

EIB MSME Conference – Georgia 2023

SMEs' Needs for Finance & Investment Landscape in the Region

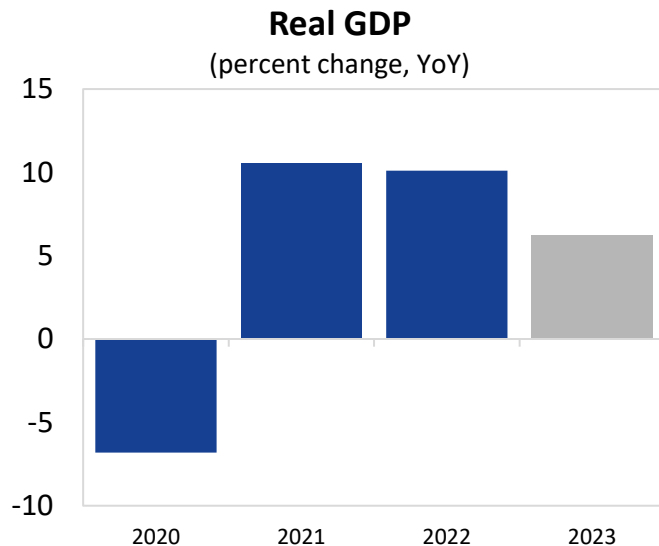


Luca Gattini

28 November 2023, Tbilisi

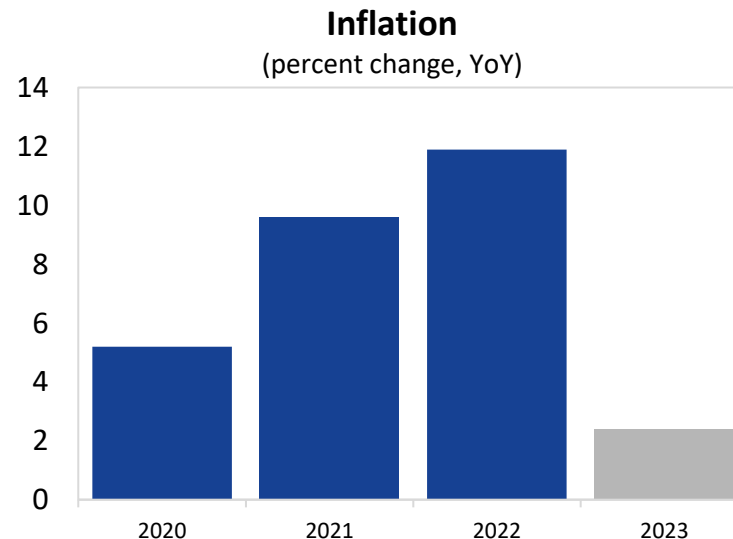
Georgia's economy weathered the twin shock of the pandemic and the war surprisingly well

Activity rebounded strongly and stayed resilient, supported by tourism, financial inflows and transit trade



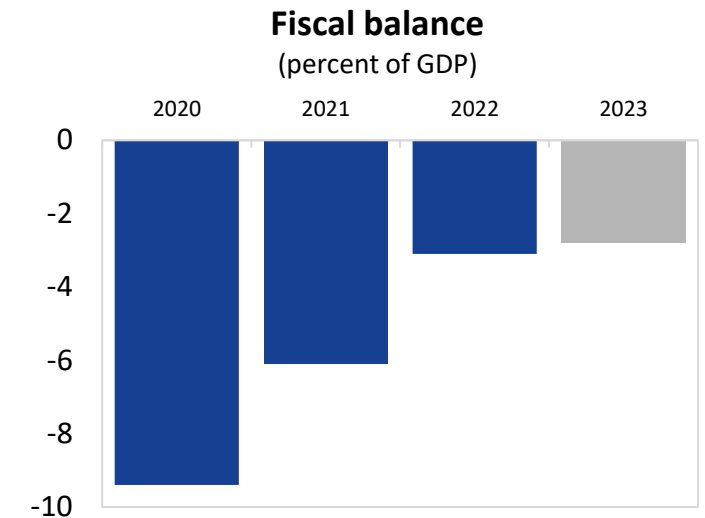
Sources: IMF Regional Economic Outlook - Oct 2023.

Headline inflation is easing amid lower commodity prices and tighter monetary policy, while core has been declining more gradually



Sources: IMF Regional Economic Outlook - Oct 2023.

Fiscal consolidation has been supported by strong revenue growth and an effective fiscal rules framework, contributing to debt-to-GDP ratio decline

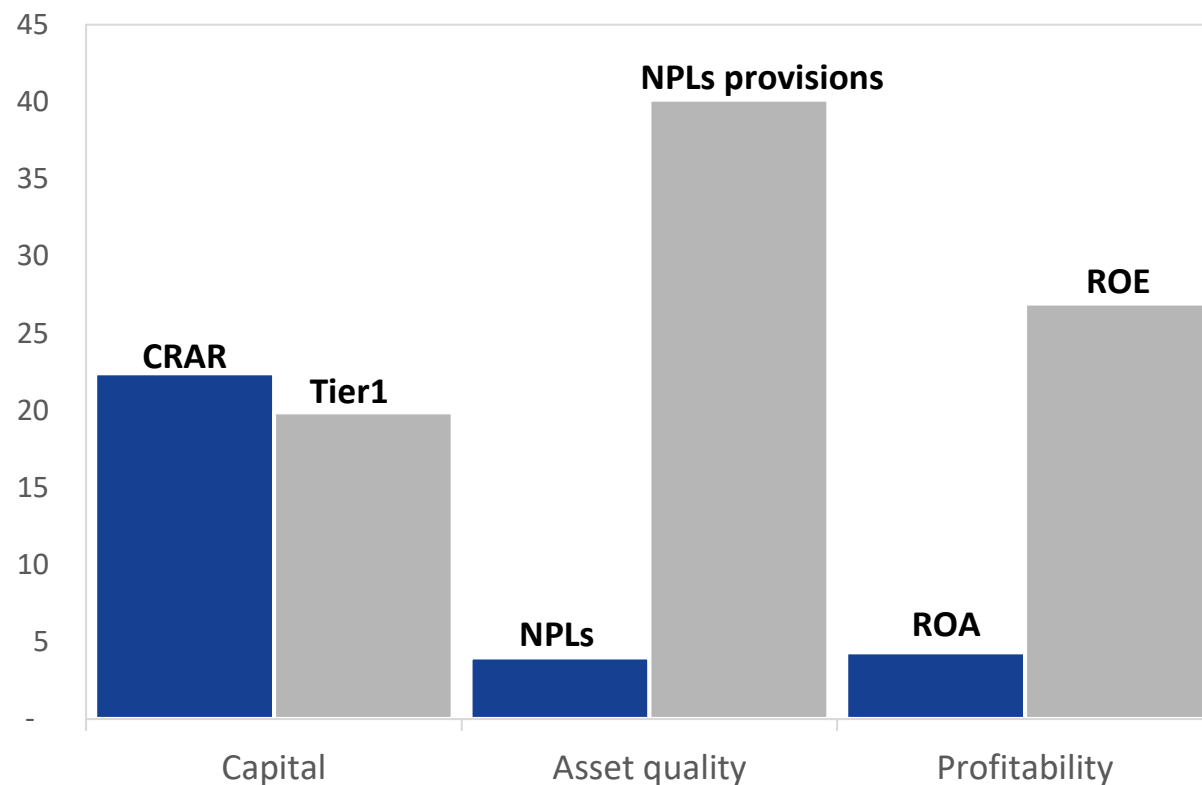


Sources: IMF Regional Economic Outlook - Oct 2023.

Resilient banking system despite heightened volatility

Selected Financial Stability Indicators

(as of September 2023)



Sources: National Bank of Georgia

Strengths

Stable provision of credit

Capital buffers

Rising profitability

Contained NPLs

Basel III (NFSR, LCR)

IFRS9

Larization plan

Relatively low share of ST external debt

Risks

Aggregate loan to deposit ratio

Still significant dollarization

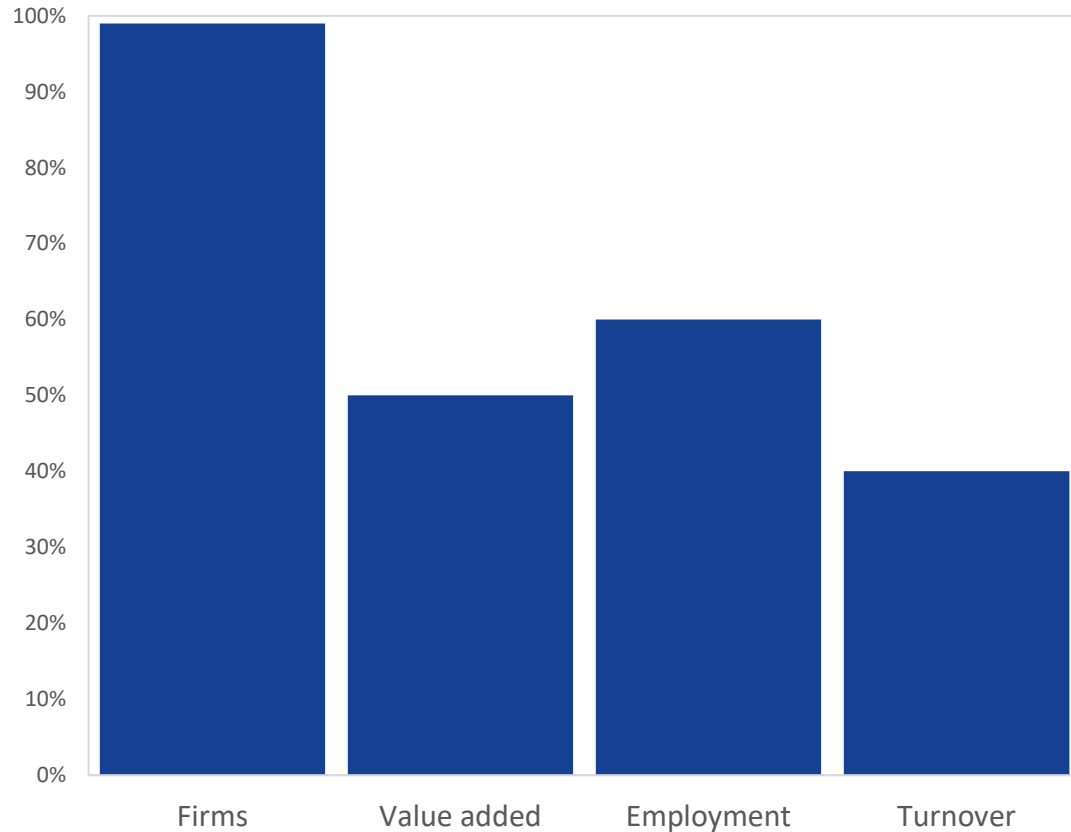
Currency induced credit risk (second round)

