax at individual level. Royalties (bar those earned by VAT registered natural persons) are taxed at the 20% standard rate. Other sources of personal income are also subject to income taxation. These include free-of-charge property transfers (above GEL 1 000) by natural persons not registered as individual entrepreneurs and income earned by natural persons rendering services (bar persons registered as VAT payers and/or benefiting from other special treatment. Personal income is generally subject to payment at the source, except for rental income and persons working for free industrial zone enterprises (see section 2). The withholding of taxes also applies to dividends, interest income, and royalties paid to non-residents (all taxed at 5%). There are no net wealth nor net worth taxes in Georgia. As regards personal income tax administration, payment is online. According to the Doing Business paying taxes sub-index, it takes 56 hours per year to complete, file and pay the tax (Table 15). That is the least lengthy amongst Eastern Partnership countries.

Personal income tax credits and exemptions are available under the Tax Code. Taxable incomes up to GEL 6 000 are exempt under specific conditions. These tax credits are available to persons with disabilities, war veterans, single mothers, permanent residents of mountainous regions, and other targeted social groups. Interest income from sovereign debt securities, as well as surplus income from their sale, do not pay taxes. In addition, surplus income resulting from property sales on assets owned for more than two years are also exempt, as well as surplus gains obtained from the sale of vehicles owned for more than six months. Finally, taxable income earned from agricultural activities benefits from a rather large exemption of GEL 200 000, which will expire in 2023.

Property tax in Georgia is progressive. For families with annual incomes up to GEL 100 000, property market values are taxed at rates between 0.05% and 0.2%, but these are exempt if families' annual incomes are below GEL 40 000. For families earning more than GEL 100 000 per year, applicable tax rates on property market values are set between 0.8% and 1.0%. Property tax is also levied on land, consisting in a nominal levy per hectare depending on the asset's location (e.g., land assets in the Tbilisi administrative area pay GEL 100 per hectare). Georgia does not wield gift or inheritance taxes on property in so far as gifts and inheritances are received by first-and second-line heirs, which are fully exempt. Otherwise, for third-and fourth-line heirs, property values received as gifts or inheritances are exempt, but only up to GEL 150 000.

In response to Covid-19, the government instituted several personal income-related benefits and tax exemptions. In 2020, direct governmental support in this domain, worth GEL 775 million (1.6% of GDP), included the following measures: increased benefits for furloughed workers and people that lost their jobs; assistance to self-employed workers experiencing declining incomes; and income tax exemptions on salaries up to GEL 750 (GoG, 2020). In sectors most affected by the pandemic, such as the tourism sector, withholding of income tax as well as property tax payments were deferred (Schreiter, 2020).

Since 2019, the pension system in Georgia has operated under a dual framework of private individual accounts and public pensions. The new features introduced in 2019 have supplemented the previously existing public pension system, which consisted only of a flat, universal basic pension (Hutsebaut, 2017), exacerbating poverty risks among older people. Under the new framework, people employed in the formal economy who are less than 40 years of age are to pay defined contributions into individual accounts. People over 40 years of age as well as the self-employed can enrol into the new system on a voluntary basis. Enrolled employees pay 2% of their gross salaries into a private individual account, while employers pay another 2% into the same account. The state then tops-up employee and employer contributions by transferring a further 2% on salaries up to GEL 24 000 or 1% on incomes between GEL 24 000 and GEL 60 000 (i.e., government contributions are capped at an annual ceiling of GEL 60 000). Self-employed workers pay 4% of annual income, which is also topped-up by the government subject to the same contribution percentages and nominal thresholds applying to employee salaries. Arbitrage opportunities usually associated with differing personal income tax rates and payroll taxes, applicable to employees and self-employed, are thus not evident in Georgia. That speaks well of tax policy design and should in principle support start-up development.

Personal income taxation in Georgia is supportive of entrepreneurial development. Most importantly, the flat tax arrangement, as opposed to a progressive tax structure, offers no disincentives to income growth. It may also prove attractive to the Georgian diaspora, particularly those active in entrepreneurship elsewhere, to whom the 20% PIT rate offers an additional incentive in returning home from higher taxing countries. Special tax treatment for so-called nomad (high-skilled) workers could be envisaged as well. The inexistence of wealth, inheritance, and net worth taxes are other potent features as regards incentives for capital accumulation. Moreover, reduced rates applicable to dividend, interest, and rent earnings are also coherent with the idea of stimulating capital investment, without which entrepreneurship is stifled. Some improvement could be achieved in the tax treatment of royalties earned at the individual level, which are taxed at a standard 20% rate for individuals not registered as VAT taxpayers. That standard rate could perhaps be realigned with capital gains tax and financial income taxation, which are both set at 5%. In addition, property tax should be realigned within the scope of Georgia's most characteristic feature of

▶ Table 15: Personal Income Taxation (PIT) in Eastern Partnership countries

PIT paying details	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Notes on payment	online	online	online	online	online	**online**	online
Time (hours, income tax or social contributions)	94,0	65,0	59,0	86,0	92,0	**86,0**	56,0
Statutory tax rate	22%	25%	13%	12%	18%	**18%**	20%

Source: Doing Business 2020, Pwc Worldwide Summaries (for social contribution rates) personal taxation: a flat (property) tax rather than the progressive rates in place. As regards the administration of personal taxation, data suggest a benign situation in Georgia. Not only is payment at the source the general rule, but filings also tend to be made online, reducing the friction involved in tax payments.

3.2.2. Corporate income taxation

Georgia applies a 15% flat tax on corporate income earned by registered legal persons. The profit tax, as it is called under Georgia's Tax Code, is paid by resident enterprises as well as by permanent (local) establishments owned by non-resident enterprises earning income from activities conducted in the country. The 15% rate – which, bar Moldova's statutory 12% rate, is the lowest amongst Eastern Partnership countries – is levied on four main objects of corporate taxation: distributed profits; costs and payments not related to economic activity; free delivery of goods and services and/or (free) transfer of funds; and entertainment expenses. Interestingly, the tax code does not levy the profit tax on non-distributed profits. This specific feature marks a major difference compared to traditional corporate taxation, which usually taxes all profits. Changes were introduced in the latest (2017) reform of Georgia's corporate income tax, taking inspiration from Estonia's framework for corporate taxation. The motivation associated with exempting non-distributed profits is about incentivizing the accumulation of internal equity, which is a policy concern in a country where external equity financing is challenging (see section on Finance). Corporate income tax has been in existence in Georgia since 2005. However, it coexists with other preferential tax regimes that allow beneficiaries of special treatment to opt-out of standard corporate taxation (see section 3). The 2017 reform has thus been an attempt at revamping the standard regime. Some sectors though, such as financial services, are not required to migrate to the new framework before the end of a transition period ending in 2023.

Tax exemptions have been streamlined following the 2017 reform of the profit tax. Amendments to the Tax Code have since reduced the number of exemptions allowed in the law, going to the heart of what is expected of a flat, low-tax structure of corporate income taxation as the one observed in Georgia. But nonetheless, two significant areas of distributable profits remain safeguarded against taxation: a GEL 200 000 exemption on profits resulting from the primary supply of agricultural products (i.e., before their industrial processing), and a full exemption on profits generated by businesses that benefit from special tax treatment. The first exemption is due to expire in 2023; it follows an identical exemption encountered in personal income taxation related to agricultural activities (whereby the same tax advantage applies to employees' personal incomes). As regards the second targeted exemption, it must be understood in the general context of Georgia's tax policy. Special tax treatment applies in Georgia on entities registered under different statuses and subject to different tax codes. The profit tax, in matters of special treatment, singles-out the following entities as beneficiary of non-taxable profits: free industrial zone enterprises; special trading companies; special enterprises; and high-mountain settlement enterprises (see section 3 for further details). During the Covid-19 crisis, certain sectors, such as tourism, have also been allowed deferred payment.

The profit tax is relatively straightforward and pro-business. From an administrative point of view, the flat tax structure simplifies the calculus of taxation and there are also no local or regional top-ups in the administration of the tax. Depreciation schedules for fixed assets vary between 5% and 20%. Accelerated depreciation rules are also available, allowing for the full deduction of depreciation costs of fixed assets. Intangible assets are depreciated according to their anticipated lifecycle, or otherwise at a rate of 15% per year. Research and development expenses are also tax-deductible. Interest expenses are deductible as well, and without limit under the official cap established by the government on the upper boundary of interest rates (i.e., to avoid usury). Finally, rules on the carry-forward of losses establish periods stretching from 1 to 10 years. Tax administration in Georgia should be simple compared to other countries, and relatively less onerous for businesses. And indeed, Georgia's profit tax amounts to only 7.8% of total business profits – the lowest burden observed amongst Eastern Partnership countries (Table 16). However, as regards the time to complete, file, and pay the tax, other countries perform (slightly) better.

▶ Table 16: Corporate Income Taxation (CIT) in Eastern Partnership countries.

PIT paying details	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Notes on payment	online	online	online	online	online	**online**	online
Time (hours)	89,5	50,0	64,0	42,0	36,5	**50,0**	**51,0**
Statutory tax rate	20,0%	20,0%	18,0%	12,0%	18,0%	**18,0%**	15,0%
Total tax and contribution rate (% of profits)	21,8%	12,7%	11,1%	8,5%	10,2%	**11,1%**	7,8%

Source: Doing Business 2020

The profit tax is calculated and paid monthly. Taxable amounts, meaning the disbursements and expenses established as the objects of Georgian corporate taxation, are grossed-up by applying a coefficient of 85%. The resulting amount is then taxed at the standard 15% flat rate (i.e., the tax base is divided by 0.85 and then multiplied by 0.15, thus arriving at the amount of tax due). Profit declarations must be submitted to the Revenue Service by the 15th day of the month following the reporting month, with taxes being paid monthly as well. The distribution of dividends is subject to withholding at a rate of 5% whenever distributed to a natural person, a non-commercial legal entity, or a non-resident enterprise. Under the Georgian tax code, these net distributions are then excluded from the receiver's tax base, thus avoiding the double taxation of dividend incomes. The tax code also establishes that dividend distributions between resident enterprises operating under the profit tax regime are not subject to withholding. The same applies to dividends earned from a free industrial zone enterprise, whereby earned dividends are also excluded from the receiver's taxable gross income. As regards group taxation, there are no especial provisions. Businesses cannot set-off losses intra-group and must file separate tax returns. Furthermore, transfer pricing violations are subject to profit tax and liable for tax penalties. Country-by-country reporting is mandatory as of reporting year 2020 for multinational groups (boasting annual revenues above EUR 750 million).

3.2.3. Value-added tax regime

The standard VAT rate in Georgia is 18% and the mandatory registration threshold is GEL 100 000. The VAT rate is below the median level observed in other Eastern Partnership countries, and so is the minimum threshold for mandatory registration (Table 17). There are neither intermediate nor reduced rates. Nonetheless, many goods and services are exempt from VAT, effectively benefitting from a zero-rate. Feedback from local respondents suggests that VAT administration is a concern in Georgia. That concern is seemingly corroborated by successive amendments to the tax code over the past decade. It is also supported by data highlighting the relatively great number of hours needed to complete, file, and pay the tax. In Eastern Partnership countries it takes 55 hours to comply with VAT filings and payments, but in Georgia the procedure is twice as lengthy (109 hours). VAT exists in Georgia since 1993. However, following the 2014 EU-Georgia Association Agreement, and the 2016 Deep and Comprehensive Free Trade Area (DCFTA) deal, Georgian VAT regulations have converged towards EU rules. Changing tax laws are fertile ground for poor adoption. VAT exemptions and restrictions on deductible VAT are also usually complex, creating additional challenges such as distortive effects on business competition and burdensome tax administration. The Revenue Service has introduced innovative initiatives, such as the RC-CAR Mobile Service Centres , to inform taxpayers on tax obligations. But the root problem lies perhaps deeper in the

Table 17: Value-added tax in Eastern Partnership countries

PIT paying details	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Notes on payment	online	online	online	online	online	**online**	online
Time (hours)	80,5	44,0	47,0	55,0	199,0	**55,0**	109,0
Statutory tax rate	20%	18%	20%	20%	20%	**20%**	18%
Mandatory registration threshold (local currency)	AMD 115 000 000	AZN 200 000	na	MDL 1 200 000	UAH 1 000 000	**92 600**	GEL 100 000
Mandatory registration threshold (USD, approx.)	241 500	118 000	na	67 200	37 000	**92 600**	32 000

Source: Doing Business 2020, Pwc Worldwide Summaries (for registration thresholds); USD exchange rates as quoted on 28 July 2021

Table 18: VAT Refunds in Eastern Partnership countries.

VAT Refunds: postfilling measure of quality	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Percentage od cases exposed to a VAT audit (%)	50-74	75-100	na	75-100	75-100	**75-100**	50-74
Time to comply with VAT refund (hours)	8,0	15,0	na	8,0	16,0	**11,5**	22,0
Time to obtain VAT refund (weeks)	28,0	29,0	na	13,0	14,0	**21,0**	10,0

Source: Doing Business 2020

complexity of VAT policy and in the myriad of tax statuses available to businesses exhibiting different VAT eligibility criteria (see section 3).

VAT payments are operated monthly. Cash registering of taxable transactions is mandatory, and only cash registering models allowed by the Revenue Service are permissible. Filing returns must be submitted until the 15th day following the reporting month. VAT is levied on taxable transactions; imports; exports and re-exports. Multiple VAT exemptions are allowed under the tax code's article 168, particularly in areas related to international commerce. Export and re-exports of goods are exempt from VAT (with the right to deduct input VAT expenses) if properly documented and filed with customs. Imports benefit from an extensive list of exemptions as well. The system operates under a traditional input-output model, whereby deductible VAT amounts paid on inputs reduce the final tax liability. Reverse charges, whereby tax liabilities are remitted by buyers (not sellers) of goods provided or services rendered, are also covered within special rules provisions. However, according to the World Bank's latest Doing Business report, data suggest that the execution of VAT refunds remains challenging in Georgia. The country is seemingly the worst performer amongst Eastern Partnership countries as regards the time needed to comply with VAT refund procedures (Table 18). As of 2021, foreign entities conducting digital sales in Georgia must be registered payers of local VAT. From July 2021, the EU's e-commerce package will have been fully in force. In this respect, since January 2021, Georgia has participated in a pilot project promoted by EU4Digital designed to ensure a smooth adoption of the EU's e-commerce standards in Eastern Partnership countries.

VAT refunds are operated monthly, and a fully automatic refund system has been in place since 2019. Early indications suggest that taxpayers have approved of the change in VAT administration, contrary to prior perceptions. According to the Revenue Service, during the first semester of 2021 more than 80 000 applications were submitted, and refund payments worth GEL 800 million were processed . That is an amount equivalent to 16.5% of 2020 VAT revenues, and 1.6% of 2020 GDP. However, extant research and feedback from local interviewees highlight two areas of taxpayer concern in VAT. First, the issue of VAT being levied on advance payments (since 2017). This stems from the harmonisation of Georgian and EU regulations on VAT, but nonetheless, it has been singled-out as the measure, introduced by recent tax reforms, carrying the most negative impact on businesses (Bukia, 2020). A second issue has arisen with respect to the definition of taxable transactions subject to VAT associated with the alleged discretion allowed to the Revenue Service under article 73.9b of Georgia's tax code. This article establishes that "To determine tax liabilities, a tax authority has the right (...) to change the classification of a business transaction based on its form and substance if the form of the transaction does not correspond with its substance". This kind of discretion, while intended at disincentivising evasion, may also lead to confusion in a country where informal transactions, including barter transactions, are still widespread. To address (some of) these concerns, the transfer of goods-samples and small-value gifts have been made exempt from VAT since 2020.

3.2.4. Other taxes – excise, import, and business property taxes

Excise duties are a relevant feature in Georgia's tax structure. These duties are levied on three main categories of goods: alcoholic beverages; tobacco products; and petroleum-and oil-related products. In addition, other goods, such as light vehicles and lubricants, are excisable as well. Exports and imports of excisable goods are treated as taxable transactions. Deductions are allowed as regards excise duties paid for inputs used in the production of excisable goods. Duties are paid monthly. In 2020, excise duty revenues amounted to 14.8% of overall tax revenues.

Import taxes have been alleviated following the EU-Georgia Association Agreement in 2014. Industrial goods imported into Georgia from the EU are now exempt from customs duties, and only minor tariffs remain in place for agricultural trade. Nonetheless, imports from EU countries accounted for only 23.1% of total imports during the first semester of 2021, and trade with other countries is still taxed for customs duties. Non-EU goods imports are levied at rates of 5% and 12%, or otherwise fixed charges, depending on the type of imported good.

Resident and non-resident enterprises are subject to property tax. Qualifying property includes fixed assets, investment property, and land, although exemptions are available. Tax revenues are assigned to local government, with firms paying 1% on the average annual net book value of taxable property. Tax liability can be reassessed under the statute of limitations, if market value is greater than net book value. Taxable property acquired before 2004 is also subject to revaluation. Land is taxed at basic rates per hectare, depending on end-use and location.

3.2.5. Tax compliance, enforcement, and reporting

Tax payments are generally due monthly, filings are available online, and payment at source is commonly used. These administrative principles, which are consistent with best international practices for reasons of timeliness and tax collection efficiency, apply to personal and corporate income taxes. As regards corporate income taxation, while the new 2017 framework establishes monthly payments as the general rule, certain economic activities (such as financial services) remain in the old profit tax regime under a transition period which will expire in 2023. For these businesses, profit taxes are paid quarterly, in the form of current taxes based on the previous year's tax liability, subject to final annual adjustments for remaining tax liabilities. Value-added tax is paid monthly, cash-registering and invoicing are mandatory, and VAT refunds can be processed through an automatic electronic system. (However, the time to file, complete, and pay VAT remains surprisingly high in Georgia compared to other Eastern Partnership countries). Excise duties are also paid monthly, except for excisable imports whereby the payment schedule is the same as that applying to import duties (payable within 5 to 45 days of goods release from customs). The main exception to the monthly payments general rule is property tax (and rental income), which is levied annually upon the submission of tax declarations. The Revenue Service assists compliance through tax and customs assistants as well as digital tools, such as a VAT portal on digital services, a customs duties calculator, online application forms, and others.

Tax compliance and enforcement mechanisms are forceful. Tax authorities may resort to liens/mortgages on any type of property owned by taxpayers, except those held under leases, to secure outstanding liabilities, simply by sending out a notice exercising the right. They may also seize any assets owned by debtors (once again, provided that those assets are not under leases), without any court decision whatsoever (article 241.1). Bank collection orders are also available under the taxman's artillery against tax arrears. Surety contracts and (irrevocable) bank guarantees are admissible to cover for tax arrears. Feedback from local interviewees has revealed discontent with some of these practices. Tax enforcement is comprehensibly not a pleasant endeavour. But taxpayers have complained about the excessive use of liens and seizures when the tax debt value is lower than the monetary value of assets, bank balances, and property forcefully secured by authorities. These administrative practices are predatory and incentivise not only informality, but also asset concealment, hurting access to finance. To prevent the build-up of tax arrears, authorities resort to standard current controls and audit. These include on-site and off-site audits, taking stock of inventories, inspection activities such as control of cash registers and controlling purchases of goods and services, and others. The statute of limitations, meaning the amount of time authorities can clawback from present date to collect pending tax liabilities, has been set at three years since 2017. However, for businesses using the 10-year loss carry-forward disposition, allowed under article 122 of the tax code, the statute of limitations is set at eleven years.

Tax disputes are resolved under a two-staged system. The competent authorities are the Revenue Service and the Dispute Resolution council (an administrative body under the Ministry of Finance), on one hand, and the court system, on the other hand. Complaints should first be filed with the Revenue Service. If not vindicated, they can be further appealed to the Dispute Resolution council. Tax disputes under this council are in theory swift. According to the tax code (articles 302 and 303), appeals to the council shall be resolved within 20 days, and no appeal should be suspended (to obtain additional information) for more than 45 days. Notwithstanding the clarity provided in the law, feedback from local respondents suggests that tax disputes are rather lengthy and that a better balance between taxpayer rights and administrative power wielded by authorities would be helpful. It is also unclear how apt the general court system is at dealing with tax disputes and related issues in tax compliance and enforcement. To address disputes pre-emptively, the Revenue Service produces advanced rulings on tax issues upon request of private enterprises. These requests provide clarity and predictability, but also carry a cost of GEL 5 000, when requested by natural persons, or otherwise GEL 10 000. Advance rulings are issued within 90 days, upon approval of the Minister of Finance, and are administered by the Head of the Revenue Service. Rulings may also be appealed under the two-staged system of tax disputes.

Tax compliance and enforcement is assisted by business reporting standards. Since 2016, the Law on Accounting, Reporting, and Audit stipulates that all registered enterprises are required to comply with International Financial Reporting Standards (IFRS), except for the smallest category 4 enterprises. The adoption of the IFRS framework places the country at par with best-in class reporting standards worldwide. A category 4 enterprise is one which meets two of the following three criteria: assets valued at less than GEL 1 million; annual revenues of less than GEL 2 million; or less than 10 employees. Full IFRS standards apply to category 1 enterprises, the largest, whereas the IFRS for SMEs standard applies to categories 2 and 3. Category 2 encompasses enterprises with revenues between GEL 20-100 million and 51-250 employees. Category 3 includes businesses with revenues between GEL 2-20 million and 11-50 employees. The reporting process is annual and occurs in October with reference to the previous reporting year. It initiates with the company's annual report, and auditor assessments. These are then processed by SARAS, an administrative unit under the Ministry of Finance, and finally the information is deposited online at REPORTAL. In addition, information about business procedures subject to public registry are also available at the National Agency of Public Registry. These are all demanding requirements for small-sized enterprises. Nonetheless, private-and public-sector organisations, as well as donor institutions, have been actively involved in training efforts directed at SMEs.

3.3. Overall assessment of general taxation in Georgia

There is no major flaw in Georgia's general tax policy. This message is consistent with Georgia's place in international rankings on taxation, and the analysis conducted in this section has indeed found no significant failure in general policy design. The main taxes – PIT, CIT, and VAT – are designed as flat rate taxes, closely (although not perfectly) aligned between each other, thus minimising distortionary effects on competition, inefficient tax expenditures, and arbitrage opportunities. In PIT, reasonable exceptions to the main rate apply to specific cases, such as the lower rate on dividend, interest, and rent incomes, which play an important role in the promotion of savings, investment, and capital deployment. In CIT, the new (2017) system has been modelled (although not as an identical twin) upon Estonia's framework, which over the years has been lauded as a role model by proponents of flat taxation and an example of administrative efficiency as well. In particular, the new streamlined, standard framework for enterprises has made taxes timely, eliminating the need for (imperfect) current taxes based on previous fiscal periods. And after years of instability, Georgia is now aligned with EU VAT-law, including in the field of digital transactions. The 2014 EU-Georgia Association Agreement, by downgrading the importance of customs duties, has also contributed to a more open economy.

