

*Working Papers*



Technische Hochschule  
Ingolstadt

*Zukunft in  
Bewegung*



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## ***The Economic Development Vector for SMEs in Germany and Georgia***

### ***Abstract***

Small and medium-sized enterprises (SMEs) play an important role in the development of the economy and contribute significantly to ensure sustainability, economic growth and wealth of nation. A strong and well-developed SME sector contributes significantly to innovation, exports and the creation of a modern entrepreneurial culture.

The main task of the research was about SMEs in Germany and Georgia. The question of research was about concomitant economic conditions and how well the segment of SMEs in the Georgian economy is developing. As a result it can be stated that the economic environment is of high importance and clear recommendations for action can be derived.

Keywords: development of economy, small and medium-sized enterprises (SMEs), gross domestic product (GDP), inflation, corona crisis

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# The Economic Development Vector for SMEs in Germany and Georgia

Günter Hofbauer und Ioseb Masurashvili

## 1. Introduction

Small and medium-sized enterprises are considered to be a guarantee for economic growth and employment. Eradicating poverty through economic growth has become a central scope of the international community. This entails poverty reduction approaches that see the poor as contributors to the growth process instead of mere beneficiaries of its outputs. As such, the promotion of productive employment and earnings increases, especially for the poor, have become important elements of poverty reduction strategies. The private sector is seen as the key driver of employment creation. In developing countries it consists of a large number of very small firms. Many workers, especially among the poor, are self-employed own-account workers and very few firms hire more than ten workers. Moreover, the majority of these firms are of low profitability and productivity, and do not have the potential to grow substantially, while there are a few small firms which are being held back by constraints such as a lack of finance or a hostile business environment. The Government of Georgia pays particular attention to enhancing the competitiveness of the private sector and in particular SMEs in the context of the EU-Georgia Association Agreement (an integral part of which is the Deep and Comprehensive Free Trade Area Agreement (DCFTA)). Adaptation and compliance with DCFTA requirements are particularly important for Georgia in order for businesses to make the most of their export potential. Consequently, in addition to legislative and institutional approximation, the compliance of the DCFTA with the private sector, including SMEs, is of great importance<sup>1</sup>.

SMEs play an important role in the economy. As globalization proceeds, transition and developing countries and their enterprises face major challenges in strengthening their human and institutional capacities to take advantage of trade and investment opportunities. This has become a top priority on the global development agenda over the past few years. Small and medium-sized enterprises (SMEs) are a very heterogeneous group. SMEs are found in a wide array of business activities, ranging from the single artisan producing agricultural products, the coffee shop at the corner, the internet café in a small town to a small sophisticated engineering or software firm selling in overseas markets and a medium-sized automotive parts manufacturer selling to multinational automakers in the domestic and foreign markets. The owners may or may not be poor; the firms operate in very different markets (urban, rural, local, national, regional and international); embody different levels of

<sup>1</sup> <http://www.dcfta.gov.ge/en/agreement> (last seen February 10, 2020).

skills, capital, sophistication and growth orientation, and may be in the formal or the informal economy.

In developed countries, such as Germany, small and medium enterprises occupy a large contribution in the operating enterprises, create over 50% of total turnover of the entrepreneurial sector and two from in each three jobs in the private sector. In the OECD-countries (Organization for Economic Cooperation and Development), more than 99% of companies are small and medium enterprises and create on average 2/3 of gross domestic product (GDP). In developing and transition economies over 90% of the total number of enterprises are small and medium enterprises, but their share in the GDP is generally quite low – in many cases less than 20%<sup>2</sup>.

SME products and services “invisible” or less noticeable are characterized by a high level of reliability and viability, have significant export market share, are global competitors and contribute a high share to the success of the country.

A major factor in the formation of small businesses is the current legislative environment in Georgia. After the second half of the 1990s there were made significant efforts for the establishment of institutional basis for SMEs in Georgia. In recent years, Georgia has made significant reforms, including economic reforms, which main objective was creating good environment for doing business and for foreign direct investments, by liberalizing the economy, reducing the administrative barriers and tax burden, improving public services, fight corruption, and in other ways. As a result of these reforms, Georgia has high economic growth rates. In addition, significantly increased foreign direct investments in the country. Economic policy has been positively evaluated by the various rating agencies and international financial institutions and appropriate results were reflected in the indices and in the ratings, which are rated the economic freedom of countries<sup>3</sup>.

The first part of the article discusses about Gross Domestic Product, Inflation, Corona Crisis in Germany and the experience in the SMEs related in Germany. The second part the paper discusses Gross Domestic Product, Inflation and Corona Crisis in Georgia and directly main directions of development of SMEs in Georgia on the basis of statistical analysis and it provides strategic priorities of the development of SMEs in Georgia.

## **2. Economic background in Germany**

### **2.1 GDP of Germany**

The Gross Domestic Product of Germany fell 2.2% in the first quarter of 2020 compared to the previous quarter (table 1, scheme 1).

<sup>2</sup> Dialogue on «SME Policy» with regard to the multilateral framework of the Eastern Partnership 2010, p. 45.

<sup>3</sup> I.Masurashvili, A.Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. “Modern Management Review”, Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016). p. 115.

The year-on-year change in GDP was -2,3%. This is 2.7 % less than the 0,4 % recorded in the fourth quarter of 2019. The GDP figure in the first quarter of 2020 was 847,440 mIn EUR, leaving Germany placed 3rd in the ranking of quarterly GDP of the top 50 countries. In Germany there is a quarterly GDP per capita, of 10,522 EUR. If we order the countries according to their GDP per capita, Germany is in 14th position of the top 50 countries.

The gross domestic product (GDP), the total production of goods and services, was almost unchanged from the previous quarter (table 2). Germany is very exposed to the tensions in international trade, and the weak new figures partly reflect a fall in overseas exports. Although there was some expansion, growth was reported at 0.0% when rounded to one decimal place by the German statistics office. The sluggish performance was down partly to a decline in exports. Investment in machinery and equipment was also "down considerably" between October and December.

**Table 1. Gross Domestic Product of Germany**

Year, quarter	At current prices				Price-adjusted, chain-linked							
	unadjusted figures		seasonally and calendar-adjusted figures using Census X13		unadjusted figures		figures using Census X13					
							calendar factors 1)	calendar effect 2)	calendar-adjusted 3)		seasonally and calendar-adjusted	
1	2	3	4	5	6	7	8	9	10	11	12	
	EUR bn.	% 4)	EUR bn.	% 5)	2015 = 100	% 4)	% 4)	2015 = 100	% 4)	2015 = 100	% 5)	
2015	3 030.070	3.5	3 026.986	3.3	100.00	1.7	100.10	0.2	99.90	1.5	99.90	1.5
2016	3 134.100	3.4	3 128.355	3.3	102.23	2.2	100.18	0.1	102.04	2.1	102.04	2.1
2017	3 244.990	3.5	3 248.733	3.8	104.75	2.5	99.89	-0.3	104.87	2.8	104.87	2.8
2018	3 344.370	3.1	3 348.877	3.1	106.35	1.5	99.87	0.0	106.49	1.5	106.49	1.5
2019	3 435.210	2.7	3 441.032	2.8	106.95	0.6	99.83	0.0	107.13	0.6	107.13	0.6
2015 Q1	738.030	3.0	746.428	0.5	98.03	1.3	99.85	0.1	98.17	1.2	99.10	-0.2
Q2	743.600	3.7	755.270	1.2	98.51	1.8	99.68	0.0	98.83	1.8	99.72	0.6
Q3	766.750	3.5	760.572	0.7	101.06	1.8	100.23	0.1	100.83	1.7	100.17	0.5
Q4	781.690	3.9	764.716	0.5	102.40	2.1	100.62	0.8	101.77	1.3	100.61	0.4
2016 Q1	762.120	3.3	774.042	1.2	99.97	2.0	99.47	-0.4	100.50	2.4	101.41	0.8
Q2	779.710	4.9	780.675	0.9	102.14	3.7	101.04	1.4	101.09	2.3	101.99	0.6
Q3	789.190	2.9	784.705	0.5	102.96	1.9	100.11	-0.1	102.84	2.0	102.20	0.2
Q4	803.080	2.7	788.933	0.5	103.85	1.4	100.10	-0.5	103.74	1.9	102.57	0.4
2017 Q1	793.760	4.2	796.975	1.0	103.58	3.6	100.67	1.2	102.89	2.4	103.79	1.2
Q2	796.100	2.1	807.133	1.3	103.17	1.0	99.73	-1.3	103.45	2.3	104.37	0.6
Q3	818.420	3.7	818.595	1.4	105.54	2.5	99.67	-0.4	105.89	3.0	105.27	0.9
Q4	836.710	4.2	826.030	0.9	106.71	2.8	99.51	-0.6	107.24	3.4	106.04	0.7
2018 Q1	819.260	3.2	828.521	0.3	105.28	1.6	99.99	-0.7	105.30	2.3	106.18	0.1
Q2	827.660	4.0	835.694	0.9	105.75	2.5	100.09	0.4	105.66	2.1	106.59	0.4
Q3	836.960	2.3	838.384	0.3	106.69	1.1	99.62	0.0	107.09	1.1	106.48	-0.1
Q4	860.490	2.8	846.278	0.9	107.66	0.9	99.78	0.3	107.90	0.6	106.70	0.2
2019 Q1	843.530	3.0	853.873	0.9	106.24	0.9	99.88	-0.1	106.36	1.0	107.21	0.5
Q2	845.610	2.2	856.950	0.4	105.69	-0.1	99.70	-0.4	106.00	0.3	106.95	-0.2
Q3	864.310	3.3	862.325	0.6	107.95	1.2	100.11	0.5	107.83	0.7	107.23	0.3
Q4	881.760	2.5	867.884	0.6	107.90	0.2	99.62	-0.2	108.31	0.4	107.12	-0.1
2020 Q1	847.440	0.5	854.569	-1.5	104.22	-1.9	100.28	0.4	103.93	-2.3	104.74	-2.2

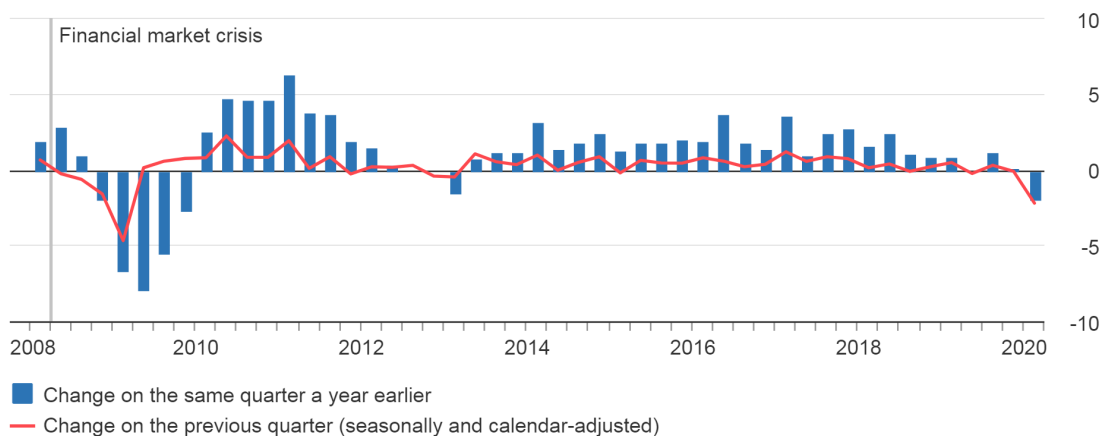
Source: <https://www.destatis.de/>

We can see from table 1 about the GDP in the 1st quarter of 2020:

- 2.2% on the previous quarter (price-, seasonally and calendar-adjusted)
- 1.9% on the same quarter a year earlier (price-adjusted)
- 2.3% on the same quarter a year earlier (price- and calendar-adjusted).

