This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Georgia during May 2021, led by Mustafa Saiyid, IMF, and Haocong Ren, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance, Competitiveness, and Innovation Global Practice, World Bank Group. The note contains the technical analysis and detailed information underpinning the FSAP assessment’s findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.
# CONTENTS

Executive Summary .......................................................................................................................... 5
Introduction ..................................................................................................................................... 10
SMEs: Overview of Economic and Financial Conditions ................................................................. 10
  A. Defining SMEs .......................................................................................................................... 10
  B. Recommendation ...................................................................................................................... 12
  C. SME Contribution to the Economy ........................................................................................ 12
  D. SME Access to Credit Products ............................................................................................ 15
  E. Demand-side issues undermining access to finance .............................................................. 18
Overview of the Supply Side ......................................................................................................... 22
  A. Overview of the Financial Sector ............................................................................................ 22
  B. Analysis of the Banking Sector .............................................................................................. 22
  C. Analysis of the NBFI Sector .................................................................................................... 25
  D. Financial Leasing and Factoring ............................................................................................ 26
  E. Private Equity ......................................................................................................................... 27
  F. Recommendations .................................................................................................................. 27
CREDIT Infrastructure .................................................................................................................. 28
  A. Credit Reporting ..................................................................................................................... 28
  B. Secured Transactions and Collateral Registry ....................................................................... 29
  C. Debtor and Creditor Rights .................................................................................................... 31
  D. Recommendations ................................................................................................................ 32
Digital Financial Services ............................................................................................................ 33
  A. Digital Ecosystem .................................................................................................................... 33
  B. Digital Payments .................................................................................................................... 34
  C. Digitization of SME business processes and e-invoicing infrastructure .............................. 38
  D. Peer-to-Peer (P2P) Lending / Crowdfunding ......................................................................... 39
  E. Regulatory Response to Fintech ............................................................................................. 39
  F. Recommendations .................................................................................................................. 39
Government Policies and Programs in Support of SME Finance .................................................... 41
  A. Government Strategies and Policies ...................................................................................... 42
  B. Public Sector Funding for MSMEs, Credit Guarantee Schemes, and Donor Interventions .... 43
  C. Recommendations ................................................................................................................ 47
Tables
Table 1. Summary of Key Recommendations ...........................................................................................................9
Table 2. SME Definition: SARAS*, Geostat, EU........................................................................................................11
Table 3. Annual Turnover by Size of Company, 2019 (or latest available) .............................................................13
Table 4. Types of products & services offered by financial institutions ...............................................................18
Table 5. Financial Sector Structure ........................................................................................................................22
Table 6. Key Movable Collateral Registry Standards .............................................................................................31
Table 7. Consumer Risks and Regulatory Approaches: Investment-Based Crowdfunding .....................................41

Figures
Figure 1. Employed Persons by Enterprise Size ........................................................................................................13
Figure 2. Distribution of Firms by Size, %..................................................................................................................13
Figure 3. Structure of value added by economic activity and size of enterprise, 2019 ..............................................14
Figure 4. Percent of firms with access to a bank loan/credit line ...........................................................................16
Figure 5. Value of collateral needed for a loan, percent of loan amount ...............................................................17
Figure 6. Registered taxing entities over time ...........................................................................................................19
Figure 7. Distribution of the bank lending portfolio for the three largest banks, 2020 ..............................................23
Figure 8. Loan portfolio vs NPL for 3 largest banks over 5-year period .................................................................24
Figure 9. Interest Rates on GEL Loans by Segments, Aggregate Stock .................................................................24
Figure 10. Movable Asset-based Lending, Enabled by Secured Transactions Reforms ........................................30
Figure 11. Encouraging confidence in using movable assets as security through a SLPCG ................................33
Figure 12. Internet and Mobile Banking Transactions in Georgia, 2018-2020 .....................................................36
Figure 13. Government Support Programs related to MSMEs, actual expenditure and 2021 budget, (thousands GEL) ........................................................................................................................................45

Boxes
Box 1. Stages of SME Development & Funding Needs ............................................................................................21
Box 2. Digital payments, fintech and informality .....................................................................................................34
Box 3. Reverse factoring and invoice discounting platforms ..................................................................................37
Box 4. The Bali Fintech Agenda ..................................................................................................................................38
Box 5. Using Teachable Moments to deliver Financial Education ............................................................................43
Box 6. World Bank Principles for Public Credit Guarantee Schemes for SMEs .....................................................49
GLOSSARY

ACH Automated Clearing House
AI Artificial Intelligence
API Application Programming Interface
ARDA Agricultural and Rural Development Agency
ATM Automatic Teller Machine
BA Banking Association of Georgia
CGS Credit Guarantee Scheme
CRS Credit Reporting Systems
EBRD European Bank for Reconstruction and Development
EC European Commission
ECA Europe and Central Asia
EG Enterprise Georgia
EU European Union
G2B Government to Business
GDP Gross Domestic Product
GEL Georgian Lari
GENIE Georgia National Innovation Ecosystem Project
GEOSTAT National Statistics Office of Georgia
GITA Georgia Innovation and Technology Agency
GoG Government of Georgia
HoReCa Hospitality, Restaurant, and Catering
ICT Information and Communications Technology
IFI International Financial Institution
IMF International Monetary Fund
ISSSG Insurance State Supervision Service of Georgia
IPS Instant Payment System
LIE Loan Issuing Entity
M&E Monitoring and Evaluation
MFI Microfinance Institution
MOESD Ministry of Economy and Sustainable Development
MOF Ministry of Finance
MOJ Ministry of Justice
MSME Micro, Small, and Medium-Sized Enterprises
NAPR National Agency of Public Registry
NBG National Bank of Georgia
NPL Nonperforming Loan
NPS National Payment System
P2P Peer-to-Peer
PCGS Partial Credit Guarantee Scheme
PFI Participating Financial Institution
PSP Payment Service Provider
SME Small, and Medium-sized Enterprises
USAID United States Agency for International Development
VAT Value Added Tax
WBG World Bank Group
EXECUTIVE SUMMARY¹

Small and medium sized enterprises are core to the economy of Georgia and will be central to building a robust and inclusive recovery from the COVID-19 crisis. SMEs represent 99.7 percent of active enterprises, 65 percent of the total number of employed persons, 44.5 percent of annual total business sector turnover and 59.3 percent of value added.

Access to finance remains a major challenge to SME growth, and it is the second most cited obstacle to doing business in Georgia, despite the growth of access to credit for SMEs from 2013 to 2019.² At 84.6 percent, the formal SME finance gap is just slightly above the regional average for ECA.³ Although access to bank loans and credit lines have increased in recent years, products and services (including non-bank) that are tailored to the diverse needs of SMEs across their lifecycle are not widely available. The bank-dominated sector’s offering is characterized by plain-vanilla loans with high collateral requirements, with land and real estate the predominant collateral type. Movable collateral is rarely accepted, and if it is, is frequently limited and marked down. Few alternative credit products are available to help bridge the limited access to immovable collateral and high levels of information asymmetry.

Despite efforts to address access to finance constraints in the past few years, without consolidated data on SME finance, evaluating the effectiveness of interventions and targeting new interventions remains challenging. There is no universal definition of SMEs. Definitions employed by government actors are not applied in the financial sector. Commercial banks typically classify their borrowers in different segments using criteria of loan amount, turnover, and number of employees, the classification of which varies between them. Banks do not tend to classify segments of SMEs, and only differentiate between micro, SME, and corporate clients. The discrepancy of these definitions creates difficulty in collecting uniform data, disaggregated based on MSME segments. To address this gap, NBG can act to collect data on SME loan portfolios using a uniform definition, including leveraging the implementation of the credit registry. With this data, a fuller understanding in the gaps of SME access to finance by segment can be used to inform the upcoming SME Development Strategy.

Demand side constraints to SMEs accessing financial services include issues with weak business skills, poor financial recordkeeping, low transparency, cash preferences, small scale, lack of eligible collateral and access to markets. Some progress has been made on informality, supported by reforms improving the business environment. Georgia business registration has been highly simplified to a single procedure for a limited liability company, and the country now ranks second in the “starting a business” indicator in the 2020 Doing Business report. In addition, a simplified and preferential tax regime for SMEs was introduced in 2018, in part to further encourage formalization - though there is some evidence this may discourage firm growth beyond tax brackets.⁵ While 99.2 percent of firms indicated that they had formally registered, 22.4 percent of firms identified

---

¹ This Technical Note has been prepared by Sheirin Iravantchi, WBG.
² As measured by the World Bank Enterprise Survey.
⁴ SME Finance Gap Report, IFC.
competition against unregistered firms as a constraint for business growth (52.4 percent in ECA), down from 56.3 percent in 2013. Nevertheless, financial institutions continue to raise informality along with lack of appropriate financial and business skills, as an impediment to providing financial services because of the difficulty in ascertaining a business’ creditworthiness, for example, due to informal activities by registered/unregistered firms and/or under-reporting of income for tax purposes.

**The retention of informal business practices is reflected in the dominance of cash.** Cash is the preferred transaction method, especially for smaller value payments in rural areas. The share of cash withdrawals from ATMs exceeds the volume of non-cash payments through POS terminals. Cash-based enterprises lack a digital footprint to establish a record of cash flows so as to prove further creditworthiness. Lack of predictability for lenders, the inability to leverage productive assets as movable collateral, and the absence of alternative credit information to reduce information asymmetry, creates a lending environment that is unfriendly to SMEs.

**In a bank-dominated financial sector, competitive pressures have led Georgian banks to grow their presence in the SME segment in recent years, yet most retain limited offerings.** In absolute terms, total SME loan portfolio has grown 188 percent since 2015, though the number of the number of loans to SMEs changed very little during that same period. The introduction of responsible lending regulations since 2017 has contributed to the increased focus by banks on the corporate and SME market segments. Requirements to incorporate solvency analysis on prospective borrowers have resulted in a smaller pool of eligible prospective retail borrowers and shifted banks’ focus to grow SME portfolios. Yet existing offering of financial products lacks necessary diversity to meet the specific needs of SMEs, despite the fact that most banks have dedicated SME departments and participate in government initiatives toward SME development.

**Though numerous, non-bank lenders do not make up a significant portion of the financial sector.** MFIs are not very active in the SME lending segment, instead focusing on loans to individuals, mostly based on competitive pressures and difficulty accessing long term and low-cost local currency funding. As banks have entered the SME segment, MFIs have reported difficulty competing on price based on their inability to mobilize local currency deposits as a less expensive funding source, and a consequent mismatch in foreign exchange funding sources and local currency lending. Civil code amendments instituted in 2018 in response to over-indebtedness issues requires that loans (or total client exposures) of up to GEL 200,000 can only be granted in GEL.

**MFIs face competitive pressures, with an average cost of funds of approximately 10 percent, against average cost of 6.1 percent for banks.** They also have a shallow capital based on some investors and international financial institution (IFI) interventions. However, IFI funds are typically lent to MFIs in foreign currency, whereas MFIs are obliged to on-lend in Lari.

**The leasing sector is underdeveloped, with four companies having combined total assets of less than 1 percent of GDP.** Leasing is not currently regulated by NBG, though the legal status and improvements in the regulatory framework are currently under review, as part of wider efforts to further develop alternative financing mechanisms for MSMEs. As non-financial entities, leasing companies are required to pay VAT based on new VAT regulations that are harmonized with EU

---

6 In this case, at issue is tax evasion via underdeclared income.
7 NBG analysis.
standards, while banks and other financial institutions are exempt from VAT on financial transactions. The two largest actors leading the market are subsidiaries of the two leading banks. Leasing companies serve SMEs, with the leading company (68 percent of market share), reporting 70 percent of their portfolio as SME, and 85 percent as legal entities.\(^8\) Leasing companies indicate that significant awareness-raising and education is required for SME clients to understand the added value of a financial lease over credit, given that a plain vanilla loan is typically cheaper than a lease.

**Factoring and accounts receivables-based finance remains to be further developed, and supply chain finance (reverse factoring), as well as agricultural warehouse receipts financing, is also missing from the market.** No factoring company is registered in the market, and only limited factoring services are deployed by banks. Some banks report offering factoring products only to select, sophisticated corporate clients on an ad hoc basis, but that otherwise the product requires significant customer education. Furthermore, factoring is not legally defined, and while trading platforms developed by banks to facilitate the sale of receivables exist, there is ongoing discussion to develop a centralized platform. Transactions are designed on a tri-lateral basis to reduce risks in assignment of receivables due to existing weaknesses in secured transactions framework. The Government is preparing a new Factoring Law, to address gaps and support movable assets-based financing. Leasing and factoring companies are not currently regulated. Gaps to be addressed include expanding the scope of the security interest regime to cover leasing and factoring. Further reform efforts reforms include the elaboration of relevant bylaws and development of a factoring registry.

**No private investment or equity funds are registered in Georgia, and venture capital is nascent, with availability ranking 109th out of 141 in the 2019 Global Competitiveness Index.** The gross portfolio equity and investment fund shares assets as a percentage of GDP is 0.5 percent for Georgia, which is comparable to Georgia’s regional and income group peers, but significantly behind the high-income country average of 33 percent.\(^9\) Angel investing is also minimal. There is no legal framework or tax incentives in place to support angel investments.