Yet, there are policy improvements to be made in individual taxes. Tax policy is inherently complex, thus, inconsistencies in individual taxes are bound to occur. In Georgia, for example, there is a large PIT exemption for agricultural-related labour income. While this exemption is due to expire in 2024, it is distortive in the general context of personal taxation, and at the same time paradoxically supportive of the informal economy (a significant issue in Georgia). Still related to individual taxation, Georgian property tax is progressive, depending on families' annual incomes, which is incoherent with the idea of having a flat PIT framework. A complete capital gains exemption on the sale of property assets owned for more than two years is also inconsistent with the capital gains tax of 5% levied at the individual level. In other taxes, the standard system of corporate taxation, the Georgian profit tax as it is known, reflects good international design (as in the realm of flat CIT frameworks), but it is seemingly struggling to make an impact. This is likely related to the extent to which CIT is undermined by the existence of multiple MSME preferential tax regimes (see section 3), which reduce the number of enterprises under the (not so) standard regime. In any case, there are also exemptions in CIT (again agricultural-related activities, and indirectly a large exemption on interest expenses by having no cap on these in the profit tax), as well as a transition period from the old system (due to expire in 2023), that are perhaps holding back the new system's potential for balancing revenue collection and growth incentives.

The administration of VAT is the most troublesome feature of Georgia's general taxation on businesses. VAT has endured countless changes over the years, most recently due to the alignment of local rules with those of the EU. There are also issues related to the contentious use of administrative discretion in defining the scope of taxable transactions – as a general theme, businesses have also expressed concerns about the lengthiness and the (lack of) impartiality in the tax dispute resolution framework –, and some other features of the VAT system, such as tax liabilities on advanced payments, while unsurprising for outsiders, are still fraught with local misunderstanding. The threshold for VAT registration (GEL 100 000) is low in Georgia compared to other countries in the Eastern Partnership region (although higher than in several EU countries), and VAT revenues are the largest contributors to government coffers. Therefore, on one hand, VAT is paid by smaller business compared to what likely occurs elsewhere in the region. And on the hand, government will be defensive on any proposal resembling, or suggesting, the idea of losing tax receipts. More efforts should thus be placed on educating taxpayers on VAT compliance. Administrative actions focused on increasing the uptake of e-filings (and e-refunds of VAT) and actions supporting the digitisation of business transactions should also be a priority.

Recommendations to improve the competitiveness of general business taxation policy in Georgia could include the following measures:

- Eliminating fixed assets and investment property from the list of qualifying assets subject to property tax applicable to legal persons.
- Eliminating taxes on dividends distributed by enterprises subject to the profit tax.
- Promoting educational initiatives on VAT compliance, such as monetary awards and PIT deductions derived from transactions in the formal economy.
- Refining the regulation on the use of liens, mortgages, and asset seizures in tax enforcement.
- Reforming the tax dispute resolution framework.

3.4. Tax Preferences for MSMEs.

Georgia exhibits a myriad of tax statuses for MSMEs, but little investor-level tax incentives towards investing in MSMEs. Preferential regimes for MSMEs are a common feature around the world. They seek to promote business registration, tax compliance, and tax advantages tailored to small(er) businesses. This section describes options available to businesspeople in Georgia, each one entailing not only distinct tax rates, but also different compliance procedures. The section concludes with a general note on preferential taxation for MSMEs.

3.4.1. Business-level preferences

Individual entrepreneurs in Georgia can establish microbusinesses exempt from income taxes. An individual entrepreneur, under the tax code, is a natural person engaged in business activities. This business status is the most common in Georgia. In 2020, amongst active (business) entities, 60% were registered as individual entrepreneurs (Table 19). This status follows not only the tax code, but also Georgia's Law on Entrepreneurs. It requires that individuals must register as entrepreneurs at the Entrepreneurial Registry, operated under the Ministry of Justice, before engaging in for-profit economic endeavours. Individual entrepreneurs without employees, or "businesses-of-one" as the self-employed are also referred to in the literature (Phillips and McKeown, 2016), constitute a microbusiness in Georgia. Having no employees is a first condition. A second condition is having a gross receivable income of no more than GEL 30 000 per year. Georgian microbusinesses are entirely exempt from income tax, and they are also not subject to any accounting requirements. However, they are required to keep records of business transactions (referred to in the tax code as "tax source documents"), including barter transactions, and a tax return must be filed annually as well. Microbusinesses cease as such under three scenarios: administrative revocation of the status; inventory stocks valued at more than GEL 45 000; or upon VAT registration. This simplified framework for microbusiness has been in place since 2011, and it is the first pillar of preferential taxation for MSMEs in Georgia.

Table 19: Business Demographics by Legal Form in Georgia

Business demographics	2014	2015	2016	2017	2018	2019	CAGR, 14-19
TOTAL Nmber of Active Entities	127 959	157 383	160 372	157 829	158 487	166 833	**5,4%**
Individual Entrepreneur	74 407	99 643	98 096	96 217	92 800	100 174	**6,1%**
% of total active antities	58,1%	63,3%	61,2%	61,0%	58,6%	60,0%	
Limited Liability Company	51 802	55 907	60 373	59 913	63 998	65 015	**4,6%**
% of total active antities	40,5%	35,5%	37,6%	38,0%	40,4%	39,0%	
Others	1 750	1 833	1 903	1 699	1 689	1 644	**-1,2%**
% of total active antities	1,4%	1,2%	1,2%	1,1%	1,1%	1,0%	

Source: GEOSTAT

Individual entrepreneurs can also be granted small business status. This regime caters to individual entrepreneurs employing hired labour, generating larger sales, and frequently already registered as VAT payers. Under this preferential regime, a turnover tax, rather than a profit tax, applies on gross incomes received from sales. Other incomes, such as financial streams and gains associated with capital transactions, are not taxed as turnover, but as incomes subject to income tax. Salaries paid to hired labour are subject to withholding payments, except for hired workers with annual salaries up to GEL 6 000 employed by small businesses with annual sales no greater than GEL 50 000. Cumulative monthly turnover (sales) up to GEL 500 000 is taxed at a rate of 1%, whereas excess sales above GEL 500 000 are taxed at 3%. Payments are made monthly and must be accompanied by a (monthly) tax return. Advance payments, based on the previous year's activity, may also be required (in four instalments during the taxing year, under article 94.2). Special accounting requirements (i.e., a "special journal") are specified by the government. The government also specifies the list of economic activities allowed under this regime. The production of excisable goods by small businesses, for example, is not allowed. A business will lose its small business status if it is found to be engaged in prohibited activities, or in violation of cash registering rules three or more times during a calendar year. Businesses with sales exceeding GEL 500 000 during two calendar years and having benefited from the small business status for at least two years will also have their status cancelled.

The fixed taxpayer status is an additional option for individual entrepreneurs. This regime is available for individual entrepreneurs not registered as VAT payers and engaged in local (proximity) businesses, such as bakeries, beauty salons, and vehicle maintenance and repair shops. Only activities specifically allowed by government fall under this tax status. These businesses pay a fixed basic rate which is determined by the government per each type of activity. For example, bakeries will be taxed based on the tons of bread consumed, and salons will be taxed according to the number of working places on display. According to article 95 of the tax code, levies may vary between GEL 1 and GEL 2 000 per object of taxation (e.g., tons of bread or barber chairs), or otherwise 3% of taxable revenues. Payment is monthly, and no advances based on previous years' activities are required. Businesses under this preferential regime are allowed to hire workers, but income paid to hired labour is subject to withholding payments established in the (personal) income tax. However, within permissible activities, fixed taxpayers are not required to abide by cash registering rules, nor are they required to maintain accounting books or submit annual tax returns. Furthermore, sales generated by permissible activities are also not taken in account for VAT purposes. This latter feature is somewhat paradoxical because VAT registration, following mandatory VAT registration requirements, constitutes reason for the disqualification of fixed taxpayer status under this regime's rules.

Enterprises based in free industrial zones (FIZs) are offered licensing, permit, and tax exemptions. FIZs are autonomous administrative designated areas within the territory of Georgia. Currently, there are four such zones. Permissible activities for businesses registered in FIZs include exports of goods from a FIZ to other countries, as well as re-exports of foreign-sourced goods, and imports of goods into a FIZ, including the import of Georgian-sourced goods (which count as Georgian exports) and imports of foreign-sourced goods. FIZ enterprises can also engage in the production of goods, in which case goods-produced will be considered as being of Georgian origin. The supply of goods between FIZ enterprises and resident companies (and vice-versa) is taxed at a rate of 4% levied on sales revenue, or otherwise at 4% of the market value of goods supplied. There are significant exemptions applying to FIZ enterprises as regards licenses and permits. One example is the licensing exemption for baby food production and packaging. FIZ enterprises are exempt from profit and property taxes. Imports of foreign-sourced goods are exempt from both VAT and import tax. FIZ enterprises buying goods from enterprises in other FIZs, which count as imports, are also exempt from import tax. Enterprises based in FIZs cannot purchase services from resident enterprises, other than basic utilities and additional goods and services necessary for operating purposes – which nonetheless cover a lengthy list of exceptions –, neither can they provide services to resident enterprises.

Special enterprises are exempt from both profit taxes and VAT. Special enterprises are companies engaged in the supply of Georgian goods to the territories of Abkhazia and South Ossetia, officially recognized as occupied territories of Georgia. This type of supply is exempt from VAT without the right to deduct. The production of goods in those regions, bar certain excisable products, and subsequent supply to other regions in Georgia is also allowed. These activities are exempt from VAT with the right to deduct. The profit tax exemption applies to both activities.

Individual entrepreneurs in high mountain settlements benefit from income tax exemptions. This applies to both personal earnings and business profits associated with production activities of firms granted the high mountain settlement enterprise status. The exemption is valid for ten years. However, it does not apply to earnings obtained from services rendered (only production and delivery of goods) nor to activities subject to licenses or third-party permissions. This disposition should be understood in the context of Georgia's Mountain Development Strategy.

Organised trade fairs offer participant traders the possibility of replacing the 20% personal income tax with a 3% turnover tax. Participants in organised trade fairs – these consist in permanent trade outlets, or at least ten mobile trade spots, and can only be established upon the government granting of a special status to a market organiser – must be registered as individual entrepreneurs and as from 2022 market organisers must ensure that all traders are equipped with cash registers. The 3% turnover tax is paid monthly and allows for no deductions.

Individuals engaged in short-term business rental activities benefit from a dedicated regime. Beneficiaries are those not registered as VAT payers, and not generating incomes from short-term rentals above GEL 100 000 during any 12-month calendar period. This regime targets activities in the tourism sector, in particular non-hotel stays. Tax payment is quarterly and subject to approval from the tax authority upon filing. These rules are not to be confused with the taxation of rental income earned from property owned and leased for residential purposes, which are covered under personal income tax rules and levied rates of 5% or 20% rate depending on the amount of deductions made.

There are too many options for preferential tax treatment in Georgia. Some of these are relatively minor in scope and significance, conveying political pleading to specific constituencies rather than producing meaningful policy actions or effects on overall tax policy. But others are relevant indeed, and some even questionable. Amongst the questionable, the fixed taxpayer status should be abrogated. This status is circumscribed to a limited set of business activities determined by the government, typically termed as proximity businesses, thereby being of divisive nature and not equally accessible to activities outside the list of activities deemed worthy of the status by governmental decree. That is the inequity argument against the fixed taxpayer status. But there is also an economic argument against it as well, notably the incentives for economic informality that it produces. Fixed taxpayers do not have to follow cash registering rules, nor are they subject to accounting requirements or annual tax submissions. The status thus exhibits a built-in incentive to avoid formal procedures and business documentation, and to avoid VAT registration altogether (which indeed constitutes reason for disqualification under the status). Tax policy and preferential treatment should aim at removing growth obstacles and providing less favoured enterprises a path for growth, one which ultimately leads to a more productive (formal) economy, not settle for less than that.

Certain regimes for preferential tax treatment in Georgia should be scrutinised for potential reform. With too many regimes available, it is not only the poor ones that should be reassessed. Good ones, often badly implemented, also deserve more scrutiny. Amongst these, the turnover tax should be closely followed, despite its recent reform. The turnover tax is also restrictive of activities permissible, providing yet another opportunity for governmental meddling. But in this case, perhaps most importantly, there is a problem with policy design in that the recent 2018 reform has left the turnover tax's higher threshold (GEL 500 000) out of sync with the mandatory VAT registration threshold (GEL 100 000). As referred to in section 3.3, this is not good practice. Eventually, this divergence will need to be sorted out either by increasing the threshold on VAT, lowering it in the turnover tax, or rebalancing both. Another regime which should be looked at is the FIZ preferential tax treatment. FIZs have been in existence in Georgia for several years. They come along with a host of exceptions and exemptions, such as licensing and taxing obligations, and should play a role in export activities, thereby, increasing potential GDP. But in practice, has the FIZ regime been effective throughout the years? Have the costs, direct and indirect, been sufficiently outweighed by positive externalities, such as greater exports or a greater technological intensity of exports? Policymakers and market participants should reflect on these issues when figuring out the validity of preferential tax treatment.

3.4.2. Investor-level tax preferences

Investor-level preferences in Georgian taxation consist of reduced tax rates and various direct exemptions, as well as indirect tax advantages generated by preferential MSME taxation. As described in sections 2 and 3.1, investors generally benefit from a reduced 5% personal income tax rate applying on dividends, interest income, and royalties. Capital gains tax at the individual level is set at the same 5% rate. Interest income resulting from government securities, and surplus income associated with their sales, are also not taxed. In addition, surplus gains from property transactions involving assets owned for more than two years are exempt as well. However, there are no investor-level incentives for directing personal savings into investments in MSMEs (see enterprise financing section of this report). As regards corporate income taxation, dividend distributions between companies subject to the profit tax are not subject to withholding tax, and the same applies to dividends paid by FIZ enterprises. FIZ enterprises are exempt from the profit tax. Special enterprises and high-mountain settlement enterprises are also exempt from the profit tax. There are no thin capitalization rules in Georgia, meaning that enterprises may freely deduct interest expenses subject only to an interest rate cap established by the government. Furthermore, capital raised through the issuance of debt and equity securities, tradeable in public markets, are not subject to profit tax either.

Investor-level preferences could be enhanced through additional exemptions. Yet, the challenge in establishing exemptions, as has been argued in previous sections, is that it is not easy to strike a balance between a reasonable economic goal (facilitated through taxation) and the inequities created in the process between taxpayers. For example, group taxation is not available in Georgia. Enterprises cannot offset losses intra-group and must file separately for taxes. From a policy perspective, the economic goal associated with group taxation is not always clear, while the disadvantages, such as tax complexity (which is frequently captured by larger groups through arbitrage and tax savings that are not as readily available to smaller businesses), is quite straightforward. Therefore, this is an avenue that is likely not worth being pursued. On the other hand, eliminating completely the double taxation of corporate income, by eliminating the taxation of dividends (which, resulting from net corporate income, have already been taxed through CIT before being taxed again as dividends), is perhaps a reasonable platform for new exemptions – one which has been adopted in Estonia, the role model for corporate taxation in Georgia. Another worthy idea would be to facilitate the development of alternative sources of finance for MSMEs, and generally the development of capital markets for smaller enterprises, through PIT exemptions on individual-level investor contributions to collective investment vehicles, as is the case in the United Kingdom via Venture Capital Trusts.

3.4.3. MSME preferential taxation regimes and Georgia.

Georgia has had a preferential tax regime for MSMEs since 2011. The novel framework ended a long struggle between policymakers in introducing a simplified, presumptive system of taxation for small-sized businesses. An initial attempt had been made in the mid-90s, which failed abruptly. A second attempt was made at the beginning of the millennium, yet it did not obtain lawmakers' approval. Eventually, a third attempt was successful and passed into law in 2011. The framework introduced a turnover tax applying on business revenues. Initially, the turnover threshold was established at GEL 100 000, up to which businesses would be taxed at rates of 5%, or otherwise 3% depending on the level of deductible and documented expenses. The system also established a floor of GEL 30 000 below which self-employed businesspeople without employees would not be taxed at all. Extant research has since concluded that the 2011 reform produced mixed effects (Bruhn and Loeprick, 2016). On one hand, it was indeed effective at inducing the registration of microbusinesses below the GEL 30 000 turnover tax exemption, although this largely resulted in a one-off effect by prompting the registration of already existing businesses in the informal economy. On the other hand, the reform produced a threshold effect on the upper GEL 100 000 boundary, lasting two years during which businesses showed signs of concentration around that turnover level and underreporting of business revenues as well.

The Georgian preferential tax regime for MSMEs was reassessed in 2018. Amongst the regime's key features, the GEL 30 000 minimum threshold remained unchanged. Eligible microbusinesses below that turnover level remain untaxed. However, the upper GEL 100 000 threshold was increased to GEL 500 000, and applicable tax rates were reduced to a 1% standard rate on turnover up to that new (upper) limit or 3% if above that limit under certain conditions. The VAT registration threshold, which previously had been set at the same GEL 100 000 limit applicable to the turnover tax, was kept unaltered. Thus, herein lies a challenge in the current policy design: typically, the same nominal threshold would apply to both VAT registration and the turnover tax's upper boundary (Wei and Wen, 2019), as indeed occurred under the original 2011 framework. In Georgia's case, changes introduced in 2018 created new inconsistencies between VAT and turnover tax, while also neglecting the integration of social benefits in the preferential regime framework. In other countries though, preferential tax regimes for MSMEs not only allow for administrative simplification, such as substituting more taxes for one single payment, but also extend the regimes into social benefits and other supporting policies (Marchese, 2021). Latin America, and to a lesser extent Asia, is home to many hybrid regimes emphasising the role of tax policy for MSMEs not only as a tool for simplified taxation, but also for increased formalisation and social inclusiveness (Box 1).

The effectiveness of preferential tax regimes in business formalisation depends on business capabilities. Taxation preferences for MSMEs are usually justified on the grounds of their contribution in reducing the weight of compliance fixed costs as a percentage of total revenues, improving access to external finance and larger markets through registration in the formal economy, and raising additional tax revenues that would otherwise remain uncollected in the informal economy. Special regimes for MSMEs typically follow four

▶ **Box 1: Argentina's "Monotributo".**

The "Monotributo" (Single Tax) is a presumptive tax regime based on turnover sales, which was originally established in 1998. Enrolment is voluntary, relying on regular self-assessment, and the regime is aimed at own-account workers and microbusinesses (with or without hired labour) operating in multiple economic activities including the agricultural sector. The single tax payment replaces (profit) income tax and VAT, and in addition also pays for social security and health insurance. Restrictions are placed on the size of premises used for commercial activity, annual electricity consumption, and annual rental expenses to control against fraud. The regime's structure consists of eight general categories of annual turnover (category A, starting at ARS 370 000 per year, through category H, starting at ARS 3.7 million) and three additional categories applicable to higher turnover levels and specific activities. The average tax burden across the eight general categories is equal to 0.5% of average turnover threshold levels, although slightly regressive (i.e., meaning a lower tax burden as turnover increases) up to category G for which the tax burden is 0.3% of the turnover threshold level (ARS 2.1 million). Within the "Monotributo" there is a specific sub-regime for agricultural activities, whereby small-sized agricultural (niche) producers are exempt from 50% of payments due.

Source: Marchese (2021) and AFIP Monotributo website (accessed on 3 August 2021).

modalities: presumptive regimes based on proxies measuring business activity (revenues, assets, or others); discounted or reduced corporate income tax rates; tax exemptions in certain taxes such as VAT; and tax credits (e.g., R&D or labour-related expenses) targeting a lower tax burden and the removal of growth obstacles (Marchese, 2021). However, making the most of these advantages depends critically on the ability and willingness of businesses to formalise, which is often missing in practice. In this respect, a recent literature review suggests that the impact of preferential taxation on the formalisation of low-productivity, subsistence-type businesses is barely inexistent (Amin et al., 2019). This is indeed a powerful argument for associating preferential tax regimes with policies aimed at building capacity in MSMEs, and perhaps including enhanced social benefits in the overall policy design as well. It is also an argument for including preferential taxation in formalisation strategies.

The labour market in Georgia is heavily tilted towards agricultural activities and this should not be ignored in MSME tax policy. Agricultural employment accounted for 38.1% of total employment in 2019, the highest amongst Eastern Partnership countries (Table 20). Furthermore, own-account workers also represented a larger than median percentage of employment (Table 21). These are relevant data because the structure of the labour market is usually intertwined with the level of business informality (Chacaltana and Leung, 2020). Many developing countries have introduced formalisation strategies over the years (Leung, 2020). The promotion of MSMEs is one key policy area addressed in those strategies. But a host of other policy areas, some of them related to MSME taxation and others not, are also part of formalisation efforts. Improved regulations, both on the legislative and business environment fronts, as well as labour inspections are the most common themes addressed in national plans against informality. Informality is commonly nested in agriculture. Therefore, bringing more people into the formal economy in Georgia will likely require a hybrid approach to incentivise potential taxpayers not only with the benefits of lower taxes, but also with the allure of social benefits such as access to pension schemes and health insurance. Pension schemes in Georgia have recently been revamped (see subsection 2.1). Yet, enrolment in the new defined-contribution system, while merely voluntary for people over the age of 40 and the self-employed, is disentangled from the preferential MSME tax regime. Social benefits should be integrated under that regime.

Georgia's preferential MSME tax regime remains underappreciated by local entrepreneurs. In a 2019 study, only 13% of respondents acknowledged the preferential regime for micro and small businesses as a positive-impact tax reform (Bukia, 2019). In contrast, according to the same study, 45% of respondents spoke favourably of the 2017 profit tax reform inspired in the Estonian model of corporate income taxation. The apparent indifference towards MSMEs

Table 20: Employment by Economic Activity in Eastern Partnership countries

Employment by economic activity	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Agriculture (thousands, 2019)	242	1752	529,4	280,8	2541,5	**529,4**	686
% of total (2019)	24,1%	36,0%	11,1%	21,0%	13,8%	**21,0%**	38,1%
Industry (thousands, 2019)	249	720	1454,3	290,9	4588,5	**719,9**	256
% of total (2019)	24,8%	14,8%	30,4%	21,7%	25,0%	**24,8%**	14,3%
Services (thousands, 2019)	516	2396	2802,8	767,9	11257,3	**2395,7**	856
% of total (2019)	51,2%	49,2%	58,6%	57,3%	61,2%	**57,3%**	47,6%

Source: ILO

Table 21: Employment by Status in Employment in Eastern Partnership countries

Employment by status in employment	Armenia	Azerbaijan	Belarus	Moldova	Ukraine	EPs (ex-Georgia)	Georgia
Employees (thousands)	665	1565	4582,1	923,8	15640,5	**1565,1**	904
% of total (2019)	66,0%	48,0%	95,8%	71,4%	85,3%	**71,4%**	50,3%
Employers (thousands)	9	666	42,1	3,6	140,8	**42,1**	36
% of total (2019)	0,9%	13,7%	0,9%	0,3%	0,8%	**0,9%**	2,0%
Own-acount workers (thousands)	320	1032	160,9	366,9	2564,4	**366,9**	538
% of total (2019)	31,8%	21,2%	3,4%	27,4%	13,9%	**21,2%**	29,9%
Contributing family workers (thousands)	13	1605	1,4	45,2	41,7	**41,7**	320
% of total (2019)	1,3%	33,0%	0,0%	3,4%	0,2%	**1,3%**	17,8%

Source: ILO

tax 665preferences is perhaps related to the frequent tax instability that has characterised policy over the years in Georgia, for which a low tax culture has not been helpful either (Abuselidze and Gogitidze, 2020). It is also likely related to the lack of business capabilities exhibited by many potentially qualifying entities, as discussed above, which means these companies are simply not interested in operating in the formal sector due to their very low average productivity. Another cause for discontent might be found in the government's micromanagement of authorised activities under the different tax statuses permissible to MSMEs, or in the no-employee limitation determined in the microbusiness status exempt from turnover tax (Erkomaishvili, 2016). Data show that the annual rate of growth in the registration of individual entrepreneurs since 2014 has been 6.1%, surpassing the 4.6% growth rate in the number of limited liability corporations. However, since the 2017-2018 tax reforms, which affected both the MSME regime and the corporate income (profit) tax, growth rates in the number of active registered entities have slowed, especially amongst individual entrepreneurs. Criticism is therefore seemingly corroborated by the data.