The corona pandemic hits the German economy hard. Although the spread of the coronavirus did not have a major effect on the economic performance in January and February, the impact of the pandemic is serious for the 1st quarter of 2020. The gross domestic product (GDP) fell down by 2.2% on the 4th quarter of 2019 upon price, seasonal and calendar adjustment. That was the largest decrease since the global financial and economic crisis of 2008/2009 and the second largest decrease since German unification. A larger quarter-on-quarter decline was recorded only for the 1st quarter of 2009 (-4.7%).

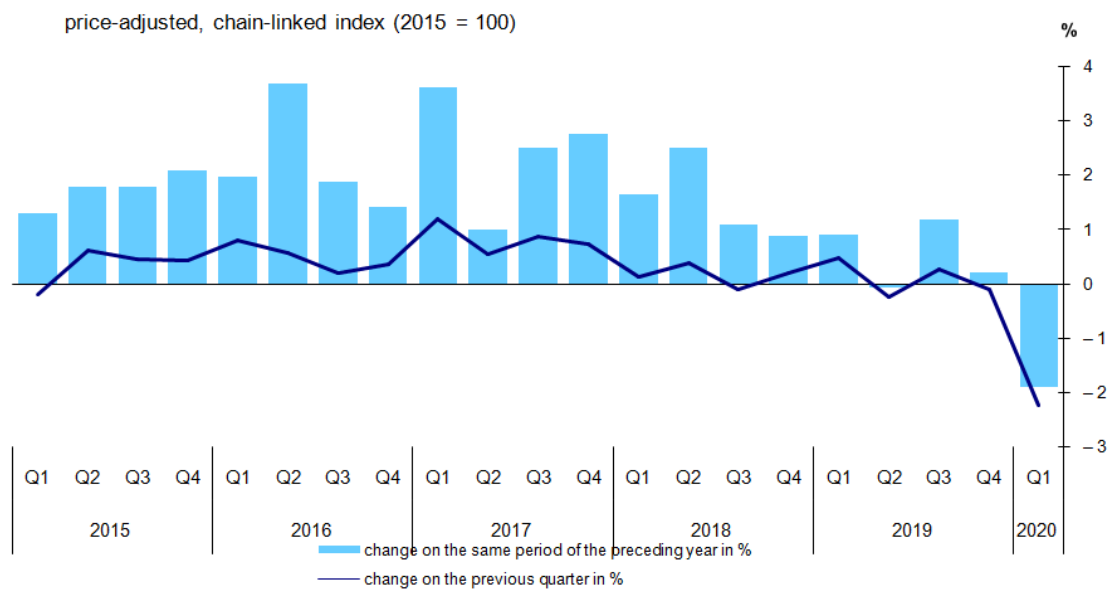
**Scheme 1. GDP Development of Germany (2008-2020)**



Source: <https://www.destatis.de/>

The statistics office doesn't offer an explanation, but it is certainly possible that this reflects the uncertain outlook for international trade. One factor that is likely to weigh on manufacturing firms when considering whether to invest is, what sort of barriers they will face, which could make it more difficult to sell their goods abroad.

## Scheme 2. GDP of Germany (Q1-Q4 2015-2020)



Source: <https://www.destatis.de/>

Exporting really matters to German industry. The country is the third-largest exporter of goods after the United States and China, which are both much larger economies. Manufacturing accounts for a larger share of German economic activity than it does for most other developed economies: 20% compared with 9% for the UK, for example, and 10% for the US. Germany is very exposed to the tensions in international trade that have arisen, or at least become more intense, since US President Donald Trump took office. That related directly to new tariffs that his administration has applied to aluminium and steel tariffs, and indirectly to the trade war between the US and China. Because both countries are important markets for German industry, any damage they inflict on one another can affect sales of German goods.

Germany would also be vulnerable if US President Donald Trump was to act on his threat to impose 25% tariffs on imports of cars from the European Union. Economic growth in Germany has been relatively weak over the last two years. There have been two quarters when GDP has declined. These have not taken place consecutively, though there has been no recession as the term is often defined - two back-to-back quarters of negative growth. The wider Eurozone has also been affected and that was underlined by new figures published by the EU's office for statistics, Eurostat. It confirmed its earlier estimate that the Eurozone managed growth of just 0.1% in the last quarter of 2019.

Germany is the area's largest economy, so the Eurozone's figures are, as a matter of arithmetic, dragged down when Germany has a weak period. But the next two largest economies also had a bad end to last year. Both Italy and France saw their national economies shrink. Germany and the Eurozone may have had a downbeat period in terms of growth, employment has been more encouraging.

New figures show an increase of 0.3% in the number of people, who do have jobs in the Eurozone. Germany has one of the lowest unemployment rates in the world. Some countries notably Spain and Greece still have a serious problem.

But for both, the Eurozone and those nations, unemployment has fallen far from the highs it reached in the last decade.

**Table 2.**

**Gross domestic product, gross national income, net national income (factor costs) (per capita data)**

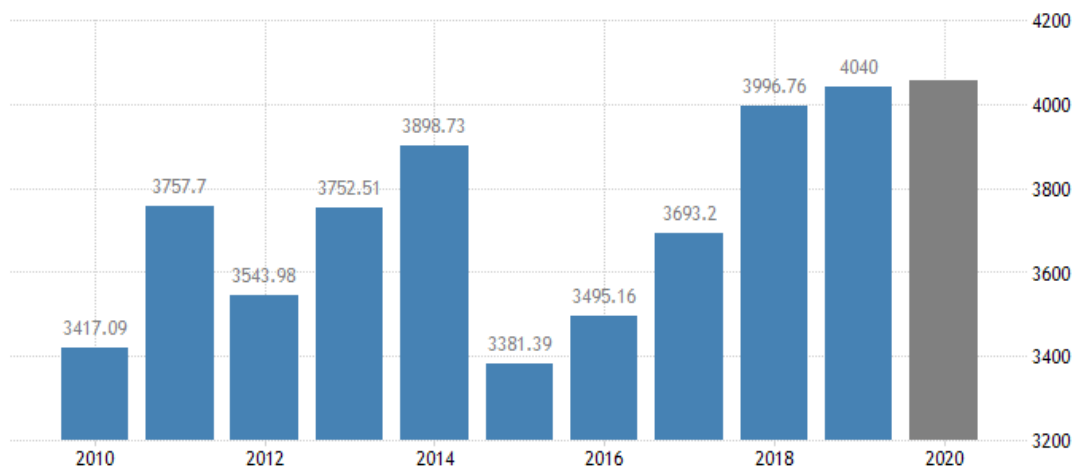
Year, quarter	Gross domestic product						Gross national income		Net national income (factor costs)				
	at current prices			price-adjusted			at current prices						
	total	per person in employment	per inhabitant 1)	total, chain-linked index	per person in employment	per inhabitant 1)	total	per inhabitant 1)	total	per inhabitant 1)			
	1	2	3	4	5	6	7	8	9	10			
EUR bn.		EUR		Index (2015 = 100)		EUR bn.		EUR		EUR bn.		EUR	
2015	3 030.070	70 267	37 094	100.00	100.00	100.00	3 099.023	37 938	2 259.375	27 659			
2016	3 134.100	71 792	38 059	102.23	100.98	101.41	3 211.263	38 996	2 346.118	28 490			
2017	3 244.990	73 336	39 259	104.75	102.09	103.52	3 328.026	40 263	2 430.531	29 405			
2018	3 344.370	74 561	40 339	106.35	102.24	104.79	3 437.908	41 468	2 503.079	30 192			
2019	3 435.210	75 940	41 346	106.95	101.95	105.15	3 534.824	42 545	2 560.225	30 815			
2015 Q1	738.030	17 331	9 069	98.03	99.27	98.39	757.558	9 309	549.714	6 755			
Q2	743.600	17 276	9 123	98.51	98.70	98.73	745.508	9 147	537.688	6 597			
Q3	766.750	17 700	9 381	101.06	100.60	101.00	788.086	9 642	576.546	7 054			
Q4	781.690	17 953	9 519	102.40	101.42	101.86	807.871	9 837	595.427	7 251			
2016 Q1	762.120	17 670	9 270	99.97	99.95	99.33	785.051	9 549	569.824	6 931			
Q2	779.710	17 896	9 474	102.14	101.10	101.38	784.135	9 528	569.619	6 921			
Q3	789.190	18 006	9 580	102.96	101.30	102.09	809.772	9 829	592.275	7 189			
Q4	803.080	18 214	9 734	103.85	101.56	102.82	832.305	10 089	614.400	7 447			
2017 Q1	793.760	18 156	9 617	103.58	102.16	102.50	817.349	9 902	593.662	7 192			
Q2	796.100	18 030	9 635	103.17	100.76	102.01	802.006	9 707	579.426	7 013			
Q3	818.420	18 418	9 897	105.54	102.42	104.26	840.977	10 170	616.072	7 450			
Q4	836.710	18 725	10 108	106.71	102.98	105.31	867.694	10 483	641.371	7 748			
2018 Q1	819.260	18 460	9 893	105.28	102.29	103.85	845.197	10 206	613.035	7 403			
Q2	827.660	18 484	9 990	105.75	101.84	104.27	836.002	10 091	602.427	7 272			
Q3	836.960	18 593	10 092	106.69	102.20	105.09	862.628	10 402	626.904	7 559			
Q4	860.490	19 019	10 363	107.66	102.61	105.91	894.081	10 768	660.713	7 957			
2019 Q1	843.530	18 791	10 159	106.24	102.06	104.53	870.034	10 479	627.421	7 557			
Q2	845.610	18 705	10 182	105.69	100.81	103.95	856.780	10 316	614.959	7 405			
Q3	864.310	19 061	10 402	107.95	102.65	106.12	891.814	10 733	646.529	7 781			
Q4	881.760	19 378	10 602	107.90	102.26	105.98	916.196	11 016	671.316	8 072			
2020 Q1	847.440	18 817	10 195	104.22	99.79	102.42	874.624	10 522	627.898	7 554			

Source: <https://www.destatis.de/>

The Gross Domestic Product (GDP) of Germany was worth 4040 billion US dollars in 2019, according to official data from the World Bank and projections from Trading Economics. This value of Germany represents 3.33 percent of the world economy (Scheme 3).