**Though reforms are ongoing, credit infrastructure in Georgia has room for improvement to support the expansion of financial products and services to SMEs.** In recent years, the Government of Georgia has undertaken reforms to improve conditions. However, the current system does not include a fully online notice-based collateral registry, nor is a complete range of alternative data, such as payments on utilities or telecom services, available to support credit referencing for SMEs. In addition, there are untapped opportunities to leverage electronic invoicing. Without robust credit information to reduce information asymmetry, the lending environment will remain unfriendly to SMEs.

**Fintechs in the market are not providing consumer-facing products, and those that have been identified do not offer products targeting SMEs.** Rather, many Fintechs are acting as service providers to leading financial institutions, including on alternative credit modeling, chatbots and AI, wearables, and digital wallets.

**Digital payments are thus far underutilized by SMEs and have much room for improvement.** In addition to enabling interoperability of retail payments infrastructure, Government could leverage

---

\(^8\) SME defined as lease value of USD100,000-500,000.

digitized public sector payments and stimulate the development of reverse factoring by allowing accounts payables to SMEs to be posted for sale on a web-based invoice discounting platform. Creating such a platform would offer SMEs an opportunity to generate cash flow and obtain working capital finance, potentially at lower rates than their existing financing options.

The regulatory response to Fintech has thus far been embracing but could be further articulated to provide a framework to spark market action towards addressing the gaps in SME Finance. NBG has taken positive steps to respond to the rise of fintech, including establishing a Fintech directorate to monitor market developments, track potential risks, and initiate several Fintech-related initiatives. NBG’s “Open Regulation” approach sets out to balance innovation and risk by employing an adaptive, agile regulatory process. NBG has set up apparatuses to operationalize this model, and tested its response to rapidly deploy digital onboarding technologies. Further pipeline projects underway that are most key to enhancing SME Finance include instant payments, cloud framework, crowdfunding, and open banking. The authorities should articulate a transparent, pro-innovation fintech vision that encourages competition and prioritizes financial inclusion.

The Government of Georgia has issued policies and undertaken significant efforts to improve the institutional environment for SME access to finance, however with mixed levels of integration of programs and participation by the private sector. Interventions span multiple agencies and include direct financial support through grants, interest rate subsidies, partial credit guarantees, as well as extensive technical support and training and ecosystem innovation investment. In addition, financial education and capacity building programs have been rolled out to address the gaps in SME aptitudes. The robust offering of support programs in some cases can be enhanced based on innovative new approaches, further collaboration with the private sector, continued effort on financial education, and in general strengthening targeting and monitoring and evaluation. This could be facilitated by developing a National Financial Inclusion Strategy to further coordinate action.

The partial credit guarantee scheme (PCGS) should be reformed to bring it in line with international best practices. Several areas for reform could benefit the PCGS, including on its legal and regulatory framework, corporate governance, risk management, operational framework, mission statement, and results measurement. Some key areas that would require further strengthening include price sustainability; dependance from budgetary allocations; and upfront cash transfers to participating financial institutions, which is an inefficient use of public resources.
Table 1. Summary of Key Recommendations

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Timeframe</th>
<th>Responsible Authority(ies)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public Sector Commitment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Adopt uniform definition of MSMEs for data reporting by regulated financial institutions and government support programs</td>
<td>ST</td>
<td>NBG, MOESD</td>
</tr>
<tr>
<td>2. The SME Development Strategy for 2021-2025 currently being drafted should emphasize enhanced coordination, targeting, additionality, and monitoring</td>
<td>ST</td>
<td>MOESD (EG, GITA), MEPA (ARDA), MOF, NBG</td>
</tr>
<tr>
<td>3. Government support programs should be coordinated and aligned with economic growth objectives and shared priorities, with a strengthened monitoring and evaluation framework, backed by rigorous data</td>
<td>ST/MT</td>
<td>MOESD (EG, GITA), MEPA (ARDA)</td>
</tr>
<tr>
<td>4. Financial education programs should be evaluated for effectiveness and efficiency, and opportunities to exploit teachable moments across other government interventions and innovative approaches explored</td>
<td>ST/MT</td>
<td>NBG, MOESD</td>
</tr>
<tr>
<td>5. Further improvement to the PCGS is needed to bring it in line with international best practices on targeting, pricing, governance, oversight, and credit risk management</td>
<td>ST</td>
<td>MOESD/EG</td>
</tr>
<tr>
<td>6. The authorities should commit to addressing disparities in financial inclusion and develop a comprehensive National Financial Inclusion Strategy (NFIS)</td>
<td>MT</td>
<td>NBG, MoF, MoESD</td>
</tr>
<tr>
<td><strong>Providers Reach, Diversity and Sustainability</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Explore options for MFIs to have greater access to wholesale credit lines, beyond the proposed banking license</td>
<td>ST</td>
<td>NBG, MOESD</td>
</tr>
<tr>
<td>8. Advance key reforms on leasing and factoring</td>
<td>MT</td>
<td>NBG, MOF, MOESD, MOJ</td>
</tr>
<tr>
<td>9. Conduct financial awareness raising for SMEs on factoring and leasing</td>
<td>LT</td>
<td>NBG, BA</td>
</tr>
<tr>
<td><strong>Credit Infrastructure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Support improvements to enhance collection of alternative data for individuals and SMEs (such as in utilities contracts, telecoms) and review public registries pricing</td>
<td>ST</td>
<td>NBG, MOJ, SARAS</td>
</tr>
<tr>
<td>11. Establish the modern online, notice-based collateral registry system and incentivize its use</td>
<td>MT</td>
<td>NAPR, MOJ, EG</td>
</tr>
<tr>
<td>12. Explore the feasibility of options to expand the secondary market for repossessed alternative collateral</td>
<td>MT/LT</td>
<td>NAPR, MOJ</td>
</tr>
<tr>
<td>13. The insolvency framework should be fully operationalized by developing and adopting needed regulations</td>
<td>MT</td>
<td>MOF, MOJ</td>
</tr>
<tr>
<td><strong>Digital Financial Services</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. Improve retail payments infrastructure to enable interoperability between bank accounts and e-money accounts, reduce transaction costs for SMEs and support development of e-commerce</td>
<td>MT</td>
<td>NBG</td>
</tr>
<tr>
<td>15. Enhance SME financial and management skills and accelerate digital readiness through support for cloud-based accounting and e-invoicing</td>
<td>ST</td>
<td>EG, GITA, MOESD</td>
</tr>
<tr>
<td>16. Pursue offering of G2B payables to SMEs for finance over Fintech based factoring platforms to incentivize creation of accounts receivable market</td>
<td>MT</td>
<td>NBG, MOESD, EG</td>
</tr>
<tr>
<td>17. The authorities should articulate a transparent, pro-innovation fintech vision that encourages competition and prioritizes financial inclusion</td>
<td>ST</td>
<td>NBG, MOJ, MOF, MOESD</td>
</tr>
<tr>
<td>18. Undertake research and explore feasibility to introduce P2P lending and crowdfunding law and regulation to provide for a clear regulatory framework for marketplace finance for SMEs</td>
<td>MT</td>
<td>NBG, MOJ, MOESD</td>
</tr>
</tbody>
</table>

10 ST = less than 1 year, MT = 1-3 years, LT=3-5 years
11 This reflects the assessor’s views on the responsible authorities; local arrangements for implementation should be factored.
INTRODUCTION

1. **This technical note examines the state of access to and use of financial services for small and medium sized enterprises (SMEs) in Georgia.** The Note was prepared in the context of the FSAP second virtual mission to Georgia from May 17 – June 2, 2021. The findings and recommendations are based on the team’s understanding of the dynamics of the Georgian financial sector, gained through interviews of stakeholders, as well as extensive desk research of available data, reports, laws and regulations. The note will provide an overview of the status quo of financial inclusion for SMEs and the correspondent enabling environment for SME finance. The focus of this assessment is to review the supply side and the availability of appropriate finance to meet SME funding, and identify any constraints to the development of more robust and diverse offerings. To gain a full picture, the note reviews the range of available financing options, the adequacy of financial infrastructure, the emergence of digital financial services, as well as public and private sector policy interventions and commitment to the SME finance agenda.

SMES: OVERVIEW OF ECONOMIC AND FINANCIAL CONDITIONS

A. Defining SMEs

2. **There is no universal definition for Small and Medium Enterprises (SMEs) in Georgia.** The definitions of SMEs differ in the National Statistics Office of Georgia, in the Law of Georgia on Accounting, Reporting, and Audit, and in the Tax Code of Georgia. Geostat (the National Statistics Office of Georgia) introduced a new methodology and definitions to collect data on Georgian SMEs in 2017. This definition is for the purposes of national data collection on enterprises, and was an action of the National Strategy of SME Development 2016-2020, in part to align the definition with European Union (EU) standards (though localized for the Georgian context). Under this definition, Small enterprises are defined as those that employ up to 49 employees and have a turnover of up to GEL 12 million (~USD 3.5 million) annually, while Medium enterprises employ from 50 to 249 employees and have a turnover of up to GEL 60 million (~USD 17.5 million) annually. Large enterprises are considered any that have more than 250 employees and have annual turnover above GEL 60 million (~USD 17.5 million). Using these criteria, 99.7 percent of enterprises in Georgia are thus classified as SMEs. In contrast from the Georgia Service for Accounting, Reporting, and Auditing Supervision (SARAS)\(^2\) definition, the Geostat definition does not establish criteria by assets -- typically, assets of MSMEs are difficult to evaluate, since investment in assets varies across sectors.

---

Table 2. SME Definition: SARAS*, Geostat, EU

<table>
<thead>
<tr>
<th>Criteria:</th>
<th>Number of employees</th>
<th>Total annual revenue</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SARAS</td>
<td>Geostat</td>
<td>EU</td>
</tr>
<tr>
<td>Small</td>
<td>&lt;50</td>
<td>&lt;50</td>
<td>11-50 GEL 20 million</td>
</tr>
<tr>
<td>Medium</td>
<td>&lt;250</td>
<td>&lt;250</td>
<td>&lt;250 GEL 100 million</td>
</tr>
<tr>
<td>Large</td>
<td>&gt;250</td>
<td>&gt;250</td>
<td>&gt;250 GEL 100 million</td>
</tr>
</tbody>
</table>

Sources: SARAS, Geostat, European Commission; *Note: SARAS’ definition does not employ the Small, Medium, and Large convention. Rather, it utilizes “Category” 1 through 4. For simplicity in this analysis, these categories have been harmonized with the Small, Medium, and Large denominations.

3. The SME definitions employed by SARAS and Geostat above are generally not applied in the financial sector, with no unified common definition employed by financial institutions to determine an enterprise’s size. Commercial banks typically classify their borrowers in different segments using criteria of loan amount, turnover, and number of employees, the classification of which vary between them. Total assets as a category is only employed by one bank. In general, an SME is defined if it meets either exposure or annual turnover criteria. However, banks do not tend to classify segments of SMEs, and only differentiate between micro, SME, and corporate clients.

4. The differences between the definitions employed by the government and the financial sector complicates the analysis of lending data in a consistent manner. While the adoption of an official definition by Geostat has been a welcome improvement to understanding SMEs in Georgia, without corresponding data from financial institutions the picture on SME access to finance is incomplete. Uniformly applied definitions of MSME segments would allow clearer reporting of MSME disaggregated data from regulated financial institutions and the broader enterprise sector and enable more efficient prioritization of policy actions to target appropriate segments of enterprises. That is, analyzing this data could identify SME sectors with opportunities for growth, as well as gaps in coverage of specific SME segments, and instruments could be deployed specifically for the segment: as noted below, SMEs have different financing needs depending on the stage of their development. With more granular data collection, program progress against results could then be tracked based on outreach to specific segments. This would allow for more efficient prioritization of policy actions.

5. Public priorities, policies, and actions should be focused on SMEs with the greatest potential to positively support economic growth and development. SME owners have varied motivations and aspirations for operating their businesses, and not all have the skills or desire to scale up. Research indicates that many businesses are wage-substitution ventures that are unlikely to grow and generate jobs and thereby contribute to the economy, and thus should be clarified to be part of government interventions with other objectives (such as livelihoods or poverty reduction) rather than

13 GEL 41 - 178M // USD 12.1 - 52M
those with objectives of stimulating economic growth. In Georgia, many SMEs and new businesses operate in low value add sectors of the economy (including retail trade, hospitality, or car repair) with limited capacity to scale up to become larger enterprises. This is especially true of the micro enterprise segment (which is not a focus of this note). In accordance with the objectives of public programs to increase productivity and support innovation, allocations of public funds to SMEs should prioritize those that are most likely to do so. Since the definition of SME in Georgia is broad and encompasses nearly all enterprises, an approach that factors these considerations into the design and targeting of an intervention can direct services more appropriately and efficiently and generate outcomes more likely to positively contribute to the desired impacts.