Preferential MSME tax regimes entice entrepreneurial activity but beware excessive simplification. Simplifying the administrative tax burden produces a positive effect on business establishment, and the effect is most powerful at the early stage of a business' life cycle (Braunerhjelm et al., 2021). From a tax collection perspective, promoting the establishment of new businesses, which can then eventually grow into larger firms, is indeed much more important than potential short-term gains in tax collection. Time and complexity associated with cumbersome tax administration come therefore at a (heavier) cost in terms of lost entrepreneurial activity and potential (future) tax revenues. However, oversimplification may also result costly. Fixed taxed regimes, which are encountered in Georgia under the fixed taxpayer status, are relatively popular amongst business-people operating small-sized businesses, yet they are hard to monitor and prone to abuse (Coolidge and Yilmaz, 2016). Moreover, as these businesses are generally under no bookkeeping or accounting requirements (as is the case in Georgia with fixed taxpayers), they tend to perpetuate a certain anti-tax culture, compromising the build-up of business and management capabilities as well. These effects lead not only to counter-productive business informality, but also to inherent growth obstacles.

A critical design aspect arising in preferential MSME tax regimes is related to potential threshold effects. Countries using a turnover-based, presumptive tax regime must establish the turnover tax threshold wisely. If chosen unwisely, the decision may produce distortive economic effects. Three policy options are usually followed in this domain: establishing the turnover tax threshold at the same level set for mandatory VAT registration; making the effective tax rate at the threshold level more onerous to businesses than the standard corporate income tax rate; or aiming to equalise after-tax profit margins across tax regimes and possibly across economic sectors as well (Wei and Wen, 2019). The problem with policy options is that some of them, while interesting from an academic perspective, are difficult to implement in practice. That is certainly the case when discussing effective tax rates and after-tax profit margins, although the emergence of real-time taxation may eventually herald a different future. As regards present-day studies, Wei and Wen (2019) estimate that the optimal turnover threshold is found between USD 100 000 and USD 150 000, and that the optimal tax rate is approximately 3% (assuming one single turnover tax rate for all sectors in the economy). These levels are roughly in-line with levels observed in Georgia's MSME presumptive tax regime, whereby a 3% turnover tax rate kicks-in at GEL 500 000 (approximately USD 162 000, as quoted on 28 July 2021).

3.5. Conclusions and Policy Recommendations

The VAT system requires reassessment. Data suggests that VAT administration is lengthy, although the introduction of automated refunds may have already yielded positive results. Higher take-up rates of the automated refund system would be positive. In addition, policymakers should also consider an assessment of the overall compliance burden associated with VAT administration, measuring the factors (or drivers) of compliance as described in Highfield et al. (2019): "tax law complexity and burden resulting from core elements of VAT policy; the number and frequency of administrative requirements to comply; revenue body capabilities in meeting taxpayers' service and compliance needs; and monetary costs/benefits associated with the act of complying" (Box 2). Streamlining exemptions and deductions would constitute a promising avenue as well, albeit at the risk of further increasing tax instability in the short run. The VAT may also require realignment with the preferential MSME tax regime.

▶ **Box 2: An assessment of the VAT Compliance Burden**

Factor A: Tax law complexity and burden resulting from core elements of VAT policy.

Indicators: The VAT rate structure; the scale (i.e. revenue impact) of reduced rates and exemptions; the use of cash records by specified small businesses to calculate the VAT liabilities; use of rules for prescribed industries that simplify calculations of VAT liabilities; VAT registration requirements; optionality (i.e. the availability of optional regimes to small businesses.

Factor B: The number and frequency of administrative requirements to comply

Indicators: Electronic VAT registration; staggered VAT payments for small businesses; staggered reporting filing periods; information requirements of typical VAT return form; documentation requirements for exported goods and services; other reporting requirements in addition to the VAT return; use of electronic VAT invoices between businesses; invoice reporting requirements to revenue body; record retention periods; number of VAT verification actions; level of disputed VAT assessments.

Factor C: Revenue body capabilities in meeting taxpayers' service and compliance needs

Indicators: The revenue body's website; the revenue body's phone enquire service; support for newly registered businesses; the revenue body's online tax payment facilities; the revenue body's VAT on-line transaction services; the revenue body's refunding of excess VAT payments; the revenue body's private rulings service.

Factor D: Monetary costs/benefits associated with the act of complying

Indicators: The payment of interest on delayed refunds; aggregate value of annual VAT refunds.

Source: As in Highfield, R., Evans, C., Tran-Nam, B., & Walpole, M. (2019). Diagnosing the VAT Compliance Burden: A Cross-Country Assessment. Available at SSRN 3726376.

The preferential MSME tax regime requires simplification and should be better integrated in overall public policy. Policymakers should eliminate the regime known in Georgia as the fixed taxpayer status. They could also consider introducing accounting requirements for microbusinesses, similar with those adopted by small businesses, together with the awarding of accounting vouchers to cost the immediate transition, building capacity. In addition, the government should assess policy impacts generated by remaining tax statuses, other than micro and small businesses, aiming for additional consolidation of special tax treatment. The turnover tax should integrate social benefits, namely pension and health insurance, under the presumptive tax framework, and perhaps integrate VAT payments as well. The revamped turnover tax could also incorporate a simple formula to calculate VAT liability based on actual turnover rather than the traditional input-output calculus (OECD, 2020a), although this option would carry informality risks by reducing the incentive to ask for bills. Finally, as regards the overall design of the turnover tax, the turnover tax threshold, currently established at GEL 500 000, is arguably too high (and too distant from the VAT threshold).

The profit tax (i.e. the corporate income tax) would benefit from closer alignment with other taxes and thin capitalisation rules (i.e., a cap on the amount of deductible interest expenses) should be established. Georgia's role model in corporate taxation, Estonia, exhibits a perfect alignment of personal and corporate income tax rates. The statutory rate in both taxes is 20% – capital gains are also taxed at a 20% rate –, and the same occurs with the standard VAT rate. Dividend incomes are also not taxed in Estonia, thus avoiding entirely the issue of double taxation of corporate income. Yet, in Georgia divergences remain between tax rates levied on (personal and corporate) income and capital gains, and the double taxation of corporate income has not been eliminated either (due to remaining withholding payments on dividends). The absence of thin capitalisation rules should also be reconsidered, and a cap on interest expensing (e.g., 30% of EBITDA as commonly seen elsewhere) introduced. The lack of a cap on interest expenses not only creates an incentive for debt build-up, but also undermines tax revenue collection. To increase the pool of available external capital, and reduce dependence on bank loans, public policy promoting collective investment vehicles would be helpful.

Enhanced transparency and user efficiency in the tax system would assist the execution of overall tax policy. There are two levels that should be observed. On one hand, the institutional arrangement involved in tax disputes should be clarified. Tax policy and tax administration require a proper appeals process, one which is credible and affordable (Loeprich, 2009). Feedback from local respondents suggests that this is missing. On the other hand, efforts by the Revenue Service to improve outreach to small taxpayers, especially those in rural areas, must be maintained. Policies aimed at outreaching taxpayers are in evolution and innovations increasingly rely on digital technologies to avoid face-to-face contact between taxpayers and tax officials. Policies are also meant to generate expected outcomes not only in the domain of tax collection, namely increased compliance, but also in terms of tax governance, meaning an overall tax framework based on reciprocity and accountability (Prichard et al., 2019). Examples of recent policy innovations in tax management include Kenya's iTax system or the U.S. Tax Filing Simplification Act of 2016. Better outreach and policy coordination could also be achieved between government agencies. Indeed, prior assessments of SME policy in Georgia have suggested that public registries containing information on business activities and business owners are not yet fully integrated and interconnected (OECD, 2020b).

4. SME Finance in Georgia

4.1. Credit market conditions in Georgia

4.1.1. Overview

Well-functioning financial markets are essential for channelling an adequate supply of finance to small and medium enterprises (SMEs) and new firms. They should also offer a mix of financial products that are appropriately adapted to SMEs at different stages of business development, including various loan products, asset-based services, such as leasing and factoring, and equity products. Well-functioning finance markets satisfy three main requirements. First, the supply side of the financial marketplace (lenders and investors, including banks, microfinance institutions, leasing companies, venture capital companies) must possess adequate capacities to assess the risks and returns of investments in SMEs and entrepreneurs' projects. Second, on the demand side, business owners should have the skills, knowledge and financial literacy to locate and draw upon the most appropriate available sources of finance and act as competent stewards of investments. Third, the infrastructure for financial intermediation should be transparent, in order to minimise information asymmetries among the parties, as much as possible. Moreover, the financial markets must be embedded within a regulatory and legal framework that protects the legal rights of all market participants.

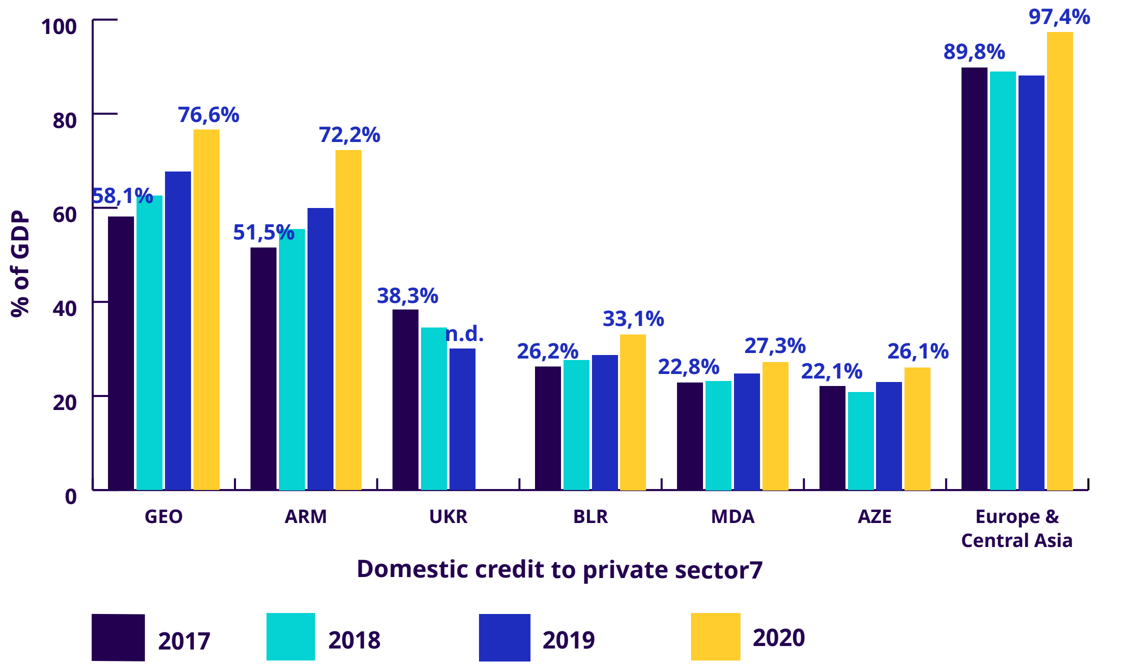
The depth of Georgia's financial markets has been increasing, but bank-dominance in the financial system reflects a low level of financial market diversity. The overall financial markets in Georgia are relatively stronger than those in neighboring Eastern European countries (Armenia/ARM, Azerbaijan/AZE, Belarus/BLR, Moldova/MDA and Ukraine/UKR), but much weaker than the average for Europe & Central Asia (ECA). Georgia outperforms neighbouring (Eastern Partnership/EaP) countries[6] on the level of domestic credit to the private sector[7], and the level of domestic credit provided by banks[8], both expressed as a percentage of GDP, but lags below the average in Europe & Central Asia (Figures 13 and 14). Higher levels of domestic credit to the private sector (as percentage of GDP) gauge the depth of financial markets and indicate greater financial intermediary development. Georgia's performance on this indicator suggests a higher level of financial intermediation that the EaP countries, but lower than in the ECA.

6 The selected neighbouring countries in Eastern Europe and South Caucasus include Armenia, Azerbaijan, Belarus, Moldova and Ukraine. The primary reason for this selection is their inclusion as EU "Eastern Partnership (EaP) Countries" and the availability of comparative data on key access to finance indicators in the assessment of the implementation of the Small Business Act (SBA) for Europe reported in the SME Policy Index for Eastern Partner Countries.

7 As per definition used by the World Development Indicators (WDI), "domestic credit to private sector" refers to financial resources provided to the private sector by financial corporations (e.g. monetary authorities and deposit money banks, and other financial corporations, such as finance and leasing companies, money lenders, insurance corporations, pension funds, and foreign exchange companies), such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable, that establish a claim for repayment. For some countries these claims include credit to public enterprises.

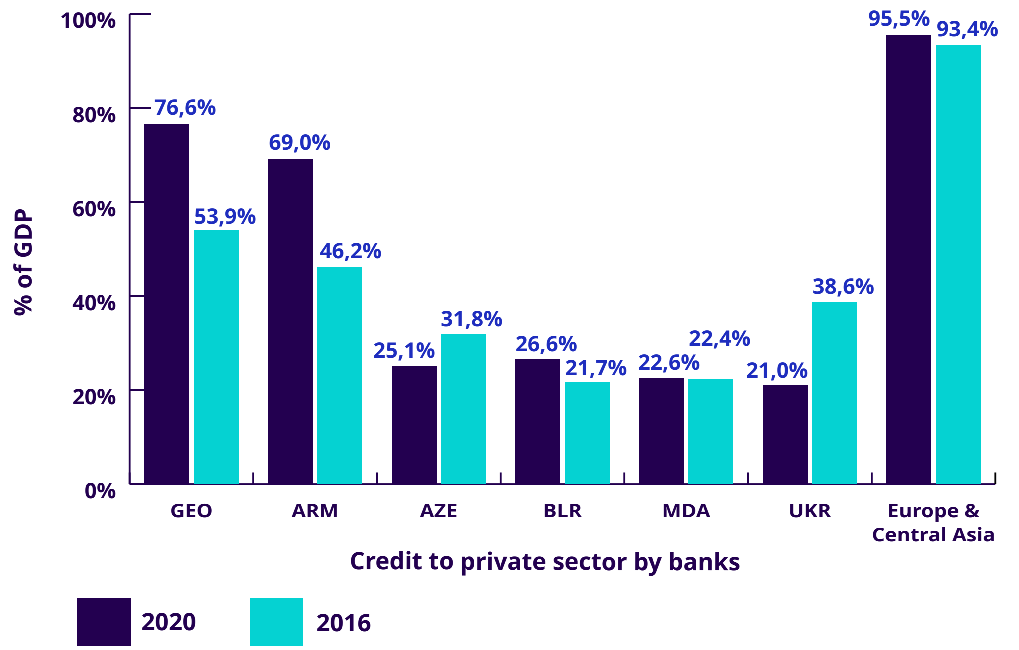
8 As per definition used by the WDI, "domestic credit to private sector by banks" refers to financial resources provided to the private sector by deposit taking corporations (except central banks), such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable, that establish a claim for repayment.

▶ Figure 13. Domestic credit to the private sector (% of GDP)



Notes: No 2020 data for Ukraine.
Source: World Development Indicators (WDI) database, World Bank.

▶ Figure 14. Domestic credit to private sector by banks (% of GDP)



Source: WDI database, World Bank.

Table 22. "Getting credit" scores – World Bank Doing Business indicators 2020

	AZE	GEO	UKR	ARM	MDA	BLR	Europe & Central Asia avg.
Getting credit rank (out of 190 countries)	1	15	37	48	48	104	n.a.
Getting credit score (0-100)	100	85	75	70	70	50	72.2
Strength of legal rights index (0-12)	*12*	*9*	*8*	*6*	*8*	*3*	*7.8*
Depth of credit information index (0-8)	*8*	*8*	*7*	*8*	*6*	*7*	*6.7*
Credit registry coverage (% of adults)	*0.0*	*0.0*	*2.4*	*0.0*	*0.0*	*53.0*	*24.0*
Credit bureau coverage (% of adults)	*44.6*	*100.0*	*56.9*	*82.5*	*18.2*	*0.0*	*41.7*

Source: World Bank (2020a), Doing Business 2020, World Bank, Washington, DC; Doing Business database, https://www.doingbusiness.org/en/reports/global-reports/doing-business-2020/.

Georgia shows growth in the contribution to private sector credit from banks (as a percentage of GDP) from 2016 to 2020, and leads the six EaP countries on this indicator (Figure 14). In most countries, data[9] show that banks predominate as a source of domestic credit, with domestic credit from the banking sector exceeding domestic credit to the private sector. However, bank-dominance in the financial system generally reflects a low level of financial market diversity (less active capital/equity markets) and tight regulatory controls.

The banking system in Georgia registers a higher level of financial health and efficiency than the other EaP countries, demonstrated by the much lower percentage of non-performing loans (NPLs)[10] in total gross bank loans: 1.9% in 2019, compared to 4.6% in Belarus, 5.5% in Armenia, and 8.5% in Moldova.[11]

Georgia performs well on the World Bank Doing Business "Getting credit" indicator, with a rank of 15 out of 190 in the 2020 report (Table 22). It has dropped in rank since 2016 (rank of 7), but its overall score has remained unchanged, with the most significant development in the increased coverage of the credit bureau from 56.8% of the adult population to 100%.

Credit registries and credit bureaus are key elements of credit information systems and play an important role in minimising information asymmetries and enabling lenders to assess the creditworthiness of borrowers, and better predict a borrower's capacity to repay and the probability of default.[12] Accessibility to credit history information is particularly beneficial for new borrowers, including micro and small entrepreneurs with limited access to physical collateral.

9 Data from the WDI database.

10 NPLs are defined as bank loans that are 90 days or more overdue.

11 WDI database.

12 The purpose of credit registries, which are usually managed by central banks or bank supervision agencies, is to monitor loans made by regulated financial institutions (by law, requiring the registration of loans above a certain amount

Table 23. Performance on Access to finance for SMEs dimensions

	ARM	AZE	BLR	GEO	MDA	UKR	*EaP avg.*
Legal and regulatory framework (protection of creditor rights, use of collateral and credit information, banking and stock market regulations)	4.18	3.63	3.74	**4.42**	4.10	3.85	*3.99*
Bank financing (lending practices of banking markets and availability of credit guarantees)	2.89	2.21	3.05	**3.42**	2.79	1.79	*2.69*
Non-bank financing (legal framework; usage of microfinance, leasing, factoring)	3.66	2.45	4.38	**3.01**	3.79	4.02	*3.55*
Venture capital (legal framework enabling venture capital and business angel networks)	3.37	1.81	2.27	**2.92**	1.53	1.66	*2.26*
Financial literacy (government efforts to promote financial know-how)	3.82	3.29	3.25	**4.66**	2.67	3.06	*3.46*
Average score	***3.81***	***3.12***	***3.87***	***4.02***	***3.61***	***3.31***	***3.57***

Source: OECD/ETF/EU/EBRD (2020), SME Policy Index: Eastern Partner Countries 2020 – Assessing the Implementation of the Small Business Act for Europe, European Union, Brussels/OECD Publishing, Paris, p. 211.

Credit bureau coverage is more prevalent in the EaP countries than credit registry coverage, with Georgia reporting 100% coverage of adults in the credit bureau. Creditinfo Georgia was established in 2005 as a partnership between leading banks and Creditinfo International. It is regulated by the National Bank of Georgia (NBG) and since 2018 "an officially registered credit information bureau".

Georgia performed well against the other EaP countries in the 2020 SME Policy Index assessment of the access to finance pillar of the Small Business Act for Europe (SBAfE) (OECD/ETF/EU/EBRD, 2020), with an overall assessment score of 4.02 (out of 5) (Table 23). The area showing the weakest performance relative to the other countries was on "non-bank financing". Although microfinance institutions do exist in Georgia (primarily geared to providing consumer credit), alternative financing instruments, such as leasing and factoring, are underdeveloped and not governed by legal and regulatory frameworks. Within Georgia, the country scored lowest on the "venture capital" sub-dimension, reflecting slow progress in building a venture capital market to meet the equity investment needs of early-stage and growth potential enterprises.

Georgia's strongest score on the access to finance dimension is on government's efforts to address financial literacy gaps, having introduced a national strategy on financial education and dedicated programme targeting SMEs in 2018. In addition to raising the level of financial management acumen of entrepreneurs and SMEs, the programme is geared to assisting SMEs in meeting the mandatory requirements for compliance with the International Financial Reporting Standards (IFRS)

in the national credit registry). In comparison, credit bureaus, which are often privately owned and operated companies, collect information from a wide variety of financial and nonfinancial entities, including credit card companies, utilities providers, and microfinance institutions and provide credit-related information to meet the information requirements of commercial lenders, such as credit scores on potential borrowers.

for SMEs adopted by the government in 2015 and in effect in 2017.

Compliance with the IFRS requires the mandatory submission of annual financial reports to the Service for Accounting, Reporting and Auditing Supervision (SARAS) in the Ministry of Finance that are made available on the online REPORTAL. The "IFRS for SMEs Standard" applies to all enterprises with revenue of more than GEL 2 million and/or assets of more than GEL 1 million, and more than 10 employees.[13] The SME Standard reduces the full IFRS disclosure requirements, offers a simplified method of accounting for investments, and makes use of a simple online procedure and simplified reporting requirements. Complying with the standard requires affected SMEs to implement standardised accounting practices, which in turn, is expected to ease access to credit by improving the quality of information to financial lenders in assessing the credit-worthiness of SME loan applications.

The Ministry of Finance, in coordination with SARAS offered free training to SMEs to familiarise them with the IFRS for SMEs Standard and also engaged the Georgia Chamber of Commerce and business associations to raise awareness of the requirements among SMEs and provide training modules to help SMEs prepare their financial reports.

4.2. The state of SMEs financing

4.2.1. SMEs and bank finance

The financial sector of Georgia is bank-centric and characterised by a high level of concentration. Financial sector assets stood at GEL 49.5 billion (110.6% of GDP) at the end of 2019 and banking sector assets represented 95.3% of total financial sector assets. There are 15 banks[14] in Georgia (all but one being foreign-owned), but the two largest banks, Bank of Georgia and TBC Bank, account for 73% of total banking sector assets, 72% of loans, and 75% of total deposits. However, considering the small size of Georgian economy, the presence of 13 additional commercial banks still allows for stiff competition in the banking sector (Conde and Gattini, 2019).