Concentration

High share of external debt

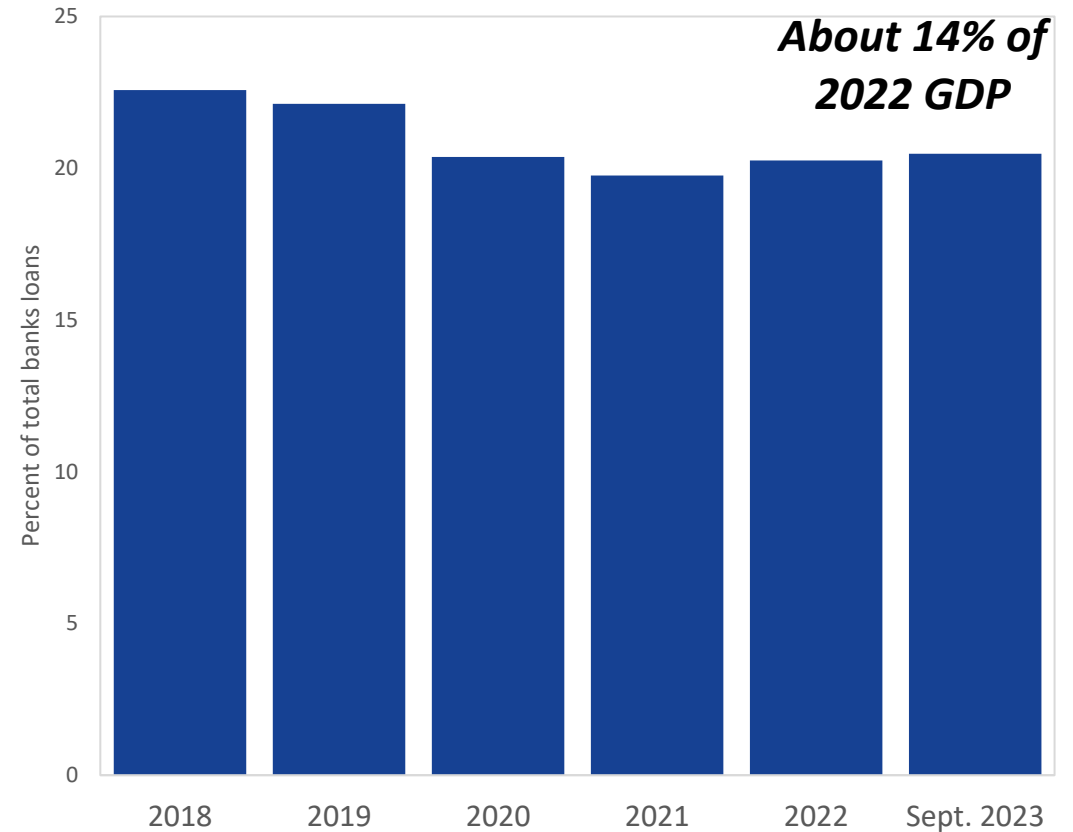
Georgia's economy relies heavily on SMEs, but their financial deepening remains limited

SMEs in Georgia



Sources: Geostat, 2022

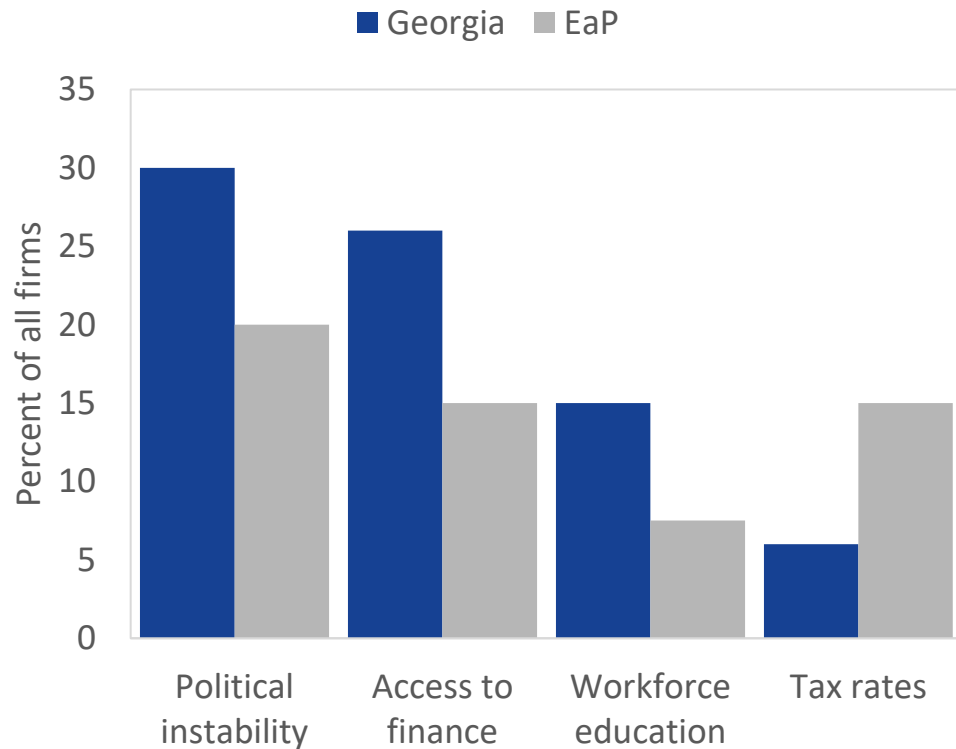
Share of SMEs loans



Source: National Bank of Georgia, author's calculations

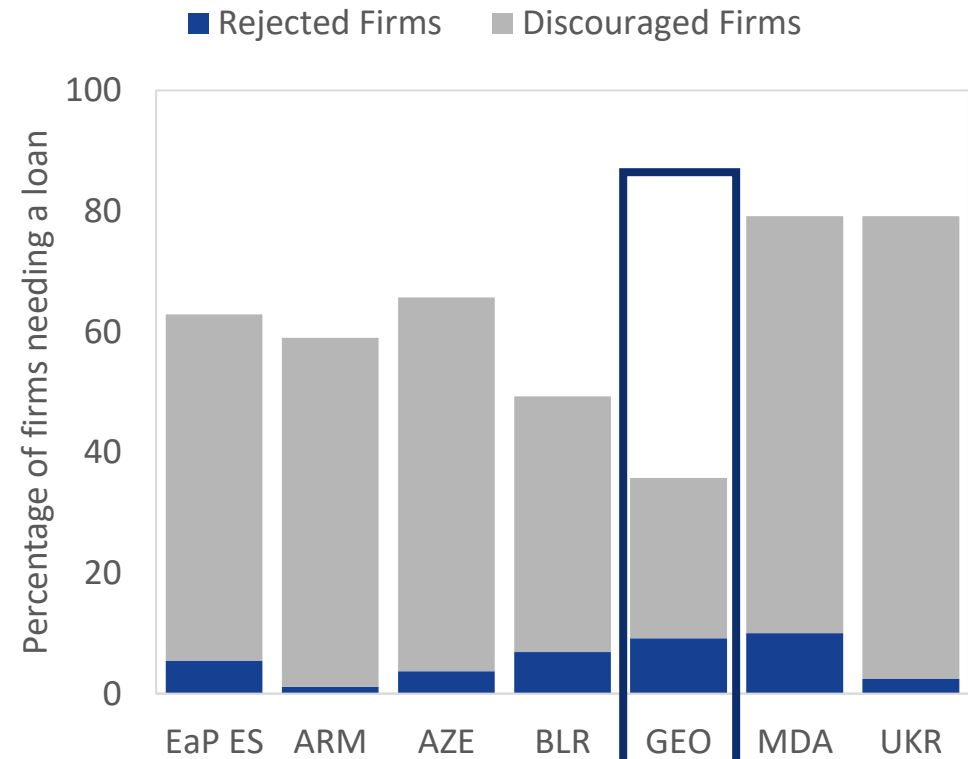
SMEs still perceive access to finance as an obstacle

Firms' four main obstacles to developing their business



Source: EIB-EBRD-WBG Enterprise Survey

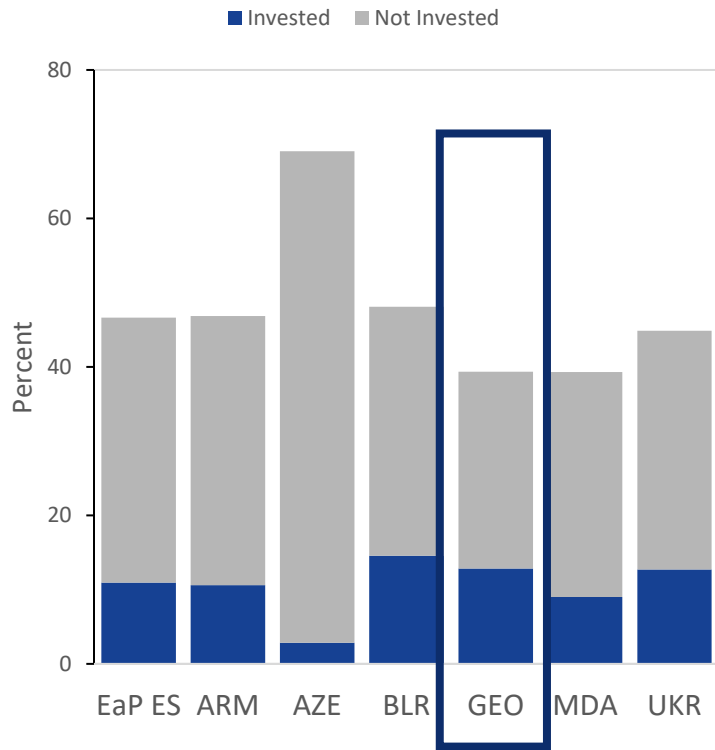
Almost 40% of firms needing a loan were rejected or discouraged



Source: EIB-EBRD-WBG Enterprise Survey

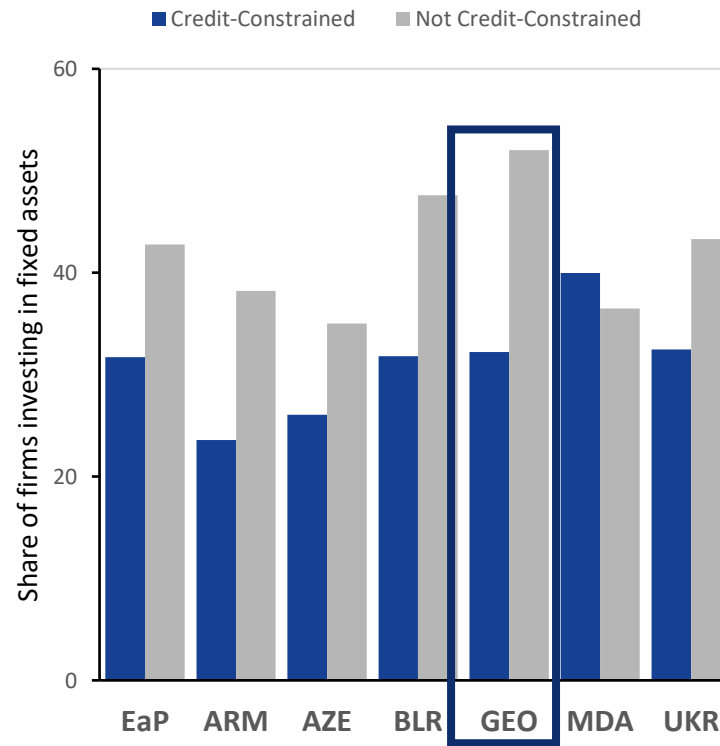
Financial access is a key enabling factor for firms' expansion