B. Recommendation

6. Data available on MSMEs should be enhanced by adopting uniform definition of MSMEs and applied to disaggregated data reported by regulated financial institutions. Significant efforts have already been undertaken by the MOESD and Geostat to develop a streamlined definition of SME and improve data collection on SMEs as an action of the SME Development Strategy. However, this definition is not employed by financial institutions. Harmonized definitions between Geostat and financial institutions would enable NBG to collect disaggregated data on MSME lending from financial institutions. Once the NBG’s credit registry comes online, this data could also be employed on an aggregate level for government and NBG policymaking. As will be described in the section on Public and Private Sector Commitment, the SME Development Strategy being currently formulated could target prioritized actions under the Access to Finance action plan with more granular data on finance available to SMEs at the different stages of development.

C. SME Contribution to the Economy

7. SMEs play a significant role in the Georgian economy: according to Geostat, in 2019 they represented 99.7 percent of active enterprises\(^{14}\), 65 percent of the total number of employed persons, 44.5 percent of annual total business sector turnover and 59.3 percent of value added. Initial data from the third quarter of 2020 suggests that, after several years of growth in SME employment (with the highest recent annual growth in 2017 at 5.7 percent), SME employment contracted by 21.8 percent in 2020, in line with the global contraction in employment due to the COVID-19 pandemic.

\(^{14}\) It bears noting that, further to the above discussion on developing an updated definition of MSMEs, that a 99.7 percent rate is an indication that the current definition likely over-represents SMEs and that further differentiation is needed.
Figure 1. Employed Persons by Enterprise Size

![Employed Persons by Enterprise Size](image_url)

Source: WBG analysis of Geostat data

Table 3. Annual Turnover by Size of Company, 2019 (or latest available)

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Active Registered Enterprises</th>
<th>Annual Turnover (GEL Million)</th>
<th>Share of total Turnover (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>172,208</td>
<td>27,454.2</td>
<td>25.2</td>
</tr>
<tr>
<td>Medium</td>
<td>1,867</td>
<td>21,065.5</td>
<td>19.3</td>
</tr>
<tr>
<td>Large</td>
<td>444</td>
<td>60,504.6</td>
<td>55.5</td>
</tr>
<tr>
<td>Total</td>
<td>178,654&lt;sup&gt;15&lt;/sup&gt;</td>
<td>109,024.3</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: WB Analysis of Geostat 2020 data

Figure 2. Distribution of Firms by Size, %

![Distribution of Firms by Size](image_url)

Source: WBG analysis of Geostat 2020 data

---

<sup>15</sup> 723,067 total registered, of which 274,152 were registered as legal persons, 448,915 as individual entrepreneurs.
8. Of the total number of enterprises registered in 2019 of known activity, SMEs were concentrated in the manufacturing, construction, wholesale and retail trade, and transportation and storage sectors. These tend to be lower value-added sectors, with SMEs contributing only 37.5 percent of total value added in 2019. Geographically, SMEs tend to be concentrated in the capital Tbilisi, while the rest are distributed mainly in the three larger regions of Georgia: Imereti (13%), Adjara (10%) and Kvemo Kartli (8%) (Geostat, 2019).

Figure 3. SME value added by economic activity, 2019

Source: WBG analysis of Geostat data

9. The introduction of special tax regimes has provided mixed results. The government has made efforts to reduce the informal economy by employing simplified business registration (including allowing VAT registration at the time of incorporation), simplifying tax payments, and creating special tax categories for smaller enterprises. Microenterprises reporting annual incomes below GEL 30,000 are exempt from taxes on profits, with entities below a GEL 100,000 threshold exempt from VAT registration, while enterprises with annual turnover below GEL 500,000 are classified as “small” and subject to a modest tax rate of 1 percent on their turnover. If annual turnover of GEL 500,000 is exceeded for two calendar years, the small business status is withdrawn. As part of reforms easing tax burdens, small businesses are now able to pay taxes at the end of the month, rather than having to
pay in advance. In addition, as of November 2020, a new system for the automated return of VAT credits came fully online for medium and large enterprises. However, as has been the case elsewhere, special tax regimes and special procedures for MSMEs may disincentivize growth, or encourage tax evasion: evidence of bunching of enterprises under the GEL 100,000 threshold suggests that companies may be understating income to avoid moving into upper tax brackets.

10. **A significant share of microenterprises and self-employed households remain informal and cash continues to dominate.** This especially true in economic activities of subsistence farming, transportation, and construction, as well as more broadly in rural areas. By some measures, Georgia ranks second in terms of the size of the shadow economy. However, there is some suggestion that the institution of the microenterprise and self-employed tax exemption noted above may overstate measures of a shadow economy.

D. **SME Access to Credit Products**

11. **Progress on financial access in Georgia masks a financial sector that still has not achieved broader financial inclusion, especially for MSMEs and traditionally underserved low-income and rural clients.** Although 61 percent of Georgian adults reported ownership of a store-of-value transaction account in 2017, up from 40 percent in 2014, Georgia did not perform well on other measures of financial inclusion: only 5 percent saved at a financial institution in 2017 (against a regional average of 37 percent), 18.5 percent used a debit or credit card to make a purchase (ECA average 38.5 percent), and 9.5 percent used a mobile phone or the internet to access an account (ECA average 23 percent).

12. **Despite progress on financial inclusion, the economy remains largely cash based.** Although there are many payment products available, high payment card penetration (over 1.68 cards per capita in 2020, compared to 1.57 per capita in the EU in 2018), card acceptance remains a challenge. As of 2020, the number of self-service kiosks was close to 12,000 and the number of annual transactions executed through these was near 150 million for 2018 and 2019. Yet, most of those transactions remained in cash, even though kiosks increasingly accept card payments. Mobile phone ownership exceeds 140 percent of population size, but e-money is not regularly used or accepted by merchants.

13. **Access to finance remains one of the major challenges to MSME growth, and it is the second most cited obstacle to doing business in Georgia, despite the growth of access to credit for SMEs from 2013 to 2019.** At 84.6 per cent, the formal SME finance gap is just slightly above the regional average for ECA. The share of firms reporting a bank loan/credit line rose from 37.9 percent to 43.3 percent, which was higher than the ECA regional average (37.1 percent). Banks also financed more investments and working capital: 31.5 percent (from 28.1 percent) and 15.2 percent.

---

19 A self-service kiosk is akin to a multi-functional ATM, that, depending on functionality, allows users to make payments, game top-ups, e-wallet top-ups, money transfers, etc.
20 As measured by the World Bank Enterprise Survey.
22 IFC MSME Finance Gap report.
(10.7 percent) of firms used banks for these services, respectively. Still, 70 percent of firms had to rely on internal funding for investments in 2019, though that represented a slight improvement, from 74 percent in 2013. Products and services available to MSMEs lack necessary diversity to address their financing needs across their lifecycle. Typical products available are accounts with overdraft facilities, working capital loans, and some long-term investment products, however typically long-term maturity loans are still less available. The bank-dominated sector’s offering is characterized by plain-vanilla loans with high collateral requirements, with land and real estate the predominant collateral type. A public program offering partial credit guarantees could help curtail the reliance on real guarantees, as discussed below in section H.

**Figure 4. Percent of firms with access to a bank loan/credit line**

![Graph showing the percent of firms with access to a bank loan/credit line across different countries.](image)

Source: Enterprise Survey 2020

14. **However, though they have eased somewhat, rejection rates and collateral requirements remained above regional peers.** In 2019, 12.7 percent of firms had a recent loan application rejected, against 8.8 percent in the ECA region. Banks cited reasons for rejection for SMEs center around lack of eligible collateral, lack of credit history, unmeasurable risks, and poor business plans, with risk the most commonly reported variable. 23 80.5 percent of loans required collateral, a significant decrease from 96.6 percent in 2013, but this is still high by regional standards (ECA average 73 percent). Similarly, the value of collateral required as a percentage of the loan amount decreased substantially, from 247.8 percent to 194.2 percent, but remained higher than the ECA average of 177.5 percent. Anecdotal evidence suggests that collateral requirements often exceed 2.5–3.0 times the loan value, with indications from financial institutions that this markup can be attributed to the difficulty in realization of the collateral value. Indeed, across sectors, the hospitality (hotels, restaurants, cafes, or HoReCa) sector reported collateral values reaching 252 percent of loan value. Similarly, areas outside the capital indicated higher collateral requirements -- 273.2 percent in the center region against 172.1 percent in Tbilisi. High collateralization ratios imply a missed opportunity for firms to benefit from high levels of financing to grow their businesses.

---

15. In addition to high collateral requirements, collateral is usually accepted typically in the form of immovable assets only. Movable collateral is rarely accepted, and if it is, is frequently limited to 30 percent of total collateral.

16. Few alternative credit products are available to help bridge the limited access to immovable collateral and high levels of information asymmetry. Only 24 percent of firms reported using supplier/customer credit to finance working capital, slightly above the regional average of 23.6 percent, and this was even less available to medium enterprises (20.6 percent). Similarly, although slightly above the regional average (10.5 percent), only 15.2 percent of working capital was reportedly financed by banks, demonstrating the scope to expand solutions in this area: working capital is a critical need for SMEs).

Figure 5. Value of collateral needed for a loan, percent of loan amount

17. Although there has been growth in loan products for SMEs, there is still a lack of diverse suite of products and tools needed to meet the range of business needs. Products such as leasing and factoring, invoice discounting platforms and other types of working capital finance, marketplace finance platforms, and integrated on-line merchant platforms do not seem widely deployed. In addition, alternative credit scoring is not readily deployed to support enhanced credit risk assessment. Banks remain the main source of external financing for SMEs, providing loans and limited other financial instruments. The main credit facilities available to SMEs are asset financing (property and vehicle), overdraft facilities, general business and agricultural loans backed by security over real estate, and some invoice financing, typically for large corporate clients only. There are infrequent offerings of supply chain financing, warehouse receipts, and accounts receivable based lending (including factoring). To fill these financing gaps, SMEs must rely on internal funds, retained earnings, or family and friends.

Source: Enterprise Survey Dataset, 2020
Table 4. Types of products & services offered by financial institutions

<table>
<thead>
<tr>
<th>Product / Service</th>
<th>Commercial banks</th>
<th>Microfinance Institution</th>
<th>Loan Issuing Entities</th>
<th>Fintechs or other providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings/Deposits</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sight deposits</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saving deposits</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term deposits</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit</td>
<td>XX</td>
<td>XX</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>Loans to small enterprises</td>
<td>XX</td>
<td>XX</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>Loans to medium size enterprises</td>
<td>XX</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Lines of credit</td>
<td>XX</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Credit cards</td>
<td>XX</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Other financing products/services</td>
<td>XX</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leasing</td>
<td>X</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Factoring</td>
<td>X</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Delivery of government subsidies</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cross-selling Products</td>
<td>XX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other insurance</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

X: service or product is offered
XX: service or product is a core activity of the institution

Source: NBG

E. Demand-side issues undermining access to finance

18. Demand side constraints to SMEs accessing financial services include issues with weak business skills, poor financial recordkeeping, low transparency, cash preferences, small scale, lack of eligible collateral, and access to markets. Georgia was ranked 74 out of 141 countries on the World Economic Forum’s Global Competitiveness Index in 2019, a decline from its ranking of 66 in 2018 but remaining within the median score of the Eurasia region. The Index ranked Georgia’s financial system as 91st out of 141, with financing SMEs ranked 83rd and availability of venture capital 109th. The World Bank’s 2020 Ease of Doing Business rankings, focusing on constraints to small and medium-sized companies, ranked Georgia 7th out of 190 economies. Political instability, an inadequately educated workplace, electricity, and access to finance have been perceived as major obstacles for firms.24

19. Progress has been made on informality, likely supported by reforms improving the business environment. Georgia business registration has been highly simplified to a single procedure for a limited liability company, and the country now ranks second in the “starting a business” indicator

---

in the 2020 Doing Business report. In addition, a simplified and preferential tax regime for SMEs was introduced in 2018, in part to further encourage formalization. While 99.2 percent of firms indicated that they had formally registered, 22.4 percent of firms identified competition against unregistered firms as a constraint for business growth (52.4 percent in ECA), down from 56.3 percent in 2013. Only 13.2 percent of surveyed firms cited practices of competitors in the informal sector as a major constraint (28.7 percent in ECA). Nevertheless, financial institutions continue to raise informality, along with lack of appropriate financial and business skills, as an impediment to providing financial services. In the case of informality, this may be the case because of informal activities by registered/unregistered firms and/or under-reporting of income for tax purposes.

Figure 6. Registered taxpaying entities over time

[Bar chart showing the number of taxpaying entities over time by category (Fixed Tax Payer, Micro Business, Small Business) for years 2016 to 2019.]

Source: SARAS data

20. **The retention of informal business practices is reflected in the dominance of cash.** Cash is the preferred transaction method, especially for smaller value payments in rural areas. The share of cash withdrawals from ATMs exceeds the volume of non-cash payments through POS terminals. Cashed-based enterprises lack a digital footprint to establish a record of cash flows so as to prove further creditworthiness.

21. **Informality and unreliable financial reporting, as well as gaps in the existing credit market infrastructure, reduce lenders’ ability to overcome information asymmetries, which translates into high cost and excessive collateral requirements.** Alternative finance markets for SMEs, including non-bank lending, start-up, or angel financing, are underdeveloped. Access to debt/equity financing from capital markets is available only for the largest Georgian firms.