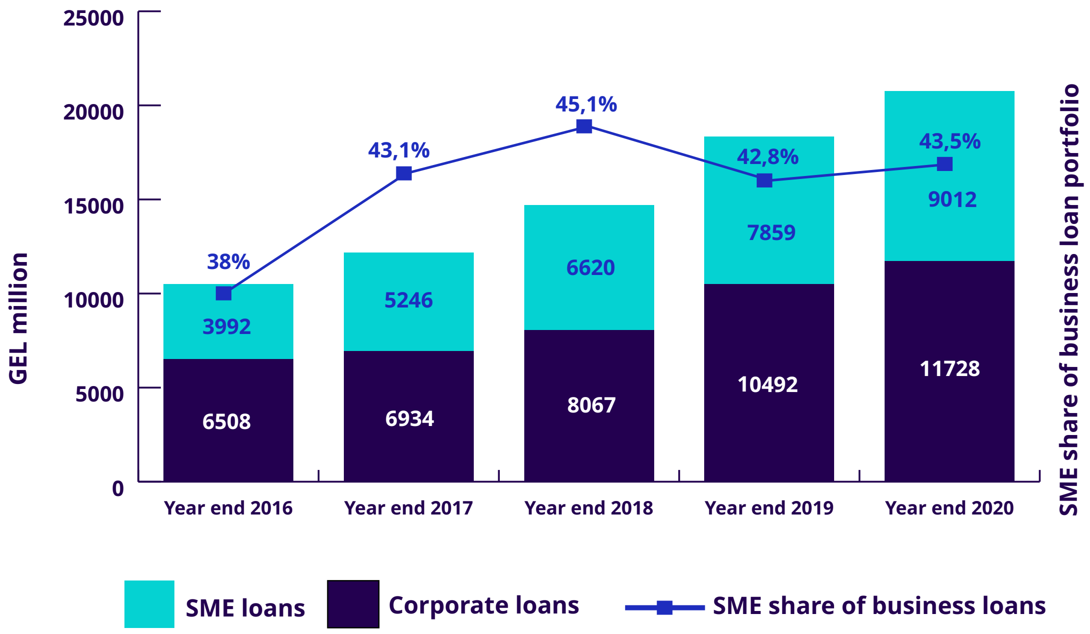
Over a third of small enterprises in Georgia (defined by the World Bank Enterprise Surveys as those with 5-19 employees) report that access to finance is the top business environment constraint, as well as 17% of medium enterprises (20-99 employees) and 23% of large enterprises (100+ employees) (World Bank, 2020c). By connecting credit-worthy firms to a broad range of lenders and investors, efficient financial markets reduce the reliance of firms on internal funds or informal sources (e.g. family and friends) to finance their business operations (World Bank, 2020c). However, the 2019 Enterprise Survey for Georgia reveals that 70% of firms rely on internal funds to finance the purchase of fixed assets; only 20% is financed by banks (World Bank, 2020c). Georgian SMEs making use of external sources of debt financing are very dependent on the banking system to meet their financing needs; bank loans are by far the most important source of external financing for SMEs in Georgia.

According to results from the 2019 World Bank Enterprise Survey for Georgia, 38% of small enterprises have bank loans, 48% of medium enterprises and 58% of large enterprises. Give the shortage of external financing alternatives among Georgian SMEs and the challenges faced in bank lending (high interest rates, high collateral requirements), the increased levels of bank lending to SMEs and entrepreneurs in recent years is very positive. By the end of 2020, bank loans to SMEs had risen to over GEL 9 billion, almost triple the amount at the end of 2016 (Figure 15). The SME

13 For IFRS reporting, a small enterprise (category III) has assets of no more than GEL 10 million, revenue of more than GEL 2 million but not more than GEL 20 million, and 10-49 employees. A medium enterprise (category II) has assets of no more than GEL 50 million, revenue of no more than GEL 100 million, and not more than 249 employees. Source: https://saras.gov.ge/ka/Home/ReportSupervision#tab-mks-1/.

14 In August 2021, CREDO Bank acquired the shares of FINCA Bank (a major microfinance lender) reducing the number of banks to 14.

Figure 15. SME share of business loan portfolio of banking system, end of year, 2016 to 2020



Source: National Bank of Georgia, Annual Reports 2016-2020, www.nbg.gov.ge.

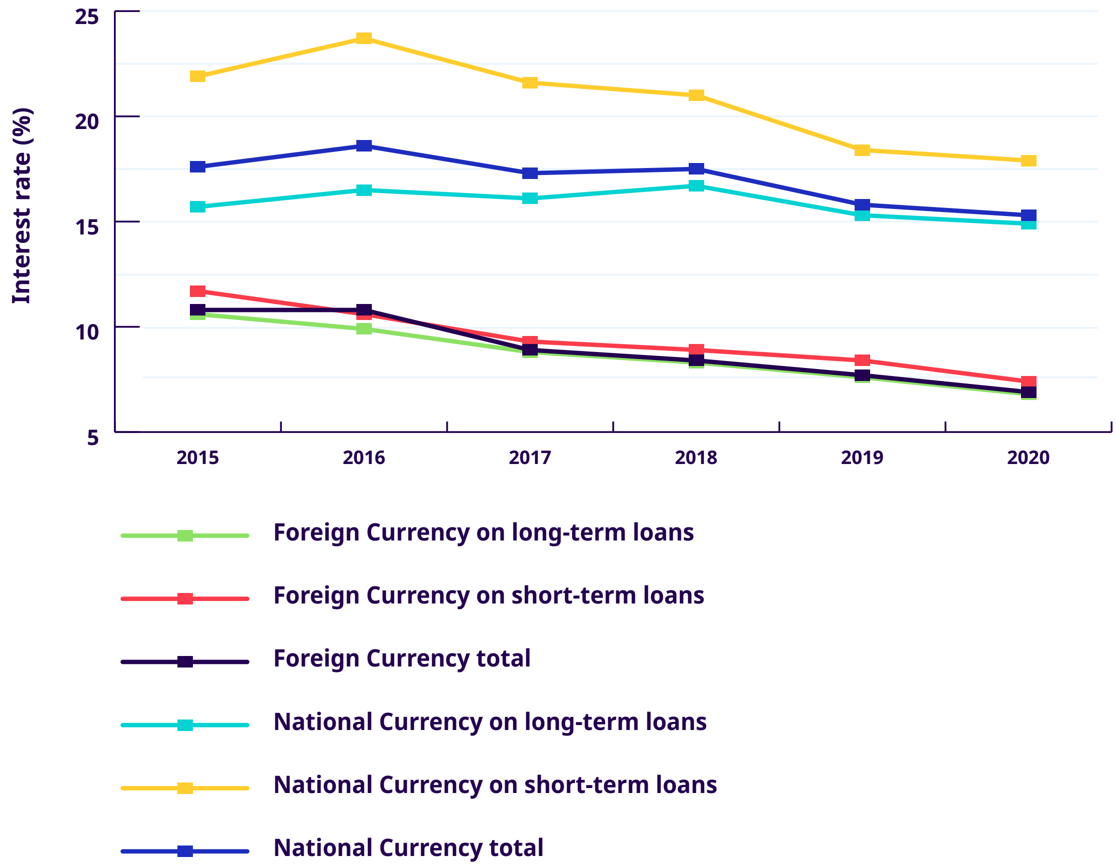
share of total business loans has increased from 38.0% to 43.5%. In 2014, the volume of SME loans represented 7.5% of GDP (GEL 2.35 billion), but it moved to 16.5% of GDP in 2019 (GEL 8.12 billion) (MoESD, 2021, p. 46, citing data from the National Bank of Georgia).

High interest rates and stringent collateral requirements are the major bottlenecks to SME financing in Georgia. Bank interest rates on lending are typically high,[15] ranging from an annual average of over 13.2% in 2015 to 10.5% in 2020, with a large spread between interest rates on loans in national versus foreign currency (Figure 16). In the second quarter of 2021, the interest rate on national currency loans averaged 15.4%, compared to 6.8% on foreign currency loans, with an even larger interest rate spread on short-term loans, which are more likely to be prevalent among SMEs. In 2020, interest rates charged to SMEs were reported as being 3-percentage points higher than for loans to large firms (12.3% versus 9.3%) (OECD, 2020).

Loan dollarisation is also an issue from an interest rate perspective. Many SMEs prefer

15 High interest rates are often associated with high inflation. For most of 2019 and 2020, Georgia's inflation rate was over 6%, but in August 2021 climbed to 12.8% (GEOSTAT, 2021). This compares to the Euro area, where the European Central Bank is mandated to keep inflation at 2% over the medium term, although inflation climbed to 3.0% in August 2021 ("Flash estimate, September 2021", Eurostat, https://ec.europa.eu/eurostat/web/products-euro-indicators/-/2-01102021-ap/). Commercial bank loan interest rates in the Euro area have averaged below 3% for past few years (https://www.euro-area-statistics.org/bank-interest-rates-loans?cr=eur&lg=en&page=1&template=1). The rise in Georgia's inflation rate is due to the sharply increased prices of food and oil in international markets since the beginning of 2021, the dynamics of international shipping costs that are making imported products more expensive globally, and the increased growth rate of lending ("Georgian central bank leaves monetary policy rate unchanged at 10%", 15 September 2021, *Agenda.ge*, https://agenda.ge/en/news/2021/2667/.

Figure 16. Annual average interest rate on commercial bank loans – loans in national versus foreign currency



Source: National Bank of Georgia, https://nbg.gov.ge/en/statistics/statistics-data/.

to borrow in dollars or Euro due to the lower borrowing rate than the rate for Georgian lari. However, a weakening local currency over recent years resulted in considerable exchange risk (and increases in the value of repayable loans) for SMEs. In response, the National Bank of Georgia (NBG) now restricts foreign currency lending to SMEs for amounts under GEL 100,000.

The strict collateral security requirements are a limiting factor for many entrepreneurs and SMEs, especially micro-enterprises, in securing bank loans. Commercial banks in Georgia often impose collateral requirements that can exceed 2.5-3.0 times the loan value, with a strong preference for "hard" collateral in the form of real estate or property, which many SMEs are not able to provide (due to a relatively small fixed asset base). Since banks are reluctant to accept moveable assets as loan collateral, SMEs are disadvantaged relevant to larger firms.

Rules governing secured lending, including establishing a legal and institutional framework for the use of movable assets as collateral, are an essential feature of an economy's financial infrastructure. Rules on the collateralisation of movable assets is particularly important for SMEs because they are more likely to possess movable assets, against which banks are reluctant to lend, than land and buildings (World Bank, 2018). Financial reform to allow other forms of collateral, such as acceptance of "movable assets" (e.g. vehicles, equipment, intellectual property) and establishment of an upgraded, modernised movable collateral registry is under development within the context of the World Bank "Georgia Relief and Recovery for MSMEs" Project 2021-2025. This involves discussions with the Ministry of Economy and Sustainable Development (MoESD) and the Ministry of Justice. Clarifying the law on movable assets will enhance access to finance by reducing the legal risks in dealing with movable assets and the higher costs of loss recovery if the lender has to call on security in cases of loan default. Legal frameworks allowing for recording of movable property in collateral registries will also support an increase in lending to SMEs.

SMEs are also subject to high bank loan rejection rates. Over 20% of small enterprises (1-19 employees) in the 2019 World Bank Enterprise Survey for Georgia reported having a recent loan application rejected by a bank, compared to 5.9% of medium enterprises (20-99 employees) and only 2.6% of large firms.[16] The COVID-19 pandemic had a significant negative impact on access to financing for firms. The World Bank Enterprise Survey monitoring during 2020 revealed that only 17% of Georgian firms had applied for credit from commercial banks (April to November period), with an application rejection rate of 79%; only 20% of the applications was approved (World Bank, 2021a).

Reasons given by banks for rejecting SME loan applications in the 2018 European Investment Bank (EIB) bank lending survey were: lack of eligible collateral, lack of credit history, unmeasurable risks, and poor business plans, essentially due to the perceived riskiness of either the SME client or the project (Conde and Gattini, 2019, p. 19).

The risk-adverse and conservative orientation of the Georgian banks is a major factor in their loan approval decision making. Due to the development of the credit bureau and quality credit information systems, banks can gain easy access to the credit histories of potential borrowers; however, young entrepreneurs and other social groups in society, such as women, may not have established their own credit histories and thus be disadvantaged in securing bank loans. Conde and Gattini (2019) conclude that expansion of bank lending to SMEs would be enhanced by provision of technical assistance to SMEs to improve the quality of business plans and reporting standards, and by the offer of new lending technologies, such as lending platforms and cloud-based lending approaches (e.g. adoption of fintech models).

Georgian banks also appear to perceive a higher risk in lending to SMEs compared to large firms. Although data from the NBG indicate a **non-performing loan (NPL) rate** of 6.1% of SME loans compared to 6.6% for all business loans[17], suggesting a lower level of risk for SME loans, SMEs, on average, are subjected to a higher rate of interest on loans than large firms (OECD, 2020, data for 2018).

4.2.2. Non-bank financing alternatives for SMEs

Georgia performs less well on the non-bank financing dimensions of the 2020 OECD SME Policy Index relative to its performance on bank financing dimensions. It also performs less well than the average for the EaP countries, except on the microfinance sub-dimension (Table 24).

Microfinance constitutes small share of total financing sector

At the end of 2019, there were 48 microfinance organisations (MFOs) in Georgia, with total assets representing about 4% of the total financing sector (NBG, 2019), although by the end of 2020, the number had declined to 40 MFOs. There is a high degree of volatility in the number of microfinancing organisations. The NBG Annual reports reported 81 MFOs at the end of 2016, 75 at the end of 2017, 67 at the end of 2018, 45 at the end of 2019, and 40 at the end of 2020. The decreasing number of MFOs is largely the result of changes in the regulatory requirements regarding capital adequacy ratios, minimum levels of supervisory capital, and liquidity limits set by the NBG in 2018,

16 https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/georgia#finance/.

17 In the calculation of NPL rates, the NBG considers substandard loans together with doubtful and loss loans, including interbank loans.

Table 24. Scores for non-bank financing dimensions, 2020 SME Policy Index

	BLR	UKR	MDA	ARM	GEO	AZE	EaP avg.
Microfinance	4.33	4.33	5.00	4.00	5.00	2.67	4.22
Leasing	5.00	4.33	3.67	3.44	3.00	3.00	3.74
Factoring	3.83	3.41	2.73	3.55	1.02	1.70	2.71
Weighted average	***4.38***	***4.02***	***3.79***	***3.66***	***3.01***	***2.45***	***3.55***

Note: Scores range from 1 (low) to 5 (high).
Source: OECD/ETF/EU/EBRD (2020), SME Policy Index: Eastern Partner Countries 2020 – Assessing the Implementation of the Small Business Act for Europe, European Union, Brussels/OECD Publishing, Paris, p. 223.

which many MFOs have not been able to meet. In some instances, changes in the regulatory requirements have also encouraged consolidation of MFOs through mergers and take-overs.

The microfinance sector in Georgia and its activities are regulated by the Law of Georgia on Microfinance Organisations that was first passed in 2006 and amended a number of times since then (e.g. 2009, 2012) as the National Bank of Georgia (NBG) sought to adjust the regulatory rules and conditions for MFOs to improve the standard of performance. Microfinance Organisations must register with the NBG, which is the supervisory body for all MFOs, and operate according to prescribed standards, including presenting financial statements to the NBG. In accordance with the law, microcredit to a single borrower is not to exceed GEL 100,000 (around EUR 27,000) and must be made in Georgian lari.

The vast majority of microfinance lending is geared to the consumer market (personal loans), with only 25% of the total credit portfolio allocated for trade and services and agricultural loans (Table 4). The share of business-related microfinance loans in the total loan portfolio is low compared to findings of the survey of microfinance institutions in Europe, which reported, that at the end of 2019, 55% of the total loan portfolio was for business loans (revenue-generating activity) and accounted for 43% of the microfinance borrowers (Pytkowska, 2020).

In Georgia, 90% of the enterprise-related microfinance loans are concentrated in four MFOs (NBG, 2020). Crystal is the longest-standing MFO in Georgia and a leader in microfinance lending, accounting for 27.4% of the total MFOs' loan portfolio.[18] In 2020, loans to microentrepreneurs and farmers accounted for 54% of Crystal's portfolio (22% was loans to SMEs; 17% to agriculture/farmers; and 15% to microbusiness loans)[19], which is more consistent with results of the Microfinance in Europe survey report (Pytkowska, 2020).

The share of NPLs in the total micro-credit portfolio in Georgia averaged between 8% and 9% in 2018/2019; higher than the NPL rate for the banking sector, and reflecting a lower quality of the credit portfolio. However, the micro-credit NPL rate in Georgia is not inconsistent with results of the survey of microfinance institutions in Europe, which reported an average 30-day overdue rate of 10.6% of the microloan portfolio (in 2019), and an average write-off rate of 5% (share of the loan portfolio deemed unrecoverable): write-off rate of

18 As reported by Crystal for the first quarter of 2021 in "How Did Tightening of the Monetary Policy Affect MFOs? – Crystal", *Business Media Georgia*, 20 May 2021, https://bm.ge/en/article/how-did-tightening-of-the-monetary-policy-affect-mfos---crystal/82979/.

19 Information stated in the Crystal 2020 Annual Report. Crystal also offers equity financing, but only 69 participants received equity funds in 2020. In 2020, Crystal established the Crystal Leasing subsidiary.

▶ Table 25. Total loan portfolio of MFOs, GEL millions, 2016-2020

GEL millions	2016	2017	2018	2019	2020
Loans to trade and services	292	249	187	211	200
Loans to agriculture	280	118	95	104	100
Subtotal	*572*	*367*	*282*	*315*	*300*
Other loans (to legal entities)	121	99	21	35	41
Consumer loans	750	650	798	780	843
Total loan portfolio	*1,443*	*1,116*	*1,101*	*1,130*	*1,184*
Loans to trade-services-agriculture, share of total loan portfolio	39.6%	32.9%	25.6%	27.9%	25.3%

Notes: The lowered loan portfolio in 2017 versus 2016 is due to the transition of the largest microfinance organisation to the banking sector at the beginning of 2017.
Source: NBG Annual Reports – section on Microfinance Organisations.

6.5% on the business loan portfolio and 2.2% on the personal loan portfolio (Pytkowska, 2020).

The microloans to trade and services and agriculture in 2020 (GEL 300 million) amounts to only 3.3% of the volume of SME loans in the banking system (as per Figure 16 above).

In the first quarter of 2021, the total portfolio of MFO-issued loans (681,000 loans) reached GEL 1.25 billion. Pawnshop loans are the biggest share: accounting for 71.2% of loans and 45.4% of the total loan portfolio. Consumer loans made up another 7.8% of loans and 21.2% of the loan portfolio. Loans to trade and services and agriculture accounted for only 8.5% of the loans and 25% of the loan volume, with an average loan size of GEL 5,000 (agriculture loans) to GEL 5,572 (trade and services loans).

Interest rates for MFOs is capped at 50% per annum (as per the Law on MFOs)[20], which micro and small enterprises may find exorbitant, MFOs complain is too low, and is high compared to international practice, where the average is more in the range of 3%-4% per month. In most developing and emerging market economies, an effective interest rate of 27%-30% appears to be the maximum acceptable, although could be higher in some regions, such as North Africa (3%-5% per month) (ADB, 2016).

One of the factors in the low growth of microcredit in Georgia (besides the organisational volatility in the sector) is undercapitalisation of the MFOs. MFOs are not permitted to take deposits so depend on borrowed funds to finance lending activity, often in foreign currency from international sources, which exposes them to exchange rate risks. The imbalance between foreign exchange funding and local currency lending creates additional complexity to MFO operations, increasing their lending costs by 3% to 4% to exchange foreign currencies to GEL through the commercial banks (IMF, 2020). Commercial banks, on the other hand, can clear their foreign currency directly through their accounts with the NBG at no exchange rate cost. MFOs advocate that access to Lari from the NBG would lower their costs of funds

20 Up until 2018, the interest rate on MFO loans was capped at 100%; subsequently reduced to 50% by the NBG.

Box 1. The legal categorisation of microfinance organisations, and example from the Kyrgyz Republic

The Kyrgyz Republic 2002 Law on Microfinance Organisations allowed for a three-tiered classification system for microfinance lenders that includes: 1) Microcredit agencies (MCAs), non-commercial institutions that cannot accept voluntary deposits; 2) Microcredit companies (MCCs), commercial institutions registered as limited liability or joint stock companies which cannot accept deposits; and 3) Microfinance companies (MFCs), commercial institutions registered as joint stock companies that can accept time deposits (although regulators have shown a reluctance to grant deposit licences) (EIU, 2009). MFCs must be licensed by the National Bank of the Kyrgyz Republic and are free to set interest rates. All three institutional forms are allowed access to foreign debt and equity financing.

Sources: "The Kyrgyz Republic Law on Micro-finance Organizations in the Kyrgyz Republic, No. 124, 23 July 2002, https://cis-legislation.com/document.fwx?rgn=62/; EIU (Economist Intelligence Unit) (2009), Global microscope on the microfinance business environment: A pilot index and study, Economist Intelligence Unit, London, UK.

and thus potentially improve microloan access by borrowers (IMF, 2020).

The NBG is considering allowing qualified MFOs to apply to be licenced as micro-banks, in which case they could also be deposit-taking entities. The rationale would be to reduce the funding costs for micro-banks, promote more lending to underserved micro and small enterprises, and improve soundness of the financial system (subject to Basel prudential requirements for capital, liquidity and leverage ratios). Other existing MFOs, such as pawn shops, could apply as loan issuing entities (LIEs) and no longer be referred to as MFOs. Kyrgyzstan, considered to be a regional leader for microcredit regulation (2002 Law on Microfinance Organisations), allows for a variety of microcredit organisation types, from small, family-owned micro-lenders to full deposit-taking incorporated microfinance institutions (see Box 1) and may provide useful lessons for Georgia.

The International Monetary Fund (IMF) is supportive of the NBG proposal to introduce a new class of banks specifically designed for microfinance and micro-savings, but is recommending a gradual transition over a two-to-three-year period (IMF, 2020). One of the first MFOs likely to apply for a micro-bank license will be Crystal, which it plans to do in 2021-2022.

In the past, some MFOs have graduated to bank licenses, the case for CREDO and FINCA. Once operating under a bank license, they are able to accept savings deposits, while still prioritising credit to micro and small enterprise borrowers and the rural agricultural sector. In addition, they are able to improve their service offerings, and graduate their clients to larger loans in line with growth and expansion plans.

Leasing and factoring markets are underdeveloped

Alternative lending schemes, such as leasing and factoring, are not well developed in Georgia. Leasing can be an attractive financial option for SMEs because it does not require a capital outlay of investment for the purchase of important production equipment. Thus, it is an alternative to improve access to finance for SMEs denied traditional bank financing due to a lack of credit history or insufficient collateral (World Bank, 2018). Factoring is important because the discounted sale of accounts receivable improves the SMEs cash flow situation.

Total assets of the leasing sector in Georgia are minimal, amounting to less than 1% of GDP (World Bank, 2021b). Leasing activity is largely unregulated at the current time. The Law on the Promotion of Leasing Activities, adopted in 2002, was well-intentioned but flawed in its practical application leading to high default rates. For example, one provision of the law allowed lessees to default and claim payments for the difference between the theoretical market value of the leased asset and their outstanding debts, which enabled the lessees to benefit financially by failing to honour their obligations (EPI, 2012). This led to high non-performing portfolios of leasing companies and legal barriers to the repossession of good assets (insufficient protection of the lessors offering leasing services), making leasing a risky financial activity. To address deficiencies in the leasing regulation, in 2011, the Georgian Parliament abolished the 2002 Law on Promotion of Leasing Activities, replacing it by the Law Amending the Civil Code of Georgia, which framed the legal rights and obligations of both leasing companies and lessees, and the Law Amending the Tax Code of Georgia, which resolved a number of taxation issues in leasing regulations having an adverse effect on the leasing industry (EPI, 2012).