### Scheme 3. GDP of Germany (bn USD)



## 2.2 Consumer price index (inflation) in Germany

The consumer price index for Germany as of December 2018 shows:

- +1.7% on the same month of previous year (provisional);
- +0.1% on the previous month (provisional).

The harmonised index of consumer prices<sup>4</sup> as of December 2018 shows:

- +1.7% on the same month of previous year (provisional);
- +0.3% on the previous month (provisional).

The inflation rate in Germany as measured by the consumer price index is expected to be 1.7% in December 2018. Compared with November 2018, consumer prices are expected to increase by 0.1%. Based on the results available so far, the Federal Statistical Office (Destatis) also reports that, on an annual average, the inflation rate is expected to be at 1.9% in 2018.

In December 2018, the harmonised index of consumer prices for Germany, which is calculated for European purposes, is expected to increase by 1.7% year on year. Compared with November 2018, it is expected to be up 0.3%. On an annual average, the harmonised index of consumer prices is expected to increase by 1.9% in 2018 compared with 2017.

The consumer price index, December and year 2019, shows:

- +1.5% on the same month for previous year (provisional result confirmed);
- +0.4% on the previous month (provisional result confirmed);
- +1.4% on an annual average in 2019 compared with 2018 (provisional result confirmed).

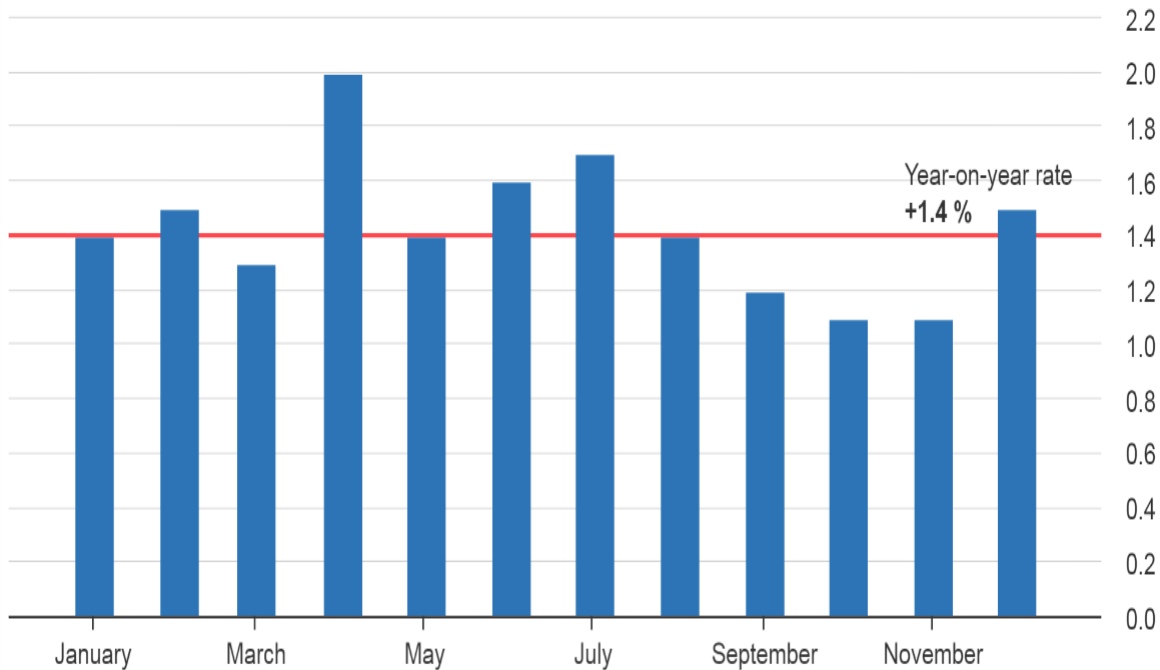
<sup>4</sup> <https://www.destatis.de/EN/> - Impact of the corona crisis on the CPI/HICP price collection. p.7.

Consumer prices in Germany rose by 1.4% in 2019 on an annual average basis compared with 2018. The Federal Statistical Office (Destatis) also reports that the year-on-year rate of price increase was lower in 2019 than in the previous year (2018: +1.8%). In December 2019, the inflation rate as measured by the consumer price index was higher than in the previous months, reaching +1.5% (scheme 4).

**Scheme 4. Inflation in Germany**

**Consumer price index 2019**

2015=100, Change on the previous year in %



Source: <https://www.destatis.de/>

For the change in 2019 in comparison to 2018 can be stated:

The prices of energy products were up 1.4% in 2019 year on year, following a 4.6% rise in 2018. The small rise in energy prices recorded for 2019 was mainly due to lower mineral oil product prices (-1.8%; of which heating oil: -2.5%; motor fuels: -1.6%). Nevertheless, the prices of some energy products went up considerably (for instance natural gas: +3.9%; electricity: +3.4%). Excluding energy prices, the year-on-year rate of price increase in 2019 would have been +1.4% as well.

Food prices also rose only slightly in 2019 compared with 2018 (+1.4%). However, there were some contrary price trends for individual products: marked price increases were

recorded for vegetables (+6.3%), meat and meat products (+3.1%). In contrast to that, consumers paid lower prices for edible fats and oils (-6.0%) and fruit (-3.3%).

The prices of goods (total) increased by 1.3% in 2019 on 2018. The highest price increases were recorded for non-durable consumer goods (+1.5%). Apart from food and energy prices (+1.4% each), higher prices were recorded especially for tobacco products (+3.7%) and printed matter (+3.4%). The prices of durable consumer goods rose by only 0.7% over the same period. Prices were even markedly lower for telephones (-6.8%) and information processing equipment (-5.6%).

Compared with goods, the prices of services (total) increased somewhat more in 2019 from 2018 on an annual average basis (+1.5%; including net rents exclusive of heating expenses: +1.4%). In addition, notably higher prices had to be paid for the services of social facilities (+5.0%) and the maintenance and repair of vehicles (+4.5%) than in 2018.

The change in December 2019 compared to December 2018 shows:

Consumer prices in total were up 1.5% in December 2019 compared with December 2018. Hence the inflation rate increased at the end of the year (November and October 2019: +1.1% each). The higher inflation rate as compared with the previous months was mainly attributable to the development of energy prices, which in December 2019 were only 0.1% lower year on year (November 2019: -3.7% compared with November 2018). From December 2018 to December 2019, a price decline was recorded especially for heating oil (-6.2%) and motor fuels (-4.5%). The prices of energy products increased markedly, for example natural gas (+5.2%) and electricity (+4.1%). Excluding energy prices, the rate of inflation would have been 1.8% in December 2019.

Food prices rose by 2.1% between December 2018 and December 2019. Markedly higher prices were recorded for meat and meat products (+5.5%).

The year-on-year increase in the prices of goods (total) in December 2019 was below average (+1.2%), mainly as a result of the development of energy product prices. Apart from increased food prices, higher prices were recorded for tobacco products (+4.2%) and printed matter (+4.1%) in particular.

The prices of services (total) were up 1.8% over the same period. Among services, net rents exclusive of heating expenses were up 1.5%. The prices of some services increased even more substantially (for example services of social facilities: +5.2%; maintenance and repair of vehicles: +4.8%).

The change in December 2019 compared to November 2019 shows:

Compared with November 2019, the consumer price index rose by 0.5% in December 2019. The increase was largely attributable to the seasonally higher prices of package holidays (+21.1%).

Experts all over the world expect that the corona pandemic will have harder cuts for the economy than the financial and economic crisis of 2008 and 2009. In such a dynamic

situation, only real economic indicators can show how badly the pandemic actually affects the economy.

The corona pandemic badly hits the German economy: The gross domestic product fell by 2.2% in the first quarter of 2020. The lockdown decided by the federal and state governments to curb the corona pandemic has largely brought the German economy to a standstill since mid-March. Although the spread of the corona virus did not significantly affect economic performance in January and February, the impact of the pandemic is already serious for the first quarter of 2020. The German GDP decreased by 2.2% compared to the fourth quarter of 2019 - adjusted for price, seasonal and calendar effects. This was by far the largest decline since the global financial and economic crisis in 2008/2009 and the second largest decline since German unification. Only in the 1st quarter of 2009 was the decline even stronger, at -4.7% on the previous quarter.

Private consumer spending declined sharply in the first quarter of 2020. Investments in equipment - particularly in machinery, equipment and vehicles - also decreased significantly. By contrast, government consumer spending and investment in construction had a stabilizing effect and prevented an even harder decline in GDP in the first quarter of the year. In terms of foreign trade, both exports and imports fell sharply compared to the final quarter of 2019. Economic output also fell year-on-year: the GDP in the first quarter of 2020 was 1.9% lower than in the previous year after adjustment for prices. Only in the years of the financial and economic crisis of 2008/2009 there were declines compared to the same quarter of the previous year, the strongest at -7.9% in the 2nd quarter of 2009.

Despite the challenges in the current corona crisis, price statistics are working on the reliable provision of the national consumer price index (CPI) and the harmonised consumer price index (HCPI) as important economic indicators.

In times of the corona crisis, missing prices are increasing. In general, missing prices in price statistics are not unknown. They often occur seasonally – as for fruit, vegetables or clothing - but also when shops are closed due to holidays or in the event of catastrophes such as floods. The current corona crisis leads to missing prices and in addition to that, the on-site survey in shops is restricted. Nevertheless, a large number of goods can still be collected, since they are not affected by the corona crisis.