Firms w/o any loans are more likely to not invest



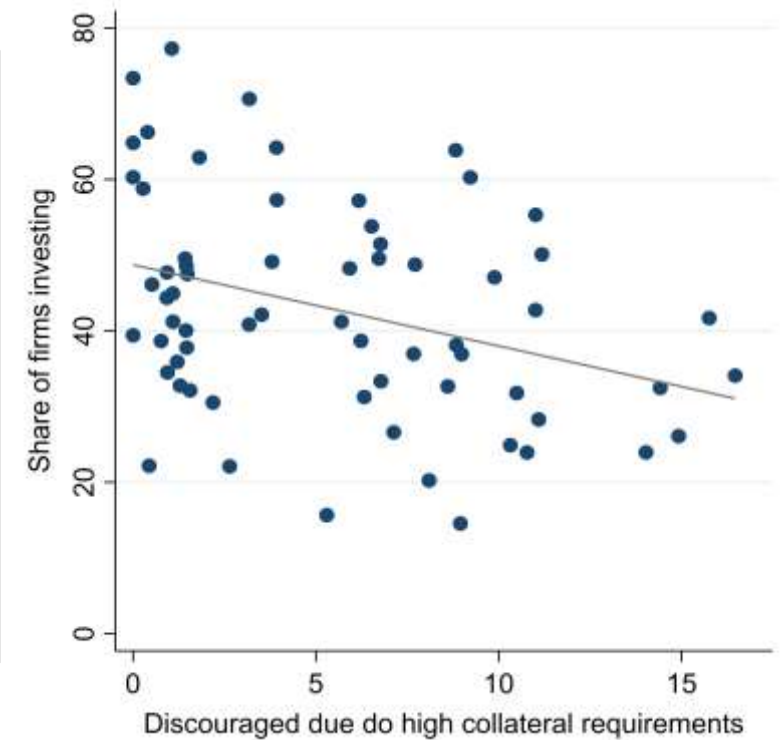
Source: EIB-EBRD-WBG Enterprise Survey

Credit constraints limit firms' investments in fixed assets



Source: EIB-EBRD-WBG Enterprise Survey

High collateral requirements limit Georgian firms' investments



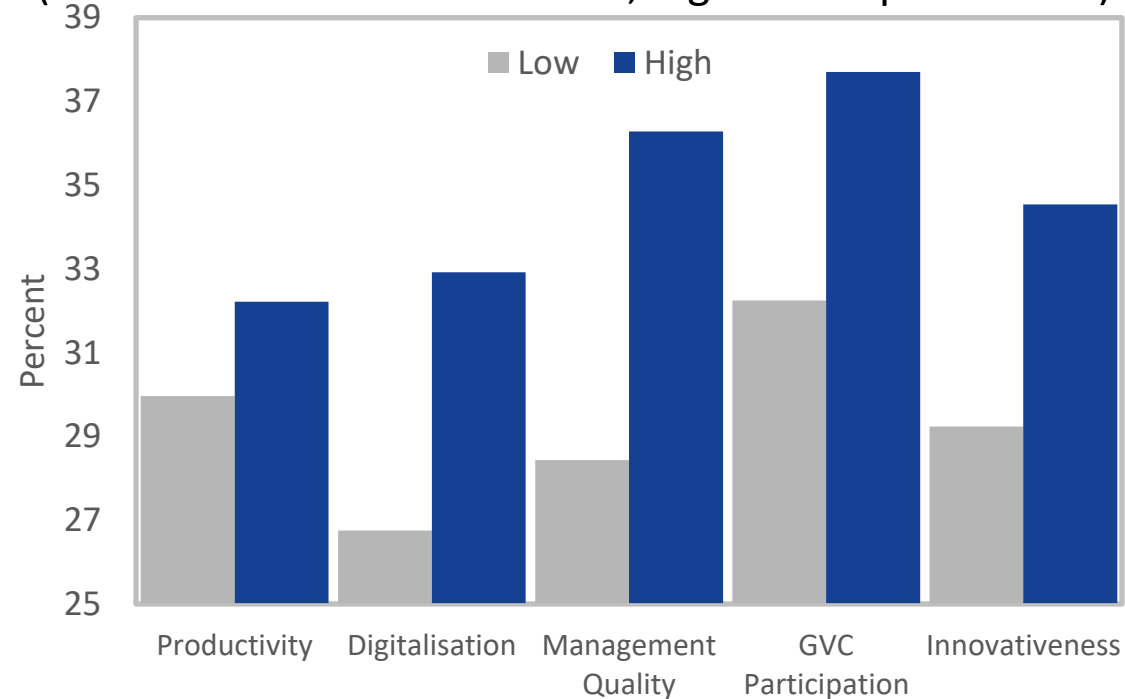
Source: EIB-EBRD-WBG Enterprise Survey

What did we learn during the pandemic?

Structural features matter for firms resilience and adaptation

Probability to adapt

(based on firms characteristics, high vs low performers)



Source: Business resilience in the pandemic and beyond: Adaptation, innovation, financing and climate action from Eastern Europe to Central Asia (2022)

Resilience

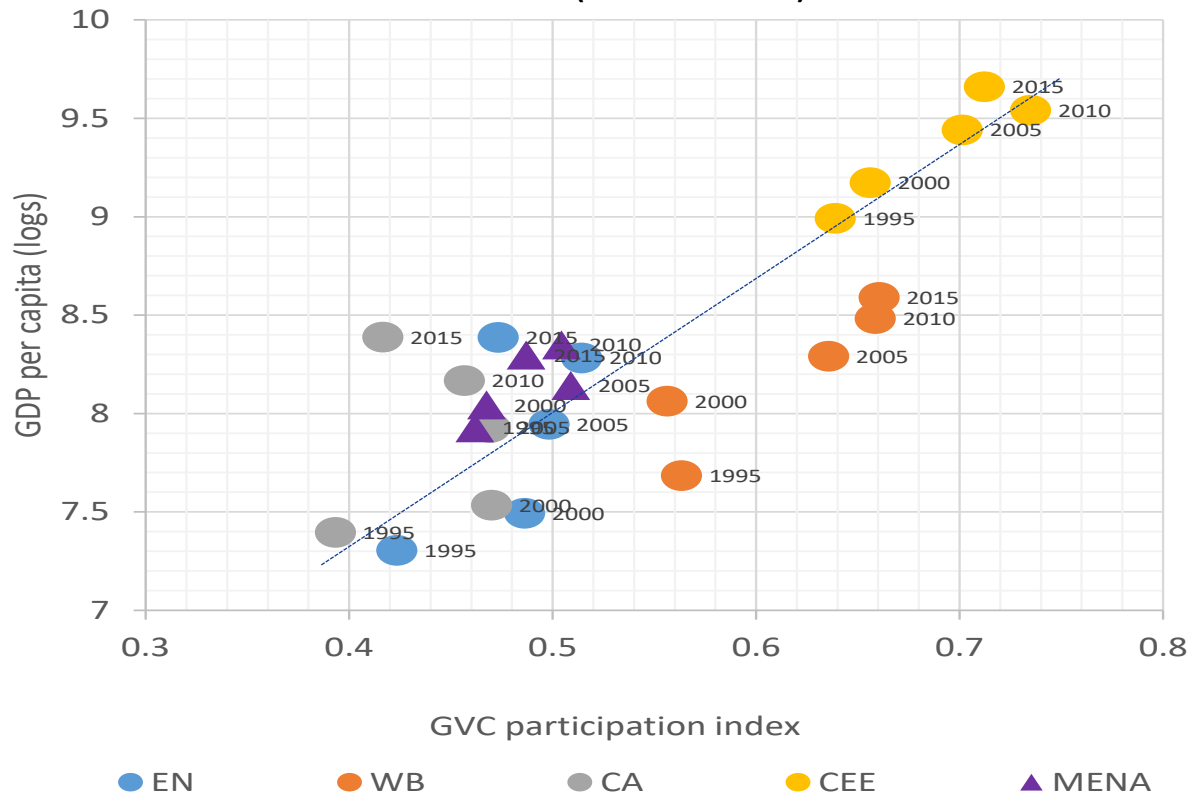
- Probability of bankruptcy

Supported by

- Being **part of a group**
- Having a **pre-existing overdraft** facility
- Stronger policy support for SMEs

The experience of other accession countries supports GVC participation as a driver of growth

Participation in GVCs and per capita real GDP
(1995-2015)



Export/GVC linked to innovation:
evidence of causality through better management and transfer of technology

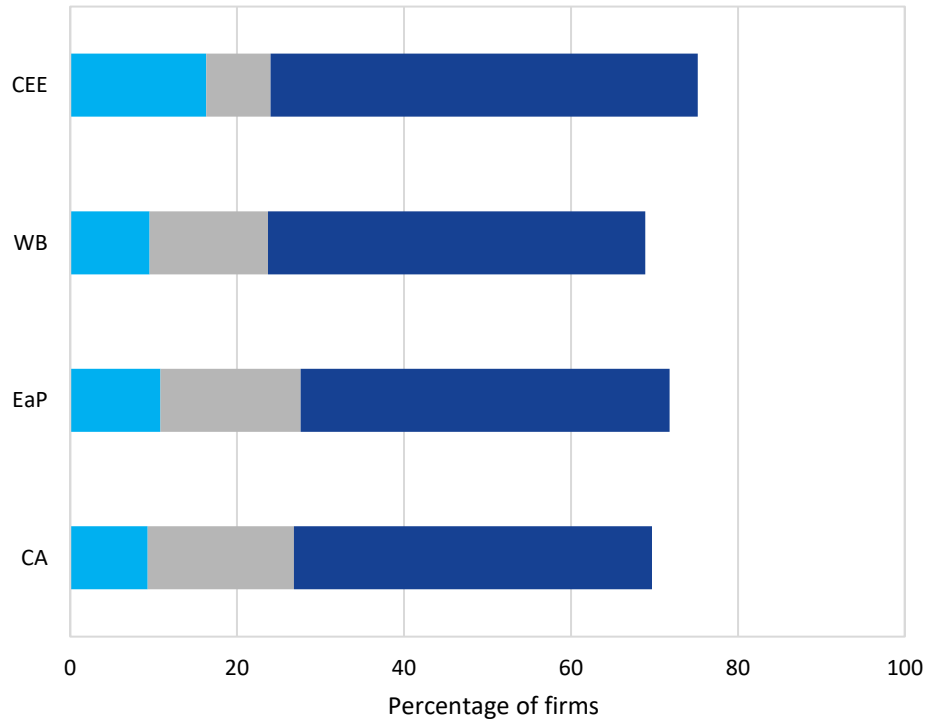
Asymmetric returns across firms:
productivity and growth premia for superstar exporters, large firms and firms engaging in trade & innovation

EU confirmed as trade facilitator and driver of innovation

Source: Business resilience in the pandemic and beyond: Adaptation, innovation, financing and climate action from Eastern Europe to Central Asia (2022)

Energy security vs the net zero transition. How to drive change?