Unlike banks and other financial institutions, leasing companies are not regulated or supervised by the NBG, with the exception of those leasing companies established as bank-owned subsidiaries; nor are there licensing or minimum capital requirements to enter the leasing market. Banks in Georgia are not allowed to provide direct lease financing. The TBC Bank and Bank of Georgia have overcome this restriction by establishing leasing subsidiaries (TBC Leasing in 2003[21]; and the Georgian Leasing Company). Some MFOs also offer lease financing and there a number of fledgling or inactive private leasing companies. A leasing association has been formed, but is not very active.

The Georgian government has received technical assistance from the International Finance Corporation (IFC), dating back to 2005, to promote the leasing sector as a nonbank source of financing for SMEs, including working with the government to improve leasing legislation, advising the country's leasing companies on operational best practices, including TBC Leasing, and training and advising SMEs on the use of leasing to acquire new production assets.[22]

The factoring market in Georgia is very small (around 0.1% of GDP compared to an average of 11.3% of GDP in the EU[23]). The factoring market is unregulated. There are no factoring companies and few factoring services offered by the banks (World Bank, 2021b). A survey of factoring companies in the EU in 2018 revealed that SMEs are the major beneficiaries of factoring services: 75% of users were small businesses, and 14% were medium-sized businesses (total of 89%) (EUFederation, 2019, p. 20). This suggests that Georgia is missing an opportunity.

The EBRD is supporting Georgia to reform its legal framework for leasing and to introduce a dedicated law on factoring (as reported in OECD/ETF/EU/EBRD, 2020, p. 430).

Other alternative financing initiatives

Apart from leasing and factoring (both alternative financing mechanisms outside the traditional banking system for SMEs unable to access bank loans), Georgia can consider other alternative financing schemes enabled by digital technologies (such as peer-to-peer lending, crowdfunding, blockchain, online business angel platforms). Georgia is progressive in exploring alternative finance through the development of a Regulatory Sandbox[24] (in initial development stage) under the leadership of the MoESD and the NBG. The regulatory sandbox framework (in force since May 2020) allows regulated financial institutions to test innovative products and services, with plans to expand the scope of the sandbox to other services, such as crowdfunding platforms (EU4Digital, 2020).

21 TBC Leasing has benefited from EBRD loans to develop the leasing market and the broader access of finance to MSMEs through leasing, including a loan of EUR 6 million to TBC Leasing for this purpose.

22 "IFC Makes its First Investment in Georgia's Leasing Sector", IFC Press Release, 10 June 2005, https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=20296/.

23 https://www.soldonhive.com/factoring/factoring-in-europe/. The EU data is for 2019 and based primarily on reporting of the EU Federation of Factoring and Commercial Finance (covers the EU-27 plus the UK). The average factoring volume to GDP varies between countries, ranging from a high of 17% of GDP in Belgium to a low of 2% of GDP in Romania and Croatia and 1% of GDP in Luxembourg (EUFederation, 2019, p. 10).

24 Regulatory Sandboxes provide a framework in which to test innovative financial products, financial services or business models for regulatory compliance and allow financial institutions to test different approaches to alternative finance, such as fintech, to find out what is needed, what works and what does not, pursuant to a specific plan agreed and monitored by a regulatory supervisor.

There is currently some experimentation with crowdfunding platforms in Georgia (Crowdfund.ge, Investme.ge, and Crystal crowd microfinance platform), but national regulation on crowdfunding is yet to be developed and the stringent requirements of the Law of Georgia on Security Markets basically dismiss start-up businesses from attracting investors through crowd-raising platforms in Georgia (EU4Digital, 2020). Amendments to the Law on Security Markets would be needed.

4.2.3. The state of equity financing

The venture capital, equity investment and business angel market in Georgia is at an infancy stage of progression.

The country has a weak culture of equity investing in start-ups, early-stage companies, and growth-potential SMEs. The 2019 Global Competitiveness Index (GCI), ranked Georgia 109 of 141 countries on venture capital availability, with a score of 26.3 out of the optimal score of 100 (WEF, 2019).[25] Georgia ranks 92 out of 125 countries on the 2021 Venture Capital and Private Equity Attractiveness Index (score of 31.7/100), with a rank of 103 on the "depth" of its capital market (IESE Business School, 2021).

There is a modest amount of venture capital activity in the country. A 2020 mapping of available venture capital funds operating in Georgia makes reference to four private venture capital companies (EU4Digital, 2020). There is evidence of state-owned investment funds that co-invest in projects, but these are focused on specific industries and larger projects. In addition, the Georgian Innovation and Technology Agency (GITA) offers co-financing schemes for Start-up Georgia companies.

Georgia also has an association of venture capital companies. The Georgian Venture Capital Association (GVCA) was established in 2017 to promote development of the venture capital and private equity sector in Georgia and helps raise funds for start-ups and seed-stage companies by encouraging an entrepreneurship culture and supporting start-ups, as well as advocating for a favorable investment climate and legislative framework for venture capital.[26]

Some developments are underway to create a more supportive environment for the establishment of investment and venture capital funds. In early 2020, the Government of Georgia presented an amendment package to the 2013 Law on Collective Investment Activities[27] and a new draft Law on Investment Funds for approval by Parliament that was to come into force by the end of 2020.[28] The objective of the law is to develop investment funds in Georgia (which may include private equity or venture capital funds) by outlining the rules for creation of investment funds, regulating their activity and protecting the interests of investors, under the registration and supervisory authority of the NBG. There is no provision for tax or other incentives to stimulate private sector investment in SMEs, which are frequently part of venture capital schemes in other countries, such as front-end tax incentives that allow for tax deductions on investments in early-stage ventures and back-end tax reliefs giving favourable tax treatment of capital gains and losses on those investments (OECD, 2013). The Georgian government could consider implementing such tax incentive schemes, which would also align well with the Start-up Georgia strategy (see also chapter on taxation).

Government funds are often required to kick-start a venture capital industry in a country. This is particularly the case in emerging and transition economies with shallow capital markets and

25 This compared to a score of 52.0 for Azerbaijan, 38.5 for Armenia, 33.7 for Ukraine, and 24.6 for Moldova.

26 Georgian Venture Capital Association, https://www.gvca.ge/en_US/web/content?content_id=1/.

27 The 2013 Law on Collective Investment Activities defined the parameters of a venture capital fund but served solely as a framework for venture capital development (the definition and listing of investment funds), but did not provide the instruments.

28 Law of Georgia on Investment Funds, https://matsne.gov.ge/en/document/view/4924135/.

low prevalence of (and experience in) formal private equity investment, particularly in support of start-ups and growth-oriented SMEs.

In its SME finance policy guidance, the International Finance Corporation (IFC) indicates that smaller emerging economies may be too limited in generating deal flow and exit opportunities to support dedicated single-country venture capital funds, and that more successful SME fund models usually cover more than one country with local management teams in each country (IFC, 2011). For example, Estonia, Latvia and Lithuania participate in the Baltic Innovation Fund (BIF) (also supported by the European Investment Fund/EIF), with an allocation of government funding to the Fund to launch Fund of Funds in each country. Connected to the BIF, the Estonian government established EstFund in 2016, a EUR 60 million fund-of-funds geared to investing in several risk capital funds that will invest primarily in smaller and earlier stage Estonian enterprises in co-investment agreements with the EIF and complementary to the BIF initiative that targets larger and later stage deals. The EstFund finances SMEs through three risk capital funds: EUR 30m Venture Capital Fund (EUR 30 million), Expansion Capital Fund (EUR 15 million) and Business Angels Co-Investment Fund (EUR 15 million)[29] that are expected to make EUR 100 million of investments available to SMEs in coming years.

The Georgian government should explore opportunities to partner with the European Investment Fund (EIB) in programmes, such as the European Fund for Sustainable Development (EFSD), the InnovFin Venture Capital Fund project, and Pan-European venture capital funds-of-funds (VentureEU) to stimulate the venture capital industry and private sector investment in Georgia.

Furthermore, the government should continue the process of elaborating a legal and institutional support framework for venture capital, in consultation with the Georgian Venture Capital Association (GVA), and the Georgian Business Angels Association (GBAA).

Business angel networks slow to develop in Georgia

Business angel networks (BANs), well developed in European countries, are slow to develop in the Eastern Partnership Countries, with some modest activities occurring in Armenia, the Ukraine, and Belarus (OECD/ETF/EU/EBRD, 2020), but weak evidence of business angel activity in Georgia. Experience reveals that development of business angel networks in other countries follows a two-stage process. In the first stage, angel investing at the local level needs to be fostered, often through the creation of local angel-entrepreneur "match-making" facilities. In the second stage, local networks are connected through a formation of a national business angel organisation, which provides visibility for angel investing, disseminates good practices, and creates linkages with government bodies and other initiatives that promote entrepreneurship, such as national "Start-up" projects. Governments can play a role in funding the set-up and/or operational costs of local business angel networks and a national umbrella network.

An important first step has already taken place in Georgia. Supported by a donor-funded private sector development programme in 2017, a group of private individuals established the Georgian Business Angels Association (GBAA) with the objective of strengthening connections with high-income angel investors to finance SMEs during their early stage of development, including building awareness of the concept and benefits of business angel investing. More recent announcements indicate ramped-up private sector efforts to establish Angel Investment Clubs in the country, comprised of networks of angel investors to finance early-stage start-ups.[30] Public support could help

29 "EIF and KredEx launch EUR 60m EstFund", European Investment Fund, 1 March 2016, https://www.eif.org/what_we_do/equity/news/2016/eif-and-kredex-launch-eur-60m-estfund.htm/.

30 "Angel Investors Club Will Be Established In Georgia – A Chance For Startups", 23 November 2020, *Business Media Georgia*, https://bm.ge/en/article/angel-investors-club-will-be-established-in-georgia--a-chance-for-startups/69391/. Also see Angel Investor Club Georgia website: www.angelinvestors.ge/. The angel investors will collectively invest from USD 30,000 up to USD 200,000 in start-ups, including seed capital at the idea stage up to Series A funding rounds.

expand the efforts of these clubs through promotion of online matching services to bring angel investors into contact with promising investment opportunities.

Another way in which the Georgian government could help build the business angel sector is through incentive schemes. Currently, the government does not provide any tax or other incentives to stimulate angel investments, which are common in many EU countries (see the overview of tax reliefs in EU4Digital, 2020, pp. 80-81). Based on the recommendations of EU4Digital (2020), the business angel market in Georgia could be extensively promoted through the provision of tax incentives for angel investors (e.g. tax credit, tax exemption, tax deferral, capital gains relief) (see also chapter on taxation) and/or co-investments in business angel investments from public funds (matching fund initiative), and active efforts on the behalf of the government to build the capacity of individual business angels through training, networking, and experience exchange with other countries. The example of the Turkish government's regulatory and policy efforts to stimulate a business angel market in Turkey may provide guidance to the Georgian government (see Box 2).

Capital markets in Georgia are underdeveloped

The notion of financing SMEs through capital market instruments has been gaining traction in recent years. Capital market access for SMEs, if tailored appropriately, can provide a viable alternative for more mature SMEs to access longer term financing, either in the form of an initial public offering or corporate bonds. Some governments have in particular adapted capital market instruments to SME needs, often by establishing a junior stock market with simplified listing and disclosure requirements. For example, Turkey created the Emerging Companies Market of Borsa Istanbul, with the objective of listing SMEs. However, given the small market size in Georgia, a viable option may be to explore an opportunity for creating a capital markets union with other of the Eastern Europe and Caucasus countries. An example of such a capital market union between Croatia and Slovenia (Box 3) may serve as a model for Georgia to explore.

4.3. SME financing policies and support programmes

This section describes and assesses the policy framework for SMEs' access to finance and the programmes in place to achieve the policy objectives and targets.

Improving access to finance was one of the core pillars of the National SME Development Strategy 2016-2020 and continues as such in the National SME Development Strategy 2021-2025. The financing pillar in the 2021-2025 strategy states the higher-level objective of "increasing the use of financial instruments by SMEs" to be achieved through: further development of state-funding programmes to improve SME access to financing; development of alternative funding mechanisms (e.g. further development of leasing and factoring instruments; refinement of the legislative and regulatory framework); enhanced financial literacy programmes for SMEs; improving the quality and transparency of financial information from, and to, SMEs; and further development of the venture capital and business angels ecosystem (which includes attracting venture capital investments from abroad and training of risk fund managers based on international experience). These policy directions build on the 2016-2020 national strategy as outlined in the mid-term evaluation report (MoESD, 2018).

Enterprise Georgia, a government agency established in 2014 to co-ordinate the implementation of SMEs policies and programmes, is responsible for the access to finance pillar of the SME Development Strategy. In this vein, Enterprise Georgia's primary financial support to SMEs is based on credit guarantees to banks for loans to eligible SMEs and interest rate subsidies on commercial bank loans for SMEs in selected sectors. Much of this support is delivered under the "Produce in Georgia" programme. Under the Micro and Small Business Support Programme, Enterprise Georgia also offers grant schemes, some tailored to start-up activity, that could range from GEL 5,000 to GEL 30,000 for specific activities. This is one of the most popular of Enterprise Georgia programmes, having provided grants

▶ Box 2. Public sector support to boost angel activity in Turkey

Through a variety of policies, from tax incentives to passing a dedicated law, the Turkish government has been successful in significantly increasing business angel activity. Business angel investment volumes have almost quadrupled within four years (2014-17), making it the fifth largest market in Europe.

The increase is commonly attributed to a number of policies. First, Turkey was the third country in the world (after the United Kingdom and the United States) to pass a dedicated angel investor law in 2013. Second, the Turkish Treasury provides a tax incentive of 75% on qualifying investments, rising to 100% on investments in projects previously supported by specific government bodies such as the Scientific and Technological Research Council of Turkey (TÜBİTAK). However, it is worth noting that such schemes primarily target the development of the short-term market and should, in the medium term, be phased out to support more commercially sustainable solutions, such as the dedicated fund announced by TÜBİTAK, to which it has pledged USD 25 million.

As a result of the various support schemes, Turkey is now one of the largest business angel markets in Europe, with 16 angel networks and a total investment volume of EUR 52 million in 2017. While it is too early to showcase exits from this recent investment growth, Turkish start-ups and venture capital funds have made headlines with large-scale exits, with multiple acquisitions in 2017 and 2018 exceeding USD 100 million.

The Turkish case highlights the importance of a clear, reliable and dedicated legal framework, as well as the role of government incentive schemes in getting financing opportunities off the ground and widening the access to finance for SMEs. While early results look very promising, the Turkish example will be an interesting one to follow as it matures and transitions to more sustainable, market-driven mechanisms.

Sources: "The Kyrgyz Republic Law on Micro-finance Organizations in the Kyrgyz Republic, No. 124, 23 July 2002, https://cis-legislation.com/document.fwx?rgn=62/; EIU (Economist Intelligence Unit) (2009), Global microscope on the microfinance business environment: A pilot index and study, Economist Intelligence Unit, London, UK.

▶ Box 3. Strengthening SME access to capital market finance: The Progress Market in Croatia and Slovenia

In 2015, the European Commission adopted an action plan setting out measures to establish the building blocks of an integrated capital market in the EU – the Capital Markets Union – to broaden the range of financing options for companies at all stages of the business cycle. Among other measures, the action plan envisages more access by SMEs to capital market funding.

One way to enable this type of finance for SMEs is via dedicated SME growth markets. Some European and other emerging market stock exchanges operate such markets, which typically have less restrictive listing and reporting requirements than the main markets. As an alternative source of financing, such dedicated SME markets can play a significant role in helping SMEs to finance inclusive, long-term growth.

Against this background, in 2017 the Zagreb Stock Exchange (ZSE), together with the EBRD, launched a feasibility study into establishing an SME growth market in Croatia and Slovenia, which was aimed at creating a regional SME financing platform. The feasibility study provided a proposal for the market set-up and most suitable measures to increase access to capital market financing by companies in Croatia and Slovenia, and potentially the wider Western Balkan region. Specifically, it provided the ZSE with sufficient capacity to decide on the optimal set-up of the SME market, together with a business and implementation plan as a policy-making lever with relevant stakeholders.

This new SME growth market – the Progress Market – has launched operations under the Markets in Financial Instruments Directive II of the EU (MiFID II). This regulation eases listing and reporting requirements for SME markets compared with the main markets, and is designed to strike a balance between listing requirements and providing adequate information for financial investors. A first listing took place in January 2019.

The implementation of the Progress Market for Croatia and Slovenia complements the successful establishment of the equity crowdfunding platform for SMEs and start-ups at ZSE in 2017, which transformed the ZSE into a company financing hub. The company financing hub is a model developed by the EBRD in which exchanges evolve into multilevel equity markets, covering issuers of various sizes at different development stages in segmented markets, thus enabling exchanges to offer access to capital market financing to small- and mid-cap companies throughout their different growth stages.

Source: Extracted from: OECD/ETF/EU/EBRD (2019), SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe, OECD Publishing, Paris, pp. 274-275.

6,212 projects, totaling an investment of more than GEL 61 million.[31]

The Agency also implements the broader credit guarantee scheme launched by the government in 2019 in partnership with Georgian banks (details below). In addition to Enterprise Georgia, the Ministry of Agriculture works through the Agricultural and Rural Development Agency (ARDA) to support SME development in the agricultural and agro-processing sectors, including the offer of interest rate subsidies, loan guarantees, and co-financing. The Georgia Innovation and Technology Agency (GITA) delivers financial support programmes in favour of innovative projects, including matching grant programmes (see chapter on innovation).

4.3.1. Debt financing instruments

Georgia credit guarantee mechanisms

Credit guarantee schemes (CGSs) are a favoured instrument of governments in practically all countries around the world to promote access to finance for less bankable SMEs by alleviating credit constraints. Credit guarantees provide governments with an efficient means of levering state resources to stimulate much larger amounts of SME lending than could be achieved by direct state lending because the public costs are limited to the administration of the programme and coverage of defaults from the minority of enterprises not repaying their loans. Different structural/institutional models exist for CGSs (public, private and mixed), but typically, CGSs are institutions owned, managed and controlled by the government, which appoints board members and senior management and provides strategic direction. More than two third of CGSs for SME lending in Central, Eastern and South-Eastern Europe are fully publicly owned, as well as being capitalised up front (Vienna Initiative Working Group on Credit Guarantee Schemes, 2014). The adoption of CGSs has been experiencing rapid growth over the last two decades (Calice, 2016).

Georgia's foray into use of a credit guarantee mechanisms was the introduction of a credit guarantee component of the Produce in Georgia programme implemented by Enterprise Georgia, whereby co-financing loans to SMEs under the programme could qualify for a collateral guarantee, up to 50% of the loan amounts.[32]

The broader State Programme of Credit Guarantee Scheme was launched in April 2019[33]; so, unlike many other countries, Georgia has a short history in adopting such a policy instrument to improve access to financing for SMEs. In the new scheme, introduced under the umbrella of the Ministry of Economy and Sustainable Development (MoESD), Enterprise Georgia (the assigned implementing body) provided a 70% guarantee to the banks on loans from GEL 50,000 to GEL 2 million, with a term of up to 10 years, if the SME or start-up met certain conditions. The total budget for the new scheme was GEL 20 million (about USD 6.4 million/ EUR 5.5 million), with the aim of generating up to GEL 250 million of bank loans to SMEs (leverage of over 10 times). This expectation may be very optimistic. While leverage rates for CGSs (ratio of outstanding guarantees to total capitalisation) can vary significantly from one programme and one region to another, a global survey of CGSs in 2016 reported an average leverage rate of 3.3 times, although this increased to a multiplier of 3.8 in Europe and 4.1 in high-income countries (Calice, 2016).

The process of implementing the guarantee scheme followed good practice in the assessment process. The SME/start-up approaches the bank; the bank evaluates the loan request; in case of

31 Enterprise Georgia News, 22 September 2020, http://www.enterprisegeorgia.gov.ge/en/News/micro-and-small-business-suppo/.

32 The Produce in Georgia credit guarantee could apply to 400 different categories of SMEs (sectors, activities), providing guarantees for commercial bank loans of GEL 50,000 to GEL 2.5 million and guarantees for microfinance loans of at least GEL 20,000, for the first 48 months.

33 The scheme is governed by Resolution 163 of the Government of Georgia, dated March 29, 2019, amended by Resolution 457 of July 23, 2020 and Resolution 539 of August 27, 2020.

collateral needs, the SME requests the bank to exercise the guarantee mechanism; the bank sends the request to Enterprise Georgia; Enterprise Georgia verifies whether the SME falls within one of the supported categories and approves the credit guarantee arrangement. Enterprise Georgia depends on the bank's evaluation of the merits of the loan application.

In case of loan default, the State guarantee scheme would cover up to the 70% of the individual faulting loans, but capping the total liability of the government at 15% of the lending bank's total portfolio of loans issued under the scheme. One of the inefficiencies in the current credit guarantee system in Georgia is the practice of depositing guarantee funds into the participating financial institution to be held on account. If the loan goes into default, the bank takes the guarantee amount from the account and returns the rest to Enterprise Georgia. Such a practice of depositing the guarantee funds with the bank limits the leverage of the scheme and ties up the use of public funds (World Bank, 2021b), as well as reduces any incentive for the bank to make every effort to recover loan funds from the defaulting client.

An initial agreement was signed with 12 participating banks but the scheme had a very slow take-up, partially due to its reliance on annual budgets, which were not enough to raise interest from financial institutions (World Bank, 2021b) and partly because it took some time for banks to learn how the guarantee instrument was to work. This is consistent with the finding of Calise (2016) that setting up small CGSs has in the past seriously undermined the confidence of partner lending institutions. In addition, one of the barriers to the use of CGSs is low awareness among Georgian SMEs of their existence. In the 2018 EIB Bank Lending Survey, fewer than 20% of micro-enterprises and about one-third of SMEs and mid-cap firms were aware of a credit guarantee scheme in Georgia (Conde and Gattini, 2019).[34] Georgian banks participating in the EIB survey reported that they do not make wide use of credit guarantee instruments citing their limited availability, cost and administrative burden as major constraints.

In response to the impact of the COVID-19 crisis on SMEs, the government allocated an additional GEL 330 million (USD 100 million) to the credit guarantee scheme in 2020 (GEL 300 million to go the banks and GEL 30 million to go to the microfinance organisations), which anticipated securing a GEL 2 billion credit portfolio. At least 40% of the guarantee resources were to support new loans and the rest to support the restructuring of existing loans for investment and working capital purposes. The guarantee coverage was raised to 90% for new loans and 30% for restructured loans, with a portfolio cap of 35% (*i.e*. in the case of loan default, the financial institution can claim up to 35% of the total guarantee portfolio). The ceiling on the maximum loan amount was raised to GEL 5 million. The guarantee scheme charges an annual fee of 0.3% on the guaranteed amount (which is low by international comparison).

After 31 December 2020, the features of the scheme were again redesigned: the guarantee coverage for new loans decreased to 80%, restructuring of loans no longer supported, and up to 20% of the guaranteed loan allowed for working capital.[35] The programme projection was to potentially support up to 1,000 SMEs and GEL 2.3 billion in loans (USD 740 million). Since the announcement of the revised programme in 2020, 151 SMEs used the guarantee scheme in 2020 and another 69 in 2021 (to July).[36] The government actions to adjust credit guarantee features for SMEs in response to the COVID-19 crisis are consistent with actions taken by governments in most countries, e.g. increasing the amount of funds available for loan guarantees, raising the maximum loan limits, and the coverage ratio, and extending the length of the guarantee term. In addition, in some cases, the governments created new or supplementary

34 In 2018, the Produce in Georgia credit guarantee scheme was the only one in place; the broader State credit guarantee scheme was only approved in 2019.

