



## EXPORT DIVERSIFICATION OF GEORGIAN FIRMS TO THE EU MARKET

Natia Daghelishvil<sup>1</sup><sup>1</sup> Doctoral Candidate of Ivane Javakishvili Tbilisi State University, Georgia

## ABSTRACT

*This paper aims at analyzing market penetration strategies in the internationalization process, obstacles of Georgian exporter firms to the EU market and to find solutions for a better level of diversification. On June 2014, EU signed Association Agreement (AA) with Georgia, which deepens political and economic ties between the signatories with a long-term perspective of closer political association and economic integration. This is a challenge for Georgia to fasten process of export diversification on the EU market. Main findings of the research is connected to the fact that Association Agreement will influence on export diversification on the EU market, when main obstacles are identified – lack of access on the financial resources, unfavourable tax environment, high competition, scarce commodity range etc. Hence, Deep and Comprehensive Free Trade Area (DCFTA) which is created under the AA will lead Georgia to benefit from new trading opportunities and easier access to the EU market – the largest in the world. Georgian companies and foreign investors will adopt opportunities implied into the Association Agreement gradually.*

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**Keywords:** Export diversification, Georgian firms, EU market, AA, DCFTA.

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## Contribution/ Originality

This study is one of very few studies which have investigated and highlighted opportunities of strengthen export diversification of Georgian firms to the EU market. This study also revealed that Georgian firms can get advantage after signing the Association Agreement (including Deep and Comprehensive Free Trade Agreement).

## 1. INTRODUCTION

Association Agreement with European Union was signed on June 27, 2014, which includes activation of the Deep and Comprehensive Free Trade area (DCFTA). DCFTA creates new opportunities for Georgian companies to make export diversification to the world-wide biggest market. Georgian firms will be able to make unprecedented trade liberalization with 28 countries of European Union, with full abolishment of tariff barriers on goods and service<sup>1</sup>.

<sup>1</sup> Association Agreement between the European Union and Georgia (n.d).

Implementation of Association agreement implies a long-term process of reforms. Georgian side has already undertaken commitments and commenced to carry out measurements to fulfill the agreement requirements. Now, fundamental review of National Legislation, its improvement and adjustment with European Union is under process.

In addition, the European Union in the process of overcoming non-tariff measures will support Georgia. Therefore, it is highly important for Georgian firms to use new opportunities and to plan future prospects correctly. Innovation of the matter means complex study of the profit of completely new dimension of trade relations, which can be obtained by Georgian firms by the diversification of the export to the European Market. In addition, the basic problems, export companies face with during the production or sales process will be analyzed, derived from the new regulation that implies Association Agenda. This paper analyzes on the one hand process of internalization of Georgian firms to the EU market and on the other hand outlines obstacles to access to the EU market. As a result, recommendations will be elaborated for Georgian firms concerning usage a range of opportunities of the Deep and Comprehensive Trade Area and overcoming non-tariff measures.

## 2. LITERATURE REVIEW

Notwithstanding the reforms that were made in Georgia in recent years, conducted for economic liberalization and creation attractive and simplified environment for the business, business is still in challenge. (Especially small and medium-sized business).

Before making analyzes of diversification process of Georgian companies to European Union markets, we would like to overview basic problems existing therein: Georgian export Diversification through European Union Market is significantly weak, due to the fact, that 10 largest sectors comprise enormous percentage of goods. Moreover, Georgian goods variety is poor, we nearly do not have high technological sector, electrical technology is very weak and heavy industrial sectors comprise only mining sector (except of some). Agricultural industry is almost under-developed as well. Thereby, it is critical to analyze those basic obstacles, which face Georgian firms while entering European Union Markets.

The issue concerning the export diversification to the European Union Market is responded by the Georgian-EU Association Agenda, according on which the parties will cooperate in preparing the proper implementation of the provisions on market access for goods of the envisaged Association Agreement, exactly: “to increase diversification of Georgia’s export structure”<sup>2</sup>.