22. **In an effort to raise reporting standards, in 2017 Georgia enacted mandatory International Financial Reporting Standards (IFRS) for SMEs.** SMEs have been required on a rolling basis\(^25\) to use simplified IFRS for SMEs with the Service for Accounting, Reporting and Auditing Supervision (SARAS) responsible for receiving and publishing the financial and non-financial statements.

\(^{25}\) This requirement has also been pushed back in response to the COVID-19 pandemic.
statements on a public portal, www.reportal.ge. This requirement has been rolled out for all businesses with a turnover of more than GEL 2 million and/or balance sheets of more than GEL 1 million and 10 employees, but compliance has been loosened in response to the COVID-19 crisis. The expectation of this initiative is that standardized accounting practices can assist financial institutions in their assessment of the creditworthiness of SMEs, and thus this increase in available financial reporting data can help ease access to credit. Nevertheless, despite this positive development, financial institutions indicate that financial statements submitted by SMEs thus far continue to remain of low, incomplete, or otherwise inadequate quality.

23. **Notwithstanding the efforts to raise reporting standards and improve entrepreneurship, access to affordable and quality online, cloud-based accounting services have not emerged in Georgia.** Such services could enable SMEs to keep improved financial records that can be used by FSPs to assess creditworthiness of these enterprises.

24. **Government efforts to improve financial literacy and reporting have thus far been in more traditional training formats.** Putting together a valid business proposal is commonly reported as too challenging for Georgian SMEs. Continued support to SMEs in developing skills and fostering access to affordable finance can serve as important incentives for higher business transparency and job creation.

25. **These difficulties have been exacerbated by the dual health and economic shocks of the COVID-19 pandemic.** 31.5 percent of surveyed SMEs reported delaying payments by more than one week due to COVID-19, and 71 percent of firms indicated they had decreased liquidity or cash flow availability in the Enterprise Survey COVID-19 follow-up survey. The negative effects of COVID-19 will increase demand for finance, especially in the trade and service sectors that have been disproportionately affected by the COVID-19 crisis.

26. **The COVID-19 pandemic may widen the significant gender gaps in the Georgian economy.** Based on Geostat data, only 2.6 percent of women engage in entrepreneurship and 29 percent of newly established firms were owned by women, compared to 6.5 percent and 52 percent for men, respectively. Similarly, Enterprise Survey results found 22 percent of firms had female ownership participation, significantly lower than the 32 percent for ECA and 38 percent for upper middle-income countries. Survey results found that female participation in entrepreneurship is more prevalent in smaller firms and in sectors which have been deeply affected by the crisis, such as HoReCa. Firms led by women have been more affected by closures, reduced sales, reduced employment, liquidity and related financial difficulties, and filing for insolvency.

27. **The allocation of inheritance amongst families may replicate and exacerbate unequal gender outcomes.** A qualitative study conducted in 2015 found that many families, as in elsewhere in the region, prefer passing on an inheritance to sons rather than daughters. Because of the heavy reliance on land and real estate for collateral, these differences in asset allocation within a family can mean the difference in obtaining access to finance. Notably, despite a similarly high rate of account

---

26 According to NBG supply side data, the share of deferred loans was even higher, at 53 percent.
ownership, only 12 percent of women reported borrowing to start, operate, or expand a farm or business, compared to 22 percent of men. This was also born out for firms, as 35.8 percent of female-led firms reported having a bank loan, a significant different from 44.7 percent of male-led firms, while 45.4 percent of firms with female owners had a loan, compared to 51.1 percent of firms with male owners.

**Box 1. Stages of SME Development & Funding Needs**

At the start of a small business or during the seed stage, personal savings of entrepreneurs, family and friends, as well as potential second mortgages on property are often the most important and readily available sources of financing, as these firms tend to be highly risky with intangible assets, a lack of trading history and informational opacity.

At the second phase of development during the start-up stage, external sources of funding become necessary. At this stage, the investment in small businesses is still regarded as high risk and the business is not large enough to attract the attention of venture capitalists. Government grants or other programs for seed funding become relevant, especially for innovative firms. Wealthy individuals like business angels can also fill the gap between personal funds and institutional finance.

After the small business has passed through the early stages, it requires a further injection of capital to fund growth. At this stage, the SME may still not qualify for longer term debt financing due to its reliance on intangible assets, inability for investors to assess its future growth prospects, low profitability and short track record. This is where alternative lending products such as leasing and factoring, invoice discounting platforms, marketplace finance platforms, integrated on-line merchant platforms and alternative credit scoring come useful.

In the more advanced stages, the firm has established a track record, has the ability to provide collateral and information regarding its performance and has become more transparent, such that it may access longer term lending. Development of corporate governance structures, real-estate registries, as well as debt and potentially equity capital markets becomes relevant in this stage.

![Financing Needs Diagram](image)


---

OVERVIEW OF THE SUPPLY SIDE

A. Overview of the Financial Sector

28. The Georgian financial sector is predominated by commercial banks, and is especially concentrated in two banks. Banking sector assets stood at GEL 56.9 billion or 115.1 percent of GDP as of the end of 2020.³⁰ The 15 banks represent an estimated 95.3 percent of total financial sector assets (see table 5 below). Total credit to GDP was 82.0 percent, up from 69.4 percent in 2019 (NBG Financial Sector Review). The banking sector is highly concentrated, with the two largest banks accounting for 73 percent of total banking sector assets, 72 percent of loans, and 75 percent of total deposits.

29. Banks also have leading positions in the non-banking financial sector, including payment services, insurance, leasing, and the capital market (investment services, custodian, and brokerage), as well as in other ecosystem actors. After the leading two banks, the third largest bank represents about 5 percent of banking assets. 15 commercial banks operate in Georgia, of which 14 are foreign owned.³¹

Table 5. Financial Sector Structure

<table>
<thead>
<tr>
<th>Entity</th>
<th>Assets, GEL Billion</th>
<th>Share of GDP, %</th>
<th>Share of Financial Sector Assets, %</th>
<th>Number of Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>56.9</td>
<td>115.1</td>
<td>95.3</td>
<td>15</td>
</tr>
<tr>
<td>Microfinance Institutions</td>
<td>1.47</td>
<td>3.2</td>
<td>2.8</td>
<td>40</td>
</tr>
<tr>
<td>Loan Issuing Entities</td>
<td>0.46</td>
<td>0.9</td>
<td>1.6</td>
<td>198</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>0.90</td>
<td>1.8</td>
<td>0.0</td>
<td>18</td>
</tr>
<tr>
<td>Pension funds (schemes)</td>
<td>1.24</td>
<td>2.5</td>
<td>0.0</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>61.0</td>
<td>123.3</td>
<td>100</td>
<td>261</td>
</tr>
</tbody>
</table>

Source: World Bank based on NBG Data, as at December 2020

B. Analysis of the Banking Sector

30. Georgian banks have grown their presence in the SME segment in recent years, yet most retain limited offerings. While the value of loans to SMEs grew significantly between 2015 and 2020 over the same period, with a 5-year growth rate of 188 percent, the number of loans to SMEs changed very little, registering only a 0.94 percent increase, thus representing a significant growth in the average SME loan size.³² Relative to the overall business loan portfolio, the ratio of SME loans to total business loans has remained relatively steady, both by value and number. By value, it increased from

³⁰ NBG data of 56.9bn GEL from NBG Financial Sector Review dated 05/20/2021, NBG 115.1 percent GDP from Key Macroeconomic Indicators and International Ratings https://www.nbg.gov.ge/index.php?m=494
³¹ Note: despite foreign ownership, not all of these commercial banks necessarily have ready access to international funds, but also are reliant on debt issued at capital markets and IFI financing.
³² However, some of this low nominal growth as of December 2020 may be related to the pandemic; as at December 2019, the number of loans had grown by 21 percent since December 2015. Nevertheless, from 2015 to 2020, average SME loan size increased 185 percent, from GEL 119,648 to GEL 341,697.
24 percent to 27 percent, but nominally decreased from 11 to 7 percent. Few banks offer financial products that are designed to meet the specific needs of SMEs, even while most banks have dedicated SME departments, and banks participate in government initiatives toward SME development.

31. **The introduction of responsible lending regulations since 2017 has contributed to the increased focus by banks on the corporate and SME market segments.** Stricter requirements of solvency analysis of prospective borrowers resulted in a smaller pool of eligible prospective retail borrowers and shifted the focus to growing the SME portfolios. For example, the large banks saw annual growth for the corporate and MSME segment of more than 25 percent in 2018 and 2019, increasing their lending portfolio from 30 percent of total assets in 2017 to 38 percent in 2019. The two largest banks, in Figure 7, have followed this trend, with loan portfolios of 22 percent and 18 percent, respectively, to SMEs. The third bank, which is significantly smaller than the top two, has an even larger portfolio to SMEs, at 35 percent. Yet, lending requirements remain centered around collateral availability and plans for more diverse offerings have not materialized substantially. This is despite the absence of any increased manifestation of risk by increased lending to the SME segment, as demonstrated by steady non-performing loans (as measured by portfolio at risk at 30 days, PAR30) over the last five years.33

Figure 7. Distribution of the bank lending portfolio for the three largest banks, 2020

![Graph showing distribution of bank lending portfolio](image)

Source: NBG Data

---

33 For the purposes of this discussion, the COVID-19 pandemic is considered exceptional and not reflective of the baseline viability of SME finance.
The increase in offerings in the SME segment has increased competitiveness of offerings, with average interest rates charged to SMEs in Georgia declining from 17.2 percent in 2015 to 14.1 percent in April 2021. The spread between the corporate and SME segment has similarly declined from 489 basis points to 145 basis points over the same period. This convergence, especially since 2017, can similarly be attributed to the stricter lending requirements narrowing the caliber of potential borrower, as discussed above.

With some heterogeneity between financial institutions, branches tend to cover all regions but are concentrated in the capital, Tbilisi. At the end of 2019, 160 branches / agencies across the country, with 53 of those in Tbilisi alone. Given the heavy reliance on land and real estate
for collateral, there is some evidence of reluctance to lend in rural areas and/or a higher discount rate on these properties is taken.

C. Analysis of the NBFI Sector

34. The non-bank lending sector is comprised of 39 MFIs, 198 loan issuing entities (LIEs) and two credit unions, and has been undergoing restructuring in part in response to regulatory changes beginning in 2017. Though numerous, non-bank lenders do not make up a significant portion of the financial sector, with MFIs and LIEs accounting for 3.2 percent and 1.6 percent of total financial assets, respectively. The MFI sector is concentrated, with 11 MFIs accounting for about 90% of total assets. The NBFI sector has shrunk over the last several years, which has been attributed to the liquidation of several MFIs, the trading of the credit portfolios of a number of MFIs, and the restriction of foreign currency loans below GEL 100,000 to private individuals, issued in 2017, subsequently raised to GEL 200,000 in 2019, and extended to legal entities as well.

35. MFIs are not very active in the SME lending segment, instead focusing on individual loans, mostly based on competitive pressures and difficulty accessing long term and low-cost local currency funding. Over 70 percent of the MFI portfolio has been classified as retail or consumer lending. MFIs that do lend to SMEs do so on either a case-by-case basis (especially for micro segment clients that have graduated to higher loan sizes). As banks have entered the SME segment, MFIs have reported difficulty competing on price based on their inability to mobilize local currency deposits as a less expensive funding source, and a consequent mismatch in foreign exchange funding sources and local currency lending. Amendments to the Civil Code enacted in 2018 in response to unhedged borrowing, requires loans (or total client exposures) of up to GEL 200,000 to be granted in GEL.

36. MFIs face competitive pressures, with an average cost of funds of approximately 10 percent, against average cost of 6.1 percent for banks. They also have a shallow capital based on some investors and international financial institution (IFI) interventions. However, IFI funds are typically lent to MFIs in foreign currency, whereas MFIs are obliged to on-lend in Lari. It is estimated this increases costs of funds by 3-5 percent. To address the asset-liability FX mismatch, MFIs report facing limited options of risky open positions or expensive hedging instruments. Noting the current pricing for retail, SME, and corporate segments as in Figure 10, these combined conditions render MFIs less competitive in the mainstream SME segment.

37. Prior to 2017, low capital requirements facilitated the entry of online lending platforms registered as MFIs, resulting in an increase in indebtedness and financial consumer protection risks. Because of instances of inadequate disclosures to customers, abusive collection processes, and inadequate credit risk assessment, NBG raised capital requirements and changes to the civil code were instituted capping interest rates at 100 percent, subsequently lowered to 50 percent, and required validation of debt servicing capability of borrowers. This action effectively eliminated online lending outside of commercial bank providers. In the period following this action, 35 MFIs were liquidated. The cap has been viewed favorably by MFIs, which viewed the online lenders as disreputable and tarnishing the MFI classification.

34 NBG analysis.
38. A new microfinance bank license is being considered by NBG. Under the proposed license, MFIs will face proportionate Basel II/III regulations and will be able to mobilize deposits. NBG estimates that up to 5 MFIs could meet qualifications for transformation.

39. Loan issuing entities (LIE) are primarily pawn shops that provide lending based on pawn of personal movable assets, and do not typically reach SMEs. LIEs account for 1.6 percent of total financial sector assets and are regulated by NBG.