35 In 2020, the unused amount from the GEL 330 million allocation was returned to the state budget. For 2021, the state budget allocated GEL 100 million to the scheme.

36 Information from Enterprise Georgia official during consultation interview with the ILO team in July 2021.

credit guarantee schemes targeting start-ups or SMEs in strategic sectors (Dreyer and Nygaard, 2020).

Georgia's credit guarantee efforts are assisted by the EUR 25 million partial credit guarantee component of the World Bank "Georgia Relief and Recovery for MSMEs" Project in 2021. The aim of this component is to further unlock financial intermediation to SMEs by addressing the high collateral requirements and the heightened risk aversion of financial institutions following the COVID-19 crisis. The target for this partial credit guarantee is SMEs with an annual turnover of up to GEL 20 million (USD 6.4 million), with an objective to include, among its beneficiaries, women-owned/managed firms or SMEs actively promoting female employment. In the case of this MSME Relief and Recovery Project, Enterprise Georgia disburses cash on a retail basis to an Enterprise Georgia account held at the financial institution, the financial institutions pay a monthly fee for the loans covered and return the repaid loan amounts plus interest (World Bank, 2021b).

An indicator of asset quality of guaranteed loans is the rate of nonperforming loans. In this regard, Calice (2016) reported a global median nonperforming guaranteed loans rate of 2.5%, ranging from a median 1.2% percent in Asia, to 2.9% in Europe, to 17.1% percent in Africa. Georgia does not have enough history with the CGS to assess nonperforming or defaulted loans.

Improvements to the Georgia credit guarantee scheme would be beneficial in increasing its effectiveness and impact. The World Bank "Principles for Public Credit Guarantee Schemes for SMEs" are offered as guidance to Georgia on good practices in the design and operation of SME credit guarantee mechanisms (Box 4). One of the major issues affecting the longer-term sustainability of the Georgia scheme is its dependence on an annual budget allocation from the Ministry of Finance. Calice (2016) cautioned that "pay-as-you- go" public credit guarantee schemes funded by annual budgetary subventions, such as the case in Georgia, should be discouraged because of the lack of transparency and reliability of such arrangements. Setting up a CGS with inadequate financial resources not only affects its financial sustainability, but can undermine the confidence of lenders and result in a limited developmental effect in terms of achieving its policy objectives (Goffe et al., 2021).

According to "good principle" guidance, the establishment of a CGS should be authorised by a law, decree or other special legislation, which defines the legal and regulatory framework for its conduct, including the supervisory accountabilities and the body in charge of oversight (most commonly, the financial sector regulator), and the minimum capital adequacy standards (World Bank, 2015; Calice, 2016; Goffe et al., 2021). It appears the State Programme of Credit Guarantee Scheme was established by a Resolution, which might indicate it is designed as a temporary, rather than a permanent scheme.

KredEx, the Estonian Credit and Export Guarantee Fund, may be an example for the Georgian government to emulate (Box 5). In this instance, the credit guarantee scheme was established by law, assigned a designated credit guarantee agency and provided with capitalisation from the government (indicating permanency).

In any event, the **Georgian CGS would benefit from enhanced promotion to raise public awareness**, including among entrepreneurs, SMEs, and financial institutions. Introduction of **a risk monitoring system should be put in place** to collect information from the participating financial institutions on the profile of beneficiaries and loans, the financial performance of guaranteed loans and the overall portfolio (e.g. default rates, etc.), and the financial performance of participating financial institutions, particularly MFOs which may have a higher level of financial vulnerability. As well, **a monitoring system should be put into place to track the financial sustainability of the scheme** and inform any pricing changes to ensure fees charged are sufficient to cover any loan losses.

Interest rate subsidies

The major support to SME financing in Georgia is through interest rate subsidies, generally framed as the co-financing of interest payments. These are available to Enterprise Georgia clients, applying to 200 different categories of eligible SMEs (sectors, activities), and with certain modifications for different groups of SMEs. The justification for

▶ **Box 4. Principles for Public Credit Guarantee Schemes for SMEs**

Principle 1. The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives.

Principle 2. The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.

Principle 3. The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.

Principle 4. The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.

Principle 5. The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.

Principle 6. The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.

Principle 7. The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.

Principle 8. The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.

Principle 9. The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.

Principle 10. The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.

Principle 11. The guarantees issued by the CGS should be partial, thus providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.

Principle 12. The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.

Principle 13. The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country's legal and regulatory framework.

Principle 14. The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.

Principle 15. The CGS should periodically and publicly disclose nonfinancial information related to its operations.

Principle 16. The performance of the CGS—in particular its outreach, additionality, and financial sustainability— should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.

Source: World Bank (2015), Principles for Public Credit Guarantee Schemes for SMEs, World Bank, Washington, DC, pp. 10-11.

interest rate support is the reluctance of SMEs to borrow from commercial banks under the high bank interest rates as highlighted in section 1 above. In addition, SMEs borrowing in Georgian lari are exposed to even higher interest rates. The government co-financing of the interest payments provides an incentive for SMEs to borrow by reducing their cost. In general, the minimum loan for the interest rate subsidy is GEL 50,000, and up to a maximum of GEL 10 million. At least half of the loan must be used for fixed and capital expenses, and not more than half for working capital. In 2020, Enterprise Georgia supported 123 companies with interest rate subsidies. As of July 2021, an additional 110 new projects were supported.

Different co-financing schemes are offered. The Industrial Component Programme offers new or existing SMEs (in eight priority sectors) 13% co-financing of bank loan interest rate for the first

Box 5. Estonian Credit and Export Guarantee Fund (KredEx)

Description of approach

KredEx was set up in 2001 as a credit guarantee agency (Business Support and State Loan Guarantee Act) under the jurisdiction of the Ministry of Economic Affairs and Communications. KredEx was established with EUR 122.7 million of capitalisation from the government. Among its key objectives were to develop SMEs and encourage export growth. KredEx targets new start-ups, SMEs and exporters through the provision of loan, leasing, and export credit guarantees. KredEx also offers state-guarantees on home mortgages, as well as loans, guarantees, and grants for solutions aimed at energy efficiency.

The rationale for SME credit guarantee programme in Estonia is similar to the situation in Georgia: SMEs find it difficult to raise finance from the commercial financial sector for reasons of insufficient collateral, limited credit history, and limited equity, as well as an underdeveloped leasing market.

KredEx offers guarantees for the following loans:

- Overdrafts and working capital for enterprises unable to meet collateral requirement or credit histories to obtain bank loans without the guarantee;
- Investment loans (for the purpose of investing in production equipment and intangible assets and related direct costs in relation to expansion of the company's activity, diversification of output or restructuring of the production process, and lacking the required capital for self-financing; loan amount up to EUR 2 million but not more than 40% of the project cost);
- Leasing - to help businesses to enter into lease agreements for machinery and equipment (comprises only 2%-3% of guaranteed loan volume).

Also supported are Start-up loan guarantees to finance investments and working capital of start-up businesses that have been active up to three years and export loan guarantees to finance the large-scale export transactions of goods-producing Estonian companies (e.g. financing the production of goods to be sold to a foreign buyer, paying a credit insurance premium, or offering a long payment term to a foreign buyer).

The distribution of guarantee agreements by size of enterprise varies from year to year. In 2018, 89.2% of the guarantee volume went to micro and small enterprises (65.8% to microenterprises, 23.3% to small enterprises), 10.7% of medium enterprises and only 0.1% to large enterprises (using the EU SME definitions).

In all cases, the finance is provided by the commercial banks, and applications to KredEx are channelled through the banks, which make the guarantee request directly to KredEx. KredEx guarantees up to 80% of the loan amount with the loan amount capped at EUR 5 million, but with special conditions if the loan amount is over EUR 2 million. The terms of the guarantee vary by the type of loan, but KredEx charges a contract fee of 1% and an annual guarantee fee ranging from 0.8% to 3.8% on the balance of guarantee (a minimum of EUR 30). These fees, and a very low incidence of guarantees being called in, have enabled KredEx to become self-financing and indeed profitable over a short period of time.

Since 2001 (to the end of 2019), KredEx has provided loan guarantees to 3,845 enterprises in the amount of EUR 845 million, which generated EUR 1.6 billion in bank loans. At the end of 2019, the KredEx loan guarantee portfolio consisted of 1,110 guarantee agreements for 742 enterprises in the amount of EUR 101.2 million (Foundation KredEx, 2019). In 2019 alone, from 424 new guarantee loan applications, KredEx issued 372 new guarantee agreements for SMEs of EUR 74.5 million, generating EUR 144.2 million of additional financing from the banks.

A number of factors make KredEx worthy of attention. It has successfully achieved financial viability, with no drain on public funds. It was able to garner credibility with the commercial banking sector in a short period, becoming an established player in the local financial market. It is relatively unbureaucratic, making for easier and quicker access to capital for local SMEs. It has developed and refined its product range to match the development of its client base. During the COVID-19 crisis, the government amended the Business Support and State Loan Guarantee Act to increase the guarantee coverage rate to 90% of the loan amount. KredEx also issued an "extraordinary small loan guarantee", extending the coverage rate to 100% for loans of up to EUR 150,000 to small enterprises; and an "extraordinary proportional loan guarantee of new bank loans" covering up to 90% of loan amounts to a maximum of EUR 10 million.

(contd.)

36 months and 15% co-financing of annual interest rate on leasing contracts for the first 36 months.

As of December 2019, Enterprise Georgia had supported 359 enterprises in the Industrial

Relevance to Georgia

The Estonian KredEx example is appropriate for Georgia because it is also a small country (population of just over 1.3 million), and demonstrates that establishment of a Credit Guarantee Institution can be viable in spite of its small population size. One of the key advantages of being a public-owned, but independent (in the sense of having the sole mandate to deliver the CGS) and capitalised entity is the credibility it garners in the banking system. By establishing such a credit guarantee agency, Georgia could bring itself more in line with key principles established by the World Bank for public SME credit guarantee schemes (World Bank, 2015). Appropriate capitalisation and encouraging the participation of banks through a public-private partnership arrangement could strengthen the credit guarantee regime. The scheme could also be strengthened by offering more diverse credit guarantee products to address areas where entrepreneurs and SMEs continue to be disadvantaged in obtaining bank financing, such as start-up credit guarantees and export credit guarantees.

Sources: Foundation KredEx (2019), Annual Report 2019, KredEx, Tallinn, Estonia. KredEx website: https://kredex.ee/en/services/business/loan-guarantee/; AECM, "KredEx / Estonia", January 2021, https://aecm.eu/wp-content/uploads/2021/01/EE_KredEx.pdf/; World Bank (2015), Principles for Public Credit Guarantee Schemes for SMEs, World Bank, Washington, DC.

Component programme with total investment value of GEL 783.2 million.[37]

For the Produce in Georgia Programme[38] and the Business Universal Programme, Enterprise Georgia combines the interest payment co-financing support with the collateral guarantee. In the Produce in Georgia scheme, Enterprise Georgia co-finances the accrued interest on loans or leases issued by a commercial bank or a leasing company during the first 24 months, and offers a collateral guarantee for up to 50% of the loan amount (no more than GEL 2.5 million) for the first 48 months. At least 80% of the loan is to be applied to capital expenditures. The Business Universal Programme subsidises the loan interest on commercial bank loans or leases at the level minus 3% of the national refinancing rate (for which the borrower accepts payment responsibility) for the full term of the loan or the lease. This programme also combines the commercial loan interest co-financing component with a credit guarantee, but up to 60% of the loan principal amount (loans of GEL 50,000 to GEL 10 million) for a period of 10 years.

The process of approving the interest rate co-financing subsidy is more elaborate than in the case of the CGS. The SME applies directly to the commercial bank and negotiates a loan. The bank informs Enterprise Georgia of the loan approval and sends details, including the client's business plan. Enterprise Georgia can take up to 30 days to review the business plan and loan details, and if the co-financing subsidy is approved, Enterprise Georgia concludes the agreement directly with the SME. However, Enterprise Georgia submits its share of the interest payment directly to the lending bank.

The Ministry of Agriculture also delivers the Agro-Credit Programme that subsidises interest payments (by 11% for capital asset investment loans and 8% for working capital loans) for commercial bank loans to enterprises in the agricultural and agro-processing sectors.

From a policy perspective, the subsidised interest payments help create credit demand and such programmes are shown to produce a positive economic impact, as long as they do not encourage

37 Enterprise Georgia News, 9 January 2020, http://www.enterprisegeorgia.gov.ge/en/News/results-of-the-industrial-comp-17/.

38 The objective of this flagship programme, established in 2014, is to support the competitiveness of Georgian industry with a focus on building entrepreneurship and export potential among SMEs. As of June 2019, the programme had supported 503 businesses with total investment value of GEL 1.18 billion (about USD 400 million), much of this invested in the field of agriculture and tourism/hotels (Enterprise Georgia, 2019, "Results of the State Program 'Produce in Georgia'", webpage, 23 September 2019, http://www.enterprisegeorgia.gov.ge/en/News/results-of-the-state-program-p/).

over-indebtedness of the borrower in order to benefit from the offer (Dinh et al., 2013). An additional caution is that the subsidy may benefit enterprises who already have access to credit, which may be acceptable to Enterprise Georgia if the recipient SME is encouraged to invest in productive activities that they would otherwise not have pursued under high interest rate conditions. It is also important to monitor the beneficiary firms to ensure the subsidised loans are used for the intended productive activities, even though this may be difficult and costly, what Dinh et al. (2013) refers to as demonstrating the dark side of the stimulus policies.

The major implication for Enterprise Georgia is to create a monitoring system to ensure the enterprises benefiting from the interest payments co-financing scheme are using the loan funds for the intended purposes and not for ineligible or speculative activities. Given a long enough history with the credit guarantee scheme and the co-financing schemes, Enterprise Georgia could also undertake a comparative assessment of the private outcomes and public costs of the two intervention approaches.

4.3.2. Addressing financial literacy gaps among new entrepreneurs and SMEs

The low level of financial literacy of SMEs in Georgia appears to be a significant barrier to their access to financing. Some MFOs have reported a serious lack of financial knowledge among their borrowers, including micro and small enterprise owners and income-generating farmers, who are unaware of how much interest they are paying on their loans or how to manage the loan funds. In a number of countries, microfinance institutions are required by regulation to provide basic business development services and orientation in financial management principles to their loan clients (bundling financial and nonfinancial services). This does not seem to be case in Georgia and may be an action to consider in the further reform of the MFO law, supported by several studies documenting improved clients' impact when accessing credit in combination with nonfinancial services or value-added services. Certain MFI programmes deliver classroom-based management training to groups of micro-entrepreneurs before they receive credit, and continue to provide services to clients after the loan is received, often during repayment meetings (Sievers and Vandenburg, 2004). The policy lesson learned from analysis of different MFI approaches is that not all micro-entrepreneurs may need to receive training, but that those who participate in the training tend to achieve better performance than if they received only the credit (Sievers and Vandenburg, 2004).

The National Bank of Georgia launched a financial education programme for SMEs in 2018, with the aim to reach over 1,000 SMEs per year with information on types and sources of business finance, relevant financial services, and financial management assessments and approaches.[39] Enterprise Georgia also makes training courses available to improve the financial literacy of SMEs. In 2016-2017, for example, this training reached 14,500 beneficiaries (MoESD, 2018, p. 20). Such financial literacy programmes help to reduce the information asymmetries between SMEs and potential lenders, as well as the risk perceived by the lenders. In the longer term, the incorporation of financial education in the national school curriculum will raise the level of financial literacy in the general populace and spill over to a better-informed entrepreneurial population.

In the short-term, more efforts can be made to make information on the sources and types of financing and the accounting and financial reporting standards available to entrepreneurs and SMEs through electronically-accessible web portals. One of the barriers to complying with the IFRS reporting requirements is that many MSMEs may not be using accountancy software. To address this issue, Enterprise Georgia (or the NBG) could make small "vouchers" available to micro and small enterprises to cover some of the costs of acquiring accounting software, the professional support needed to install and use the software, and consultancy services to guide them in the implementation of the IFRS reporting standard.

39 NBG "Finedu" Portal, the "For entrepreneurs" link - https://www.finedu.gov.ge/ge/metsarmeebistvis-1/.

4.4. Conclusions and policy recommendations

The Georgian government has made considerable progress in strengthening and improving the financial sector since the 2008-2009 financial crisis through better regulation of the banking system and microfinance sector and supervisory role by the NBG. Banks are more responsive to the SME lending market and now the dominant source of external finance for SMEs. The microfinance sector is playing an important role in serving underserved or unbankable clients, although makes up a very small share of overall lending activity and caters predominantly to the consumer market.

Access to finance is a core pillar of the national strategy for SME development and progress has been made in implementing key policies and actions. Public support for SME financing rests with Enterprise Georgia which strives to channel more bank financing of SMEs through the provision of credit guarantee schemes and interest rate subsidies. It does not do direct lending to SMEs, so it is not crowding-out private lenders, although it does provide some co-financing grant schemes to start-ups and SMEs in selected sectors.

However, there are areas for further improvement. Alternative financing sources are underdeveloped, including leasing, factoring and all forms of equity financing, and lack legal or regulatory frameworks that could promote their greater use. Specifically, the government should address the wider issues of access to finance for SMEs, including building SME financial literacy, expanding credit guarantees for SME lending and promoting non-bank financing, such as leasing and factoring.

In addition to a limited appetite for risky investments in Georgia, the government does not provide incentive schemes to stimulate development of a private venture capital industry. Thus, the venture capital industry and the less formal business angel investor networks are at an infancy stage. Much could be done to accelerate the development of these equity markets. In addition to refining legal and regulatory frameworks for venture capital investments, additional policy measures could be considered to kick-start the sectors, such as through public-private partnership arrangements and matching investment funds, and tax incentives for private business angel investors and venture capital funds to direct investment into promising early-stage start-ups and growth-potential SMEs. In this regard, Georgia could study possible tax schemes, such as tax deduction, tax exemption, tax credit, tax deferral, and loss relief, as well as co-investments schemes to foster investments into start-ups and innovative early-stage enterprises. Development of business angel activity could be enhanced through training and networking initiatives to build the capacity of individual business angels, which would also serve to increase the success rate of Georgian business angels. This co-investment might be done by a dedicated public fund (from the state budget), or be a private-public find, or a fund established with assistance of international financial organisations, such as the EIB (EU4Digital, 2020).

Policy recommendations

- Make information on the sources and types of financing and the accounting and financial reporting standards available to entrepreneurs and SMEs through electronically-accessible web portals.
- Escalate efforts to improve the financial literacy of SMEs, including knowledge of factoring and leasing as financing options.
- Implement a “voucher” system to encourage SMEs to make use of accounting software packages and to seek consultancy advice on preparation of financial statements to meet the IFRS standard for submission to the Ministry of Finance.
- Enhance promotion of the current Georgian credit guarantee scheme to raise public awareness, including among entrepreneurs, SMEs, and financial institutions.
- Introduce a risk monitoring system to collect information from the participating financial institutions on the profile of credit guarantee beneficiaries and loans, the financial performance of guaranteed loans and the overall portfolio (e.g. default rates, etc.), and the financial performance of participating financial institutions.

- Establish a specifically mandated and capitalised SME credit guarantee agency in line with key principles for public SME credit guarantee schemes established by the World Bank, and examine opportunities for offering diverse credit guarantee products tailored to address the needs of start-ups and SMEs that are disadvantaged in meeting the requirements for bank financing under normal conditions.

- Establish a workgroup involving both regulators and the Venture Capital Association for the specific purpose of elaborating a legal and institutional support framework for venture capital.

- Explore opportunities to partner with the European Investment Fund (EIB) in programmes, such as the European Fund for Sustainable Development (EFSD), the InnovFin Venture Capital Fund project, and Pan-European venture capital funds-of-funds (VentureEU) for co-funding of venture capital investments in Georgia and stimulate the industry.

- Expand the business angel market in Georgia by providing tax incentives for angel investors (e.g. tax credit, tax exemption, tax deferral, capital gains relief), and/or co-investments in business angel investments from public funds (established with assistance of international financial organisations, such as the EIB), and active efforts to build the capacity of individual business angels through training, networking, and experience exchange with other countries.

- Fully operationalise the Regulatory Sandbox to encourage innovation in the design and delivery of alternative financing solutions involving fintech, such as peer-to-peer lending and crowdfunding platforms and blockchain (which would facilitate supply chain financing for SMEs).

5. Other govt. incentives (which includes business innovation and business internationalisation)

5.1. SME Development Incentives in the Field of Innovation

5.1.1. Policy Overview

Georgia currently has no formal innovation policy in place. Innovation was briefly addressed in the previous general strategy ("Georgia 2020") for national development (GoG, 2014). However, the government's 2021-2024 programme makes no reference to innovation policy, indeed only a reference to a science and technology strategy that is in the making (GoG 2020). According to the government, the action plan for science and technology will feature expanded financing via enhanced grants competitions, further state funding for scientists engaged in both fundamental and applied science, as well as a revamp of the management and infrastructural underpinnings of science development in the country. In 2019, the expenditure on research and development (R&D) in Georgia was GEL 140.2 million, or 0.3% of nominal GDP. In total, there were 48 institutions officially conducting R&D activities, and 10 191 active researchers (GEOSTAT).

The legal framework for innovation is underdeveloped. The Law of Georgia on Innovations was enacted in June 2016, whereby a designated Research and Innovations Council was tasked in delivering annual reports on the progress of innovation-related activities. However, that initiative has lost momentum over the years. Studies have described several weaknesses limiting innovation in Georgia. According to a USAID report (USAID, 2019), which had set out a blueprint for an innovation strategy in Georgia (though not enacted by the government), those limitations include weak innovation assets (in the "education system and talent pool, research capabilities, high-growth entrepreneur ecosystem, and access to capital"), as well as low incentives for innovation (as regards "market information, sophisticated demand, policy and regulatory assurances, and competitive procurement"). Moreover, according to local interviewees, scientists have yet to appreciate the commercial advantages of registered intellectual property.

The 2016-2020 SME development strategy remains the main innovation policy guidance for micro, small, and medium sized enterprises (MSMEs). (As of this writing the new MSME development strategy is still under review.) Under the 2016-2020 strategy, there were five high-level policy directions, one of which was facilitating innovation and R&D at SMEs. Georgia was ranked 118th in the World Economic Forum's 2014-2015 innovation pillar (WEF, 2015). By 2019, the country had advanced to 91st place (WEF, 2019). Priority actions addressed under the innovation policy direction included the "stimulation of innovations among SMEs; elaboration of effective schemes of innovation and R&D financing; support to the commercialisation of innovations and R&D; improvement of information and communication technologies (ICT) skills among businesses; and providing infrastructure for innovation" (GoG, 2015).

Government innovation programmes are mostly implemented by Georgia's Innovation and Technology Agency (GITA) and the Shota Rustaveli National Science Foundation of Georgia (SRNSFA). GITA was established in 2014 under the Ministry of Economy and given a key role in the SME development strategy. On the other hand, the SRNSFA, under the Ministry of Education and Science, is more oriented towards the promotion of academic and scientific research. Nonetheless, some overlaps have been detected in the past. For example, in 2018 a European Commission assessment of Georgia's innovation system highlighted the lack of complementarity between GITA and SRNSFA (EC, 2018). The same study also recommended that Georgia adopt a 4C-strategy ("coordination, concentration, collaboration, and coherence") to reform its innovation system. Aside from GITA and the SRNSFA, the National Intellectual Property Center of Georgia ("Sakpatenti") is the third pillar in Georgia's innovation institutional landscape.