Green investments



Firms' green managerial capacity and ESG influenced by:

- ✓ Customer pressure, energy taxes and experience with climate risk
- ✓ firm size, foreign ownership, exporters, listed firms

Firms' investment propensity: influenced by green managerial practices and credit constraints

- ✓ Targeted access to finance facilities for SMEs paramount in combination with TA/advisory

Source: Business resilience in the pandemic and beyond: Adaptation, innovation, financing and climate action from Eastern Europe to Central Asia (2022)

Conclusions

SMEs significant contributor to Georgian growth and prosperity and their potential can be harnessed further

Overcoming remaining barriers to accelerate firms' growth, support investments and technological upgrades, and participation in GVCs

- ✓ Especially for **start-ups, younger and export-oriented** firms
- ✓ To enhance **SMEs adaptability** to multiple and recurrent shocks

Market infrastructure geared to support SMEs financial inclusion:

- Continued expansion of **local currency lending** to limit credit risks
- Further growth of **long-term funding options** to better match the investments' lifecycle
- **Guarantee schemes to boost risk-taking** appetite and smooth collateral bottlenecks

Green investments much needed and targeted support paramount

THANK YOU



European
Investment Bank

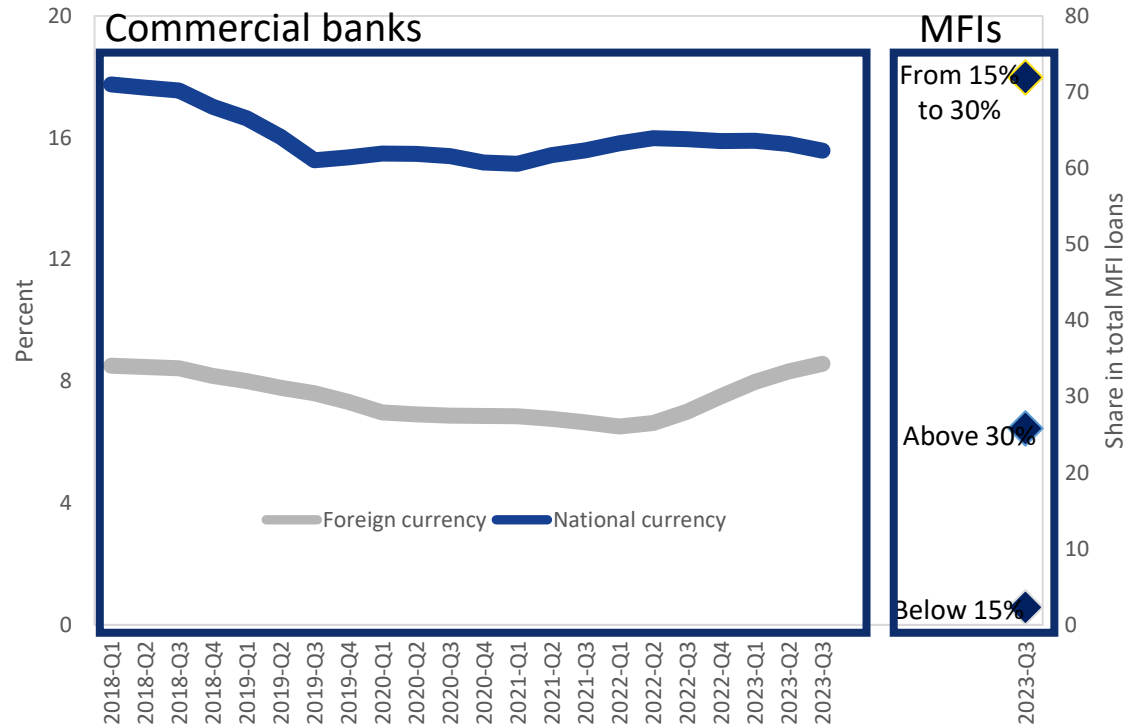
Global

For further information
on EIB in Georgia...



Despite progress, more needs to be done to overcome remaining obstacles

Interest rates on loans
(annual weighted average)



Source: National Bank of Georgia, author's calculations

Commercial banks are the main source of firms' finance, with MFI growing rapidly but from a low base

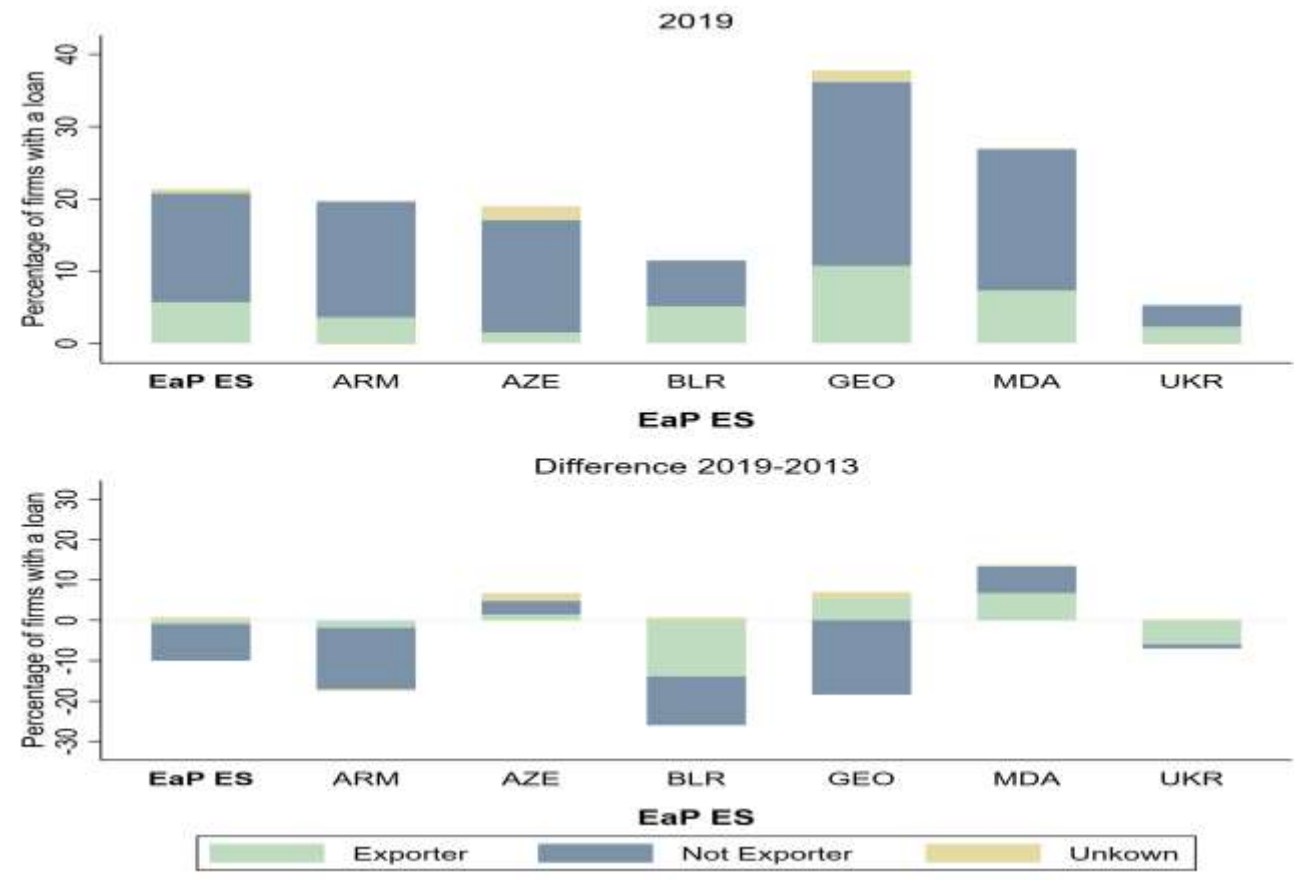
- Interest rates on (both GEL- and FX-denominated) loans originated by commercial banks have been creeping higher in line with global trends
- Interest rates on MFIs loans are even higher: about 70% of MFIs have an annual interest rate between 15% and 30%

Additional obstacles

- High collateral requirements
- Over-indebted borrowers or lack of sufficient assets
- FX-lending offers lower rates, but exposes to exchange rate volatility risks given limited use of hedging instruments

Risks from unhedged exposures remain

Dollarization of exporting and non-exporting firms



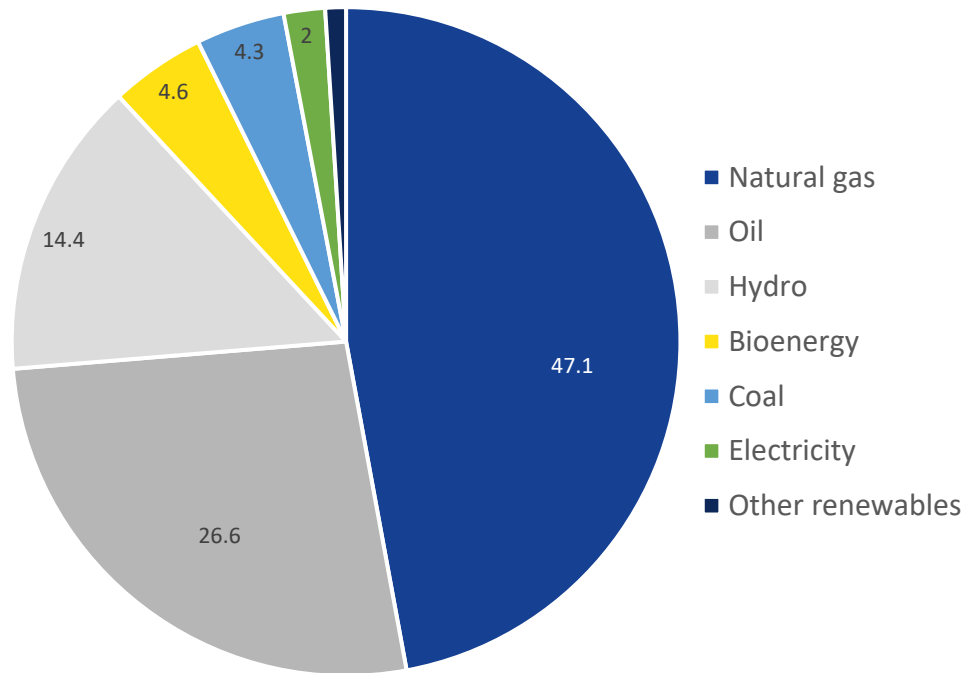
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Source: EIB-EBRD-WBG Enterprise Survey

Georgia has trailblazed the energy sector development, capturing a substantial share of FDIs

Total primary energy supply by source
(2020)

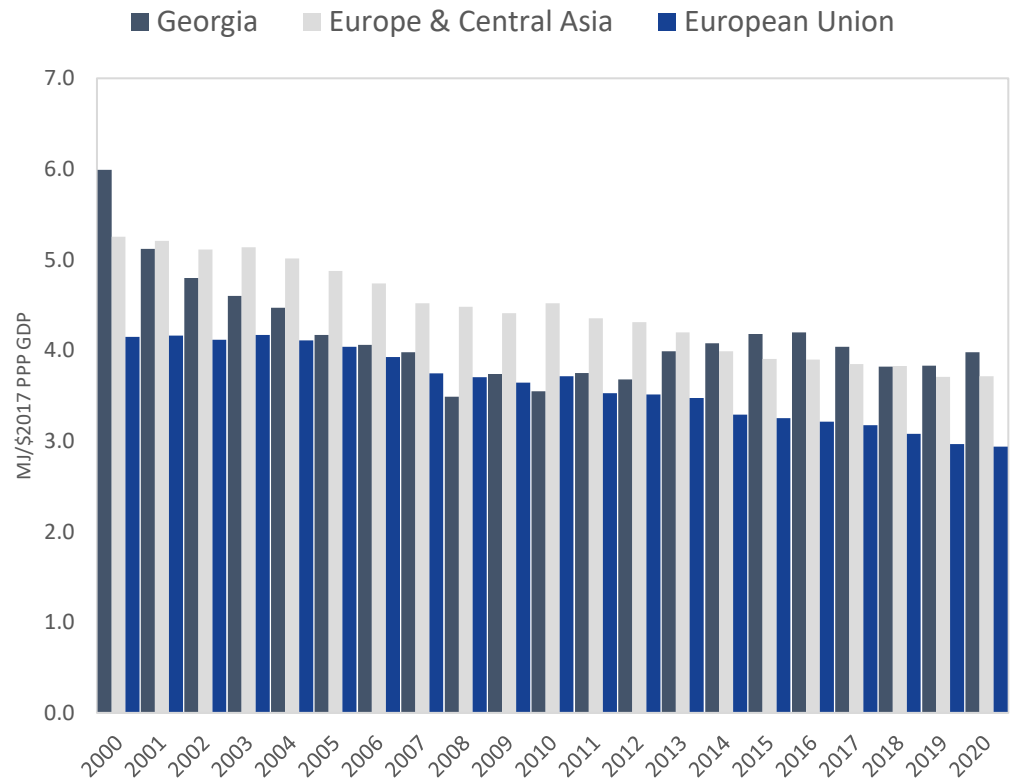


- Georgia's total primary energy supply (TPES) amounts to approximately 5 Mtoe and it is dominated by natural gas (47%) and oil (27%), while renewable energy counts for about 20%
- Georgia depends on imports for all its natural gas and most of its oil products
- Most of Georgia's domestic energy production comes from hydro and bioenergy
- Hydroelectric capacity, already substantial, holds tremendous untapped potential