40. The rest of the non-banking sector is underdeveloped. While 17 insurance companies are licensed to operate in Georgia, two major groups dominate, though products remain limited. The equity market is shallow, with no private investment or equity funds (private equity, venture, or otherwise) registered in Georgia.

41. FSPs should be incentivized to innovate and widen the offering of suitable products through strengthened credit infrastructure and enhanced digitization efforts, accompanied by financial sector laws that enable competition. Principles of a strong financial sector ecosystem rest on allowing the entry of new providers through a proportionate legal and regulatory framework, facilitating flow of funds and information through robust financial infrastructure, and the wide availability of affordable delivery channels, all while support for increased financial and digital capability is made available to SMEs.

D. Financial Leasing and Factoring

42. The leasing sector is underdeveloped, with four companies combined total assets measuring less than 1 percent of GDP. Leasing is not currently regulated by NBG, though the legal status is currently under review. As non-financial entities, leasing companies are required to pay VAT, while banks and other financial institutions are exempt from VAT on financial transactions. The two largest actors leading the market are subsidiaries of the two leading banks. Leasing companies serve SMEs, with the leading company with 68 percent of market share reporting 70 percent of their portfolio as SME, and 85 percent as legal entities.35

43. Leasing services are limited to select assets with perceived higher resell potential because of concerns about limited secondary markets for repossessed assets. The business model for leasing requires companies to assess the value of physical assets being leased to sell on secondary market, or else re-lease assets that go unpurchased by customers. To limit risk, leasing companies report financing of select assets in limited sectors, including for construction, manufacturing, health, HoReCa, services, and agriculture. In addition, vehicle leases are widely available for both retail and commercial use. Financial leasing, operating leasing, sales and leasebacks are offered by leasing companies, with financial leases predominant. Government programs to expand SME Finance include subsidizing companies’ interest expenses for leases in the manufacturing, service, and agriculture industries, through Produce in Georgia and ARDA. Leasing companies indicate that significant awareness-raising and education is required for SME clients to understand the added value of a financial lease over credit, given that a plain vanilla loan is typically cheaper than a lease.

35 SME defined as lease value of USD100,000-500,000.
44. **Factoring and accounts receivables-based finance is not developed, with no factoring company registered in the market, and limited factoring services deployed by banks.** Some banks report offering factoring products to select, sophisticated corporate clients on an ad hoc basis, but that otherwise the product requires significant customer education. Furthermore, factoring is not legally defined, and trading platforms to facilitate the sale of receivables have not been developed. Transactions are designed on a tri-lateral basis to reduce risks in assignment of receivables due to existing weaknesses in secured transactions framework.

45. **Supply chain finance (reverse factoring), as well as agricultural warehouse receipts financing is also missing from the market product offering.** Attempts have been made by the ARDA to develop this area, and some support has been provided to select financial institutions by international financial institutions. Specialized segmented warehouses are nascent.

46. **The Government is preparing a new Leasing and Factoring Law to address gaps and support movable assets-based financing.** Leasing and factoring companies are not currently regulated. Gaps to be addressed include expanding the scope of the security interest regime to cover leasing and factoring. A working group with participation by MOESD, MOF, NBG and others in collaboration with EBRD is advancing this. In addition, improvements to the e-signature and e-payment frameworks are also in development to further support the framework for asset-based lending.

E. **Private Equity**

47. **No private investment or equity funds are registered in Georgia, and venture capital is nascent, with availability ranking 109th out of 141 in the 2019 Global Competitiveness Index.** The gross portfolio equity and investment fund shares assets as a percentage of GDP is 0.5 percent for Georgia, which is comparable to Georgia’s regional and income group peers, but significantly behind the high-income country average of 33 percent. Angel investing is also minimal. There is no dedicated legal framework in place to support investments. A dedicated agency tasked with supporting innovation, Georgia Innovation and Technology Agency (GITA), has rolled out programs to support the startup lifecycle, from ideation to market. It has prioritized facilitating the growth of venture capital, and although it has drawn international VCs as judges for its Startup Matching Grants Program, thus far there are limited opportunities in Georgia to go beyond pre-seed and seed funding. Some available programs are associated with incumbent banks, such as the joint Liberty Bank-Smartex Group start-up incubator for Georgian entrepreneurs, which focuses on seed and early-stage investments.

F. **Recommendations**

48. **Explore options for select MFIs to have greater access to GEL via wholesale credit lines, in addition to the proposed banking license.** Given the complexities and costs involved in institutional transformation, even the most professional MFIs may have difficulty in obtaining a license and successfully becoming a microfinance bank. Despite their small size relative to the banking sector, MFIs play an important role towards including unbanked and underbanked populations in Georgia.

---

36 World Bank Global Financial Development Database, 2017
37 USAID, Smartex.ge
and merit consideration of support measures taking consideration of the competitive landscape noted above. Potential for a wholesale lending facility for qualifying MFIs extending finance to SMEs could be explored to align with existing public enterprise support programs. Additional options for MFIs to expand access to GEL include utilizing capital markets or regulated investment-based crowdfunding.

49. **Expanded product diversity should be fostered by advancing key reforms on Leasing and Factoring.** Leasing and factoring for SMEs are very limited in Georgia yet are key instruments to enable SMEs to preserve and expand cash on hand for profit-generating activities. Advancing the laws on leasing and factoring will provide market clarity. For example, providing a clear definition of factoring and the most typical (basic) versions of factoring products can help to increase legal certainty and predictability of factoring transactions. This would also support the judiciary by providing a clear guiding to local courts on how to recognize, interpret and support factoring transactions. As key legal reforms are advanced and provide regulatory clarity to providers, sensitizing the market to the usefulness of these instruments could help spur demand.

**CREDIT INFRASTRUCTURE**

50. **Though reforms are ongoing, credit infrastructure in Georgia is incomplete, constraining financial institutions’ ability to expand their financial products and services to SMEs.** In recent years, the Government of Georgia has undertaken reforms to improve conditions. However, the current system does not include a fully online notice-based collateral registry, nor is a complete range of alternative data available to support credit referencing for SMEs. Because of the strong cash preference and weak financial reporting, a traditional credit bureau approach does not provide a full picture of borrower creditworthiness. In addition, there are untapped opportunities to leverage electronic invoicing. Without robust credit information to reduce information asymmetry, the lending environment will remain conservative to SMEs.

**A. Credit Reporting**

51. **Several legal and regulatory improvements of the credit reporting system (CRS) have been implemented in recent years.** Recent reforms include the establishment of a CRS regulatory framework and oversight of the CRS by the NBG in 2019. With these changes, the Credit Information Bureau became regulated by NBG, with a new Credit Bureau Regulation unit under Financial and Supervisory Technologies Development Department. Procedures for consumer protection were also developed and enacted, including a framework for handling disputes and protecting data subject rights; the credit bureau now faces penalties if incorrect information is not corrected within five days. With these improvements, Georgia is outperforming peer countries in terms of Getting Credit as measured by the Doing Business Report 2020, with a top score for depth of credit information (8) (compared to a regional ECA average of 6.7), 100 percent of adults covered by the credit bureau (41.7 percent ECA), and a score of 9 (7.8 for ECA) for the strength of legal rights.

52. **However, coverage of legal persons and use of alternative data to develop credit scores for MSMEs who have been outside the formal credit market is more limited.** Although the credit bureau reports that it has over 200 clients, mostly institutions regulated by NBG and by NBG’s approval, at the time of the mission, it only tracked loan data up to 300,000 GEL, representing a significant gap. The bureau indicated that it had reached an agreement with NBG and the Georgian
Banking Association to increase this amount to 10 million GEL, which would cover all SME loans since very few SME loans go above that threshold. Still, according to the credit bureau, data from utility bills cannot be incorporated because bill accounts are associated with an address, rather than an entity. While it has access to certain public databases, the credit bureau indicated that pricing to pull data from the unified government portal operated by the Data Exchange Agency (under the Ministry of Justice) is cost prohibitive. Meanwhile, financial institutions indicate that for the SME segment, they generally employ traditional credit analysis and in-house scorecard methodologies and did not typically avail the credit bureau for data on SMEs (though they did for retail lending). Nevertheless, the credit bureau does provide value-added services, including scoring, benchmarking, and monitoring services.

53. **However, work remains to establish a public credit registry (PCR) and further enhance Georgia’s CRS.** A PCR is under development at NBG, which would increase the quality and quantity of data available to lenders.

**B. Secured Transactions and Collateral Registry**

54. **Movable properties are seldom used as security by creditors in Georgia, and the opportunities in the movable asset-based lending space (see Figure 11) remain largely untapped.** Few financial institutions employ significant movable collateral (such as machinery, equipment, receivables, or intellectual property) to secure loans. Uncertainties around priorities, enforcement, and secondary markets are a deterrent for financial institutions. In the case of MFIs, movable collateral is sometimes employed but microfinance methodologies typically employ relatively higher risk and are priced accordingly, rendering the movable collateral more akin to a symbolic moral pledge. This is especially true for more rural or remote areas, where loss recovery proves more difficult. Rather, movable collateral is viewed as an option in the microfinance segment out of necessity only.

55. **Heavy dependence on immovable collateral (in the form of land and real estate) can drive uneven outcomes for SMEs that do not own significant property assets, especially for women-owned and rural SMEs.** A limited percentage of the population holds title over land and real estate. SMEs in developing countries typically hold most of the firms’ capital stock in movable assets such as equipment, machinery, or receivables, rather than buildings or land.38 Global estimates indicate on average firms hold 34 percent of capital stock in accounts receivable, 44 percent in vehicles, machinery, or other equipment.

---

38 Across developing countries, movable assets represent as much as 78 percent of the capital stock of enterprises relative to 22 percent held in immovable assets such as land and buildings (World Bank, 2011).
56. **Strengthening the secured transactions framework, movable collateral registration and execution can help reduce the overreliance on land and real estate collateral and enable movable asset-based lending (see Figure 11).** Georgia has made progress in adopting best practice provisions for a modern secured lending regime, and in establishing a new collateral registry, however further reform is needed. The gaps in the secured transaction framework include on the legal and institutional frameworks, in particular the public registry and enforcement mechanisms. Key aspects of the legal framework to be reformed include: a) creation, which currently hampers the use of receivables as collateral; b) registration, as the system is document-based rather than notice-based, creating both inefficiency and risk; c) priority, as some uncertainty exists with respect to establishing the priority of possessory pledges, presenting a legal risk; and d) enforcement, which does not have provisions to empower the creditor to repossess the collateral extrajudicially and provide for its sale as the sole form of disposal.

57. **A new Security Interests Law, accompanied by amendments to the Civil Code and Registry Law, is needed to provide clear rules on creation, registration, perfection & priority, and enforcement.** Upgrading the registry itself to bring it in line with best practice (see Table 6), will require new software, linking it to other registries, and developing regulations for maintenance and implementation. The government is supporting improvements of the legal and regulatory framework modernization of the collateral registry and related capacity building for its users. It is critical that needed stakeholders, including MOESD, Ministry of Justice (MOJ), NBG, and the National Agency of

---

39 World Bank Group, “Secured Transactions, Collateral Registries, and Movable Asset-Based Financing Knowledge Guide,” 2019. summarizes the requisite credit infrastructure, the fundamental types of secured credit products, the categories of assets used as collateral in modern regimes, and the beneficiaries of those credit products.

Public Registry (NAPR), collaborate to realize these needed modernizations, as the issues in question transect institutions.

Table 6. Key Movable Collateral Registry Standards

<table>
<thead>
<tr>
<th>Standards</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accuracy</td>
<td>Capture information presented precisely</td>
</tr>
<tr>
<td>Speed</td>
<td>The system should immediately accept or reject a notice upon submission.</td>
</tr>
<tr>
<td></td>
<td>Notices should be reflected as soon as effected, and should be immediately</td>
</tr>
<tr>
<td></td>
<td>searchable.</td>
</tr>
<tr>
<td>Availability &amp; Accessibility</td>
<td>Should be available to users for registration and searching at any time,</td>
</tr>
<tr>
<td></td>
<td>from any place via the internet.</td>
</tr>
<tr>
<td>Cost effectiveness</td>
<td>Fees should be kept reasonably low. Fees can help cover cost of operations,</td>
</tr>
<tr>
<td></td>
<td>but should not be a general revenue source for government.</td>
</tr>
<tr>
<td>Simplicity</td>
<td>Use of simple, user friendly interfaces to reduce risk of error and encourage</td>
</tr>
<tr>
<td></td>
<td>use.</td>
</tr>
<tr>
<td>Limited to purposes of</td>
<td>The registry should only perform the purposes of the registry, which are to</td>
</tr>
<tr>
<td>registration</td>
<td>give notice that a security right may exist for the collateral and establish</td>
</tr>
<tr>
<td></td>
<td>priority of the secured creditor.</td>
</tr>
<tr>
<td>Rule-based decision-making</td>
<td>No bureaucratic discretion in registration and searching</td>
</tr>
</tbody>
</table>

58. Concerns about a limited secondary market for movable collateral act as a further deterrent to the use of movable collateral. Financial institutions indicated that options for secondary markets tended to be restricted to vehicles and that the small size of the Georgian market inhibited further growth of this market. Options for cross-border or regional platforms to expand the resale markets for repossessed collateral have not been explored. The appeal of movable assets is also diminished by the perception of lengthy and costly enforcement.

