Section 11. Economics and management

<https://doi.org/10.29013/ESR-20-3.4-73-80>

*Gamsakhurdia Tamar,
PhD in Economic Sciences,
Professor, School of Business and Management
Grigol Robakidze University, Georgia
E-mail: gamsakhurdia.t@gmail.com*

*Kadagidze Lamara,
PhD in Education, Professor, School of Humanities
and Social Sciences Grigol Robakidze University, Georgia
E-mail: Lamara_kad@yahoo.com*

INNOVATIVE FINANCIAL INSTRUMENTS TO ENSURE THE ADVANCEMENT OF SME IN GEORGIA

Abstract. The widest spread and most efficient mechanism to increase financing availability for small-to-medium size businesses is to enhance the ecosystem of financial innovations. The mechanism will trigger the advancement of crediting, thus providing a positive impact on economic growth indicators. The desk study presented in the paper proves 1. The significance of financing issues for the development of small and medium-sized firms, and 2. The efforts of only a minority of financing institutions to offer novelty to businesses. Moreover, we should not overlook the fact that, considering the expansion of international economic investment in an atmosphere of fierce competition, the enlargement of promoted financial technologies will be impossible without adequate governmental policy. Among other critical concerns, the policy should reflect and focus on the development of academic programs in business education, particularly in poor regions, contributing to the mitigation of population drain together with an increase in regional revenues.

Keywords: small-to-medium size businesses, ecosystem of new financial technologies, state financing projects, need for education.

Urgency: The business sector in general, and small-to-medium size business, in particular, play an important role in the development of economy, while at the same time fostering sustainable and inclusive growth. Likewise, it considerably contributes to creating jobs and producing employment. Throughout the entire EU, over 99% of enterprises bear the small-to-

medium size business status, with 67% of total employed and 57.5% of overall value added. The statistics point to the significance of small and medium sized firms in the prosperity of business [1].

The research focuses on the determination of the role of financial innovations to promote SMEs in the country; outlines the mechanisms supporting

SME development; defines the role and significance of financial innovations, and highlights the practical implications and recommendations based on existing challenges.

Research Method: The paper rests on the SME enhancement situational analysis. The results rise from the so-called Desk Study method related to the information gained through the procession of the secondary data.

Foreign experience of promoting the ecosystem of financial innovations: Fintech supports new methods of finance that provide for faster and more efficient investment. Its market is comprised of crediting, trade, electronic and online commerce within the sphere of finance. This trend has the potential to replace traditional processes of finance. Incultation of financial innovations is a serious task to perform for any country from the perspective of economic enhancement. Currently, most of the world attempts to introduce maximally contemporary methods where each legal subject (disregarding legal or physical entity) would be able to conduct financial operations in progressively shorter time frames. Fintech companies provide financial services through computer programs and technologies. As a result, a consumer is able to simply and easily plan, run, and control their own finances. It ensures timely and convenient service for consumers, reduces costs, and improves existing

business models and services. Online services offer customers a variety of financial products, creating more independence for them. Additionally, with the assistance of technology, financial organizations possess more detailed databases about their consumers. Respectively, clients are offered the most appropriate product or service. Fintech activity includes:

- Operations management in financial services;
- Payments, International transactions, crypto currency, blockchain;
- Credits and deposits, Peer-to-Peer (P2P) loans;
- Issues related to investments, financial markets, and commerce and risk management.

Successful start-up companies like: Robinhood, Acorns, Plaid, Coinbase, Affirm, Behavox, SoFi, Betterment, Bitfury, Circle, Zenefits, Bolt, Mint, etc. are worth being mentioned here. According to TechCrunch, the market capitalization of the market value of the 10 leading American Fintech firms increased by 50% in 2018 and the trend is projected to continue. It is noteworthy to mention the merger of Fiserv and First Data, the value of which amounted to 22 billion USD. The merger will boost the implementation tempo in technology finances. The same tendencies are seen worldwide according to research conducted by one of the auditory companies of Big 4 [2].

Diagram 1. Global Investment in Fintech

The **PricewaterhouseCoopers** LLP (PwC) report says “in the nearest 3–5 years, 50% of the world

finance sector company representatives plan to purchase technological start-ups.” At the same time, 8

out of 10 banks intend to create strategic partnerships with p2p redirection services, money transfer digital platforms, and firms able to potentially reform the finance sector. PwC carried out research of 1300 participants who were leaders of large finance establishments. The outcome reveals that 88% of those surveyed fear novices who devise money transfer, payment and personal finance administration services. The greatest threat in the banking sphere comes from Fintech start-ups operating in the field of crediting [3].

Therefore, we can plainly see the crucial role of financial innovation in the economic and social progress of countries, as well as being the main source of economic growth. Financial innovation creates an opportunity for developing countries to avoid trailing the advanced world and improves quality of life through the course of sustainable development [4].