Source: Geostat

Further efforts are needed to decouple economic growth and emissions

Energy intensity level of primary energy



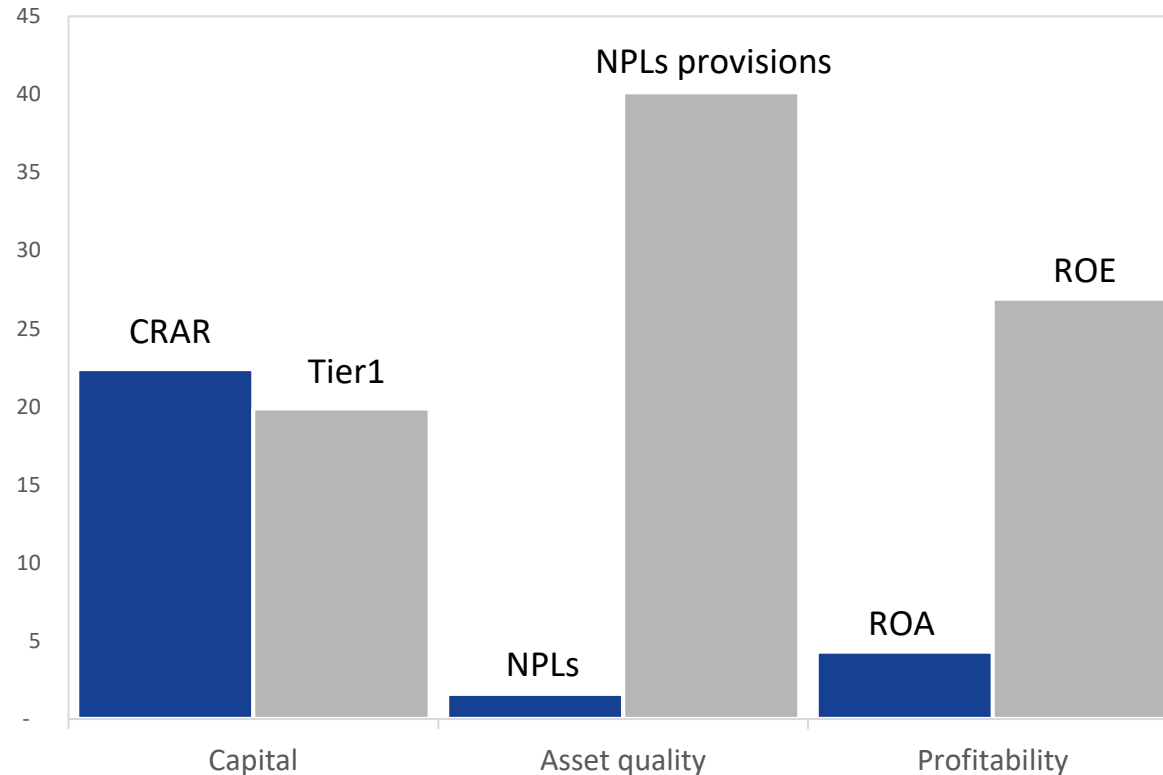
- **No decoupling of economic growth and emissions:** in 2010-22, GHG emissions growth in Georgia outpaced output expansion (77% vs 58%)
- **Scale effects and structural transformation explain this trend:** the larger production capacity, combined with the expansion of energy-intensive sectors and a deterioration in firms' efficiency since 2017 are behind the rise in emissions
- **A supportive institutional and regulatory framework, access to innovative technologies, availability of credit for green investments, and good managerial practices are key to successfully transition to greener production systems**

Source: IEA Statistics

The banking system has remained resilient despite heightened volatility

Financial Stability Indicators

(as of September 2023)



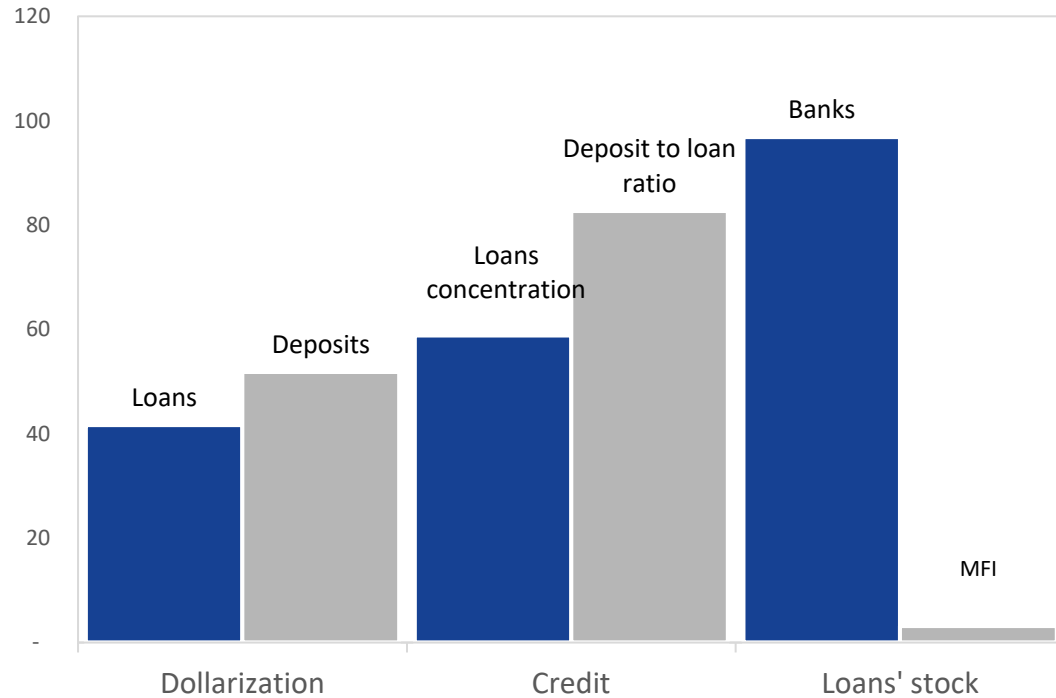
- Solid capital buffers
- Declining NPLs ratio since mid-2021
- Rising profitability
- Ample liquidity (LCR @129%)

Sources: National Bank of Georgia

Structural elements of Georgia's financial system remain broadly unchanged

Selected Financial Stability Indicators

(as of September 2023)

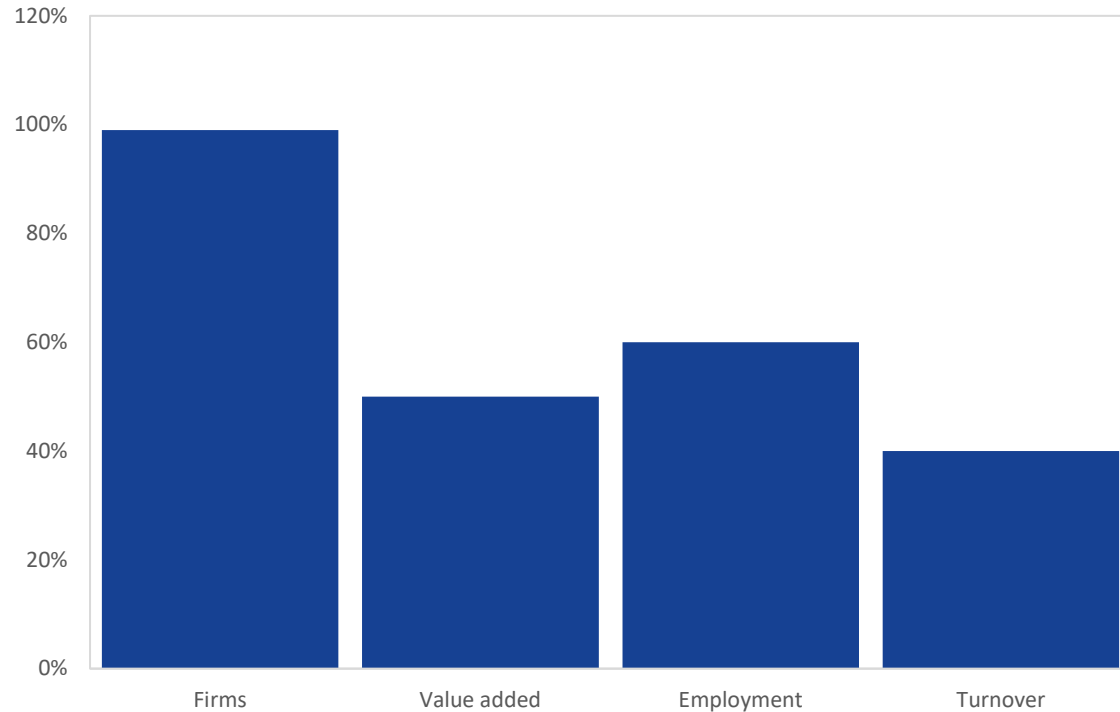


- Declining but still-high dollarization
- Aggregate leverage and loans' concentration
- Bank-centric financial system

Sources: National Bank of Georgia

Georgia's economy relies heavily on SMEs, [posing challenges to sustained growth]

SMEs in Georgia



Sources: Geostat, 2022

SMEs represent an important share of Georgia's economy

SMEs' growth faces several obstacles:

- Informality
- Active in low value-added sectors
- Weak financial literacy
- Poor record keeping and business planning

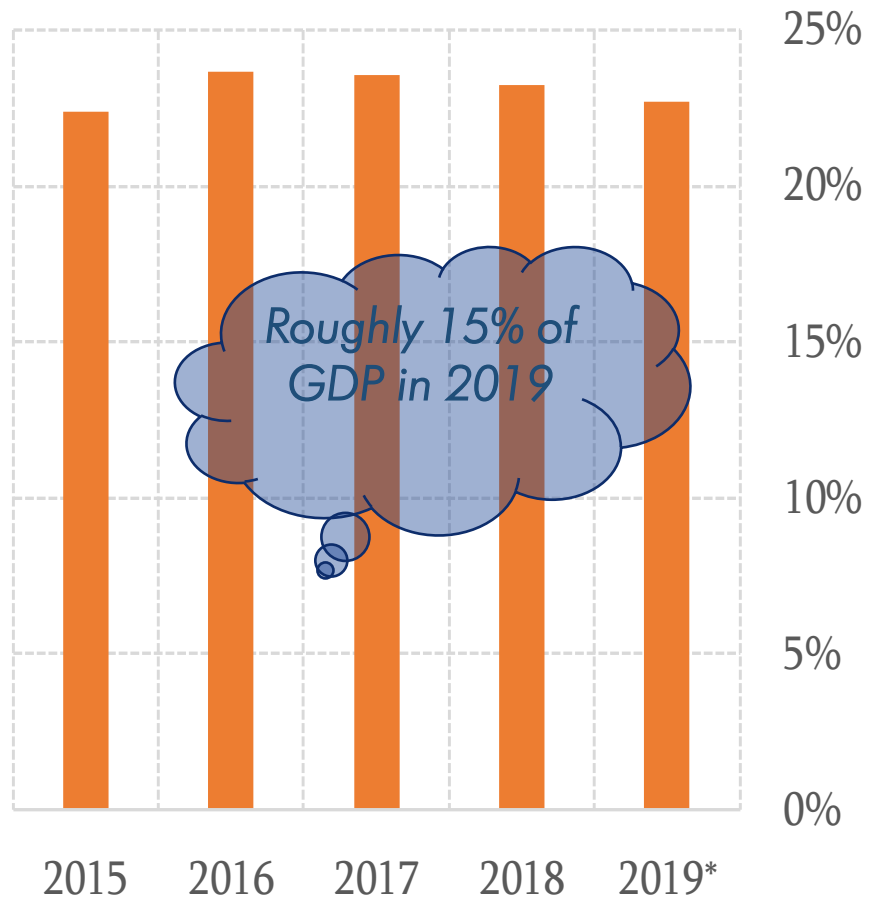
Supporting the expansion of innovative and dynamic SMEs is key to spur broader economic benefits and overcome some of the obstacles associated with the low firm size