C. Debtor and Creditor Rights

59. Georgia has strengthened debtor and creditor rights, and has further enhanced the insolvency framework by making proceedings more accessible for debtors and creditors. Strong legal, regulatory, and institutional frameworks are core to both financial institutions and companies, allowing for the resolution of NPLs, facilitating business exit and reorganization, settling commercial disputes, and collecting debts. Without effective debt recovery and or strong mechanisms for business exit, resultant losses both drive a higher cost of capital and generate a heightened perception of risk among financial institutions and other investors. Globally, Georgia ranks 64 out of 190 economies in resolving insolvency, however this assessment was made before the new Corporate Insolvency law was enacted by parliament in September 2020. Under the new law, the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors’ Claims, which came into force on April 1, 2021 creditors now have been granted greater participation in important decisions during insolvency proceedings, which also now include time limits during an automatic stay (in the case of reorganization). Minority shareholder rights have also been strengthened, provisions on the

---

treatments of contracts during insolvency have been improved, and a rehabilitation framework has been developed in line with best international standards.

60. **Insolvencies are expected to increase in the aftermath of the COVID-19 shock, and operationalizing more efficient procedures will help to resolve these more quickly.** Following a 28 percent increase in the number of liquidation procedures in 2017, there was a 48 percent decrease in 2018, or 153 cases in total. Liquidation procedures are likely to increase in the medium and long term.

61. **Some concerns about the inefficiency of court decisions contribute to the risk perception of SME finance.** Stakeholder interviews indicated that commercial cases are frequently protracted, with some disputes taking years to work their way through the court system -- some that last up to five years. Despite the Law on Insolvency Proceedings, liquidation proceedings should be completed within 225 days, in practice statutory deadlines are not always followed. Although out-of-court solutions are available, they are not popular with consumers, including SMEs.

D. **Recommendations**

62. **The existing credit infrastructure should be improved to better support FSPs and enable them to respond to the financing needs of SMEs with a wider variety of products and services.**

63. **The authorities should support improvements to expand collection of alternative data.** Given the existing adequate consumer protection safeguards, this includes exploring whether the pricing of alternative data from public registries is indeed set too high (e.g., at fully recuperating registry costs rather than providing a public service) and whether utilities contracts can become linked to individuals and entities, rather than addresses.

64. **A modern online, notice-based collateral registry system should be established, and its use encouraged through correspondent structuring of the PCGS.** Authorities could, for example, explore the feasibility of incentivizing the use of the modernized online movable collateral registry through the PCGS. Guarantees will not achieve their purpose if lenders use them as a buffer for an already well-collateralized loan, whereas a well-designed public guarantee program could help stimulate finance secured by movable collateral. One potential innovative alternative could include establishing a pilot for a second-loss guarantee (SLPCG) to support asset-based lending. This could help expand financing opportunities for SMEs (see figure below).

---

42 NAPR data.
Figure 11. Encouraging confidence in using movable assets as security through a SLPCG

A working group should be established to explore the feasibility of options to expand the secondary market for repossessed collateral. Because the perceived value of movable collateral is diminished by concerns about secondary market inefficiencies, alternatives should be explored. Potential avenues for secondary markets include regional platforms. If secondary markets can be expanded, and thereby improve liquidity of movable assets and increase execution value, the use of movable collateral or a wider variety of leasing products may become more appealing.

The insolvency framework should be fully operationalized by developing and adopting needed regulations. In addition to operationalizing the insolvency framework, authorities should also consider other steps to improve the business environment through a supportive insolvency ecosystem, such as through conducting awareness building for the private sector and appropriately training judges, insolvency administrators, and lawyers to execute the reformed

DIGITAL FINANCIAL SERVICES

A. Digital Ecosystem

Fintech has the potential to bridge the SME finance gap and deliver services to underbanked clients in Georgia by disrupting traditional models and widening access to a diverse range of tailored financial services. The potential for fintech to transform the financial sector is being realized globally, both in terms of opportunities and risks. Fintech is increasingly being embraced towards achieving objectives in financial inclusion, as well as broader goals of financial sector development, competition, efficiency, and ultimately, economic growth and poverty reduction. The Bali Fintech Agenda (see Box 2), as laid out by World Bank Group and International Monetary Fund in October 2018, establishes a framework for countries to harness these opportunities while

---

44 Defined here and by the World Bank as advances in technology that have the potential to transform the provision of financial services spurring the development of new business models, applications, processes, and products.
balancing risks. Unexploited opportunities exist to encourage digitization and leverage digital means (payments processors, e-commerce platforms) to reduce information asymmetry on SMEs.

**Box 2. Digital payments, fintech and informality**

Digital financial services and tools can make it easier for informal firms to engage in the formal economy and increase a firm’s creditworthiness. Digital sales establish a track record of cashflow history, while digital payments facilitate business operations and tax payments. Establishing electronic payroll can even help formalize labor arrangements. The data trail that results from digitized business operations like these can be used to develop credit assessment tools, both for firms and individual borrowers. Non-traditional data can even include social media data, which studies shown can improve the quality of credit scoring for SMEs. When undertaken holistically, such data can help build “reputation collateral” for potential borrowers, which is based on the established track record of financial behaviors (such as bill payment, payroll history, and other such transactional history).

Source: Based on Pazarbasioglu et al, Digital Financial Services, April 2020.

68. **Digital infrastructure and access to internet is strong in Georgia, with similarly high rates of mobile telephone ownership.** As of 2019, approximately 69 percent of the population is using the internet, which ran below the 84 percent average for ECA, but above the latest available upper middle-income average of 56 percent (2017).\(^{45}\) Fiber optic cable penetration has advanced, though quality of internet connection reportedly varies by region. Approximately 90 percent of Georgia’s territory is covered by 2G and 3G networks, with LTE covering 73 percent; similarly, 99 percent of Georgia’s population is covered by 2G and 3G networks, and LTE covers 97 percent.\(^{46}\)

69. **While most mobile subscribers are individuals, business subscriptions are growing, though e-commerce remains low.** Three mobile network operators are active in Georgia, Magticom, Beeline (Veon Georgia), and Silknet. In 2019 mobile phone ownership reached 90 percent, and mobile broadband subscriptions reached 80 per 100 inhabitants.\(^{47}\) Georgia’s mobile data basket cost is comparable to European averages and lower than the region.

70. **Fintechs in the market are not providing consumer-facing products, and those that have been identified do not offer products targeting SMEs.** Rather, many Fintechs are acting as service providers to leading financial institutions, including on alternative credit modeling, chatbots and AI, wearables, and digital wallets.

**B. Digital Payments**

71. **The lack of interoperability between e-money accounts, cards, and bank accounts limits the uptake of electronic payments over preferred cash payments.** Payment services in Georgia comprise the issuance of e-money and credit cards, bill payment services, and money remittances services. Payment card issuance in Georgia is high—over 1.68 cards per capita in 2020, compared to 1.57 per capita in the EU in 2018. However, conditions hinder merchant payment acceptance, including the absence of direct connectivity between the two domestic card switches and high interchange fees.

---

\(^{45}\) International Telecommunication Union (ITU) World Telecommunication/ICT Indicators Database.

\(^{46}\) ITU 2017 data.

\(^{47}\) ITU 2019 data.
Cash continues to predominate, and SMEs are typically not accepting non-cash payments, including e-money. Without the development of such an electronic ecosystem, further financial innovations for SMEs, like payment card receivables finance, cannot emerge.

72. **Evidence suggests individual and business digital payments increased as a result of social distancing measures during the COVID-19 pandemic.** Digital payments are transfers of value made through digital or electronic devices and channels. They can be initiated by debit or credit cards, or devices such as computers, tablets, or wearables. Georgia developed a universal national ID system, that cover around 75 percent of the population with digital ID cards. The availability of remote customer due diligence measures supported enrollment in government programs and expansion in mobile banking services.

73. **E-money and mobile money are in limited use for physical and e-commerce merchant payments, and the lack of acceptance of e-money by the government and prohibition of reuse of e-money by merchants constrain the further growth of e-money acceptance by SMEs.** Globally, e-money has been enabled as a viable alternative instrument to cards by allowing for equal footing of all payment instruments and their issuers. This has facilitated the generation of use cases by providers, and allowed for more consumer choice and flexibility between providers, instruments, and channels. A more detailed discussion about improving e-money ecosystem and ensuring equal footing of all payments instruments can be found in the FSAP technical note on payments systems and financial market infrastructure.

74. **Rather than being able to reuse e-money balances to pay for regular business transactions, as they would with cash or card payments received, merchants receiving e-money must transfer funds into bank accounts.** This restriction is based on tax law provisions, which designate SARAS’ authority to seize balances from bank accounts, but not e-money accounts. This effectively discriminates against e-money by rendering it less appealing. Otherwise, e-money regulation falls under the Law of Georgia on Payment Systems and Payment Services.

---

75. Beyond their importance for individual consumers to transact efficiently, digital payments are important to SME finance because they can help SMEs to establish and build a credit history. Data on the transaction flows of SMEs can help reduce information asymmetries on sales, performance, and cash flows.

**Government to Business (G2B) Payments for SME Finance**

76. Government payments of salaries, wages, and suppliers are submitted by the Treasury as a batch to the RTGS to beneficiary accounts in commercial banks. To encourage use of a variety of instruments, government should consider allowing beneficiaries to select the preferred financial service, provider, payment instrument, and payment channel. Similarly, to further encourage the ecosystem, government should expand its accepted form of payment instrument for collection instruments away from exclusivity with commercial banks.

77. Government could further leverage digitized public sector payments and stimulate the development of reverse factoring by allowing accounts payables to SMEs to be posted for sale on a web-based invoice discounting platform. Creating such a platform would offer SMEs an opportunity to generate cash flow and obtain working capital finance, potentially at lower rates than their existing financing options. Some international examples of platforms are provided in Box 3.
Box 3. Reverse factoring and invoice discounting platforms

SME suppliers should have practical financing options to help bridge needs for cash injections (in addition to being supported by a culture of prompt payment in private and public sector). This can be achieved by deploying financial instruments leveraging a SME’s relationship with its large private and public sector customers. Factoring, invoice discounting, and reverse factoring (also known as supply chain finance) are options to do so.

Virtual platforms can be set up to host reverse factoring or invoice discounting. If a platform can attract substantial numbers of large buyers, it can potentially spur competition between available financiers and thereby lower the cost of working capital finance for SMEs, irrespective of their location. Under this model, only receivables from select, lower-risk customers are purchased from SMEs. Types of these firms include large corporates and public sector actors, such as central governments, local governments, specialized agencies, and state-owned enterprises. Because the financier takes a risk position against a large buyer, and not the SME supplier directly, a financier’s risk exposure is increased to that particular customer, but this is lower relative to the cost of acquiring information and undertaking a credit risk assessment since high-quality receivables are the main focus. Since these accredited firms that are considered more creditworthy than the SME suppliers in question, working capital becomes more available and at more favorable rates to SMEs than it otherwise would be to these SMEs. Financiers could also benefit from more favorable sales terms from SMEs.

Developing online platforms interconnecting buyers, financiers, and SME suppliers is a way to render this product accessible and efficient. Platforms can either be developed by public or private sector actors. Global examples of national efforts include:

- Argentina: Banco de Inversion y Comercio Exterior (BICE), e-Factoring
- Bulgaria: Bulgarian Development Bank, factoring municipal PPP contractor payables
- China: Credit Reference Center of the People’s Bank of China (PBOC-CRC), Receivables Finances Service Platform
- Hong Kong: Hong Kong Monetary Authority (HKMA), eTradeConnect
- India: Reserve Bank of India (RBI), Trade Receivables Discounting System (TReDs)
- Mexico: Nacional Financiera (NAFIN), Cadenas Productivas

In addition to these, platforms and programs have also been developed by IFIs, such as Asian Development Bank (ADB)'s Supply Chain Finance (SCF) Program, European Bank for Reconstruction and Development (EBRD)'s Trade Facilitation Program, and International Finance Corporation (IFC)'s SCF-Related Advisory, Financing and Investment. Private platforms for invoice discounting are also emergent, selling receivables to interested investors (whether institutional or peer to peer) on online marketplaces, further enabling suppliers to obtain working capital through receivable exchanges.

Source: World Bank Group⁴⁹

⁴⁹ World Bank; also IFC, Supply Chain Finance by Development Banks and Public Entities,” 2021.
C. Digitization of SME business processes and e-invoicing infrastructure

78. Most SMEs must register for VAT and issue tax invoices, creating an opportunity for FSPs to offer invoice discounting products against tax compliant invoices. Taxpayers are required to register for VAT if sales for the preceding 12 calendar months exceed GEL 100,000, which covers many SMEs. Georgia has made strides in e-government and SARAS has an electronic tax system where taxpayers can file. E-Invoices are already supported in Georgia, but have not been used towards invoice discounting.