It is worth to mention, that level of export is not the main factor in growth of economic. It is effected by the quality of export diversification, as well. Roomer has identified diversification as the factor of production (Romer, 1990)<sup>3</sup>. It is considered, that export-based expansion via the diversification of national trade portfolio can be activating for stabilization of export that will reflect on the economic growth in long-term period.

Empirical studies point out that the export diversification facilitates growth of the level of income per capita. As Love noted, the country should prevent dependence on limited product, because it decreases potential to balance fluctuation in export sectors by the other stable sectors. Love concluded that the export diversification is the right strategy to decrease instability (Love, 1986)<sup>4</sup>.

Morgan and Raut had an interesting discovery, showing that economic development is depended not only on the growth of export, but also on export structure. They believe, that the production sector, compare the other sectors, is

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<sup>2</sup> Association Agenda between the European Union and Georgia Trade and Trade-Related Matters (n.d).

<sup>3</sup> Romer (1990).

<sup>4</sup> Love (1986).

effected by factors that are more external. These external factors can lead towards the horizontal diversification; moreover, it will incur industrial progress to withstand the competition.

Levin and Raut concluded that if the most part of export of country were locally produced, it would have a positive impact on the growth of economic (Levin and Raut, 1997)<sup>5</sup>.

According to the all abovementioned, and based on the researches conducted by the Polish organization “Ecorys” and “Case”, it is forecasted that the Deep and Comprehensive Free Trade Area will enhance trade between the EU and Georgia by 12% when exporting from Georgia to European Union and by 7.5% when importing from the European Union. It is forecasted, that GDP will increase by 4.3% annually<sup>6</sup> (292 Million Euro as a country’s income) (Trade sustainability, 2012) as well. Hereby, during the research process the question of the matter is emphasized:

### **How Do Georgian Firms Make Export Diversification to the European Union Market?**

Despite the reforms that were conducted within the frameworks of the Association Agreement, the actual problem, concerning the access to the European Markets, still remains lack of the knowledge of the EU member states’ markets by Georgian companies. Low competitiveness; Noncompliance with EU markets’ standards; Weakness of State Institutions (esp. Quality of infrastructure) and non-recognition from the European Union; defected systems in marketing and Logistics; lack of the knowledge of the laws and regulations of European Union; Lingual barriers (esp. In case of small business) still remains challenges in this filed.

### **3. RESEARCH METHODOLOGY**

Main aim of the survey was to analyze Georgian export sector, to assess process of internationalization and export diversification of Georgian firms to the EU market and study impact of the Association Agreement (AA) on exporters.

The research process was conducted by the quantitative and qualitative methods. For the quantitative method – inquiry was used, and for the qualitative method – focus group was determined. The next step was a massive inquiry – filling in forms of questionnaire. Semi-structural questionnaire (which was comprised of 29 questions) was self-developed and divided by the following blocks: I block – General information about the company; II block – Assessment of quality of the export diversification and internationalization of the firms; III block – influence of export-supporting programs and IV block – influence of the Deep and Comprehensive Free Trade Area (DCFTA) on the export activity. We studied official statistics of the exporters and asked the Revenue Service to provide us with the list of the biggest 200 exporters to the EU market. Using a simple random sampling method, we contacted the firms personally, either via phone or by using a google doc format for the interviews. Place of the research was the whole country.

Questionnaire was comprised of open and closed questions. From the closed questions, respondents were able to select not only one correct answer, but to use a Likert scale - range questions using 4-point scales system (4 – strongly agree, 1 – disagree). As for the open questions, respondents were able to express their opinion. After the quantitative inquiry, focus group was conducted. In discussion of studying issue, there were participating various stakeholders, including various experts, representatives of Export Development Association, representatives of the EU-Georgia business council etc.

Electronic Questionnaire was worked out for conducting the research, and the information received via this questionnaire was processed by use of statistics programme SPSS and Excel. The Questionnaire was send out to the

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<sup>5</sup> Levin and Raut (1997).

<sup>6</sup> Trade Sustainability (2012).

export-related companies of Georgia (about 150 export-related company), database of which was received from the National Statistics Office of Georgia and interviews were used, as well. About 75 exporters agreed to take part in the research.