Since a national and European level approach is essential in this particular situation, there is continuous, close coordination with Eurostat, the statistical office of the European Union, and with the statistical offices of the states in Germany. On this basis, certain regulations were set for the price collection in April 2020. In the event of reporting unit failures, the update mechanisms, which are also common in "normal" price collection business, take effect. This means, for example, that temporarily unobservable prices are automatically updated with the price development of similar products. If no prices are available for this, there are other options, such as taking over the prices of previous months. This applies above all to price-stable survey positions, such as hairdressers or health services.

Special update methods are used for seasonal goods, in which the seasonal figure is taken into account. A particular challenge form services for which, on the one hand, no or almost no transactions are currently taking place and which in addition show seasonal price

developments, for example package holidays and accommodation services. For these services, Eurostat has stipulated as a requirement for the national statistical offices that the selected update method should not interrupt the usual seasonal pattern, but should largely continue. In order to update the package holiday price development, for example, the change rate on the previous month of one year ago is applied.

In summary, the following thesis can be stated about the economic development in the first four months of 2020:

- The German economy recorded the largest decline in economic output since the first quarter of 2009 and the second largest decline since German unification. Overall, the price, seasonally and calendar-adjusted gross domestic product decreased by 2.2% compared to the fourth quarter of 2019.
- The labor market - measured in terms of the number of people in employment moved close to stagnation with a slight increase of 0.3% compared to the same quarter of the previous year. The increase in short-time working in the second half of March was already having a negative impact on working hours and employee earnings.
- In the crisis month of March 2020, there was a clear slump in central economic areas: industrial production, new orders in manufacturing and exports in March 2020 plummeted compared to the previous month as never before since the start of the time series in 1990 and 1991. Turnover in the retail sector affected by closures plunged as strongly as in May 2007 and passenger traffic almost came to a standstill.
- In April 2020, the monthly truck toll mileage index is still compared to March 2020. Once decreased by almost 11% after already falling by almost 6% in February compared to February of previous year. Furthermore, the low level of new personal loan agreements suggests that consumer behavior will continue to slow. At the same time, a drop in prices at various economic levels and low inflation are visible, which is primarily due to the lower energy prices, while the prices for food have risen.

### **3. Small and Medium Sized Enterprises in Germany**

German entrepreneurship research can be interpreted in different ways<sup>5</sup>. Entrepreneurship can be another name for the management of start-ups, respectively ventures. On the other hand, entrepreneurship can also mean entrepreneurial behavior and the execution of entrepreneurial functions within the firm. By analyzing the two different interpretations, it turns out that the research streams in Germany completely differ.

<sup>5</sup> Hofbauer/Gandhi (2016): Understanding the Entrepreneurial Mindset as a Key to Innovation for Business.

In case of venture management there is, in fact, no long research tradition. Unlike the US-american research, which started very early with first academic contributions in the year 1947, in Germany the first entrepreneurship chairs in the area of business studies and economics were founded in the year 1998.

Although even before 1998 there have been some academic contributions in the field of venture management written by German academicians, one can say that the contributions are still thin on the ground. Accordingly, if there are some advices for developing countries to be given based upon German entrepreneurship research, it makes sense to look a little bit deeper into the contributions dealing with entrepreneurial behavior and entrepreneurial functions. By doing so, the so-called "Unternehmertum" research offers indeed a rich and meaningful tradition – in particular by extending the view to the German-speaking countries, which makes sense due to several interdependencies.

The German government, in its official documents, pays great attention to SMEs and views them as the backbone of the German economy, known in Germany – and increasingly worldwide – as the "German Mittelstand". The small and medium-sized enterprises (SMEs) are indispensable for growth, jobs and innovation in Germany. The family businesses in particular are representative of a business culture, which brings together ownership, liability and management. These business people do not think in terms of quarterly figures, but in generations. They derive their particular strength from long-term relations with their employees, suppliers and customers. Their traditionally strong regional ties and well-developed sense of commercial responsibility make them a pillar of the Social Market Economy.

More than 99% of German companies are categorised as "small or medium-sized"; more than 84% of all trainees receive their instruction there; SMEs provide nearly 60% of all jobs. 56% of Germany economic output is generated by the SME. The German SME community is diverse, innovative and internationally successful<sup>6</sup>. Alongside the many small and medium-sized enterprises, the start-ups, skilled craft firms and self-employed persons, Germany particularly benefits from the larger SMEs. Many hidden champions from Germany work closely with their clients all round the world to develop highly specialised innovative products and solutions. The secret to their success is top quality products, a high depth of value creation, and concentration on core capabilities. The strong export performance of German SMEs does not only result in higher sales abroad, but also in higher growth in Germany.

To help the German SMEs to remain vigorous, strong and innovative in the face of a wide range of challenges in the age of globalisation, digitisation and demographic change, the Federal Ministry for Economic Affairs and Energy presented the "Future of SMEs' Action Programme" in July 2015<sup>7</sup>. To ensure that the German SME can remain healthy, strong and innovative in the face of the challenges sketched out above, the Economic Affairs Ministry is implementing measures in ten fields. Government SME policy aims to: promote the spirit of entrepreneurship, strengthen the financing of start-ups and growth, tackle the skills shortage, press ahead with better regulation and cutting red tape, utilise and shape digitisation,

<sup>6</sup> Hofbauer/Bergmann (2008), pp. 22-27.

<sup>7</sup> "Future of the German Mittelstand" Action Programme. Berlin, Germany, 2016. p.2.

strengthen innovative capacities, support SMEs as they globalise, actively shape European SME policy, strengthen SMEs in structurally weak regions, and support the development of new fields of business deriving from the energy transition.

The significance of the single European market as a sales market is great: more than 93 % of exporting SMEs supply the European market. The basis for European SME policy is the Small Business Act (SBA), which aims to anchor the "Think Small First" principle throughout the EU. Further to this, the European Commission is also including policies for SMEs and start-ups in the new Single Market Strategy, to help them make even better use of the potential of the internal market. Also, numerous EU funding programmes offer possibilities for German SMEs. Better regulation and bureaucracy reduction, particularly for SMEs, also play a key role for competitiveness, growth and jobs at the European level. The German government will continue to press hard to encourage this and want to increase the level of interest taken by SMEs in Europe, and also to be a strong advocate of the interests of German SMEs in Brussels. This also means that SMEs need to be made aware of planned EU legislation at an early stage. German government is already doing this in the shape of the EU SME monitor and in future, will involve SMEs even more in decision-making processes<sup>8</sup>.

In structurally weak areas, SMEs generally face a difficult situation: a lack of business services like financing, logistics and R&D infrastructure; difficulties with the recruitment of skilled workers; in many cases higher distances to major sales and procurement markets. Also, the low density of companies makes it more difficult for efficient supplier networks and regional sectoral centres to form. Furthermore, demand for local services declines as the number of inhabitants falls. More people of working age are leaving rural regions and moving to larger towns and cities, which promise a better availability of jobs and higher quality of life. German government has to keep monitoring this development in terms of its effects on companies in conurbations. There continue to be differences in the level of productivity between the east and west of Germany. For example, the productivity of micro-enterprises and small firms in the structurally weak regions of eastern Germany is roughly 80 % of that of similar companies in western Germany. There are similar differences in export ratios and the innovation intensity of companies not receiving assistance. In rural areas in particular, tourism is a driving force for growth and jobs. It can make a major contribution towards preserving public structures and infrastructure.

The Federal Government is drawing up a proposal for a nation-wide assistance system for the post-2020 period; the Economic Affairs Ministry has the lead ministry for this. In the opinion of the Government the focus is to be on measures to boost the potential for growth and innovation in structurally weak regions, supplemented by measures to promote infrastructure and services of general interest. The government wants SME-policy to take account of the different regional conditions in the fields of financing, innovation, investment and sales in particular. In the field of financing, possible respond to this with more favourable interest terms, different loan periods or shares of financing – as is e.g. the case in the existing ERP Regional Programme. The government is also responding to this via fixed quotas or regional preferences in innovation funding, and these could be enhanced or extended to include other

<sup>8</sup> "Future of the German Mittelstand" Action Programme. Berlin, Germany, 2016. p.18.

funding programmes and instruments. The funding of networks and value chains in structurally weak regions is of particular importance. For example, the Eastern Germany Cleantech Initiative helps companies to develop their capabilities together and to open up opportunities for growth, particularly in the fields of energy and resource efficiency and the circular economy. Also, the new initiative of the Commissioner for the New Federal States entitled "Dialogue Business: grow" aims to spark off joint projects in eastern Germany together with partners (chambers, associations, intermediaries such as clusters) in order to strengthen growth and competitiveness. The "Cultural Tourism" brand is to promote tourism in rural areas in the future as well. At present, the Economic Affairs Ministry's project entitled "The destination as a stage: how does cultural tourism make rural regions successful?" is developing and testing implementation concepts in three model regions. The experience gained in this will serve as a blueprint and to be transferred to as many rural areas as possible across the country. An online dialogue platform is available in this lively project, which aims to form networks as a means of communication and a catalyst<sup>9</sup>.

Micro, small and medium-sized enterprises (SMEs) are the engine of the European economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the EU and thus crucial for fostering competitiveness and employment<sup>10</sup>. On November, 2015, The European Commission released an annual report on European SMEs (2014/2015). This report has been prepared in 2015 for the European Commission, Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs; Directorate H: COSME Programme; Unit H1: COSME Programme, SME Envoys and Relations with EASME by the consortium composed of CARSA, PwC Luxembourg, Innova SpA, The University of Manchester, Manchester Institute of Innovation Research, London Economics, DIW Berlin, DIW Econ.

It is well known that SMEs are defined as businesses, which employ less than 250 people and have an annual turnover of less than EUR 50 million, and/or their balance sheet total is less than EUR 43 million. There are three categories of enterprises, namely micro, small, and medium-sized enterprises<sup>11</sup> (table 4).

**Table 4. EU definition of SMEs**

	Employees	Turnover or Balance sheet total	
Micro SME	< 10	< €2 million	< €2 million
Small SME	< 50	< €10 million	< €10 million
Medium-sized SME	< 250	< € 50 million	< € 43 million

Source: Own study was based on: Commission Recommendation of 6 May 2003 concerning the definition of micro, small, and medium-sized enterprises (2003/361/EC), Official Journal of the European Union, L 124/36, 20 May 2003.

<sup>9</sup> "Future of the German Mittelstand" Action Programme. Berlin, Germany, 2016. pp.19-20.

<sup>10</sup> Hofbauer/Sangl (2017): Improving Competitiveness Through Innovation Management.