79. Fintechs do not appear to be offering cloud-based business services to MSMEs (accounting, supply chain management, e-commerce, payments, etc.) and stand-alone finance services in the market. The two leading banks are building online ecosystems aimed at creating new sales channels, offering an “end-to-end” customer service experience, and, at some point, monetize the new data. As part of this approach, the banks are investing in e-commerce platforms and offering cloud based financial and accounting tools for their small business customers. These tools could enable informal firms to formalize (see Box 4). As banks gain a foothold in this digital ecosystem without market alternatives, it risks further eroding both traditional providers competitiveness as well as the viability of potential new entrants. The FSAP Competitiveness in the Financial Sector Background Note examines these dynamics in greater detail.

Box 4. The Bali Fintech Agenda

The Bali Fintech Agenda is a framework developed by the International Monetary Fund and the World Bank Group, aimed at helping member countries to harness the benefits and opportunities of rapid advances in financial technology that are transforming the provision of banking services, while at the same time managing the inherent risks. The framework sets twelve policy elements that countries should consider in their own domestic policy discussions

I. Embrace the promise of fintech.
II. Enable new technologies to enhance financial service provision.
III. Reinforce competition and commitment to open, free, and contestable markets.
IV. Foster fintech to promote financial inclusion and develop financial markets.
V. Monitor developments closely to deepen understanding of evolving financial systems.
VI. Adapt regulatory framework and supervisory practices for orderly development and stability of the financial system.
VII. Safeguard the integrity of financial systems.
VIII. Modernize legal frameworks to provide an enabling legal landscape.
IX. Ensure the stability of domestic monetary and financial systems.
X. Develop robust financial and data infrastructure to sustain fintech benefits.
XI. Encourage international cooperation and information-sharing.
XII. Enhance collective surveillance of the international monetary and financial system.
D. Peer-to-Peer (P2P) Lending / Crowdfunding

80. No online lending platforms or equity crowdfunding exists in Georgia. Many online retail lenders existed prior to 2018 policy actions, including amendments to the civil code that instituted a cap on effective interest rates at 50 percent and effectively eliminated these players. However, these were not functioning as P2P lenders or crowdfunding platforms. There is no specific regulation for crowdfunding, with only the Law of Georgia on Securities Market pertaining.

E. Regulatory Response to Fintech

81. The NBG has taken positive steps to respond to the rise of fintech, including establishing a Fintech directorate to monitor market developments, track potential risks, and initiate several Fintech-related initiatives. NBG’s “Open Regulation” approach sets out to balance innovation and risk by employing an adaptive, agile regulatory process. The apparatuses NBG has set up to operationalize this model include an Innovation Office to provide regulatory clarity, the RegLab, which includes a Regulatory Sandbox to address specific technology challenges and test for systemic risks. NBG is also collaborating internationally, including through regional and international platform such as GFIN.

82. NBG’s fintech regulatory response has already been tested, including during the COVID-19 pandemic, when it was employed to rapidly deploy digital onboarding technologies. A digital bank license has also been developed, though thus far it has only been employed by incumbents.

83. Further pipeline projects underway that are most relevant to SME Finance include instant payments, cloud framework, crowdfunding, and open banking. NBG is leading consultation on developing an API hub for open banking on a phased basis based on PSD2, in partnership with the Georgian Banking association. The Open API standard is based on Berlin Group standard. At the time of the assessment, the first phase, allowing banks to share payment information for access by other banks, had been initiated. The second phase will allow information sharing with non-banks, with the third phase to enable transactions based on such information.

84. Despite these encouraging actions, the regulatory environment can be difficult for fintechs to navigate. There are some indications that determining the validity of new partnership models between startups and incumbents can pose a challenge for NBG, sometimes requiring extensive review of the intellectual property in question, and that the time for a decision has, in some cases, surpassed NBG’s own stated timelines for decision-making. As fintech advances, strengthening institutional capacity to undertake such assessments as well as adapting existing regulation and supervision to new fintech models by using an activity-based approach may facilitate innovation.

F. Recommendations

85. Improving retail payments infrastructure to enable interoperability between bank accounts and e-money accounts could help facilitate development of alternative payments providers, as well as reduce transaction costs for SMEs and support development of e-commerce.

86. Supporting cloud-based accounting, e-invoicing, and Fintech-based factoring platforms could generate further opportunities for diversified financial services. The further development
of electronic transactions and e-invoicing will also support improvements in the reliability of invoices and contribute to the exploration of various invoice discount techniques.

87. **The authorities should provide clarity to the market and consumers by developing and embracing a transparent, pro-innovation fintech vision that encourages competition.** While the initiatives undertaken by NBG to date demonstrate promise, without defined vision to chart a structured pathway forward through enabling policy and standardized engagement models, they exist in isolation of a clear signal to market players of Georgia’s commitment to promoting competition, innovation, and financial inclusion through fintech. By identifying barriers and opportunities for the development of financial innovations to address these, a focused Fintech roadmap can prioritize regulatory and enabling actions. This will also serve the dual purpose of setting expectations and encouraging market response in the focal areas.

88. **Design the open banking framework to support entrants by diverse third-party providers-based on APIs and incentivize interoperability between banks, PSPs, and Fintechs.** Ensuring a level playing field and encouraging positive disruption in the context of dominance by incumbent banks is critical to avoiding further replication -- or even the increase -- of dominant market positions. The proposed access criteria should be evaluated against a lens of whether entrants or smaller financial sector actors can surmount the costs or whether these pose a significant barrier. The competitive dynamics worth considering are further analyzed in the FSAP Competitiveness in the Financial Sector Background Note.

89. **Research and explore feasibility of introducing P2P lending and crowdfunding law and regulation to provide for a clear regulatory framework for marketplace finance for SMEs.** Although relatively new, internationally regulator approaches have already emerged to address or mitigate risks, especially those faced by potentially uninformed consumers. Some of these are highlighted below in Table 7.
Table 7. Consumer Risks and Regulatory Approaches: Investment-Based Crowdfunding

<table>
<thead>
<tr>
<th>RISKS TO CONSUMERS</th>
<th>REGULATORY APPROACHES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor inexperience and higher-risk nature of investee companies</td>
<td>• Require risk warnings and disclosures about key aspects of crowdfunding</td>
</tr>
<tr>
<td>• Small business and start-up investee companies may constitute a riskier investment for retail investors</td>
<td>• Impose issuer caps—limitations on the size of an issue</td>
</tr>
<tr>
<td>• Investors are often unlikely to possess sufficient knowledge or experience, or lack access to financial advice, to assess offers</td>
<td>• Impose investor caps—limitations on individual investments/exposures</td>
</tr>
<tr>
<td>• Investees may have majority shareholder and management arrangements that present risks for minority shareholders such as external crowdfunding investors</td>
<td>• Require investor-suitability assessments to be undertaken by platform operators</td>
</tr>
<tr>
<td></td>
<td>• Establish cooling-off periods for investors</td>
</tr>
<tr>
<td>Risks relating to the nature of securities offered on crowdfunding platforms</td>
<td>• Prescribe disclosure requirements focused on emphasizing the illiquid nature of issued securities</td>
</tr>
<tr>
<td>• Securities rarely traded on any kind of organized market and may have limitations on transferability—investors may not understand or are unable to deal with risk of being unable to exit their investment</td>
<td>• Restrict the types of securities that can be issued</td>
</tr>
<tr>
<td>• Creation of complex hybrid securities by incorporating rights and restrictions for security holders to match issuer's needs</td>
<td>• Impose targeted product intervention</td>
</tr>
<tr>
<td></td>
<td>• Require targeted warnings</td>
</tr>
<tr>
<td></td>
<td>• Introduce rules facilitating information exchanges and secondary trading</td>
</tr>
<tr>
<td>Consumers are not provided with adequate information</td>
<td>• Introduce investment-related disclosure requirements</td>
</tr>
<tr>
<td>• Crowdfunding issuers often tend to be small businesses or in their start-up phase with a limited track record, limiting the availability of information</td>
<td>• Introduce regulation of bulletin boards and crowdfunding trading facilities (including secondary market) to assist information accuracy</td>
</tr>
<tr>
<td>• High separation between ownership by crowdfunding investors and parties that control issuers—potential lack of information provided to crowdfunding investors</td>
<td>• Apply fair marketing rules to investment-based crowdfunding activities</td>
</tr>
<tr>
<td>• Retail investors in crowdfunding securities are also at risk of misleading marketing practices, potentially exacerbated as a result of issuers being new to making public offers</td>
<td></td>
</tr>
<tr>
<td>Platform operator misconduct or failure</td>
<td>• Introduce authorization and vetting requirements</td>
</tr>
<tr>
<td>• Platform operators and related parties may engage in misconduct under a range of circumstances that affect investors, from outright fraud to incompetent administration to undertaking unfair conflicted behavior</td>
<td>• Require business/service-continuity arrangements</td>
</tr>
<tr>
<td>• Failure of a platform can leave investors without services essential to the continued integrity of their investment</td>
<td>• Require segregation of client funds</td>
</tr>
<tr>
<td></td>
<td>• Apply management requirements of the kinds summarized above in the context of P2PL</td>
</tr>
<tr>
<td>Issuer fraud: Consumers investing on crowdfunding platforms may suffer losses due to issuer fraud, such as sham offers or concealing or providing misleading information</td>
<td>• Require platform operators to undertake due diligence</td>
</tr>
</tbody>
</table>

Source: Consumer Risks in Fintech: New Manifestations of Consumer Risks and Emerging Regulatory Approaches, World Bank
GOVERNMENT POLICIES AND PROGRAMS IN SUPPORT OF SME FINANCE

A. Government Strategies and Policies

90. The Government of Georgia has taken steps to improve the institutional environment for SMEs through many policies and programs aimed at promoting economic growth and innovation, however with mixed levels of integration of programs and participation by the private sector. The government’s Four-Point Reform Plan and Socioeconomic Development Strategy of Georgia, *Georgia 2020*, aims to support higher and more inclusive growth through three prioritized pillars: strengthening competitiveness of the private sector; developing human capital; and deepening access to finance. Within these pillars, greater SME financial access is highlighted as a key source of private sector growth, jobs creation, and innovation -- especially noting that limited access to finance, including long-term finance, impedes SME development and growth.

91. In 2015 the Government of Georgia adopted a SME Development Strategy 2016-2020, to prioritize focused actions SME development. The development strategy was oriented around five pillars, including improving access to finance. At the time of the FSAP mission, an updated strategy for 2021-2025 was being prepared under the leadership of the Ministry of Economy and Sustainable Development (MOESD) in consultation with NBG and other stakeholders.

92. National Bank of Georgia’s National Strategy for Financial Education, launched in 2016, has supported the rollout of financial literacy programs for individuals and SMEs in collaboration with public and private sector stakeholders. The NSFE is ongoing, with an Action Plan for 2018-2021; a new NSFE may be considered in the future. Activities have been mainly employed in more traditional areas of classroom-based teaching, rather than during teachable moments (see Box 5). While there has been some evaluative work on the financial literacy programs deployed to date, and indications from NBG that pre- and post-tests have been undertaken for each project, these interventions do not appear to have been thoroughly evaluated for effectiveness. An additional question worth exploring as such an evaluation would be the efficiency of NBG staff directly delivering financial education programs. That is, as a regulator, whether these activities are within the core mandate of the institution, or whether alternatives exist within Georgia to provide education where beneficiaries are already being reached.
Many training programs for SMEs have been deployed, including to support the rollout of IFRS for SMEs. As part of the staggered requirement for SMEs to adopt IFRS standards, SARAS offers free-of-charge training to enterprises to familiarize themselves with IFRS for SMEs. Guidelines have been issued to commercial banks, auditors, and universities to help with the transition to this practice. However, despite the many interventions in the area, there is no broader national initiative on financial inclusion.

Beyond interventions focused specifically on SME access to finance, significant business environment reforms and innovation enablers have been prioritized. These range from the simplification of the tax regime and business registration, as well as the growth in e-government, to efforts to expand access to fast and affordable broadband across the country, such as through the Log-In Georgia project.

**B. Public Sector Funding for MSMEs, Credit Guarantee Schemes, and Donor Interventions**

In tandem to policy initiatives, Georgia has also expanded public sector funding for SME and start-up support programs to 294 million GEL, against 6.4 billion GEL in private SME lending, creating new agencies in 2014, Enterprise Georgia (EG), Georgia Innovation and Technology Agency (GITA). Along with the Agriculture and Rural Development Agency (ARDA), Enterprise Georgia was put in charge of implementing the government’s flagship umbrella entrepreneurship, Produce in Georgia. Produce in Georgia’s objective is to promote entrepreneurial culture throughout the country by stimulating the establishment of new enterprise, and supporting the expansion of existing operations.