Analysis of general and new financial technologies of SME in Georgia: We would like to review

the current reality in the area of general financing of SME in Georgia and of financing through new financial technologies among those. In order to accomplish this task, we reviewed the annual action plans of 2016–2020 SME strategy development in Georgia and on its implementation, in addition to research conducted by international organizations, including governmental and private entities with expertise on the subject matter.

Small and medium businesses are the essential sectors for the economic growth of Georgia. Based on the National Service of Georgian Statistics data, in the second quarter of 2019, 52.3% of the total turnover fell on large business, while 20.5% and 27.2% are distributed across medium and small businesses. We have a slight difference in case of the production total output where large business accounts for 40.1%, medium accounts for 25.8%, and small business represents only 34.1% (See the diagram 2. Total Output of SME).

Diagram 2. Total Output of SME [5]

The European Bank of Reconstruction and Development (EBRD), in the strategy prepared for Georgia, considers it as a country having a low culture of innovation. The document states the low level of innovations, research, and development point to Georgia's small and medium entrepreneurs investing little in research and enhancement, which hinders

the generation of innovation, resulting in less favorable outcomes.

The Innovation Global Index of 2018 displays business development opportunity as a particular weakness (point 25.7, position 91), pointing to a lack employee awareness, lack of connections essential for innovation, and a low knowledge base.

Relative indicators to note here are: financial system (position –25), bank stability (position –12), and venture capital availability (position 19). The lowest estimates fixed by Georgia according to the index are professional training quality (position 131)

and credit deficit (position 119). The same reality is conveyed according to innovation and advancement, where Georgia holds a position of 112 (118 in innovations, 99 in innovation potential, and 70 in technological readiness) out of 137 countries [6].

Table 1. – Position of Georgia based on the 2018 Global Competitiveness Report [7]

Index Estimates Criteria	Position		Variable
	2017–2018	2018	
Financial System (2018)/Financial Market Growth(2017–2018)	63	88	(25)
Bank Stability	64	76	(12)
Venture Capital	80	99	(19)

A note: the article mainly focuses only on the significance data for the study

Prominent international researchers combine the SME problems into four blocks: administrative, finance availability, market availability, and knowledge availability. Half of those surveyed state the third problem, market availability, as the main challenge; 40% consider finance availability as the essential obstruction, while only 10% think knowledge availability is a substantial barrier. However, in the case of subsequent polling, the number of respondents stating knowledge availability to be the main challenge doubled [8]. Another grand-scale study with 236 participant companies (26% large businesses and 36% small firms) proved finance availability to be the major problem. 16% of large businesses and 27% of small firms consider low demand as the basic challenge. The survey also mentions limited access to bank finance (especially large mortgages); other sources of financing and antiquated cultural attitudes [9].

Even though SME enhancement is one of the economic policy priorities of the Georgian government, the business sector, and 90% of small companies in particular, are financed by the owners, since again, finance availability is one of the most acute issues [10]. Additionally, the following complications are exposed while exploring SME strengths and weaknesses: low competitiveness, low productivity, limited access on finance/long-term investment resources, low level of

innovation, inadequate research and development, insufficient cooperation of the private sector with research and development institutions, and high expenditure of new technologies/basic means [11].

375 surveyed entrepreneurs, within the framework of the SME support project of the Frydrych Ebert Fund in Georgia, named substantial disturbing factors such as high interest rate on credit (77% of the surveyed), bank provision of loans on the basis of only mortgage and business idea assessment (78.3%), high costs of mortgage (42.2%), bureaucracy, a lengthy credit approval process (41.9%), and breach of loan contract terms from the bank (72%) [12].

As we have already mentioned above, the advancement of SME has been a declared state priority since 2016. Based on the data 2015–2018, in the framework of the agency “Produce in Georgia”, 5,313 projects were supported with the total investment of about 50 million GEL. Moreover, nearly 23 million GEL was provided as co-financing with 8,412 beneficiaries. The project is being implemented in all the regions of Georgia, except Tbilisi [13].

Economic growth and development are the stated priorities of the Georgian government, but whether each such project reaches it, or how, has always been a matter of conflict (See Chart 2. Governmental Projects of Financing SME) [14].