<sup>11</sup> I. Masurashvili, A. Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. "Modern Management Review", Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016). p. 116-117.



For the term middle class there is no legal or generally valid definition. However, as hardly any buzzword is used so often in economic policy, it is particularly important to ask for the underlying definition. The following are common definitions that introduce quantitative characteristics for delineation. But qualitative aspects also play a role in some definitions. In particular, the unity of ownership and corporate responsibility is more often considered characteristic. Generally accepted statistical demarcation criteria do not exist. According to IfM Bonn data, Germany's SMEs (table 5) are classified as such<sup>12</sup>:

**Table 5. Overview of the SME definition of the IfM Bonn**

Company Size	Number of employees	and	Sales € / year
small	up to 9		up to 1 million
medium*	up to 499		Up to 50 million
(SME) together	up to 500		Up to 50 million

\*and not a small company.

More than 95 percent of all companies in Europe are small and medium-sized enterprises (SMEs). In Germany, even 99.6 percent of all companies subject to value added tax are SMEs. Nearly 60 percent of all employees work at these companies. SMEs and their innovative strength are the economic engine of this country. About 71 percent of the German companies in the mechanical engineering and plant engineering sector are affected by product and trade mark piracy. According to the 2018 Product Piracy Study conducted by the VDMA working group for product and know-how protection (Frankfurt/Main, 2018), these companies record an estimated loss of over seven billion euros per year. Adequate protection of intellectual property can be a key factor for the success of small and medium-sized enterprises. IP rights are strategic assets that increase the value of a company and promote its innovative capacity and profitability – regardless of the company size. However, many SMEs do not make effective use of their intellectual property to gain a competitive advantage. Often there is no strategy for dealing with IP rights – but something can be done about that.

SMEs generate 54.4% of overall value added and 63.7% of overall employment in the German „non-financial business economy“, slightly less than the respective EU averages of 56.4% and 66.6% (table 6). For German SMEs, the outlook is very positive, with predicted value added growth of 10.2% and employment growth of 5.1% in 2018-2020, although global trade disputes and other risks may dampen this outlook.

Germany remains strong in skills, innovation and internationalisation, and its score in 'second chance' and environment puts it among the top performing EU member states. For state aid,

<sup>12</sup> <http://www.ifm-bonn.org/mittelstandsdefinition/definition-kmu-des-ifm-bonn/> (last seen December 10, 2019).

public procurement and access to finance, the country's profile has remained in line with the EU average. However, Germany's performance in single market decreased slightly and is now also in line with the EU average. On entrepreneurship and 'responsive administration', Germany has room for improvement as it scores below the EU average.

Although Germany is making continued efforts to reduce the burden on businesses caused by bureaucracy, many other EU member states have progressed at a faster rate. Rapid progress towards an efficient e-government system is crucial in this respect. Evidence pointing to a gradual decline in SMEs' R&D activities should lead to a review of the underlying causes. Skill shortages in practically all areas of the economy remain a serious competitiveness threat to many SMEs. In addition, the country could strengthen the teaching of entrepreneurial activities, particularly in secondary and tertiary education.

**Table 6. SMEs – basic figures (2018)**

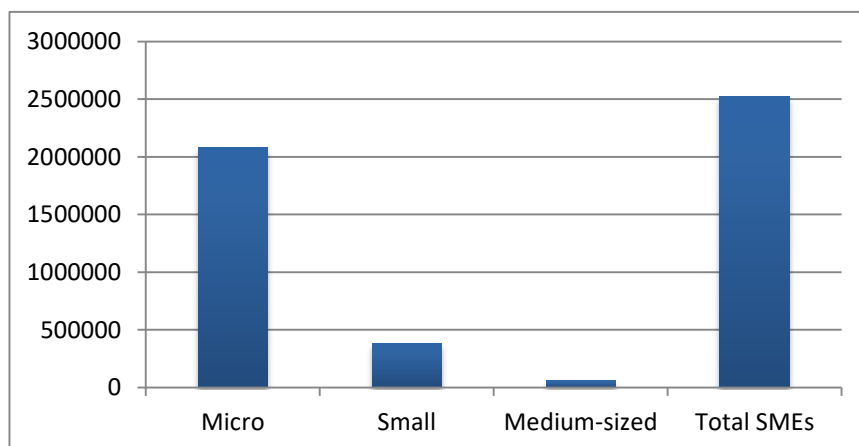
Class size	Number of enterprises			Number of persons employed			Value added		
	Germany		EU-28	Germany		EU-28	Germany		EU-28
	Number	Share %	Share %	Number	Share %	Share %	Billion €	Share %	Share %
Micro	2,079,078	82.0	93.0	5,795,011	19.3	29.7	276.5	15.5	20.8
Small	381,739	15.1	5.9	7,208,212	24.0	20.1	334.4	18.8	17.6
Medium-sized	62,073	2.4	0.9	6,096,584	20.3	16.8	357.7	20.1	18.0
SMEs	2,522,890	99.5	99.8	19,099,80	63.7	66.6	968.7	54.4	56.4

Source: <https://www.destatis.de/>

Note: These are estimates for 2018 produced by DIW Econ, based on 2008-2016 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health.

Statistics on SMEs in Germany for 2018 (table 6) show that there are total SMEs 2,522,890, and 2,079,078 of total SMEs are micro, 381,739 small and only 62,073 are medium sized enterprises (Scheme 5).

## Scheme 5. Statistics on SMEs in Germany for 2018



The average SME productivity, calculated as value added per person employed, amounted to around €50,700 in 2018, exceeding the EU average of €44,600. German SMEs employ an average of 7.6 people, almost double the EU average for SMEs. Large firms' value added and employment growth is similar to that of SMEs, but the increases were lower, at 14.1% and 6.2% respectively. Most recently, in 2017-2018 SME value added continued to grow, increasing by 4.4%. Micro firms contributed most to this growth, with an increase in value added of 5.9%. In the same period, SME employment increased more moderately by 1.5%.

In recent years, developments in two sectors -wholesale and retail trade and professional services- have been particularly noteworthy. SMEs in the wholesale and retail trade sector, the largest sector in terms of SME value added in Germany, have grown significantly in recent years. In 2014-2018, SME value added increased by 26.8% and SME employment by 7.3%. The growth of large firms was also healthy, albeit not as strong as that of SMEs, with value added rising by 18.5% and employment by 4.6%. One factor likely to have contributed to this growth differential between SMEs and large firms was their different approach to e-commerce. Small businesses and start-ups, in particular, have exploited the opportunities of e-commerce more extensively than large firms. Many start-ups, especially in the wholesale and retail trade sector, have chosen to focus their business models almost entirely on digital distribution of their goods and services<sup>13</sup>. In addition, the difference between value added and employment growth, in both SMEs and large firms, can be explained by the ongoing decoupling of GDP from job creation in the overall German economy. This is largely due to the increasing use of automation, which enables businesses to generate higher value added without need to increase labour input to the same extent<sup>14</sup>.

<sup>13</sup> KfW, Focus on Economics, available at : [https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-englische-Dateien/Fokus-2017-EN/Fokus-Nr.-161-February-2017-E-Commerce\\_EN.pdf](https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-englische-Dateien/Fokus-2017-EN/Fokus-Nr.-161-February-2017-E-Commerce_EN.pdf). last accessed on 05.29.2020.

<sup>14</sup> DG GROW, European Semester Officer Report Berlin, May 2019.

In 2014-2018, the professional activities sector generated strong overall growth. SMEs, as an important part of the sector, have contributed significantly to this growth, with SME value added increasing by 15.7% and SME employment by 15.2%. Large firms were unable to match the value added growth of SMEs, with an increase of only 12.5%. However, they surpassed SME employment growth, with a rise of 18.3%. In recent years, the sector's overall growth, generated by both SMEs and large firms, has been supported by major public and private investment in innovation and research and development (R&D) activities.

For example, Germany has already exceeded the Europe 2020 strategy target to spend at least 3% of annual GDP on R&D. As a result, Germany accounts for 30% of all R&D expenditure in the EU as a whole<sup>15</sup>, and ranked ninth in the „Global Innovation Index“ in 2018<sup>16</sup>. The automotive industry is in lead in this field<sup>17</sup>. A further factor in the strong growth of SME value added and employment in the professional activities sector has been the support given to innovative SMEs by the German Federal Ministry of Education and Research. For example, the „10 Point Programme – Priority for SMEs“ has made an important contribution to the sector's strong SME growth by increasing grant provision for innovative SMEs and by supporting collaboration between universities and SMEs<sup>18</sup>.

In 2018, a total of 542,500 new businesses were registered in Germany, 1.3% less than in the previous year<sup>19</sup>. Despite deregistrations did not change (0.0%) in the same period, totalling 512,800, the outcome was still net growth of 29,700 firms<sup>20</sup>. Information on liberal professions is not included in the figures. Reflecting Germany's overall strong economic growth, the number of bankruptcies fell by 3.9% in 2018, totalling 19,302 businesses. This represents the lowest level of bankruptcies since the introduction of the current Bankruptcy Code in 1999<sup>21</sup>. However, despite the economic upturn, the overall number of start-ups in Germany has declined, partly because the job market has reduced the need to set up a new business purely to avoid unemployment<sup>22</sup>. As a result, the start-ups that entered the marketplace have largely done so by choice, and therefore tend to be of a higher business calibre<sup>23</sup>. As per the data collected by the European Startup Monitor 2019 project<sup>24</sup>, 69% of

<sup>15</sup> Federal Ministry for Research and Innovation, available at <http://www.datenportal.bmbf.de/portal/en/research.html>. last accessed on 05.29.2020.

<sup>16</sup> Global Innovation Index, available at: <https://www.globalinnovationindex.org/analysis-indicator>, last accessed on 05.29.2020.

<sup>17</sup> Hofbauer, G.; Sangl, A. (2019), The German Automotive Industry as a Driving Force for Innovation.

<sup>18</sup> Federal Ministry for Research and Innovation, available at: <https://www.bmbf.de/de/zehn-punkte-fuer-mehr-innovationen-im-mittelstand-2333.html>, last accessed on 05.29.2020.

<sup>19</sup> Federal Statistical Office, 2019, Press Release No. 118 of 28 March 2019, available at: [https://www.destatis.de/DE/Presse/Pressemitteilungen/2019/03/PD19\\_118\\_52311.html](https://www.destatis.de/DE/Presse/Pressemitteilungen/2019/03/PD19_118_52311.html), last accessed on 05.29.2020.

<sup>20</sup> Ibid.