There is no selection without error. During the process of the research, 3 percent was regarded as an error.

#### 4. FINDINGS OF THE RESEARCH

One of the most important direction of economy for developing countries is the growth of export opportunities, which maintains economic development in the mentioned countries, as well as improvement of social state and functions towards the export diversification. It means, movement to the European market from the markets, such as Russia, central Asia etc. companies that were participating in the research were selected according the database of the National Statistics Office of Georgia on the ground of their high speed of growth of export volume. Among the inquired companies, there were as experienced companies as young ones, which have started export activity for a couple of years.

Business activity, for 67% of the companies participating into the research, was agriculture and as a main sector, it was outlined wine and nut production/realization. Business activity, for 21% of companies, was industry, and 11% was united into the other business category (see figure 1).

Right trade policy provides companies with accessibility to the market, which is comprised of more than 502 million European consumers. It should be noted, that Integration with EU remains as the most important priority for Georgia, that itself implies economic integration of Georgia. Leading sector in Agricultural production, which is exported in EU countries, pointed out to be nut and wine production, however, industrial sector should be noted as well.

Countries, where the export is higher than in other countries, were outlined based on the research (see table 1). For example, Germany - 37% of respondents are exporting. Then it comes – Italy with 26%, Lithuania – 18%, Latvia – 19%, The United Kingdom – 15%, Poland – 11%.

Companies, which remain on the market and continue to produce and deliver goods and service through the strong competitive area, continuously, are trying to create international business links and establish cooperation with foreign enterprises. The research findings ascertained that most exporters (64%) have links with 3 or more than 3 Partner/Client companies abroad. Existence links like that facilitates to benefit from all advantages given thereby (see figure 2).

In order to determine how Georgian companies are implementing export diversification on the European Union Markets, it is worth to know the incentives that trigger them to enter on new markets. Figures of the research are as follows: high motivating sector is - 1. Sales growth (58% of respondents); 2. Diversification of markets (41% of respondents); 3. Higher price compared with domestic market – 27% of target companies. As for weak incentive, international experience ranked the highest index, while diversification of the markets and growth in sale gained no score, “that they are not incentives” (see figure 3).

The company’s success is significantly based on the selected strategy when the matter of the export to the foreign market arises. The research revealed that among the strategies to access the EU market, direct export is actively used – and is considered as desirable strategy for 78% of respondents (see figure 4).

Requirements that were introduced upon the demand of the EU member countries on the European Market should be taken into consideration as well. 51% of respondents claim that there were no additional requirements during the exportation of the product. As for the remained 49%, they affirmed existence of such requirements and it was ascertained that to enter the product to the concrete foreign market 44% of respondents had to meet the

requirements such as Quality Certificate, 15% was asked to make special packaging, 19% passed marking process, and 11% was claimed to submit the health Certificate (see Figure 5).

In Georgia, there is functioning Exporters Development Association, in order to stimulate exporters. Its member is only 23% of respondents, while 77 % of exporters even have not heard about the existence of such association. (See Figure 6).

The more market the company enters, the more regulations have to be acquainted with during the exportation. Respondents notice that export volume is significantly influenced by the regulations they face during the trade activity in the foreign market, therefore knowledge of regulations of the markets they are interested in, is important matter for 52%. However, working out of the export strategy is arguent for 68% and target market research is important for 60%. Participation in export trade fairs is less important for the 30% of respondents (See Figure 7). Question given in Questionnaire - “Which measurement is important for you that should be taken by the government, to access new export market?” – Answers were as follows:

1. The measurement, which should be taken by the government to access the export markets, like activating Free Trade Agreements, is extremely important for 38% of respondents, while 15% of them consider it as less important and 46% think that this measurement does not have any sense.
2. Improvement of the legal framework is important matter for 64% of respondents, for 8% it is less important and 28% consider it as an extremely important.
3. Professional trainings revealed to be less important for 20% of respondents, whilst 60% consider it as an important measurement for the success of the company;
4. Governmental programs consider to be as one of the prime measurement for 44 % of respondents, which provide to boost company’s motivation to improve product quality, introduce new technologies and increase productivity. (See Figure 8).