ARDA, EG, and GITA span several sectors of the Georgian economy, from agriculture to HoReCa to innovation. ARDA’s activities range from technical assistance for specific products, such as tea, dairy, and wine, to broader support for agricultural cooperatives, agroinsurance, and cofinancing of processing and warehousing. ARDA’s Preferential Agro-Credit program has deployed

---

50 Estimated SME lending of top 15 Georgian banks.
51 Via Enterprise Georgia.
agricultural loans and agroleasing for fixed and current assets through financial institutions to beneficiaries of the program. ARDA’s biggest program by budget is the co-financing of interest payments of borrowers, which offers an interest rate subsidy of 8 to 18 percent from 6 to 66 months, depending on the purpose of the loan. Since for SME loans carry on average a 14 percent annual interest rate, this is a high subsidy. Based on mission discussions, the secondary loss guarantees funded by ARDA have received positive feedback from PFIs for its efficiency.52

97. **GITA’s mandate for sparking innovation has led to a multipronged approach, including both financing of ecosystem facilities such as labs and technoparks, in combination with early stage financing and capacity building programs focused on startups.** The range of GITA support spans across the range of startup development, from ideation to growth. Feedback from the startup ecosystem has been largely positive, though the scale of direct financial support remains limited based on the very early stage financing it provides. Indeed, some of the grants on offer are of very small amount, starting at 15,000 GEL to support prototyping. GITA also provides matching grants: 100,000 GEL for prototyping, and 250,000 GEL for market entry and growth stage startups. Moreover, there are opportunities to further involve the established private sector, including as potential investors, beyond focus on startups in isolation, to help encourage an innovation ecosystem.

98. **Enterprise Georgia’s support programs cover three divisions, focused on business, investment,53 and export promotion, with SME financing available across these.** A significant area of EG’s support is credit and lease co-financing program that offers a subsidy of annual interest rates for bank loans and leases ranging from 50,000 to 10 million GEL for the first 36 months. As part of COVID-19 response efforts, the subsidized interest rate is set at NBG refinancing rate plus 3 percentage points per loan and NBG refinancing rate plus 5 percentage points per lease.54 As in the ARDA subsidy program, given prevailing interest rates this represents a very high subsidy. However, the microgrants program, which is aimed at reaching unbanked MSMEs, has been focused on the development of new enterprises and may have limited impact given the small grant size of 30,000 GEL (with the average requested value of grants by beneficiaries of GEL 20,000). Enterprise Georgia is also the agency administering the public Partial Credit Guarantee scheme, which will be covered in more detail in the section below.

---

52 Since only three claims were issued against the Preferential Agro Credit program guarantees during 2013-2018, however, this picture is incomplete.
53 The objective of the investment division is to attract, promote and develop foreign direct investments in Georgia.
54 NBG refinancing rate + 3% (5%) co-financing rate was set as a response to the Covid-19 pandemic to provide further economic relief to the affected SME’s. The subsidy rates before pandemic outbreak were set at 7% and 9% for credit and leases respectively. The provisional interest rates will return to the pre-pandemic values or be further reduced. Provisional clauses are set to expire on 31st December 2021.
As part of the government’s efforts to enhance SME access to finance, a partial credit guarantee scheme (PCGS) was initially launched in 2019 and revamped in 2020 in response to the COVID-19 crisis. The stated objective of the program is “to improve access to finance for small and medium-size businesses, facilitate lending and ensure inclusive economic growth,” aimed at those who do not meet the requirements of the loan collateral. The program is a hybrid portfolio program, guaranteeing up to 90 percent on an individual loan approved in scopes of the program and up to 35 percent of a portfolio of SME loans, for loans restructured/refinanced in scopes of the program up to 30 percent of the loan is guaranteed. A guarantee fee of 0.3 percent per annum is contributed by participating financial institutions (PFIs). The maximum term of the credit guarantee is 10 years, with the range of loan size covered for commercial banks set from GEL 50,000 to 5 million (USD 16,000 to 1.6 million). For microfinance institutions, which were added to the program in June 2020, this size was from GEL 20,000 to 5 million (USD 6,000 to 1.5 million). There has been a significant uptick in usage since the program was reoriented. As of early May 2021, 252 loans (231 new and 21 restructured) were supported in the amount of GEL 218 million (USD 69 million), with an average size of GEL 865,000 (USD 275,000). Main beneficiaries include restaurants, food processing, wine production, and the construction and health sectors. The program could potentially support up to 1,000 SMEs and GEL 2.3 billion in loans (USD 690 million), with the 2021 budget set at GEL 50 million.

55 The program’s resolution specifies a GEL 330 million allocation. In 2020, the unused amount from the allocation was returned to the state budget. In 2021, the state budget included a GEL 100 million allocation to the scheme.
100. However, the PCGS is not aligned with international best practices in terms of design, corporate governance, monitoring & evaluation, though several reforms are planned or under consideration. There are several notable gaps. These include, but are not limited to: pricing, which is unlikely to cover potential losses to sustain the PCGS based on a maximum payout of 35 percent; the scheme deposits funds directly (at a dedicated agency account) with participating lenders, which, although earning interest, is a suboptimal use of funds and assumes a high percentage of the covered portfolio will default; governance, as the PCGS is run by a government agency rather than as a standalone independent entity; the lack of independent oversight, outside of government to perform a financial or program operations audit (third-party audit is planned for 2022); reliance on NBG to provide oversight of PFIs' credit risk analysis process and recovery policies (rather than having its own credit risk management function).

101. In addition to the public PCGS, other PCGS have been set up by international financial institutions to support MSME finance in Georgia. One example of this is the European Investment Fund's (EIF) InnovFin SME Guarantee Facility, which targets SMEs that require investment and working capital to finance research, development and innovation activities. It covers 50 percent of every loan disbursed by PFIs, which include Bank of Georgia, ProCredit, and TBC Bank. The EIF and European Investment Bank (EIB) also offer credit guarantees through the EU4business Initiative. The Development Finance Corporation (DFC, formerly OPIC), United States Agency for International Development (USAID), and Swedish International Development Cooperation Agency (SIDA) also launched a PCG in November 2020, targeting 5,000 Georgian MSMEs through MFO Crystal. It is structured as an eight-year, USD 15 million, 50 percent loan portfolio co-guarantee. FMO, a Dutch development bank, is also reportedly exploring the development of a PCGS. During mission discussions, some financial institutions contrasted the public PCGS to these programs, indicating that the options offered by IFIs were preferred, in part because of the less onerous qualifications of these programs, but also since the public PCGS is distributed based on market share, rendering the quota of smaller financial institutions correspondingly small.56

102. The robust state programs for SME development are further complemented by strong donor support, both direct and in kind. In addition to WBG and IMF programs, GOG also has engagements relevant to the SME Finance agenda, including with the Asian Development Bank (SME PCG), EBRD (technical assistance for small businesses and SME PCG), OECD (financial education, SME development strategy M&E), USAID (innovation strategy, technical assistance and matching grants for small businesses), and GIZ (corporate insolvency and SME support), among others.

103. While these programs and support mechanism offer a wide variety of solutions that touch the SME ecosystem, in isolation of more comprehensive complementary reforms to address the shortcomings of the finance offerings for SMEs, they are inadequate to stimulating the market action needed to close the SME Finance gap.

56 Including loan type (refinancing does not qualify, only new loans); Firm type (no unregistered informal firms permitted)
C. Recommendations:

104. **The SME Development Strategy for 2021-2025 currently being drafted should emphasize enhanced coordination, targeting, additionality, and monitoring.** Recognition of the importance of SMEs to Georgian economy has generated robust support programs spanning microgrants, interest rate subsidies, credit guarantees, and beyond. These initiatives represent a massive public sector investment, raised to a budgeted 294 million GEL in 2021 (from expenditures of 144 million GEL in pre-pandemic 2019) to support COVID-19 economic recovery, and should be aligned, targeted, sequenced, and timebound to avoid market distortions. Developing a uniform definition of SME to capture enterprises small enough to justify support but with growth potential to ensure sustainability is critical to establishing clear priority target groups across the many interventions and avoiding inefficient overlaps. In addition, this definition can help with results measurement, including in collaboration with the private sector.

105. **To maximize the impact of public spending, government support programs should be coordinated and aligned with economic growth objectives and shared priorities.** Coordination and linkages of public initiatives should be improved to increase economies of scale by undertaking a thorough mapping of existing programs across shared objectives and outreach. For example, business advisory initiatives are currently being delivered by multiple agencies, on topics such as IFRS for SMEs. The ongoing SME Development Strategy provides an excellent opportunity for this improved coordination amongst multiple interventions. Some opportunities to exploit harmonized objectives include: structuring the PCGs to stimulate the use of the movable collateral by FSPs; encouraging interest of the private sector in SME investment by increased collaboration in business plan preparation and review (rather than through selected NGOs).

106. **Financial education programs should be evaluated for effectiveness and efficiency, and opportunities to exploit teachable moments across other government interventions explored.** With the many interventions that are ongoing, the deployment of rigorous evaluation should be employed to ensure the right programs are being delivered by the right actors, at the right time.

107. **The PCGS should be reformed to bring it in line with international best practices and help it achieve its catalytic role in the development of real and financial sectors.** Undertaking reforms could benefit the PCGS, including on its legal and regulatory framework, corporate governance, risk management, operational framework, mission statement, and results measurement. Several areas have been identified for strengthening, and a few are highlighted here (while other improvements are being considered, such as a comprehensive impact evaluation framework for EG programs writ large). First, the pricing of the PCGS is unlikely to cover the expected losses, as the current design of PCGS implies a need for continued budget support by the government. Considerations should be given to increase the cost of the guarantee to bring it closer to market rates. Tiered coverage, in function of the size of the loan and the SME could be an option to consider when restructuring the PCGS. Moreover, while it is important to set expectations on program duration and graduation for all public support programs, it is especially critical for those designed to address information asymmetries like a PCGS: i.e., as the financed SMEs establish a track record of timely

---

57 A draft was not available for review at the time of the mission.
58 For details, see Principles for Public Credit Guarantee Schemes (CGSs) for SMEs, World Bank Group.
repayment, the need for a guarantee should decline. Lastly, as the program advances, it will be key to evaluate whether it is meeting intended outcomes -- for example, whether guarantees reduced interest rates or otherwise positively affected credit conditions towards SMEs.

108. **A strengthened monitoring and evaluation framework that links clear objectives and is backed by rigorous data should be developed for state support schemes.** In line with segmented data on SMEs, a careful analysis of the impact of government support programs should be undertaken to understand whether programs are achieving objectives, especially on access conditions, and reaching prioritized beneficiaries. Given the heavy investment being undertaken by several public agencies, it is key to ascertain whether programs delivered are having desired effects on SMEs. Examples of areas worthy for examination include assessing whether trainings being deployed have supported critical skills development and where priority skills gaps remain and are unmatched by SME access to training. Programs should also be evaluated to determine whether benefits should incorporate graduation criteria or other sunset criteria for participants. For example, PCGS participation could be phased out for firms with established credit histories by gradually reducing coverage ratios in function of classified firm credit profiles. For programs where direct grants or subsidies are provided, a review of supported firms should be undertaken to gauge whether the value of the support is aligned with the size of the firm being supported. On a more wholistic level, supported firms should be small enough to justify support, but also have sufficient growth potential to support the growth and economic development objectives of SME Development programs.

109. **A champion within the government should demonstrate commitment to addressing the disparities in financial inclusion and take the lead to develop a comprehensive National Financial Inclusion Strategy (NFIS).** Beginning with a thorough financial inclusion diagnostic to identified persistent constraints, public-private stakeholder consultation can underpin a strategy. Targeted action can be organized around pillars such as SME Development, Fintech, Financial Education, and other identified priorities. While previous experience with over-indebtedness and rapidly expanded credit provision in the retail segment offers useful lessons for responsible financial inclusion, many opportunities exist to enhance financial inclusion in unserved and under-served population and improve access to financial services beyond credit products. A NFIS can help coordinate and expand effective interventions to drive innovation and raise the profile of financial inclusion as a national priority.
Box 6. World Bank Principles for Public Credit Guarantee Schemes for SMEs

Public credit guarantee schemes (CGSs) are a commonly employed government intervention aimed at improving MSME access to finance. A CGS provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender’s losses on the loans made to SMEs in case of default, typically in return for a fee. More than half of all countries in the world have deployed a CGS to support MSME finance expansion. When well designed, CGS can spur participating banks and non-bank financial institutions grow their MSME portfolio and have positive ecosystem effects by demonstrating the business case for serving previously unreached MSME segments.

When they are not well designed or implemented, CGSs can be costly, inefficient, and provide limited benefits. Based on global experiences in design, implementation, and evaluation of public CGSs to improve access to finance for SMEs, CGS guiding principles were developed by the World Bank Group in coordination with the SME Finance Forum.

16 principles cover four key areas that are critical for the success of CGSs:

**Legal and regulatory framework**

1. Establish the CGS as an independent legal entity.
2. Provide adequate funding and keep sources transparent.
3. Promote mixed ownership and treat minority shareholders fairly.
4. Supervise the CGS independently and effectively.

**Corporate governance and risk management**

5. Clearly define the CGS mandate.
6. Set a sound corporate governance structure with an independent board of directors.
7. Design a sound internal control framework to safeguard the operational integrity.
8. Adopt an effective and comprehensive enterprise risk management framework.

**Operational framework**

9. Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments.
10. Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability.
11. Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.
12. Set a transparent and consistent risk-based pricing policy.
13. Design an efficient, clearly documented, and transparent claim management process.

**Monitoring and evaluation**

14. Set rigorous financial reporting requirements and externally audit financial statements
15. Publicly disclose non-financial information periodically.
16. Systematically evaluate the CGS’ performance and publicly disclose the findings.

Source: World Bank