<sup>21</sup> Federal Statistical Office, 2019, Insolvenzen von Unternehmen und Übrigen Schuldner, available at: <https://www.destatis.de/DE/Themen/Branchen-Unternehmen/Unternehmen/Gewerbemeldungen-Insolvenzen/Tabellen/anzahl-der-beantragten-insolvenzverfahren.html> and

Federal Statistical Office, 2019, Press Release No. 091 of 13 March 2019, available at: [https://www.destatis.de/DE/Presse/Pressemitteilungen/2019/03/PD19\\_091\\_52411.html](https://www.destatis.de/DE/Presse/Pressemitteilungen/2019/03/PD19_091_52411.html), last accessed on 05.29.2020.

<sup>22</sup> DG GROW, European Semester Officer Report Berlin, May 2019.

<sup>23</sup> KfW, KfW-Gründungsmonitor 2018, available at:

the German startups that responded to the online questionnaire were set up by one male founder or an all-male team of founders. 6% were set up by one female founder or an all-female team of founders. The remaining 25% were set up by at least one man and one woman. In terms of their stage of development, 13% are in the pre-seed or seed stage, 47% in the start-up stage, 6% in the steady stage and 34% in the growth stage. Regarding financial aspects, 69% are operating at a loss, 13% currently break-even and 19% are profitable. Of those start-ups that are operating at a loss, 64% expect to break-even in less than 2 years, while 36% expect that it will take them over 2 years to break-even. 69% have a turnover between €1 and €500,000; 13% report having no turnover yet and the remaining 19% have a turnover of over €500,000. They have 15 employees on average, of which around 36% work on a part-time basis. On average, they plan to hire 4.8 people within a year. In 2016, 39,529 firms (11.1% of all firms in the „business economy“ with at least 10 employees) were high-growth firms<sup>25</sup>, compared with the average EU of 10.7%. In 2018, German SMEs in the specialised knowledge-intensive services and high-tech manufacturing sectors, both of which are usually R&D-intensive, accounted for 32.9% of SME value added in the manufacturing and services sectors. This almost matches the EU average of 33.0%. For German SMEs, the outlook is very positive, with predicted value added growth of 10.2% and employment growth of 5.1% in 2018-2020. As a result, some 968,000 new SME jobs are likely to be created by 2020. These estimates are of course subject to recent developments and future developments as well as incidents.

SMEs are the backbone of the German economy and a central pillar of the society. However, they increasingly face numerous hurdles and difficulties: external economic developments, skilled labour shortages, growing bureaucracy, a high tax burden, high social security contributions and high energy costs.

With the SME Strategy, Germany is presenting the first comprehensive approach to show more appreciation for SMEs, strengthen their position and reduce the burden on the SME sector. Following the broad support for the “key points” of the SME Strategy presented on 29 August 2019, an extensive process of discussion and consultation was conducted with many stakeholders and they were able to take many valuable additional suggestions and ideas on board. The result is a bold strategy that now needs to prove effectiveness in practice. Together with the stakeholders concerned and the parliamentary representatives, the government will rise to this challenge with energy and conviction. Germany is a country of small and medium-sized enterprises. SMEs account for over 99% of all businesses. They provide over 80% of training places and roughly 60% of all jobs subject to compulsory social security contributions. Germany’s SME sector is extremely diverse, running the range from large family-run businesses established generations ago in rural areas, craft and trade

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<https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Gründungsmonitor/KfW-Gruendungsmonitor-2018.pdf>, last accessed on 05.29.2020.

<sup>24</sup> [www.europeanstartupmonitor2019.eu](http://www.europeanstartupmonitor2019.eu)

<sup>25</sup> In line with Commission Implementing Regulation (EU) No 439/2014, high-growth enterprises are defined as firms with at least 10 employees in the beginning of their growth and average annualised growth in number of employees greater than 10 % per annum, over a 3-year period. The share of high-growth enterprises is the number of high-growth enterprises divided by the number of active enterprises with at least 10 employees. Source of the data on high-growth enterprises is Eurostat ([http://ec.europa.eu/eurostat/web/products-datasets/-/bd\\_9pm\\_r2](http://ec.europa.eu/eurostat/web/products-datasets/-/bd_9pm_r2), last accessed 05.29.2020).

businesses, liberal professions and self-employed persons to start-ups and a disproportionately high number of “hidden champions” – largely unknown global leaders in niche markets. This diversity is one of its assets, and makes an important contribution to the resilience and agility of our economy. A strong SME sector also means a strong economy”<sup>26</sup>.

## 4. Economic background in Georgia

### 4.1 GDP of Georgia

The GDP is an important indicator of the economic power for Georgia, too. The gross domestic product (GDP) denotes the aggregate value of all services and goods produced within a country in any given year. The economy of Georgia is an emerging free market economy. Its gross domestic product fell sharply following the collapse of the Soviet Union but recovered in the mid-2000s, growing in double digits thanks to the economic and democratic reforms. The GDP of Georgia for 2018 and for Q1-Q4, 2019 year can be analysed from table 7.

**Table 7. GDP of Georgia<sup>27</sup>**

	2015	2016	2017	2018	I 2019	II 2019	III 2019	IV 2019	2019
GDP at current prices, billion GEL	33.9	35.8	40.8	44.6	10.2	12.0	13.4	14.3	50.0
GDP at constant 2015 prices, billion GEL	33.9	34.9	36.6	38.4	9.1	10.2	10.6	11.0	40.4
GDP real growth, percentage change	3.0	2.9	4.8	4.8	5.0	4.6	5.8	5.1	5.1
GDP deflator, percentage change	5.8	2.6	8.5	4.4	1.7	5.1	7.2	11.2	6.6
GDP per capita (at current prices), GEL	9 109.4	9 613.9	10 933.9	11 968.0	2 739.4	3 229.5	3 611.3	3 848.8	13 428.9
GDP per capita (at current prices), USD	4 012.6	4 062.1	4 358.5	4 722.0	1 026.7	1 179.0	1 237.0	1 306.5	4 763.5
GDP at current prices, billion USD	14.9	15.1	16.2	17.6	3.8	4.4	4.6	1.9	17.7

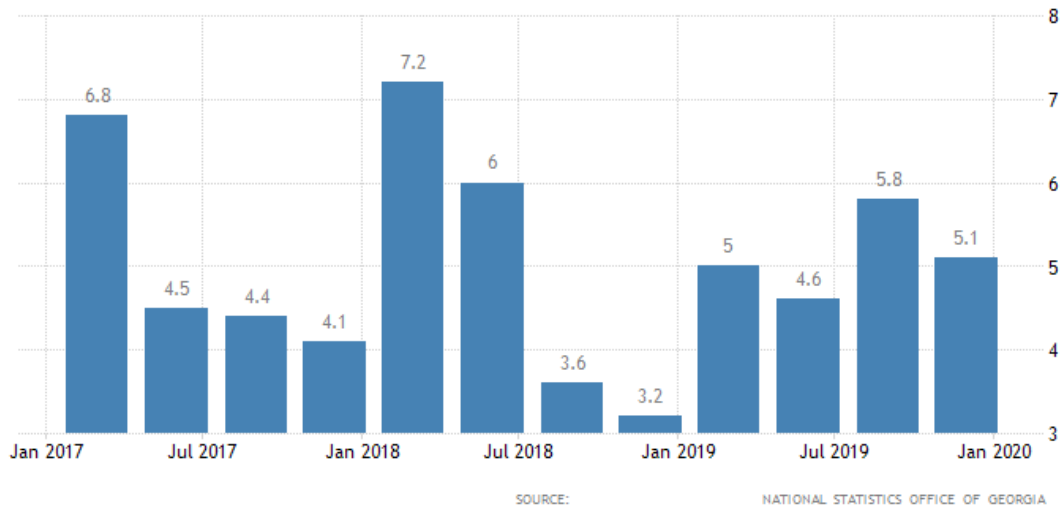
Georgia's GDP expanded 5.1% year-on-year in the fourth quarter of 2019, slowing from a 5.8% advance in the previous period (scheme 6). Output growth eased for: construction (1.4% vs 17.1%), information and communication (17% vs 18.2%), other service activities (5.1% vs 7.7%). Output growth accelerated mainly for: manufacturing (6.3% vs 4.9%), transport (8.3% vs 2.2%), real estate activities (7% vs 3.8%), arts, entertainment and recreation (25.2% vs 19.9%), electricity, gas and water supply (4.2% vs 2.6%), wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods (12.4%

<sup>26</sup> Valuing SMEs. Federal Ministry for Economic Affairs and Energy. Berlin. 2019. p.5-6.

<sup>27</sup> <https://www.geostat.ge>

vs 9.8%), education (11.2% vs 6.3%), while that of mining and quarrying rebounded (0.4% vs -2.2%). Conversely, the output shrank for: agriculture, hunting and forestry, fishing (-5.1% vs 2.1%), insurance activities (-10.3% vs -2.2 percent), and public administration (-2.6% vs -4.0%). Considering full year 2019, the economy grew 5.1% from a year earlier, after expanding by 4.8% in 2018.

**Scheme 6. GDP of Georgia**



## 4.2 Consumer Price Index (Inflation) in Georgia

Price stability is a fundamental factor for the country's sustainable economic growth. High inflation -that is characterized by large fluctuations- impedes the country's economic growth in the long run. The consumer price index (CPI) is a widely used indicator that measures changes in consumer prices in the country. The CPI is estimated by a consumer basket that includes the goods and services consumed by an average household. An increase in the prices of goods and services included in the consumer basket results in inflation (table 8).