Respondents were able to state the most important issues for them in order to access the information about which should significantly determine to enter company’s production to the market. The following striking nuances revealed out of research: The most important issue stated to be information about the characteristics of the market (size, forecasts, trends, prices, competition) that was supported by 68 % of respondents; next it were fees and taxes – 54%; Then Standards and Certificates – 48%. It should be noted that almost every information is important for Georgian exporters, except the contact information of trade agents/representatives, which was not considered to be as an important information for 4% of respondents (see Figure 9).

As it was mentioned, in order to boost and develop an export, the government tries to support them by providing and implementing export facilitating programs. As for the rate of using mentioned programs, it pointed out that 70% of interviewed exporters are not involved into the mentioned programs, while remained 30% are actively participating into the present programs and they remark that any opportunity proposed for them should be used inevitably (see Figure 10).

In addition, 12% of respondents have frequently applied the export facilitate service of Ministry of Economy and Sustainable Development of Georgia, while 72% deny using the present service (see Figure 11).

One of the key issues during the survey was to identify problems exporters face in the production process. Evaluation of findings was even more interesting because Deep and Comprehensive Free Trade Area with European Union has just activated, that means that “rules of play” is changed not only for exporters, but for production on the local level as well. The findings were distributed as follows: The most important problematic issues for respondents are considered unfavorable tax system - 15% (see Figure 12).

One of the main objective for the research was to ascertain the problematic spheres that companies face during the exportation. Findings of the research outlined that 61% of respondents consider the matter of Licensing-

permitting issues less problematic and as the most problematic matter remains influence of exchange rate (69% of respondents). This one is the most active problem nowadays, which implies in strengthening USD currency and devaluating national currency. It is worth to mention, that rate, concerning the difficulties to access the export market, is sufficiently high (44 % of respondents), especially in leading countries of EU, where competition is high (see Figure 13).

During the research process, we were interested in views and expectations of exporters concerning the activation of the Deep and Comprehensive Free Trade Area. The findings were distributed as follows: It was ascertained that only 4 % of companies consider it in a negative context, while others describe it positively and believe that it is one more step taken towards the economic integration process in EU, generally in the trade sector of country (see figure 14).

Implementation of the export-related activity in the EU countries implies itself to meet the high standards and requirements of the Euro-regulations on the EU markets. Quality Control System of company, such as ISO, own 33% of respondents; 7% of them own ISO certificate and HACCP<sup>7</sup> as well, and almost 4 % of respondents own ISO certificate, HACCP and Organic (See figure 15).

During the research process it is highly important to mention future plans and show which markets are perspective to enter in the future for the interviewed exporters. It pointed out, that 22% of them are planning to deliver goods and service in Germany, 11% - in France, 7% - Poland, as for other exporters, they name such countries like: Estonia, Spain, Austria, Finland, Sweden, Slovenia (see table 2).

It was mentioned, as well, that most important thing for them is to find the markets where they will be able to make realization of their goods, so it does not matter which country's market is it.

## 5. CONCLUSIONS AND RECOMMENDATIONS

As a conclusion it should be noted, that the Association Agreement would have a great impact on Georgia regarding to change its External-Economic priorities. Georgian companies and foreign investors will adopt opportunities implied into the Association Agreement gradually. Joint-venture enterprises with the third party will be established, as well. Production culture will be increased and tradition of high technological competitive goods production will be developed.

In addition, we can receive meaningful profit and fair liberalization for the export by the export diversification. It is worth to mention, that while accessing the EU market, barriers that restrict the export diversification, may be appeared, especially in developing countries.

Such obstacles are: difficulty in accessing financial resources, unfavorable tax system, high competition, lack of goods assortment, difficulty in accessing material, lack of high technological fields, inadequate infrastructure etc. The World Bank adds that one more obstacle is weak public institutions that have an impact on policy makers and public administration, private entrepreneurs, competition and level of corruption. Despite the fact that Georgia has an unprecedented success in corruption (Corruption perceptions Index – 52; Georgia ranks 50<sup>th</sup> among 175 countries in the 2014 Corruption Perception Index<sup>8</sup>) still remain elements of so-called Elite Corruption.