Innovation activities in Georgia benefit from technical assistance and co-funding by foreign donors and international development agencies. These international organisations are actively engaged not only with GITA and the SRNSFA, but also with other Georgian governmental entities, such as Enterprise Georgia, the Export Development Agency, or the Ministry of Agriculture, in areas adjacent to innovation (e.g., cluster development, digitalisation, e-commerce, export readiness, management and skills development, technical extension services, and others). Other large-scale organisations, including large banks in the private sector and universities in the public sector, have also developed innovation support initiatives. Furthermore, recent efforts to develop closer bonds with the Georgian diaspora, such as the Angel Investor Club Georgia, are also encouraging for innovation-related activities. Yet, the overall institutional landscape for innovative SMEs remains at an embryonic stage.

5.1.2. Government Innovation Incentives

GITA is the main driver of Georgia's innovation ecosystem. GITA is the implementing agency of the GENIE project, a partnership signed in 2016 between Georgia and the International Bank for Reconstruction and Development, whereby Georgia was granted USD 40 million until 2021 to establish an initial landscape for innovation. The agency thus provides innovation infrastructure consisting in dedicated physical facilities and equipment; innovation services such as mentoring and access to incubators and accelerators; and innovation financing to assist the growth of eligible MSMEs, the commercialisation of applied research, and technology transfer. GITA also carries out educational activities to support skills build-up towards a knowledge-driven country vision. The agency is set on increasing national R&D expenditure and inducing the growth of private-sector investment in R&D; reaching out to more potential beneficiaries of financial grants not only in urban centres but also in rural areas; expanding the base of international ICT companies operating in Georgia as well as providing local access to international investors; and contributing to a more robust regulatory framework in the domain of innovation.

Innovation infrastructure includes technology parks ("TechPark"), innovation centres, factory laboratories ("FabLabs"), and innovation laboratories (iLabs"). There are currently 3 "TechPark" in Georgia (located in Tbilisi, Zugdidi, and Telavi) and 5 innovation centres (in Kharagauli, Baghdadi, Choportu, Akhmeta and Rukhi). In addition, there are also plans to open-up new regional innovation hubs around the country. Technology parks and innovation centres aim at assisting the growth of high-tech businesses by concentrating in single physical locations multiple resources and supporting services. "FabLabs", for their part, provide space for high-tech manufacturing workshops in 3D printing, laser cutting, CNC routing, and experimenting with vacuum forming, PCB, and programmable sewing machines. These spaces are inspired in the Massachusetts Institute of Technology's FabLab model; there are 8 industrial laboratories in the country. Lastly, "iLabs" are focused on computer programming. There are currently 3 "iLabs" in Georgia, hosting start-ups dedicate to computing and organising events such as hackathons, computing Olympiads, and other innovation-related competitions in information technologies.

Innovation services include educational and business activities. GITA provides for free training programmes in information technologies and business management courses, which can be attended at technology parks, innovation laboratories, or universities associated with the agency. GITA also offers access to incubators and accelerators. As of this writing, the agency has direct equity stakes in 26 start-ups[40]. Originally, these equity stakes were managed by the agency itself. They have now been farmed out to a limited liability company called Startup Georgia. On the international front, GITA recently established

40 https://gita.gov.ge/eng/startups

a partnership with 500 Startups (a US-based venture capital firm) and Bank of Georgia (a private commercial bank operating in the country and elsewhere) to create the 500 Georgia programme. This 7-month long programme, which concludes with a Silicon Valley immersion, aims at selecting 30 start-ups annually. Already a second cohort of 15 Georgian start-ups has been selected in 2021[41]. International collaboration between Georgian start-ups and foreign entities is fostered further through GITA's membership at the Enterprise Europe Network and the Startup Europe Regions Network. The agency also interacts with the EU's Horizon programme and other donors such as the World Bank and others.

Innovation financing consists of different grant programmes. As regards business grants, these come in the form of co-matching schemes, under three main lines of support. The 'GEL 650 000 Innovation Matching Grants' scheme is available to businesses that have been registered for at least one year prior to grant application and which exhibit annual turnover (sales) of no more than GEL 30 million. Eligible projects must be executed within 24 months and financial support is capped at 50% of eligible costs from a minimum of GEL 150 000 to a maximum of GEL 650 000. The 'GEL 100 000 Startup Matching Grants' financial support line is available to existing businesses registered for no more than two years prior to application, and to individual persons subject to business incorporation if awarded the grant, whereby GITA finances 90% of an approved project's first year budget up to GEL 100 000. Finally, the 'Small Grants for Individuals' programme is available to individuals under different headings, such as travel or prototype grants, for amounts that vary between GEL 5 000 and GEL 15 000. GITA is also the implementing agency of the World Bank's Technology Transfer Pilot Program in Georgia, which provides funding for the commercialisation of applied science research in agriculture and ICT projects.

The Shota Rustaveli National Science Foundation of Georgia (SRNSFG) is also involved in innovation financing. SRNSFG is responsible for applied research funding grants to selected scientists from academia and non-profits under the GENIE project, and it has also been the main implementing agency of initiatives financed under the EU's Horizon programme. The foundation is a public entity, actively engaged in shaping government strategy in science, technology, and innovation by hosting its International Policy Board which brings together national and international scientists as well as Georgian government officials. The foundation provides funding in six scientific fields, namely: exact and natural sciences; engineering and technology; medical and health sciences; agricultural sciences; social sciences; and humanities. However, recent calls for applied research grants have prioritised the engineering and technology field, as well as computer and information sciences (under the field of exact sciences). Grants awarded have ranged from GEL 140 000 to GEL 420 000, and term limits between 2 and 4 years. These calls have been available to public and non-commercial entities only, and eligible candidates organised as consortiums with a minimum of 2, and a maximum of 5, organisations.

Enterprise Georgia (EG) executes government programmes in entrepreneurship and adjacent to innovation activities. The agency promotes small business development, foreign direct investment in Georgia, and export support. EG is GITA's sister organisation, both established under the Ministry of Economy and likewise key actors in SME public policy. But there is seemingly little interconnection between both agencies, though existing programmes operated by EG and GITA exhibit similarities and close business appeal. That is the case with EG's micro and small business 2020 support, focused on individual entrepreneurs, whereby selected beneficiaries receive funding up to GEL 30 000 per project subject to a maximum 75% coverage of eligible expenses (or 85% if implemented in mountainous regions). Another example is the "Produce in Georgia" programme, which dispenses GEL 10 000 mini grants destined for technical assistance in strategic priority economic sectors where innovation is cornerstone. Under the industrial component of "Produce in Georgia" specifically, priority sectors include paper and paperboard, wood processing, metal products, chemical manufacturing, mechanical

41 https://ecosystems.500.co/500georgia/startups

engineering, textile production, electrical equipment, and rubber and plastics.

The Export Development Agency (EDA) is charged with export promotion, which ought to consider the technological intensity of exports. The challenge EDA faces is indeed twofold: increasing the pipeline of potential exports, which are few in numbers, and increasing the technological intensity of Georgian exports, which are still dominated by agricultural products and destined for (less demanding) non-EU markets. The EDA conducts other activities, such as export readiness and export capacity assessments, whereby innovativeness concerns are also likely present. These are not only related with R&D at firm level, but with technology adoption as well. Digitalisation is a major constraint for Georgian MSMEs. According to local interviewees, MSMEs are lagging in efforts to integrate digital technologies into their ongoing business routines and are generally not present in global e-commerce platforms. These are all growth obstacles, which act against the effectiveness of policy efforts to integrate MSMEs in global value chains and to make the most of tax incentives aimed at increasing exports. Collaboration between EDA and GITA could perhaps address some of the underlying (and specific) challenges in export promotion and more generally in economic diversification in Georgia as well.

The Ministry of Environmental Protection and Agriculture plays a critical role in agricultural innovation. Agriculture represents almost 40% of Georgian employment and generates a significant share of economic output. Indeed, agricultural productivity will remain a major driver of the country's overall economic performance for many years to come amid a very ambitious 10-year strategy for growing crops production and exports. However, agricultural production still adopts suboptimal techniques and standards; innovation is therefore inescapable in a sector that is also undergoing its own technological transformation worldwide. The Rural Development Agency (RDA) is the ministry's implementing agency as regards programmes leading innovation-led government efforts in agriculture. However, collaboration between the RDA and GITA is not evident despite both being active in innovation-related activities. The RDA's activities involve technical assistance provided by foreign specialists and subsidised financing. Activities benefit from funding by international donors such as the European Neighbourhood Programme for Agriculture and Rural Development, the United Nations Development Program, or USAID.

International donors act not only as innovation supporting entities, but also as innovation agenda-setters. As this section has highlighted, Georgian governmental incentives are heavily dependent on access to international funding. Naturally, that limitation increases the (policy) leverage asserted by foreign donors in the design of programmes directly supporting innovation, and indirectly in adjacent fields. In the absence of a structured innovation policy, donor support is helpful in driving potential innovation hotspots, and eventually policy coordination as well. Cluster development is an illustrative example. Cluster development in Georgia is gradually moving from what were essentially agglomeration criteria to a more comprehensive strategy anchored around strategic investments. Already, a packaging cluster has been supported by the UNDP and the EU. In addition, under the 'EU innovative action for private sector competitiveness in Georgia' project, the United Nations Industrial Development Organisation (UNIDO) has developed plans for 57 potential clusters focused on manufacturing and agribusinesses, including a promising greenhouse cluster in the Imereti region. The EU and other European institutions, such as the European Bank for Reconstruction and Development (EBRD), have played a pivotal role in funding the modernisation of Georgia's economy and overall innovation activities.

5.1.3. Overall Assessment

Innovation would benefit from a structured and tailored policy approach. Currently, there is no integrated vision, nor any updated performance benchmarks, with regards to what Georgia aims for in the domain of innovation. Implementing agencies are uncoordinated, each one competing for donor funds, but exhibiting little collaboration (and some programme overlaps) amongst themselves. The government should thus make clear what innovativeness means, and how to address it across the business lifecycle, under existing and new programmes. Observable criteria underpinning the concepts of innovativeness and scalability are seemingly missing.

Policymakers should set out a clear vision of Georgia's place in the innovation cycle. It would be unrealistic for Georgian MSMEs to compete across different stages of innovation (e.g., novel vs. incremental; niche vs. scale), and it would also be unwise to disperse efforts across too many fields. Donor support, through funding and technical assistance, should mesh with overall public policy towards matching Georgia's main assets with local opportunities for innovative activities. In addition, policymakers should also adopt a clear criterion for identifying high-growth firms, to assist the concept of scalability that is frequently interconnected with innovation policies.

Intellectual property should be better embedded in innovation programmes. The total number of intellectual property applications (including all categories) filed with the National Intellectual Property Centre of Georgia has remained relatively unchanged over the course of the years (Sakpatenti, 2019). However, as regards inventions and PCT applications specifically, the number of filings has declined. Programmes aimed at supporting technology transfer onto the business world could benefit from a more proactive, early-stage role by Sakpatenti or from the existence of intellectual property offices managed at university-and research institution-level.

Public procurement for innovation could incentivise the development of innovative processes and products. Already, there are governmental efforts underway in rural development, however, economic activity in industry and commerce could also benefit from those. From an international perspective, R&D expenditures in Georgia remain low at 0.3% of GDP, and the government's role in increasing private-sector innovation would likely result in expanding aggregate R&D expenditures. Closer coordination between the state and the private sector would also facilitate technology transfer from public laboratories to the real-world economy.

A stronger emphasis on open innovation would stimulate collaboration not only between the public and private sectors, but also between MSMEs and large-sized enterprises. Open innovation initiatives could be managed by the private sector, making use of the innovation infrastructure set up by the government. Innovation calls and priority areas of interest would thus be determined by large businesses, better integrating promising MSMEs in global value chains and cluster policy. These initiatives would also likely benefit from the introduction of investor-level tax incentives aimed at increasing the size of the venture capital fund market.

5.1.4. Policy Recommendations

To drive the policy agenda for innovation, the following measures are recommended:

- Adopt the EU's innovation-related performance benchmarks.
- Define Georgia's place in the innovation ladder.
- Set the criterion for high-growth firms according to the OECD definition.
- Set up intellectual property offices at universities.
- Stimulate open innovation programmes.

5.2. SME Exporting and Internationalization

5.2.1. The context for SME export development in Georgia

Georgia has a small domestic market and is dependent on export markets for economic growth, typical of countries with a small population base. It is a relatively trade-open country, with 2019 exports and imports totalling 118.6% of GDP[42], compared to an average of 84.4% of GDP in Europe

42 Georgian exports totalled 54.8% of GDP, and imports totalled 63.8% of GDP.

& Central Asia (ECA) and 90.9% of GDP in the European Union (EU).[43]

The share of manufactured goods in Georgia's merchandise exports is low compared to the average in the ECA and the EU countries (39.1% versus 71.8% and 78.7% respectively), and the share of food products in merchandise exports is much higher (37.2% versus 9.2% in ECA and 9.8% in the EU).[44] In the past decade, economic growth has resulted in few changes to the structure and sectoral composition of the Georgian economy, with limited developments in increasing the value added of export-oriented sectors and advancing productivity through integration in the global market (OECD, 2020). Georgia's basket of exports remains relatively undiversified. Outside of agricultural and food-related products, which is a strong export sector (e.g. hazelnuts, wine, citrus fruits), a large share of export sales is comprised of base metals (copper ores[45], ferro alloys), used cars, and re-exports. The small size of the manufacturing sector limits opportunities to broaden its range of exports.

5.2.2. The network of free trade agreements offers potential for Georgian exporters

Enterprises in Georgia have access to significant export markets and opportunities through Georgia's wide network of existing free trade agreements (FTAs) with the EU, Turkey, the Commonwealth of Independent States (CIS)[46], China (signed in 2017), India, etc. Of particular importance is the EU-Georgia Deep and Comprehensive Free Trade Agreement (DCFTA), signed in June 2014, giving Georgian products access to over 500 million people in the EU. Since the provisional application of the DCFTA in 2014 (up to 2019), the number of Georgian companies exporting to the EU increased by 46% and the value of exports to the EU rose by 30%; however, there has been limited diversification in the types of exports (Guruli, 2020). Georgian exports to the EU are mostly comprised of base metals (copper ore, ferro alloys) and agricultural products (hazelnuts, dried and fresh fruit, wine) (GEOSTAT, 2021a), a sign that FTAs have not contributed much to the development of new sectors of the economy by shifting its domestic production from low value-added products and resource extraction towards the manufacturing of high-tech goods (Eradze, 2021). This is also the case in trade with China, where more than 70% of Georgian exports to China are copper ores and concentrates, and 10% is wine exports.

One of the Georgia's challenges is being able to take greater advantage of these trade agreements. Generally, the deeper regional trade agreements (RTAs) signed by Georgia in recent years have benefited large firms much more than small firms, promoted relatively more exports of low-quality products than those of high quality, and had a statistically significant impact on firms' exports for only a few manufacturing sectors (Neri-Lainé et al., 2021). This may indicate that actions complimentary to the RTAs are needed to boost the productivity and sophistication of smaller firms, as well as measures to assist "productive small exporters" who have not managed to take advantage of the opportunities created by the RTAs (Neri-Lainé et al., 2021).

The small size of its manufacturing sector, the dominance of low-value production, and an undiversified export base, all limit its export potential. Many SMEs lack sufficient awareness of the opportunities offered by the DCFTA and other trade agreements and the necessary preparation and capacity to export. Furthermore, many Georgian exporters are more oriented towards the familiar and accessible markets in neighbouring countries. Agricultural products have significant potential for exports to the EU, but SMEs in the sector also face major hurdles. Most agricultural SMEs are not able to meet EU quality standards due to the high compliance costs as well as the lack of specialised

43 World Development Indicators (WDI) database, https://databank.worldbank.org/source/world-development-indicators#/.

44 WDI database.

45 As of 2020, copper ore accounted for 22% of total exports (Eradze, 2021).

46 CIS states: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Uzbekistan.

testing laboratories in Georgia[47], struggle to access credit and proper insurance packages for agricultural goods, and are challenged by the small scale of production (Eradze, 2021). Furthermore, farmers and agricultural producers are not well-informed about the DCFTA and the environmental standards for exporting products to the EU. Capacity building and quality upgrading would enable exporting and export potential SMEs to realise more benefit from the DCFTA opportunities (Conde and Gattini, 2019).

Georgia has realised relatively stable annual growth in exports since 2014

Georgia's export volume increased steadily from 2015 until 2019; 172.3% higher in 2019 than in 2015.[48] As in most countries, the volume of exports dipped during the COVID-19 crisis in early 2020, but has since rebounded. **Countries in close proximity to Georgia are its major export market destinations.** The CIS countries[49] account for about one-third of its domestic exports volume, particularly Russia (largest export customer), Ukraine, Armenia and Azerbaijan.[50] In 2019, these four countries, along with Bulgaria, accounted for over half of Georgia's export volume (52.4%); in 2020, over 60% of Georgia's exports went to China (19.1%), Russia (16.7%), Bulgaria (12.9%), Turkey (7.2%), and Ukraine (5.2%) (GEOSTAT, 2021b). Georgia's FTAs with the EU and China have helped diversify its trading partners, but many markets remain to be developed.

SME exports account for a high share of total export volume, accounting for about 60% of Georgian exports in 2015, and hovering between 51% to 56% of total export volume since then[51], high by international standards. For example, EU-27 data on SME export activity in 2017 reported that SMEs' exported goods represented 28% of the total value of extra-EU exports in that year, 12% from micro and small enterprises and 16% from medium enterprises (Cernat et al., 2020). In Georgia, the small enterprise share of exports has been declining, accounting for slightly more than half of the SME export volume in 2015, and shrinking to about 34% of SME exports for the first eight months of 2021 (based on an analysis of GEOSTAT trade statistics).

Policy and measures directed to increasing the participation of Georgian SMEs in internationalisation activity could be further facilitated if, in addition to reporting on the SME share of export volume, GEOSTAT reported on the number of SME exporters by size of enterprises. Since exports of a given firm can be tracked over time by use of a unique firm identifier, it should be relatively easy for GEOSTAT to report on the number of exporting firms by size, sector, and export destination. Tracking the progress of SME internationalisation could also be enhanced by monitoring the share of SMEs that receive at least some revenues from exporting their products and services (setting thresholds for the share of revenue from export activity, such as more than 10%, more than 50%, etc.) (recommendation of OECD, 2019a).

Georgia performs comparatively well on trade facilitation indicators

Georgia is making considerable progress towards implementing the long list of World Trade Organisation (WTO) Trade Facilitation Agreement (TFA) measures, having achieved a score of 82.8% in the 2021 UN Global Survey on Digital and Sustainable Trade Facilitation, more advanced than the average for the Caucasus[52] and Turkey region, the Economic Commission for Europe (ECE) and Eastern Europe, except on cross-border

47 For example, Georgia lacks the kinds of laboratories that producers of honey, dried fruit, tea, and hazelnuts need to conduct microbiological and chemical testing to meet EU requirements (UNECE, 2018, pp. 92-95).

48 GEOSTAT trade statistics, https://www.geostat.ge/en/modules/categories/637/export/.

49 CIS countries include: Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine.

50 Georgian Domestic Exports by Country, https://www.geostat.ge/en/modules/categories/639/domestic-exports/.

51 GEOSTAT trade statistics, https://www.geostat.ge/en/modules/categories/637/export/.

52 Caucasus countries include Armenia, Azerbaijan, Georgia and Russia.

paperless trade measures.[53] Georgia has also implemented 80% of the "SME-related" trade facilitation measures.[54]

At least partially due to its performance in implementation of TFA measures, **Georgia's score on the World Bank Doing Business "trading across borders" indicator has been improving since 2017**,[55] at which time it introduced advanced electronic documents systems to speed-up the export and import documentary compliance process. Georgia is operating with an upgraded E-customs system that enables paperless processing of most customs operations and that is also integrated with the information systems of other state authorities related to customs operations, such as permits, licenses and certificates.

5.2.3. The main national SME export support policies and programmes

Promoting internationalisation is one of five strategic objectives of the National SME Development Strategy 2016-2020 and remains a core pillar of the National SME Development Strategy 2021-2025 (MoESD, 2021). The major goal of this pillar is to increase the competitiveness of SMEs by promoting export development, market access and internationalisation. This is to be achieved through actions to provide information on market trends and the requirements of export markets; raising greater awareness of the DCFTA requirements and capabilities through information and training sessions; increasing the export knowledge and skills of entrepreneurs; assisting SMEs in establishing linkages with companies operating in export markets; developing the National Quality Infrastructure (NQI) and relevant quality institutions (metrology, standardisation, accreditation) by further harmonising and aligning national standards with those of regional and international organisations; and increasing access of SMEs to European standards and metrology.

Enterprise Georgia is the key public body and main institution responsible for export promotion and export support services

Enterprise Georgia (Export Division), along with the Agricultural and Rural Development Agency (ARDA) of the Ministry of Environmental Protection and Agriculture and the Export Development Association (EDA)[56], are the main institutions engaged in promoting and supporting export development activity.

The primary objective of Enterprise Georgia's Export Division is to promote the export potential of Georgian enterprises by helping to improve their overall competitiveness, find new partners, diversify production, penetrate new export markets, and increase the overall volume of goods directed towards international markets. Under the Produce in Georgia programme, it provides a number of export support services related to market access, information, capacity-building and business matching. This includes co-financing the participation of SMEs in trade shows and international trade missions; disseminating trade-related information, including on documentation and certifications necessary for exports from Georgia; connecting foreign buyers with Georgian producers through the online trade platform (www.tradewithgeorgia.com) and the national exporters database/directory; education and training to increase the professional capacity of export

53 UN Global Survey on Digital and Sustainable Trade Facilitation database, 2021 Georgia data, https://www.untfsurvey.org/economy?id=GEO/.

54 Georgia has fully implemented "trade-related information measures for SMEs" and the Authorised Economic Operator (AEO) scheme for SMEs, and partially implemented SMEs access to the Single Window and inclusion of SMEs in the National Trade Facilitation Committee.

55 Georgia's score on the "trading across borders" indicators increased from 75.3/100 in 2016 to 90.1/100 in 2020 and its rank among 190 countries improved from a rank of 78 in 2016 to 45 in 2020 (World Bank Doing Business reports).

56 The EDA is a member-driven association founded in 2012 to help Georgian enterprises grow and diversify their exports through advocacy, advisory and promotion. Its membership consists of about 100 Georgian export-oriented producers and service providers. It offers export information (e.g. Export Help Desk, product/market briefs for exporters) and development services to build exporter capacity and break down the barriers to trade.

managers; and advice to companies interested in expanding their export activities. Much of this support is targeted to and based on demand of eligible companies in "strategic sectors" under the Produce in Georgia programme.

However, Enterprise Georgia's major export policy tool is trade promotion activity, where it plays the traditional role of an export promotion agency by providing information on trade procedures, organising trade missions and B2B exhibitions in strategic and priority markets (often in cooperation with GITA and the Georgian Chamber of Commerce and Industry), and co-financing connections for Georgian companies with new partners and diversified export markets.