SMEs

landscape

Steady share of SMEs lending

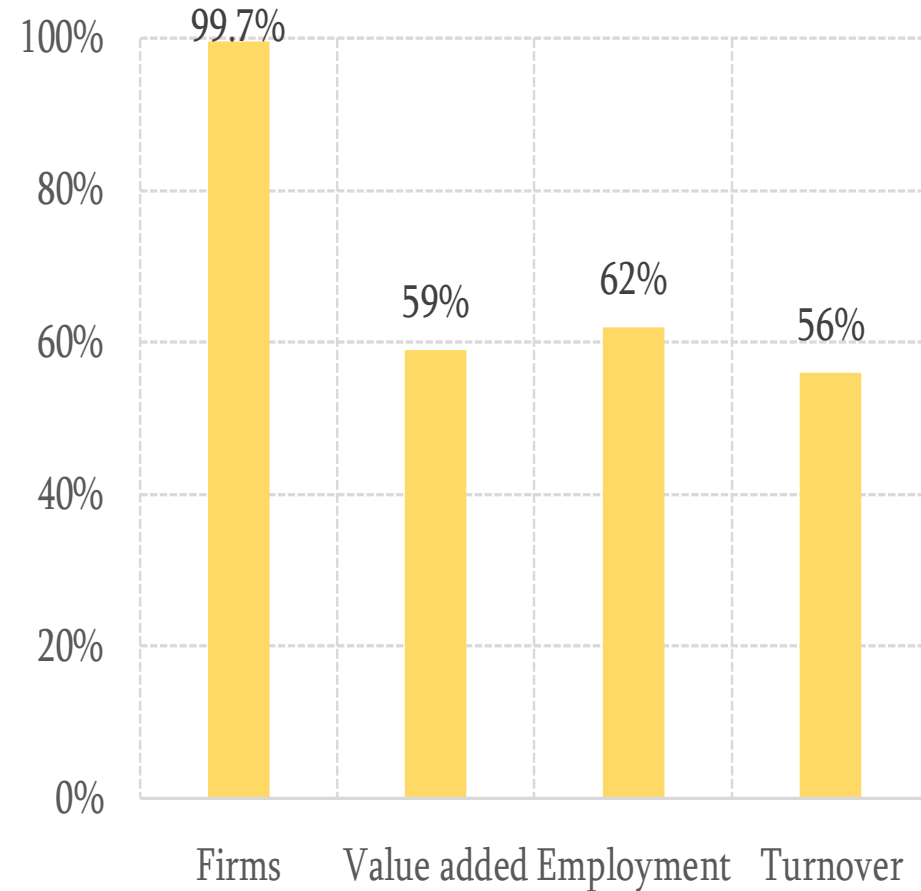
Share of SMEs loans in total loans



Source: Authors' calculation on National Bank of Georgia data

Mismatch: SMEs loan share lower than SMEs economic contribution

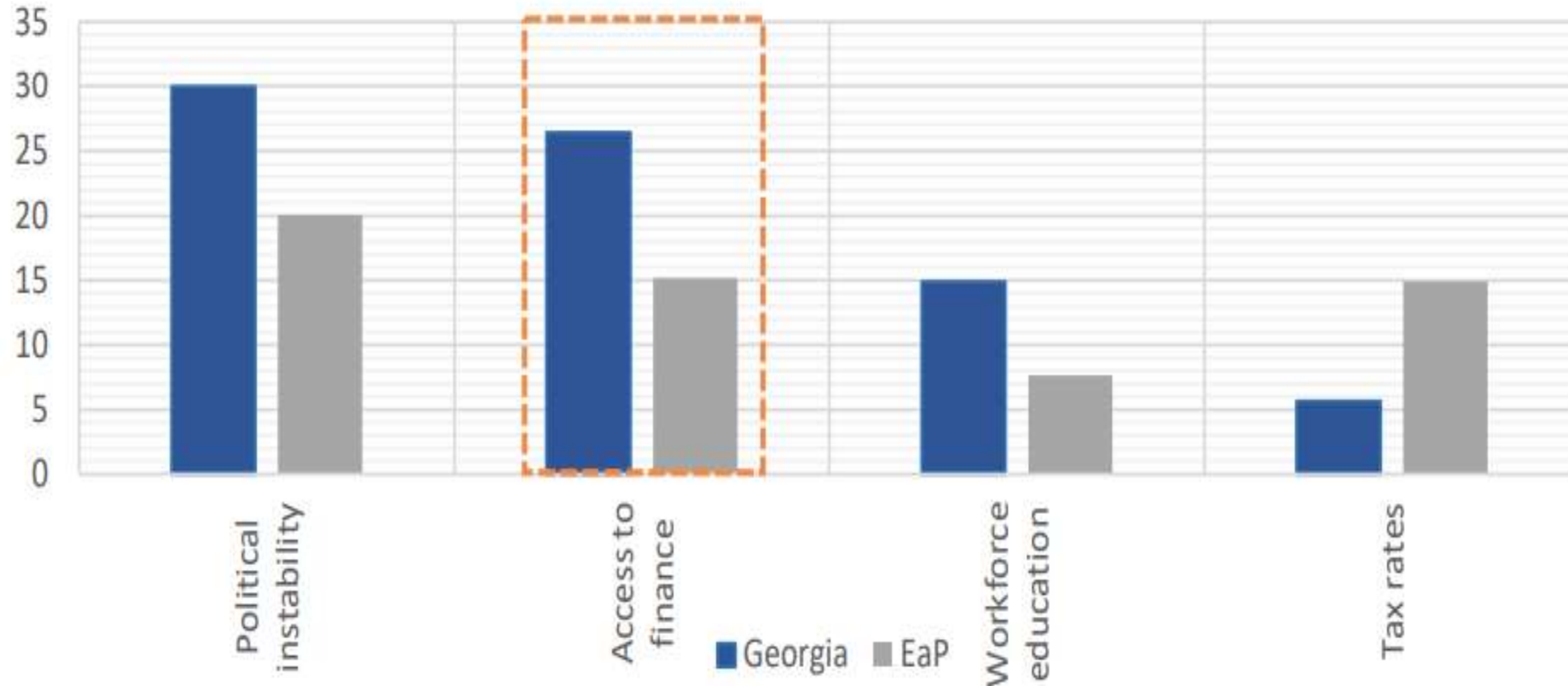
Size of the SMEs sector



Source: Authors' calculation on OECD and Geostat data

Access to finance still perceived as a relevant obstacle to firms' operations

Firms' four biggest obstacles to developing their businesses - % of all firms



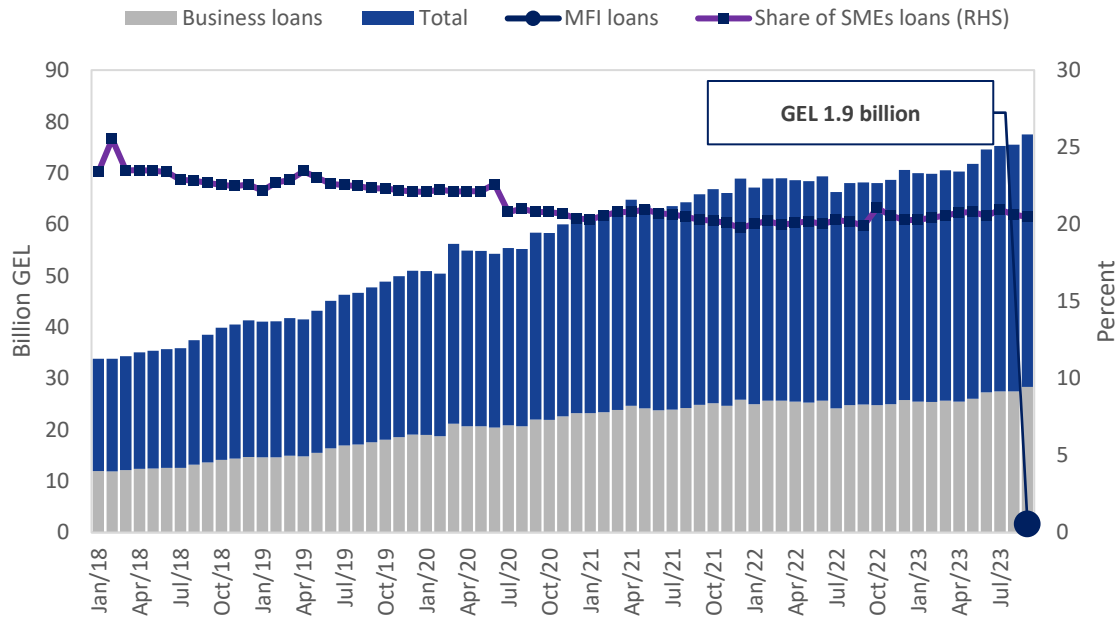
Source: EIB-EBRD-WBG Enterprise Survey

Despite progress, more needs to be done to overcome remaining obstacles

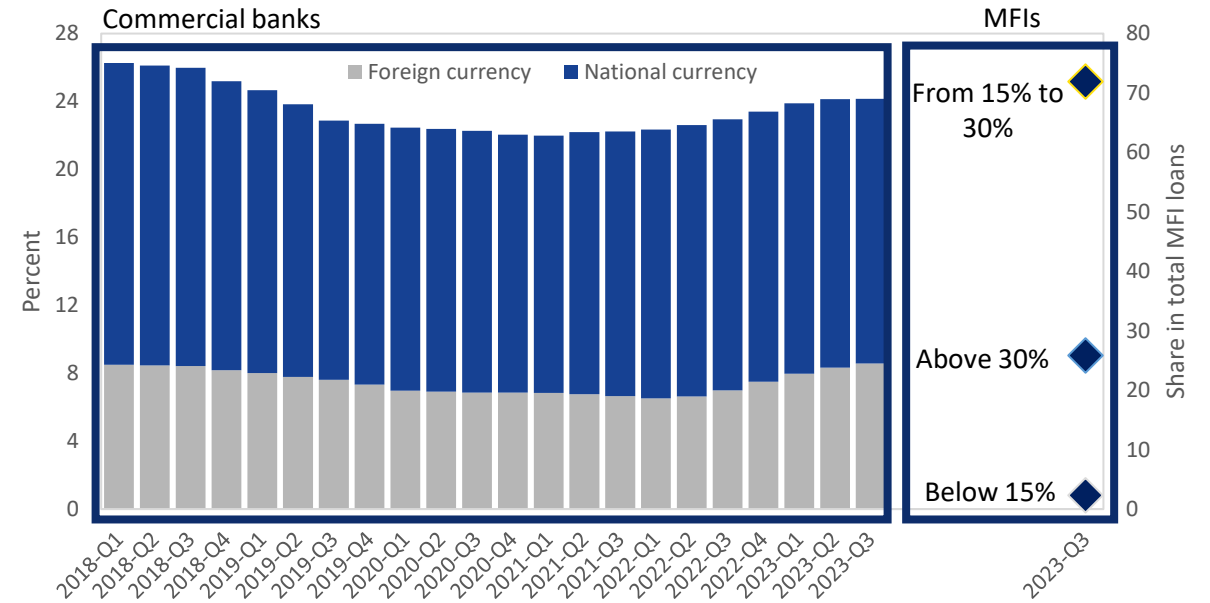
Commercial banks are the main source of firms' finance, with MFI growing rapidly but from a low base