The country has an important role in facilitating political adaptation in regards of implementation diversification, supporting to raise awareness concerning the measurements that are already conducted and that will be taken in the future and their results under Association Agreement. The country has a great role in supporting financial sector and attract direct foreign investments, as well as in implementation a range of export supporting programs. The mentioned

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<sup>7</sup> HACCP - Hazard analysis and critical control points

<sup>8</sup> Transparency International Georgia (n.d).

factors will support growth of export diversification level that has such an important role in economic growth of country. In order to face the challenges, the following recommendations should be considered:

To raise awareness of representatives of Georgian companies is very important. Georgian entrepreneurs should be provided by the information about the Association Agreement.

Identification of Export Markets of European Union Countries (market of 28 state members). Association Agreement concluded between the EU and Georgia and its trade component – the Deep and Comprehensive Free Trade Area implies trading to the EU market with goods and service without any tariffs and quotas and removal/facilitation of non-tariff barriers.

Considering its location, Georgia owns priority for economic integration with EU, because it is direct neighbour and participant of EU initiative – “Eastern Partnership”. All these factors support Georgian exporters enter to the markets of EU member states;

It is possible to consolidate traditional sectors, especially Agricultural products and entrepreneur sectors; Special attention will be given to the high level of productivity, creation of Value Added Taxes, that means modernization of technological base of the mentioned sectors. Therefore, it will be able to meet high demands of the mentioned sectors on the EU markets upon the context of the Association Agreement.

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Annexes

Major Sectors

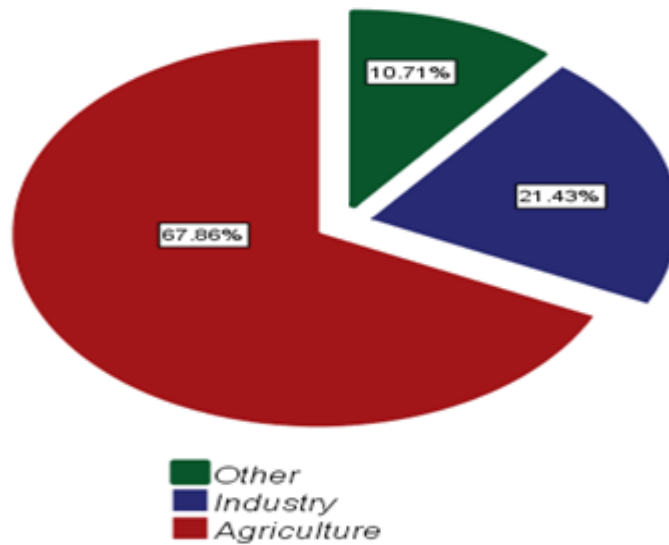


Figure-1. Major Sector

Table-1. Five leading EU member states with the highest export performance

EU Member State	Export Share
Germany	37%
Italy	26%
Latvia	18%
Lithuania	19%
United Kingdom	15%