Currently, the Georgian consumer basket contains 305 items of goods and services that are divided into 12 categories. Each component is assigned its own weight, which is based on data from national accounts. Food and nonalcoholic drinks have the highest weight (about 30%) in the Georgian consumption basket. Such a high share of food products in the consumer basket is natural for developing countries like Georgia. Correspondingly, the inflation rate is very sensitive to food price changes. It is also worth noting that food prices are characterised by high volatility that distorts the overall picture of general price level dynamics. As households change their expenditure behavior with time, the CPI basket is subject to revision and the Georgian CPI basket is updated annually. In the long-run, the desirable rate of inflation in Georgia is 3%. It should be noted that developing countries are characterized by

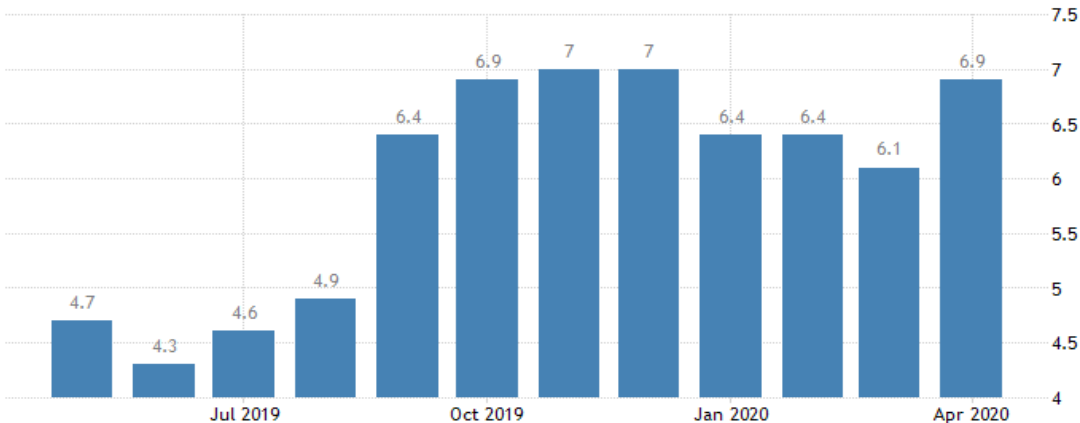
high levels of inflation, which is mainly caused by a rapid growth in productivity. At the current stage of economic development in Georgia, the inflation target is set at 3%.

**Table 8. Consumer Price Index (Inflation) in Georgia**

	2012	2013	2014	2015	2016	2017	2018	2019
Annual Average to the Annual Average	99.1	99.5	103.1	104.0	102.1	106.0	102.6	104.9
December Over December of previous year	98.6	102.4	102.0	104.9	101.8	106.7	101.5	107.0

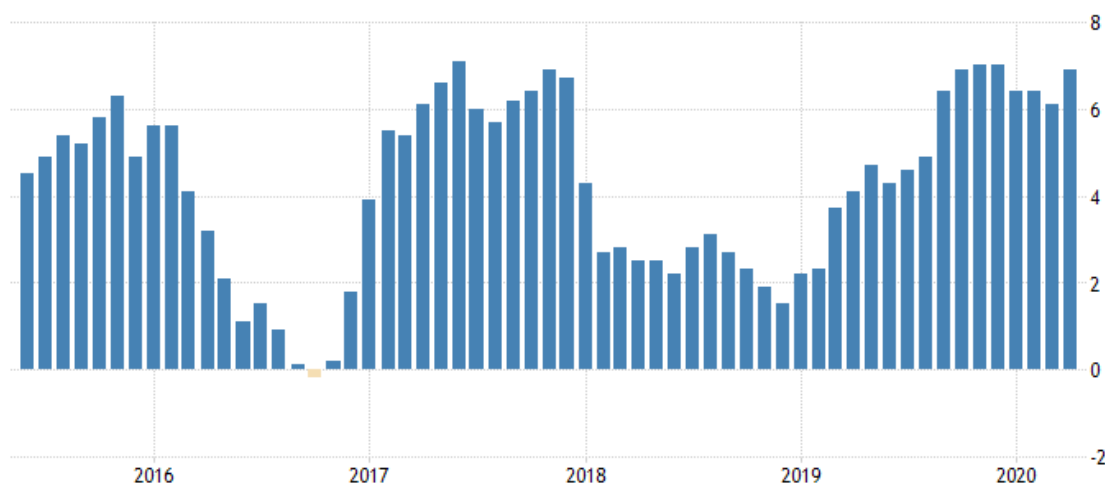
The annual inflation rate in Georgia rose to 6.9 percent in April of 2020 from 6.1 percent in the previous month (scheme 7-8). It was the highest inflation rate since last December, amid surging prices of food & non-alcoholic beverages (16.1 percent vs 13.4 percent in March); miscellaneous goods & services (8 percent vs 6.8 percent); furnishings (9.6 percent vs 4.1 percent) and housing & utilities (3.7 percent vs 3.2 percent). In contrast, costs declined for transport (-0.4 percent vs 3 percent); communication (-0.5 percent vs -1.8 percent); recreation & culture (-4.3 percent vs -4.4 percent) and clothing & footwear (-2.2 percent vs -0.9 percent). On a monthly basis, consumer prices inched up 0.9 percent, after increasing 0.7 percent in the previous month.

**Scheme 7. Inflation in Georgia (one year)**





## Scheme 8. Inflation in Georgia (last five years)



Source: [www.geostat.ge](http://www.geostat.ge).

A decrease in demand is the most significant side effect of Covid-19 for Georgian companies among all sectors, which is shown in the new study of PricewaterhouseCoopers Georgia LLC (PwC Georgia) and the Investors Council. The purpose of the survey, which included 1,938 respondents, was to properly assess the scale of the impact that companies are facing during the coronavirus pandemic and to consider the challenges they will face after it. The intention of the study was to capture the "first" reactions of businesses to the pandemic situation. The survey answers the question of what difficulties businesses experience, what are their first actions related to combating the effects of the virus, what is the situation of companies in terms of financial liquidity and what are the businesses' predictions regarding the development of the situation in their companies. The key findings of the survey are:

About 65% of the surveyed companies identify a decrease in demand as the major challenge. Over 59% of micro self-employed enterprises have suspended their business activities in response to the emerging difficulties; 63% of respondents indicated a more than 50% revenue drop in March and April 2020 compared to last year; 44% of companies have not reduced their employees in March and April 2020; 71% of the companies operating in accommodation and food service sectors predict revenue drop above 50% in the upcoming three months compared to the previous year; more than 60% of companies in the agriculture sector do not expect a reduction in the headcount or unpaid leaves for the employees in the upcoming three months; only 15% of companies forecast that they can maintain their liquidity over six months; 79% of the respondents see the need for additional financing, of which 85% have not yet approached financial institutions; 27% of the respondents look for additional funding to finance the working capital.

Decreased demand, cash collection shortages and changes in customer behaviour triggered liquidity challenges of the companies. As a quick solution to resolve decreased demand and liquidity issues, companies started to reduce their headcounts. More than 50% of surveyed companies have already experienced some employee reductions, with the tourism and service-related industries being most vulnerable (more than 40% have already reduced

100% of their employees). The agriculture sector has been the least affected from this perspective", reads the research.

As the trend continues, the majority of companies are facing additional financing challenges. 79% of all respondents mention that they need additional financing. However, 85% of those companies have not yet approached the financial institutions and the majority that did were not successful in obtaining additional financing. The only exceptions from that segment were large enterprises: 42% of companies, which approached banks, were able to obtain additional financing, 22% were rejected and 36% are still waiting for a response", reads the research.

The analysis "Regions vs Tbilisi" shows differences in the expectations in the regions compared to the Georgian capital city of Tbilisi. From the surveyed companies, less people in the regions expect a drop in revenues by more than 50% than in Tbilisi (44% in regions compared to 51% in Tbilisi). These differences are maintained in the headcount reduction field, too: 45% of the companies from regions have not planned headcount reductions compared to 37% of companies in Tbilisi.

Three different scenarios have been derived:

*Scenario I: Optimistic*

Economic activity completely stalls for 2.5 months, and then partially stalls for a further three months. Consequently, economic activity partially resumes by the start of June and fully resumes by the start of September.

*Scenario II: Less pessimistic*

Economic activity completely stalls for four months, and then partially stalls for a further three months. Consequently, economic activity partially resumes by the middle of July and fully resumes by the middle of October.

*Scenario III: Very pessimistic*

Economic activity completely stalls for six months, and then partially stalls for a further three months. Consequently, economic activity partially resumes by the middle of September and fully resumes by the middle of December.

If the optimistic scenario proves true, Georgia's real economy is expected to shrink by 4.3 percent, which would be more severe than in 2009 (-3.7%). Should the less pessimistic scenario play out, the Georgian economy is expected to decrease by 8 percent while in the event of the very pessimistic scenario becoming reality, the expected fall is 12.9 percent. For all three of the proposed scenarios, five sectors are likely to be most affected and five sectors likely to be least affected.

The following five sectors are expected to be the most severely affected: arts; entertainment and recreation; accommodation and food services; transport and storage; wholesale and retail trade.

The five sectors expected to be least affected are: information and communication; human health and social activities; professional, scientific and technical activities; public administration; mining.

The employment/unemployment according to 3 scenarios is estimated as:

In the optimistic scenario a 6.3% decrease is expected in the total number of employed persons, while job losses are forecasted to be higher in the less pessimistic scenario (-9.8%) and in the very pessimistic scenario (-14.4%).

The average unemployment rate in 2020 is forecasted with an increase of 14.1 percent, while for the less pessimistic scenario the expected increase is 17.7 percent and for the very pessimistic scenario it is 22.7 percent.

Additionally, it is likely that the negative impact of the pandemic will change the structure of the labor force in Georgia. The self-employed, which represented 44 per cent of the Georgian labor force in 2019, will be particularly vulnerable to the changes.

## 5 Analysis of Small and Medium Enterprises in Georgia

Prior to October 1, 2012, it was a difficult situation in business administration of Georgia. After the change of government in Georgia, the attitude towards business changed radically<sup>28</sup>. The simplicity of starting a business in the country (generally in the world) and therefore its business strategy depends on the business environment of the country, which in turn contributes to the growth of the economy and the growth of private sector. The economic environment of Georgia is evaluated annually by various international and local organizations. Estimates of international organizations are mainly based on reports, new laws and legislative amendments. These assessments are not directly related to entrepreneurs<sup>29</sup>.

The situation in Georgia shows a positive progress with the Deep and Comprehensive Free Trade Agreements with the EU, with reforms that foster the economic growth. Negative consequences resulting from the regional crisis decreased the external demand for products

<sup>28</sup> I.Masurashvili, Past and Future of Business Administration in Georgia, International Conference for Academic Disciplines, Cambridge, USA. May 26–30.2013.

<sup>29</sup> I.Masurashvili. Simplicity of running business in Georgia – Present and future development. "Modern Management Review", Quarterly, Volume XXIII (April-June), Research Journal 25 (2/2018). p.51.

and services and tourism and led to economic slowdown since the second half of 2014. However, the positive outcome of DCFTA is being observed.

Georgia has maintained a well-capitalized and soundly managed banking sector despite the recent slowdown in economic activity and weaker credit growth. Sector-wide capital adequacy ratio stands at 19% (in Basel standards), what is higher than the regulatory minimum of 12%<sup>30</sup>. The NPL ratio, defined according to the international standards (loans in arrears over 90 days), is one of the lowest among the peer countries and it stands at 3.4%<sup>31</sup>.