To a more limited extent, Enterprise Georgia engages in export development activity to build the competence of Georgian companies to export. Due to capacity limitations, it does not directly offer technical "export" assistance to individual SMEs. Alternatively, it provides contractual support to the EDA to deliver the "Export Managers Course" on its behalf. This includes an "export-readiness" tool to assess the internationalisation capacity of SMEs (a valuable initiative) and export training. Enterprise Georgia does, however, make a free 10-module online course in the "Basics of Export Management"[57] available on its website to firms interested in exporting their manufactured products or to individuals planning to work as an export manager. This course introduces learners to the basic areas of knowledge required by beginner exporters, but online learners are not supported with technical advice or mentoring during the online course. **The uptake of these exporter training programmes remains limited**.

International organisations, such as the International Trade Centre (ITC) and development partners, and the EU also support Georgia with SME export support projects. For example, the "Eastern Partnership: Ready to Trade" initiative, launched in Georgia in 2017, targets Georgian SMEs in the agro-processing sector with potential for integration into global value chains and accessing new export markets, particularly in the EU (processed fruits and vegetables, hazelnuts, dried fruits, juices, spices, and tea). The project aims to enhance the capacities of SMEs to produce goods in accordance with global and EU market demands through provision of advisory services, coaching and training on sourcing, quality (including certification), packaging, production, marketing, branding, e-commerce, promotion and others.[58] It also increases awareness of the requirements for access to international and EU markets through various workshops and seminars, and establishes business linkages with EU value chains and markets through participation in trade fairs, study tours, buyer/seller meetings and others.

In addition, the EBRD introduced the "Trade Ready in Georgia" programme to support SMEs in 2018, with the goal of accompanying them in their export development and improving their competitiveness in international markets. The programme facilitates business advice provided by EBRD and access to finance for SMEs engaged in import and export activities.

Assessment of areas for improvement in export-related policy measures/support programmes

More resources could be made available in Enterprise Georgia and/or through the EDA to make export-readiness and training services more available to SMEs.

While trade promotion efforts are critical to facilitating export activity, it is equally important to place a strategic focus on creating a pipeline of new exporters and targeting the export-readiness and capability of SMEs through more intensive training and support programmes. This would include follow-up support to SMEs participating in the Export Managers Course and the Enterprise Georgia online "Basics of export management" course, such as advisory and coaching services to

57 See: http://www.enterprisegeorgia.gov.ge/ka/export-management-fundamentals/. Enterprise Georgia contracts management of the online course to Mindworks, a Georgian management and ICT consulting firm.

58 https://www.intracen.org/ready2trade/.

Box 1. The export-readiness training and development programme for brazilian micro and small enterprises

Description of the approach

The Brazilian Export and Investment Promotion Agency (APEX-Brasil) is the key federal agency, under the Ministry of Foreign Affairs, for facilitating access of Brazilian companies to international markets and diversifying the destination of Brazilian exports. It operates in several Brazilian states and 10 offices abroad that work closely with the Trade Promotion and Investment Sectors in Brazilian embassies and consulates.

APEX-Brasil operates a number of programmes that target SMEs at various stages of the exporting and internationalisation process. This includes exporter training and capacity building, export promotion activities, business matchmaking, and prospecting and trade missions abroad. These initiatives are all directed to increasing the number of exporters and internationalised Brazilian companies. In 2020 over 14,000 companies were supported by APEX-Brasil programmes; 52.4% were micro and small enterprises (MSEs).

Of particular note is the comprehensive Export Qualification Programme (*Programa de Qualificação para Exportação*, PEIEX), an exporter training programme targeting MSEs that have either never exported or have very limited exporting experience, and assisting them with preparation for exporting activity. APEX-Brasil partners with educational and research institutions, and industry federations (selected on the basis of capacity and expertise), to form PEIEX "nuclei" in regional locations. In 2020, the programme operated through 32 regional centres (PEIEX "Nuclei") covering 818 Brazilian municipalities. The nuclei partners bring together experts in business management and foreign trade from the region who are then trained in the PEIEX methodology and deliver the programme that helps the companies prepare to export, including information and knowledge on how to develop an export strategy. Thus, entrepreneurs are guided on the most suitable paths into the foreign market by professionals specialising in foreign trade. The PEIEX partners in each area recruit companies for the programme and also provide other services needed by the companies to implement management improvements.

Some of the PEIEX training is delivered in group sessions, but most of the programme consists of visits to each enterprise by a PEIEX technician. During the first visit, the technician assesses the company's exporting potential. During the second visit, the technician conducts a diagnosis of the enterprise and determines its level of export-readiness. Following this, the local PEIEX core team prepares a work plan providing guidance on the improvements needed in order to meet the requirements for export activity (e.g. marketing, financing, quality). This intervention, which takes about 38 hours, is followed up with training meetings to help the MSE improve process and product management, and progress is monitored by PEIEX extension technicians. At the end of 18 months, the MSEs with an exportable product offer are given the opportunity to participate in international trade promotion initiatives and match-making opportunities organised by APEX-Brasil and its partners. Participation in PEIEX is free of cost to the MSEs.

Over the past 10 years, almost 25,000 enterprises have completed the programme. In 2020, PEIEX qualified 9,379 in the programme, and supported 6,875 of them with Export Promotion Actions that included participation in APEX missions abroad, international trade fairs, etc. Over one-third (35%) of the PEIEX-qualified exporters registered export sales in 2020 and 7.7% were new exporters. Exports from these companies represented 32% of the total value of Brazilian exports.

In 2020, the Export Qualification Programme went through a digital transformation, with creation of the PEIEX Center for Distance Education to serve companies from any region of Brazil. The online training makes the programme more accessible to SMEs far away from the places where PEIEX service centers are located. This improved the reach of the programme in qualifying more businesses to start selling their products worldwide, while also reducing the training costs. The online training also offers participants mentoring by foreign trade experts who help in the diagnosis and development of an action plan.

Sources for further information
APEX-Brasil website at: https://portal.apexbrasil.com.br/qualifique-sua-empresa-peiex/.
APEX-Brasil (2020), Relatório Integrado de Gestão 2020, Ministro das Relações Exteriores, (Integrated Management Report 2020, Minister of Foreign Affairs), Brasilia, https://portal.apexbrasil.com.br/noticia/apex-brasil-lanca-relatorio-de-gestao-com-resultados-de-2020/

assist SMEs in the post-training export journey and necessary linkages to secure export sales.

Moving forward, Enterprise Georgia could increase the scope of these export development support

Box 2. The Small Business Standards Association – a learning model from the EU

The Small Business Standards (SBS) Association was established in 2012 with the objective to raise awareness of SMEs on the benefits of European and international standards, and to further encourage them to get involved in the standardisation process. The SBS has produced a number of products to inform the various stakeholders on the broader inclusion of SMEs in standards, including:

- The **"SME Standardisation Toolkit"** to provide information to national standards bodies and point to services to ensure the participation of SMEs, such as the dissemination of leaflets on SMEs and standardisation, establishing national SME "helpdesks", and promote strengthened cooperation of national standards bodies and national SME associations to promote the benefits of acquiring and meeting standards to SMEs.
- The **SME Toolbox of Solutions** to initiate SMEs to standards and the standardisation-making process, providing them with a better understanding of the benefits to their business of using standards, how to identify the right standards, where to obtain relevant information, with the objective of encouraging SMEs to be engaged in standardisation activities.
- The **"Knowledge platform"** that provides information on SME standards to national standards bodies, SMEs and business associations and recommendations on how business associations and standards organisations can help raise awareness among SMEs about standards, provide them with relevant information, and promote their participation in standardisation.
- The **SME Compatibility Test** to aid standards bodies in taking SMEs' needs into account when writing standards and providing guidance on how to improve the standards by making them more SME-compatible. The test's criteria focus on the standard itself, the way it is written, its impact on SMEs and ease of implementation and can be applied at any stage of the standards development process and to all types of standards (international, regional or national).

The SBS advocates for funding and support schemes to be made available to help SMEs with the implementation of standards. This includes the development of practical guides supporting the implementation of standards; availability of standards in the national language and special favourable pricing schemes for SMEs; and stronger promotion of the SBS SME Compatibility Test for Standards to ensure a better uptake of standards among SMEs (SBS, 2021).

Sources: Small Business Standards, https://www.sbs-sme.eu/. SBS (2021), "Position Paper: SBS comments on the future Standardisation Strategy", Small Business Standards, Brussels, https://sbs-sme.eu/sites/default/files/publications/SBS%20 Position%20Paper_Standardisation%20Strategy_FINAL.pdf/.

programmes and ensure their proper evaluation. What appears to be lacking is a coordinated export-readiness training and support programme that is supplemented with follow-up activity to assist the participating companies through the export journey to a first export action. An example from Brazil may be a good learning model for an approach to this (Box 1). APEX-Brazil, Brazil's export promotion agency has been delivering a national wide, standardised pre-qualification, export-readiness training and development programme for nascent and novice micro and small exporters which has been achieving successful results. Of note also is the accompaniment of SMEs enrolled in the APEX-Brasil online version of the exporter training programme by foreign trade mentors, which the Enterprise Georgia online training programme does not offer.

Upgrading support to help Georgian SMEs meet international standards

Implementation of the DCFTA, which aims to create new trade and investment opportunities, requires alignment of Georgian companies with EU standards. Many of the standards issues are being taken up by the DCFTA Implementation Medium Term Action Plan for 2021-2023 for Georgia, such as the adoption of International and European Standards as Georgian Standards, harmonisation of standards, taking necessary measures to maintain and/or expand the international recognition of priority reference laboratories in the field of metrology, strengthening development of accreditation schemes in various areas of conformity assessment, etc. In addition, the "SME Development and DCFTA in Georgia" Project, funded by the EU and implemented by GiZ-Georgia, promotes information sharing about the DCFTA with the

Box 3. SME Export Consortia, Italy

Export consortia in Italy are voluntary alliances of firms whose objective is to enhance their export performance through joint actions. Members of export consortia retain their financial, legal and management autonomy but cooperate on specified joint actions undertaken by the consortium. Export consortia are active across a range of different industry sectors, including engineering, textiles, food and wine, chemicals, wood and furniture, construction, textiles and clothing, electronic goods and jewelry, but mostly specialise in traditional sectors. Examples are the Quality Wines Export Consortium, the Proexport Sicily Consortium, a consortium of agri-food production companies offering a large basket of regional specialties, and the International Service Export Consortium. There are two main types of export consortium. Promotional consortia explore specific export markets by sharing promotional and logistic costs among participating firms. Actual sales are the responsibility of the individual firms. Sales consortia in contrast handle the sales of member firms' products in addition to promotional activities.

Cooperation among SMEs in the Italian export consortia promises greater success in foreign markets at reduced cost and risk and offers the opportunity to develop the scale needed to internationalise. The benefits of cooperation include a larger choice of products and a more reliable source of supply for large overseas clients. Moreover, in the most successful export consortia, SMEs can gain enough negotiating power to take a more active role in selling products to these clients.

The Italian Institute for Foreign Trade gives grants to export consortia to incentivise their use. In order to qualify, export consortia must comprise a minimum of eight SMEs (five for artisans and consortia operating in Southern Italy). Grants are made annually and are calculated on the basis of expenses incurred in the previous year. Up to 40% of the annual management and promotional expenses (60% for export consortia based in Southern Italy) are eligible for funding in this way. In addition, consortia are eligible for some tax concessions, such as exemption from VAT for the services provided by the consortium itself to the associated companies.

The Italian Federation of Export Consortia (Feder-export), set up to represent the 110 consortia and interact with the Italian Institute for Foreign Trade, provides tax and legal advice, organises conferences and market surveys, and arranges trade delegations. It also negotiates credit lines with major Italian banks to finance the export activities of the consortia members.

The policy of supporting export consortia achieves a leverage effect by channelling resources to a group of SMEs, rather than individual firms, and in doing so, spreads the financial benefits across a larger number of beneficiaries, while implementation costs are reduced by the fact that the government only interfaces with the leaders of the consortia. The success of the export consortia in Italy has been influenced by the following factors: i) precise and realistic objectives, which are agreed with all the members of a consortium; ii) consensus building and constant communication, to establish trust between the members; iii) a clear message that success takes time, and patience among members as the consortium works towards its goals; and iv) supportive institutional and regulatory frameworks.

On the downside, UNIDO (2005) identified both internal and external obstacles to successful export consortia. Some of the most salient are: i) reluctance of individualistic entrepreneurs to collaborate with "competitors", as well as lack of trust and difficulties of raising member contributions; ii) scepticism about the benefits of consortia, especially among SMEs which are already exporting; iii) lack of effective consortium leadership, resulting in ineffective consortium performance; iv) divergent export interests of members; v) financial fragility of the consortia. According to international best practice guidelines, trust problems can be alleviated by appropriate consortium design, e.g. ensuring that member firms are of a similar size, and offer complementary rather than directly competing products. Also, transparent accounting is needed to reassure members that money is being raised and spent on a fair and consistent basis. Motivation problems can be reduced by selecting as members SMEs who lack exporting experience but have viable products for export. Finally, leadership issues can be assuaged by hiring an export consortia manager who is charged with informing and organising SME members. Although it is often necessary for the public sector to offer initial funding support to set up the export consortia, it is important that SMEs pay fees, both to ensure they are motivated to contribute actively in the consortium and that the consortium becomes financially self-sustainable.

Source of further information
More information about Italian export consortia can be found at UNIDO (2005), Development of Clusters and Networks of SMEs: A Guide to Export Consortia, United Nations Industrial Development Organization, Vienna.

business community, including SMEs, through establishment of DCFTA information centres at the Georgian Chamber of Commerce and Industry throughout the country, which also offer training courses for adoption of EU standards.

However, adapting to and complying with the EU standards is particularly challenging for SMEs. Many Georgian SMEs lack awareness of standards or do not understand the value of acquiring standards, and lack the know-how of acquiring "standards", without which their export development opportunities will be limited. In addition, most of the international standards references are not available in Georgian national legislations, and the interest of SMEs in acquiring and complying with the international standards is often undermined by the lack of financial resources (UNECE, 2018). At the national policy level, the specific needs of SMEs in acquiring standards and conformity assessments are often not considered by the National Quality Infrastructure (NQI).

Greater consideration must be given to the adoption of international and EU standards and conformity assessments by Georgia's SMEs in order to prepare them for exporting to the EU and integration into European supply chains. The EU has been dealing with the issue of promoting the use of standards by European SMEs through establishment of the Small Business Standards (SBS) Association (Box 2). Georgia would be well advised to develop/strengthen a relationship with the SBS with a view to implementing the various SME support initiatives in Georgia to the benefit of its SMEs.

5.2.4. Promoting SME exports through support for cluster development

Although cluster initiatives are relatively recent in Georgia, Georgia is seeking to increase the capacity of local SMEs to meet international demands by supporting cluster development in the furniture, apparel, film production and ICT sectors (in cooperation with the GIZ SME DCFTA project). Formation of a Georgian National Cluster Programme, with dedicated government funding and a management mechanism, could support cluster development in additional sectors (OECD, 2019a). The roadmap for such an initiative has been developed by the Ministry of Economy and Sustainable Development (MoESD) and should be implemented. The UNIDO diagnostic mapping of emerging and potential clusters identified cluster development opportunities in the wine sector, pharmaceuticals, poultry, marine fishing, furniture, jewelry, apparel, the processing and preserving of fruit and vegetables, and in the packaging and seeds/seedlings sectors (UNIDO, 2020).

SMEs within a cluster approach could also be assisted to form export consortia to overcome economies of scale issues (small size, limited capacities), which would enable them to work cooperatively and collaboratively by combining their resources to facilitate export activity, either directly or through relationships with larger exporting firms. Export consortia are a natural offshoot of a cluster and network development strategy as they also tend to promote interfirm cooperation in areas related to export, such as quality improvements and upgrading of production methods.

Participating in an export consortium reduces the risks and costs involved in penetrating foreign markets for SMEs (UNIDO, 2005) and can be done by creating a new legal form for the export consortia and incentivising the participation of small businesses with grants or tax benefits. For example, in Italy, a forerunner in the establishment of SME export consortia, the Italian Institute for Foreign Trade provides grants to incentivise their development (Box 3). The export consortia play a role in fostering the "Made in Italy" brand, companies and products in emerging markets. The mechanism could also play a similar role in the context of the "Produce in Georgia" programme.

Although export consortia could be national, the geographical dispersion and remoteness of some Georgian SMEs might make the creation of regional-based consortia advisable, possibly overseen by a local chamber of commerce. These regional consortia would pool resources and target particular foreign markets. Chambers of commerce could advertise and promote the export consortia, and help to identify suitable members.

Addressing the lack of an export credit facility to support trade finance for SMEs

SMEs in Georgia often report limited access to finance as a significant barrier to increasing their export capacity. Currently, there are no trade-targeted financial instruments available in Georgia and the lack of trade finance for export-oriented SMEs also warrants further attention. To further support SME internationalisation, Georgia could start providing targeted financial support, such as trade insurance or export credit guarantees. The Estonian Credit and Export Guarantee Fund (KredEx) example highlighted in the chapter on SME Finance is a potential model for Georgia.

Digitalisation of SMEs and adoption of e-commerce tools to increase export potential

Another policy mechanism for engaging more SMEs in export activity and international trade is through digitalisation and promotion of e-commerce. Evidence shows that firms using online tools are more likely to export to more countries and obtain larger shares of their turnovers from exports (OECD, 2019b) and that access to and deployment of digital technology has a positive effect on SME participation in backward-linked GVCs and on total SME exports (Ganne and Lundquist, 2019; WTO, 2019). The rise of the digital economy and its increased importance as a result of the COVID-19 crisis opens up new opportunities for SMEs to play a more active role in exports and GVCs. In the face of the COVID-19 pandemic, many SMEs were forced to move to the online sale and purchase of goods and services, investing heavily to launch their own online platforms or to offer their goods and services through third-party marketplaces, including Georgian platforms, such as mymarket.ge, extra.ge, vendoo.ge (digital trade platform of the TBC Bank), be.ge, etc. Galt & Taggart (2021) estimate significant growth potential in Georgia for developing the e-commerce environment in all product categories, but particularly in the fashion and beauty sector and in the electronics and appliances segment.

However, SMEs face challenges in making the transition to online sales, and in particular for cross-border e-commerce trade. Paramount among these are the lack of know-how and skills to operate online, and the additional investments required to introduce goods online.[59] The situation is exacerbated by the poor presence of Georgian businesses in online ecosystems. As of January 2020, only 18.4% had a web page, and a mere 3.3% of total businesses offered online shopping services via the web pages (Galt & Taggart, 2021). The World Bank (2020) study on e-commerce in Georgia found that firms do not fully utilise the potential opportunities of ecommerce (e.g. company websites and social media were seldom used; few firms have ever received online orders for goods or services; only 1.9% had already used an e-commerce platform), and their interest in participating in the delivery of training interventions on utilising e-commerce was very low.

The World Bank report concluded there is a **need for complementary interventions to help firms exploit the deployment of e-commerce to support business growth**, such as a combination of e-commerce training and a small, subsidised initial order to incentivise the start of a firm's participation in online retail (World Bank, 2020). This could build on the pilot test of e-commerce training and a small subsidy that was implemented by GITA in 2019 with support from the World Bank.[60]

The Export Division of Georgia Enterprise could prioritise the delivery of a training programme in digital exporting or e-commerce for international trade to SMEs. Such programmes are becoming increasingly common in EU and other countries. The "Digital Export Academy" from Italy is highlighted as one such example of relevance to Georgia (Box 4).

Developing the e-commerce and digital marketing capabilities of SMEs will make foreign markets more accessible to domestic producers. However, other

59 EU4Digital, "eCommerce pilot between Armenia, Azerbaijan, Georgia and Germany: how EU4Digital activity seeks to increase volumes of eCommerce", 5 February, 2021, https://eufordigital.eu/ecommerce-pilot-between-armenia-azerbaijan-georgia-and-germany-how-eu4digital-activity-seeks-to-increase-volumes-of-ecommerce/.

60 The pilot consisted of a 3-day e-commerce training to businesses located outside of Tbilisi, delivered by GITA through face-to-face sessions and including the use of common, well-known online platforms. The training also covered developing a business model and raising funds, provided consultations on website development, and followed through with an incentive for the firms to engage in online sales with quality products (World Bank, 2020).

Box 4. The digital export academy, the italian trade agency

The Italian Trade Agency (*Agenzia per la promozione all'estero e l'internazionalizzazione delle imprese italiane/ ICE*), in collaboration with the Chamber of Commerce of Umbria and Umbria Export, organises the "Digital Export Academy", a webinar-based training course intended for a maximum of 80 companies interested in the processes of internationalisation and promotion abroad through the new digital tools. The aim of the Digital Export Academy is to strengthen, deepen and develop SMEs' skills in accessing foreign markets through targeted training on Web Marketing, Social Media, and e-Commerce and Marketplace Platforms, now fundamental themes in any export strategy that intends to make use of the digital tools. The training consists of eight sessions, delivered in virtual mode, and offers insight into web marketing strategies for the search for new and potential markets, e-commerce and the management of contracts and online payments.

Complementary to this, in 2021, micro and small businesses and MSE networks are offered digital temporary export manager (TEM) vouchers in the amount of EUR 20,000 per company (and up to EUR 30,000 if the company achieves its expected growth in export turnover and share of exports in total turnover) to be used to cover consultancy expenses of a TEM with digital skills to accompany and enhance the internationalisation process.

Source: On the Digital Export Academy, http://www.exportraining.ice.it/it/attivita-e-servizi/lista-corsi/462-digital-export-academy-friuli-venezia-giulia.html; on the Digital TEM Voucher, https://www.fimap.srl/contributi-fondo-perduto-export-finanziamenti-commercio-digitale/.

aspects of policy are implicated to better support the digitalisation of SMEs, such as appropriate shipping logistics, e-payments systems, and supply chain financing, requiring a holistic and integrated policy approach and development of coherent national strategies (Ganne and Lundquist, 2019), as well as improvements in the digital infrastructure, including increased usage of internet and mobile banking services (Galt & Taggart, 2021). Many of these issues will be addressed by the new Law on E-Commerce, when it comes into force, which will seek to ensure that industry regulations are in compliance with European standards.

5.3. Policy recommendations to improve support to SME exporters

- Improve the reporting on the SME share of exports by disaggregating the number of exporters by firm size, sector, and export destination. Enhance monitoring of the progress of SME internationalisation by tracking the share of SMEs receiving at least some revenues from exporting their products and services (setting thresholds for the share of revenue from export activity, such as 0%, more than 10%, more than 50%, etc.).
- Increase the scope and depth of Enterprise Georgia export development support programmes, particularly the provision of follow-up advisory and coaching to SMEs completing the export training courses.
- Prioritise through Enterprise Georgia the delivery of digital/e-commerce training for exporting SMEs and consider the potential for implementing a Digital/E-commerce Voucher Scheme to incentivise these firms in adopting e-commerce capability.
- Integrate the concept of SME export consortia within the framework of cluster development activities, and provide funding support for the development and operationalisation of these export consortia.
- Design and implement an Export Credit Guarantee/Insurance Fund to support SME exporters.
- Strengthen the relationship with the EU Small Business Standards (SBS) Association with a view to implementing the various SME "standards" support initiatives to the benefit of Georgian SMEs and the relevant Georgian national quality institutions.
- Provide sufficient information to SMEs so they can benefit more from opportunities provided by free trade agreements.

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