Interest rates have been reversing earlier gains since the global monetary tightening cycle begun

Lending activity



Interest rates on loans
(annual weighted average)



Source: National Bank of Georgia, author's calculations

Shock after shock - What did we learn during the pandemic? Structural features matter for firms resilience and adaptation

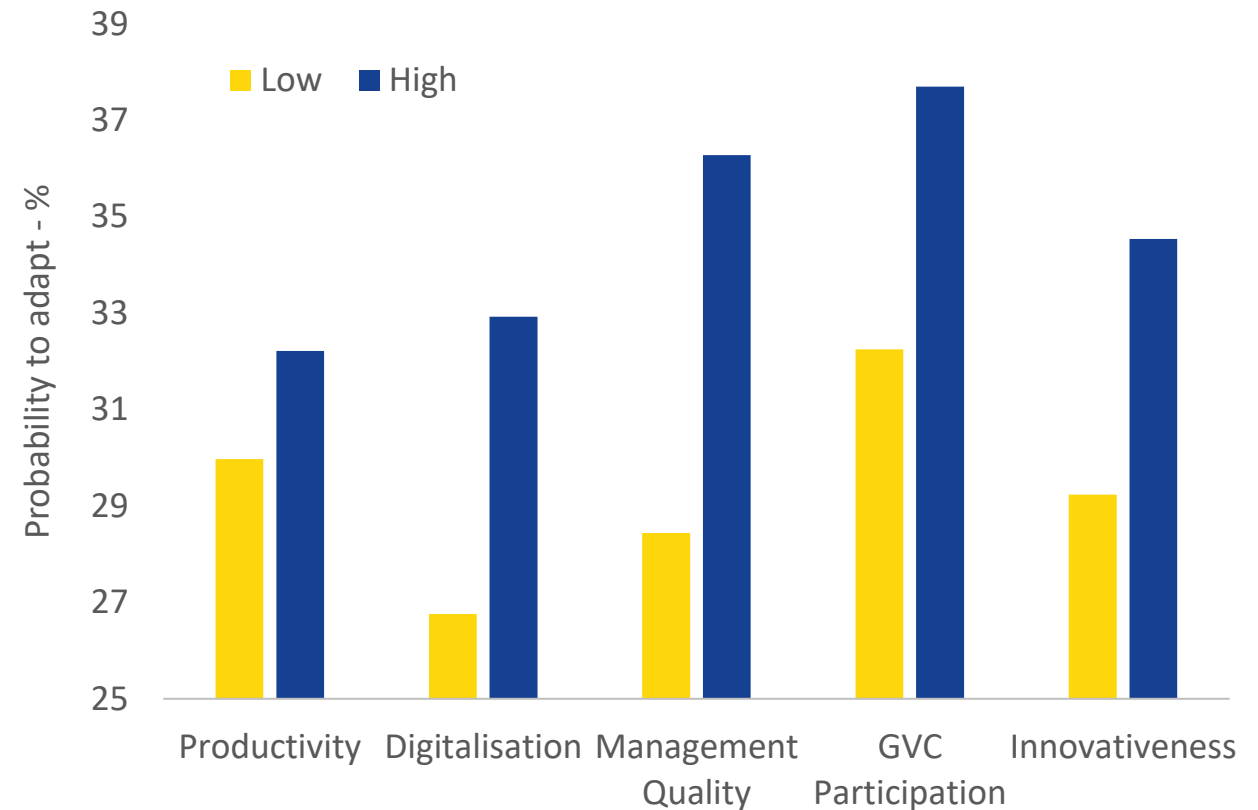
Resilience: probability of bankruptcy

reduced by:

- ✓ Being **part of a group**
- ✓ Having a pre-existing **overdraft facility**
- ✓ Being in a country which implemented stronger **policy support for corporates**

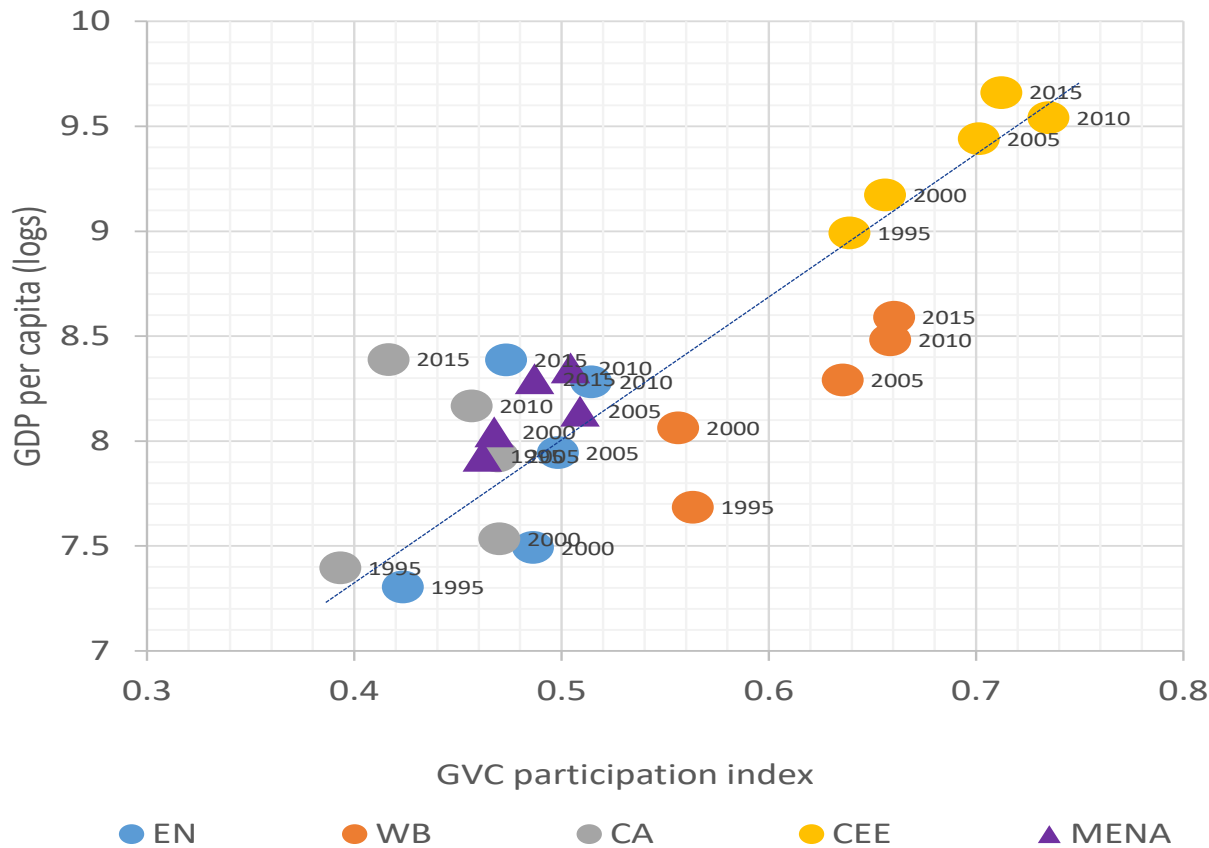
Adaptation: probability to adapt

(based on firms characteristics, high vs low performers)



In an accession context GVC participation is a crucial driver of growth and firms transformation

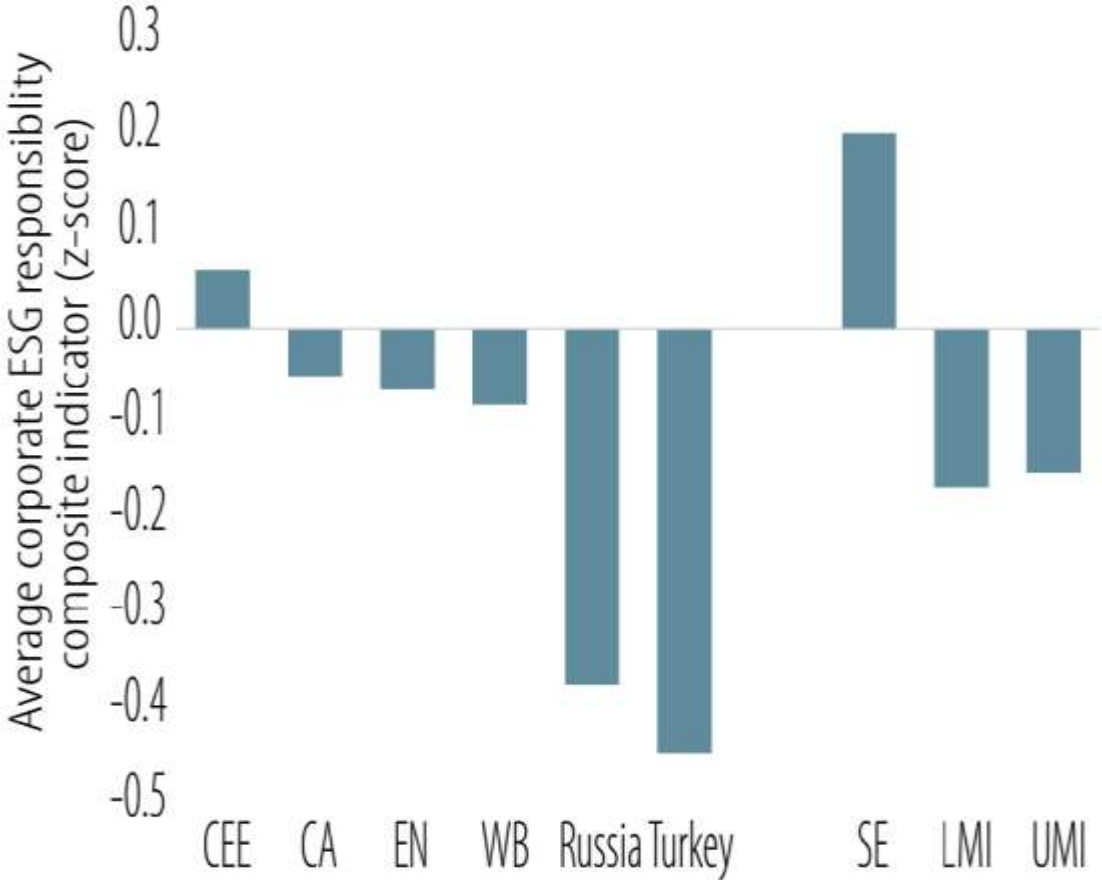
Participation in GVCs and per capita Real GDP
(1995-2015)