SMEs are the backbone of the Georgian economy like in Germany. But the definition of SMS is very different to Germany. Therefore, the compilation of statistics on SMEs comparable across sectors and establishments represents a challenging task. The National Statistics Office of Georgia classifies enterprises as small (or medium-sized) if the number of employees does not exceed 20 (100) and the average annual turnover is up to 0.5 (1.5) million GEL. For taxation purposes, the status of a small business may be granted to a natural person, whose gross income from economic activity during a calendar year does not exceed 100,000 GEL. As for the financial sector, measures for defining businesses by size are quite diverse among the several market players, some utilise total exposure to the client, turnover measures, annual sales or combination of them<sup>32</sup>.

The Economics Department of the European Investment Bank has recently conducted a Bank Lending Survey among main financial institutions in the Georgian market. Information were collected on lending conditions, availability of different financial products and credit extensions to corporates, particularly to SMEs. The survey included questions related to recent credit developments, demand and supply factors that affect credit growth, availability of various financial instruments, breakdown of loan portfolio by sectors/maturity/purpose, and perception of credit conditions. The respondents provided information according to their definition of SMEs. Six respondents were chosen from the financial intermediaries in Georgia (5 commercial banks and one microfinance institution). The survey covered 75% of banking sector assets and approximately 65% of banking sector SME portfolio. Some of the key results of the survey are reported here.

The SME sector has to play a special role in the process of transition of the economy of Georgia. However, although SMEs make up the large majority of firms in Georgia, many of them are still restricted to niche markets with little growth potential. SMEs account for 94% of enterprises in Georgia. However, with their concentration in the micro segment and subsistence activities, their contributions to employment and turnover are much lower. The employment contribution, for example, is 43% in Georgia.

<sup>30</sup> Hofbauer, G.; Klimontowicz, M.; Nocoń, A. (2016). Basel III Equity Requirements and a Contemporary Rating Approach, in: Copernica Journal of Finance and Accounting, Vol. 5, issue 1, pp. 91-105.

<sup>31</sup> I.Masurashvili, A.Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. "Modern Management Review", Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016). p. 119-120.

<sup>32</sup> I.Masurashvili, A.Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. "Modern Management Review", Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016). p.120.

The access to finance is one of the main obstacles in doing business as perceived by SMEs. Other factors highlighted by the Enterprise Survey include political instability, corruption, and tax rates. The survey was conducted in 2012 when the country was going through political changes, therefore, they must be compared to data of today when the access to finance is much better.

With limited access to external funding, SMEs rely heavily on internal sources of funding and retained earnings. In Georgia over 70% of investments in fixed assets and 80% of working capital are financed with internal resources. Bank lending makes a small contribution to total financing needs, which for both fixed assets and working capital are predominantly met by internal finance.

The index published in Economic Freedom of the World measures the degree to which the policies and institutions of countries are supportive of economic freedom. The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to enter markets and compete, and security of the person and privately owned property. The data points are used to construct a summary index and to measure the degree of economic freedom in five broad areas:

- size of government: expenditures, taxes, and enterprises;
- legal structure and security of property rights;
- access to sound money;
- freedom to trade internationally; and
- regulation of credit, labour, and business.<sup>33</sup>

Most of the SMEs are oriented toward the local market. A small share of SMEs is involved in direct export activities<sup>34</sup>. Inter alia, small volumes of production make it more costly for SMEs to explore export opportunities and expand in foreign markets. In addition, the share of firms with internationally recognized quality certification is relatively low. The quality of the business environment reflects to a large degree the underlying institutional framework for SMEs. Assessment and recommendations for the institutional framework has been made under the OECD's initiative on the small business act.

In Georgia the legal framework has been improved, particularly with regard to private credit bureau information. Bank lending is constrained by high interest rates and collateral requirements. Microfinance institutions are widespread but lack capital, while other non-bank financial institutions are less developed. The legal framework for venture capital is in place but activity remains low.

<sup>33</sup> I. Masurashvili, A.Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. "Modern Management Review", Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016). p.121-122.

<sup>34</sup> [http://www.eib.org/attachments/efs/economic\\_report\\_neighbourhood\\_sme\\_financing\\_georgia\\_en.pdf](http://www.eib.org/attachments/efs/economic_report_neighbourhood_sme_financing_georgia_en.pdf)

Georgia had formulated a SME strategy for implementation for the period 2016–2020<sup>35</sup>.

Despite the improvement in the general business environment, by viewpoint for development SMEs in Georgia are the same challenges, which in many other developing countries. Although small and medium-sized enterprises have the largest part of existing enterprises, their contribution to GDP is still very low.

But the SME activities are especially noticeable in Tbilisi, Imereti, Qvemo Qartli and Achara region. On the other side the activities in Racha-Lechxumi, Qvemo Svaneti, Samcxje-Javakheti and Guria are very passive. The fact is very important that SMEs are playing a negligible role in the economic development of the country. In particular there is one reason: high retardation of SMEs in the transfer of innovative technology.

Strategic directions and policy appropriate measures, which are reflected in this strategy, developed for the analysis of the economic situation, SMEs institutional and business environment analysis, considering of existing assessments and recommendations. The effective implementation of the relevant policy measures should provide a strategy to reach their goals in 2020<sup>36</sup>. Specific measures are set out in the Action Plan. The strategy also involves the monitoring and evaluation mechanisms. "The small and medium Entrepreneurship Development strategy for the years 2016–2020" developed active cooperation for Organization Economic Cooperation and Development (OECD) and of the support the German International Cooperation Society (GIZ)<sup>37</sup>.

In 2015, the Government of Georgia embarked on an ambitious journey to improve business environment conditions and tackle market failures that make it harder for entrepreneurs and managers of small and medium-sized companies to start, run and grow their business. With the support of the OECD, the Ministry of Economy and Sustainable Development (MOESD) of Georgia engaged in a series of thematic public-private workshops to identify policy challenges and develop targeted measures to support Georgian SMEs. These activities led to a peer review of Georgia at the OECD Eurasia Competitiveness Roundtable in November 2015, and to the subsequent adoption by the Government of Georgia's SME Development Strategy 2016-2020.

The Strategy is based on the main principals of Small Business Act (SBA) for Europe, covering important areas such as improving SMEs operational environment, access to finance, enhancement of skills, facilitation of internationalization and innovation activities.

Table 9 shows the number of registered enterprises, the structure and the trend in numbers.

<sup>35</sup> Ibidem.

<sup>36</sup> Y. Babych and M. Fuenfzig, An Application of the Growth Diagnostics Framework: The Case of Georgia (Working Paper No. 001-12). International School of Economics at TSU, Tbilisi, Republic of Georgia, 2012, <http://ideas.repec.org/p/tbs/wpaper/12-001.html>.

<sup>37</sup> I. Masurashvili, A. Rzepka. Strategic perspectives for Georgian business – an analysis for medium-sized enterprises in EU and Georgia. "Modern Management Review", Quarterly, Volume XXI (July - September), Research Journal 23 (3/2016), p.121-122.

Table 10 shows according to the April 1, 2020 Business Registry, that there were 775,097 business entities registered in Georgia, 184633 of which were operating. The registered individual enterprises were 454,934 (58.7%), of which 95,587 were actually operating (51.8%); Limited Liability Companies had a total of 269,016 (34.7%). Of those, the actual operating LLC was 80,002 (43.3%).

**Table 9. Number of registered enterprises in Georgia (2018, 2019)**

	2018	2019
Number of registered organizations by year - total cumulative, thousand	722.9	765.7
Number of newly registered organizations by year, thousand	51.8	50.9
Number of newly registered business entities, thousand	50.4	49.6

source: www.geostat.ge

As one can see from Table 6 in Georgia although there are 6 legal and organizational forms, the most active are limited liability companies and individual enterprises.

**Table 10. Number of registered and active entities by organizational-legal form**

Legal status	1 April 2020			
	Registered entities		Active entities	
	Number	%	Number	%
TOTAL	775097	100	184633	100
Commercial legal persons	280167	36.1	81353	44.1
Joint liability companies(JLC)	2755	0.4	203	0.1
Limited partnerships (LP)	188	0.0	22	0.0
Limited Liability companies (LLC)	269016	34.7	80002	43.3
Joint stock companies (JSC)	2809	0.4	918	0.5
Cooperatives (CP)	5399	0.7	208	0.1
Non-commercial legal persons	28232	3.6	3879	2.1
Individual entrepreneur (IE)	454934	58.7	95587	51.8
Other	5903	0.8	1144	0.6
Entities of public law	5861	0.8	2670	1.4

source: www.geostat.ge

The Strategic Plan of the government "Small and Medium Enterprise Development Strategy for 2016-2020" was aimed at strengthening small and medium enterprises in Georgia and to improve the competitiveness for local and international markets:

Strategic direction 1: Improve legislative, institutional and entrepreneurial environment;

Strategic direction 2: Improve access to finance;

Strategic direction 3: Development of SME skills and promotion of entrepreneurial culture;

Strategic direction 4: Export promotion and internationalization of SMEs;

Strategic direction 5: Promoting innovation, research and development.

The necessity arises to write a new strategic plan for the development of small and medium enterprises of Georgia, which will be in compliance with the global challenges and will be foreseen in the coming period 2021-2025.

## 6 Summary

The SME development vector in Georgia is comparable to the German one. The economic environment has a huge impact as a breeding ground for sustainability and prosperity.

However, some conclusions can be derived for Georgia from the research:

- The SME development strategy and the relevant action plan should be more precise in terms of budgetary issues regarding needs of donors' support as well as state financing;
- The action plan should include information on possible risks related to the implementation of priority measures envisaged under the strategic directions;
- The regulatory impact assessment remains an important area of future improvement for SME policy. While monitoring and evaluating the implementation of the SME strategy, the evaluation revealed that additional action is required in the institutional framework and operational environment for SMEs.
- The development of an SME-specific monitoring is an essential element of the policy making process and will enable the government to design specific tools to ensure that proposed legislation (new or amended) will not impact disproportionately SMEs.
- The government has to make considerable efforts to use SME monitoring in order to mitigate negative regulatory impact on small and medium sized enterprises. Drawing on EU examples, Georgia should develop its unique SME monitoring and designate a central entity to support its development and implementation.

Future research is intended on a more detailed basis, evaluating the development vector of SMEs on a single basis.

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***The Economic Development Vector  
for SMEs in Germany and Georgia***

***Impressum***

**Herausgeber**

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**Druck**

Hausdruck

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