Chart 2. Governmental Projects of Financing SME

Program	Annual Budget
Lax Agro-credit	47.000.000
Agricultural Insurance	7.000.000
Plant the Future	7.000.000
Tea Plantation Rehabilitation Program	400.000
Co-Financing Program for Savings and Processing Enterprises	9.865.000
Agro-Production Support Program	2.700.000
Start-Up Georgia	2.000.000
Produce in Georgia	14.800.000
MSB Grants	7.000.000
Highland Micro-Grants for Mountain Development	8.000.000
Sum	105.765.000

Additionally, there is recent doubt about budget funded programs supporting SME functioning having met only a minimal portion of existing needs. The programs were mainly focused on the export growth of the leading sectors (wine business, tourism) [15]. International organizations add to the list of conditions which hinder SME advancement as follows: uncertainty due to frequent amendments in the tax legislation with rapid implementation, information dissemination restrictions, transitional provisions, and vague articles in legislation [16; p. 4–6].

Currently, seven commercial banks functioning in Georgia possess Internet-acquiring license of international payment systems and successfully serve the spheres of trade and service (state spheres as well). Their electronic systems work through the world recognized Verified by Visa™ and MasterCard Secure Code™ technologies [17]. In order to support SME development, the Bank of Georgia introduced an entirely new instrument – the business-banker service. For the purpose of advocating tourism growth, the bank elaborated a special package, i.e. providing finance for 15-year terms in order to enhance hotel business. Finances are also assigned within the framework of the state program “Host in Georgia.” The future hotel revenues will be considered as a loan payment source; only existing and future real and movable property of the project to be financed will be considered to guarantee the loan.

The Bank of Georgia carried out the investment of a total of 153 million USD. It implemented several projects to foster the development of small and medium business in rural regions. 71% of the hotels financed by the bank are located in regions promoting economy and tourism. Last year, with the advocacy of the Bank of Georgia, 4,622 people were provided jobs at hotels, 23% of those participated in the projects financed by the bank. In 2018, the number of rooms in the accommodation facilities increased by 6,701; 32% from hotels financed by the Bank of Georgia [18].

In 2018 the Bank of Georgia presented a new program of promoting open banking called BOG Fintech and a website: www.fintech.ge. Open banking is a joint initiative of the world’s leading banks and other participants of the finance sector aimed at increasing the involvement of new technology companies, referred to as “Fintech Startups”, with the goal of increasing service choices to the customer. The Website www.fintech.ge represents 19 Fintech companies.

Moreover, the research outcome conveys that only one Fintech company currently performs crediting – Quick Cash of SME. The company is an innovative high-technology platform of cloud banking and SME creditworthiness assessment. It ensures the provision of desired sums through several simple steps. After registration, the business is immediately estimated by automated data processing and the sum is assigned as

soon as the credit line has been approved. If it takes other financial institutions two or more weeks to assess business, the platform enables it in 5 minutes. Also, there is no need to collect papers and go through other bureaucratic procedures [19].

A significant source of finance in many countries is Credit Unions, the amount of which significantly declined in Georgia in recent years. By the end of 2018, only 2 out of 8 credit unions continued to function on the Georgian market. The total amount of their transactions equaled 2.4 million GEL. Out of eight licensed credit unions, five voluntarily ceased their activities (based on their own written statements). In the case of the sixth, the Credit Union License cancellation and the beginning of liquidation was attributed to the supervisory activities of the National Bank of Georgia.

All this was brought about by changes in legislation. According to the amendments enforced on December 23, 2017, in the Law of Georgia on “Credit Unions of Non-bank Depository Institutions”, unification of physical entities in the administrative unit of the same community by a common feature, was defined as one of the principles of Credit Union activity. The limit of the number of Credit Union members was stated to be less than 200. The main goal of the amendments was to unify members in the Credit Union according to their real common objectives and needs, as opposed to simply attracting deposits from the Credit Union members [16; P. 150].

The emergence of foreign private equity in start-ups is vitally important for the further advancement of the financial innovation ecosystem in Georgia.

Silicon Valley Tbilisi and Israeli Techub in Georgia, the official partners for Global Startup Foundation, create significant access to investment for Georgian start-ups. Eligible candidates will pitch an innovative idea and business development strategy in front of the Israeli angel group investors. This is a considerable novelty in the Georgian finance system to support the financial technology ecosystem in the country.

Conclusion and recommendations: The inculcation of financial innovations is a significant task for any country to facilitate growth and progress. Currently, the whole world is striving to implement contemporary methods where any representative of small and medium business will be able to perform financial operations in a maximally short time period. Each country is unique from the perspective of its own traditional financial activities since, as a rule, all this stems from the development level of the country and consumer interests. The study conveyed that only a small portion of Georgian financial companies attempt to offer novelty to SME representatives. The research also claims that if Georgia introduces different platforms assisting businesses in better functioning, they will inevitably be used efficiently.

SME support should be more focused on academic programs enhancing business education, especially in poor regions, thus fostering the growth of revenues and hindering population drain. Moreover, we should sufficiently consider the fact that in the conditions of fierce competition on the expansion of economic investment, meaningful inculcation of financial technologies will never be adequately possible without governmental policy.

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