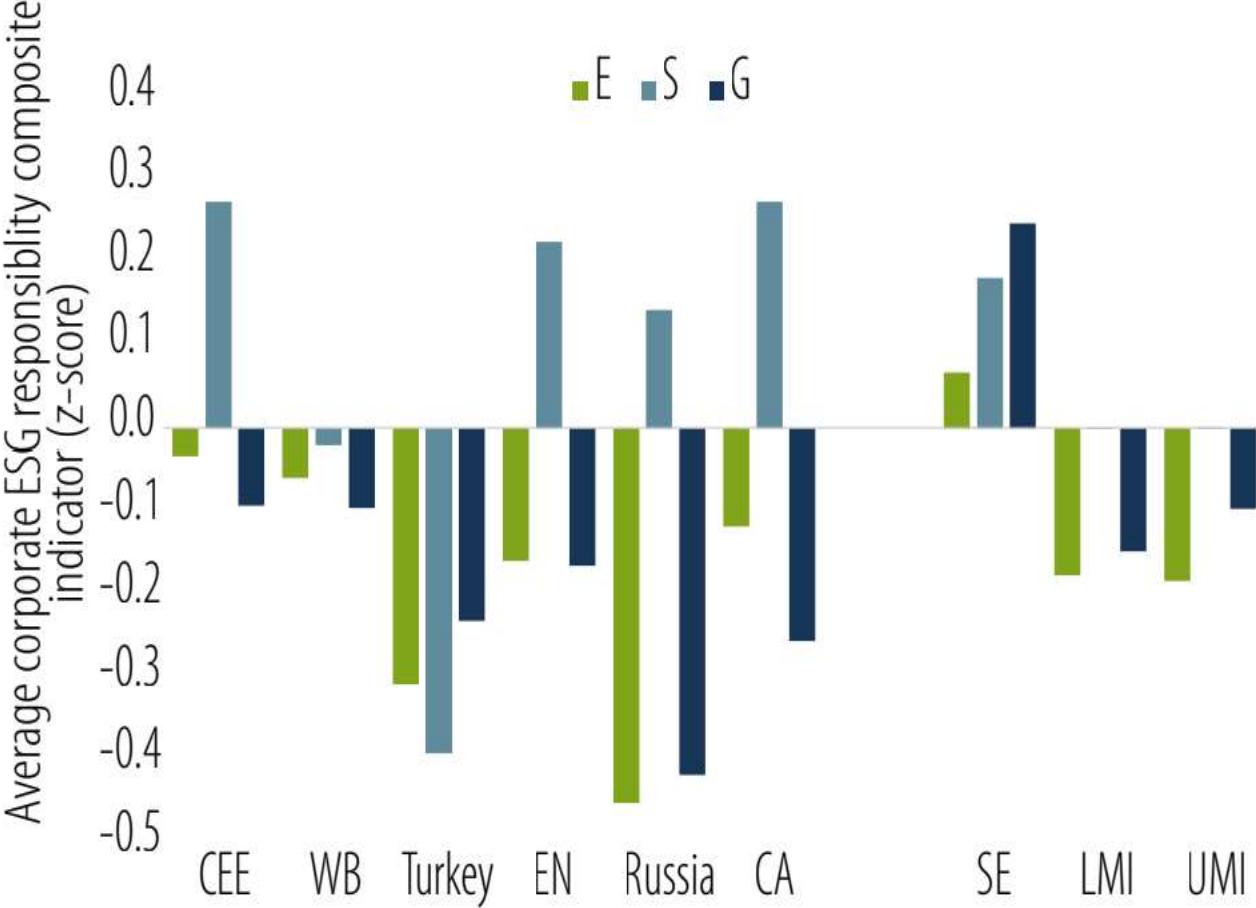
- ✓ **Export/GVC linked to innovation:** evidence of causality through better management and transfer of technology
- ✓ **Asymmetric returns across firms:** Productivity and growth premia for superstar exporters, large firms and firms engaging in trade & innovation
- ✓ **EU confirmed as trade facilitator and driver of innovation**

Low performance on ESG, particularly on “E” and somewhat on “G”

Average quality of Corporate ESG responsibility composite indicator

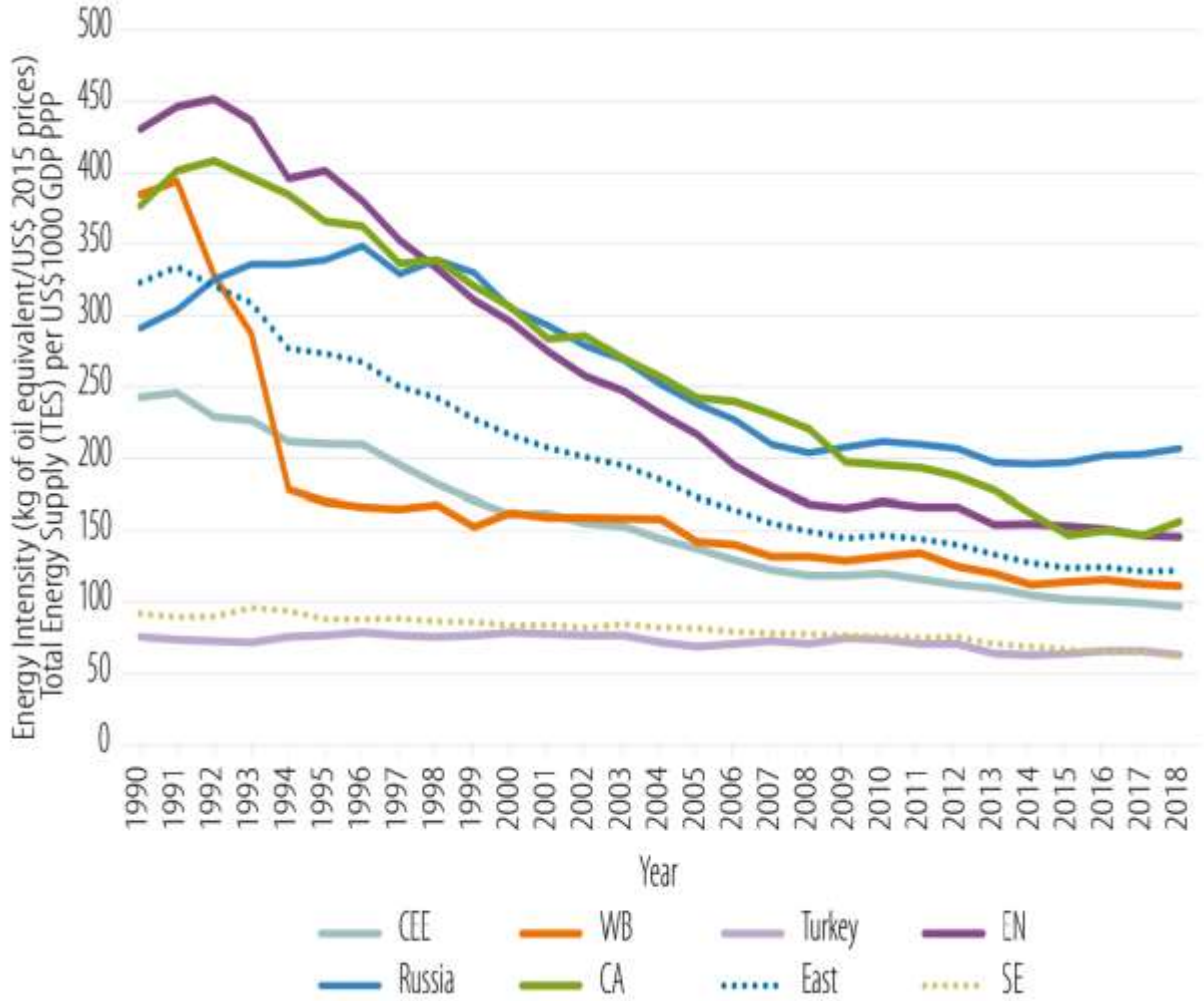


Average quality of Corporate ESG responsibility pillars - composite indicator



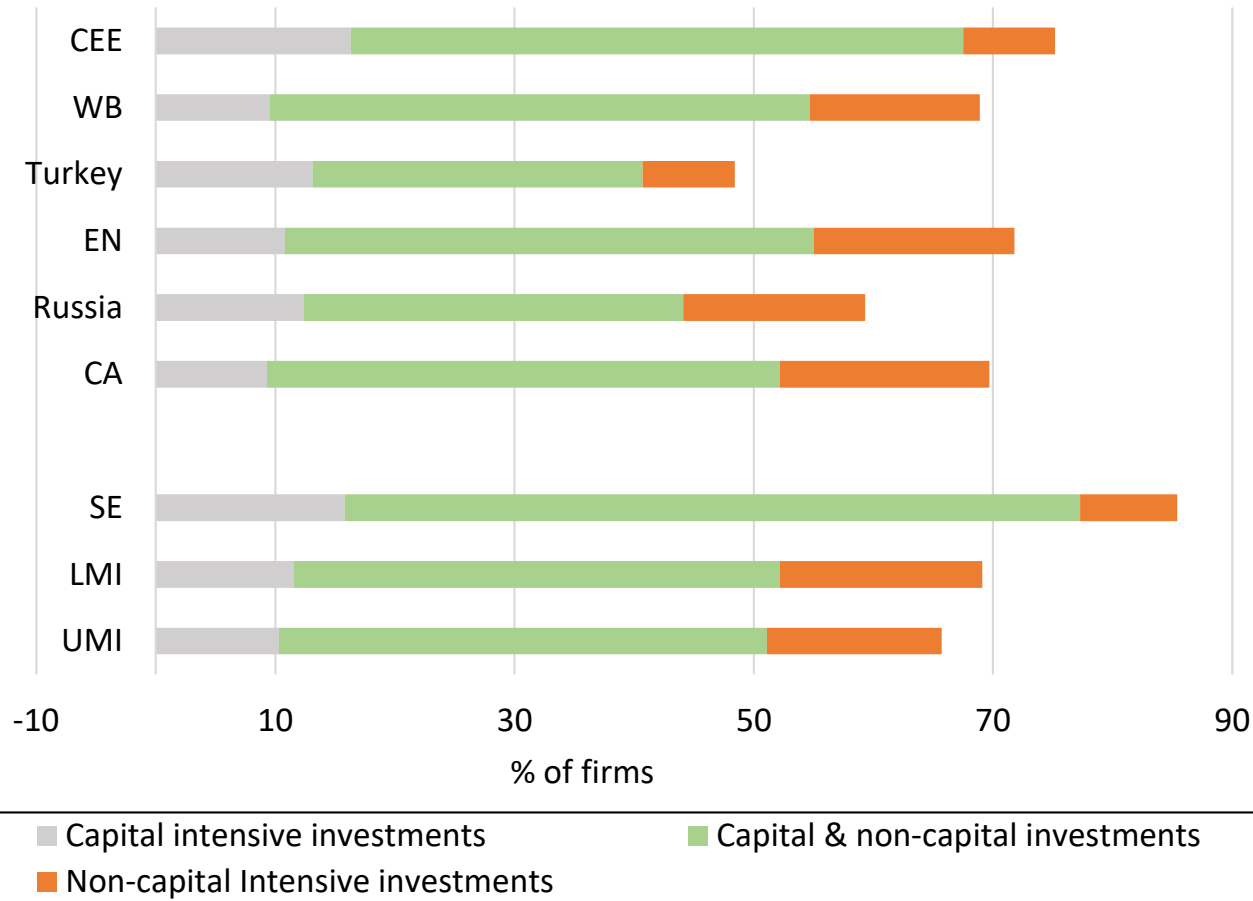
Energy intensity still elevated and for net-zero transition still lot to do

Carbon emission per unit of GDP



The net zero transition poses challenges, with wrong incentives from fossil fuel subsidies and capacity constraints

Green investment



✓ Firms' green managerial capacity and ESG influenced by:

- ✓ Customer pressure, energy taxes and experience with climate risk
- ✓ firm size, foreign ownership, exporters, listed firms

✓ Access to finance

- ✓ Green credit lines by banks becoming more common
- ✓ But many energy and resource efficiency investments made by small firms are too big for microfinance institutions and

EPTFAT project and Enterprise

Survey

- The World Bank, EBRD, and EIB have fielded Enterprise Surveys in 43 countries, more than 28k observations
- EPTATF grant financed a survey covering 2,500 firms in EaP region: Armenia, Azerbaijan, Georgia, Moldova and Ukraine
- **ES data** are a global public good
- **Analytical report** on the key impediments to private sector development in Eastern Neighborhood (EaP), Central Eastern Europe, Central Asia and Western Balkans
- Inter-institutional collaboration with EBRD, EIB and IMF with report to be released in Q4 2021