Permanent EU member Partners

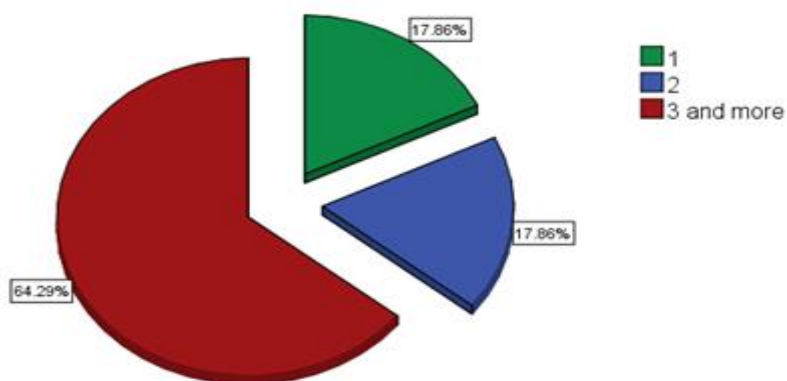


Figure-2. Permanent EU member Partners



**PLEASE ASSESS INCENTIVES INFLUENCING EXPORT**

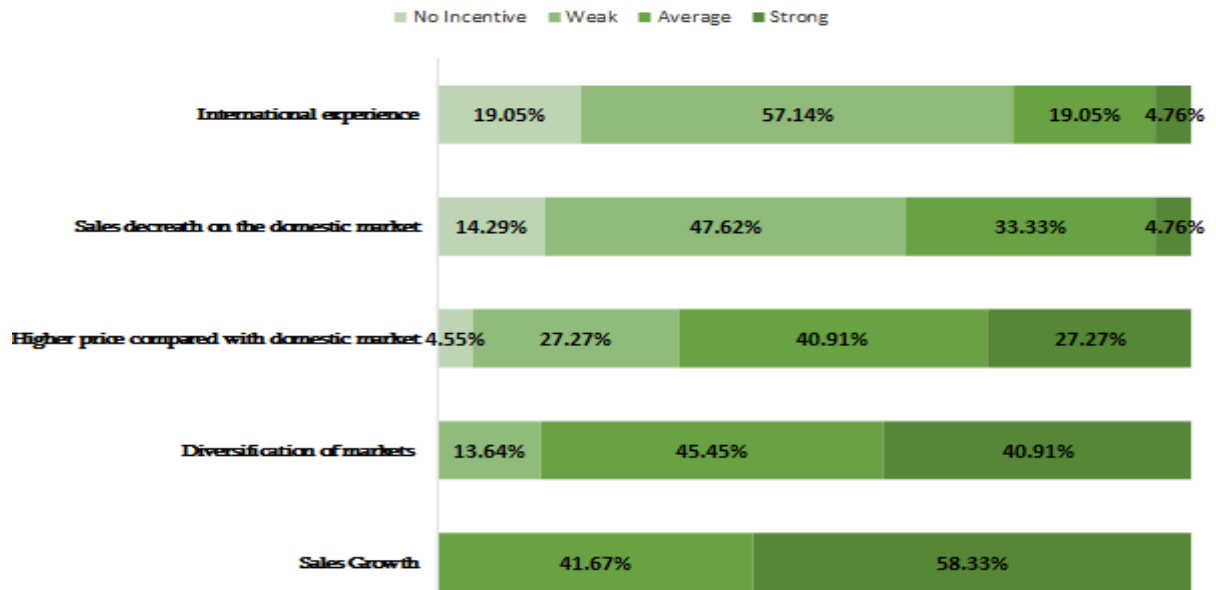


Figure-3. Please Assess Incentives Influencing Export

**Market Penetration Strategies**

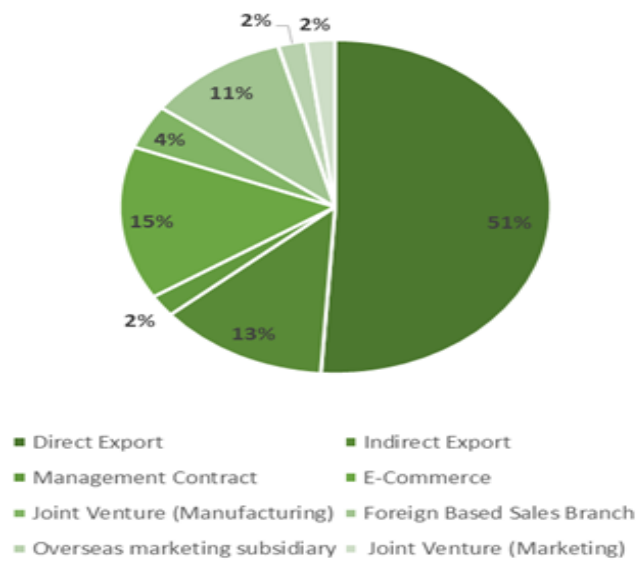


Figure-4. Market Penetration Strategies

### Additional requirements during the exportation



Figure-5. Additional requirement during the exportation

### Membership of the Export Development Association

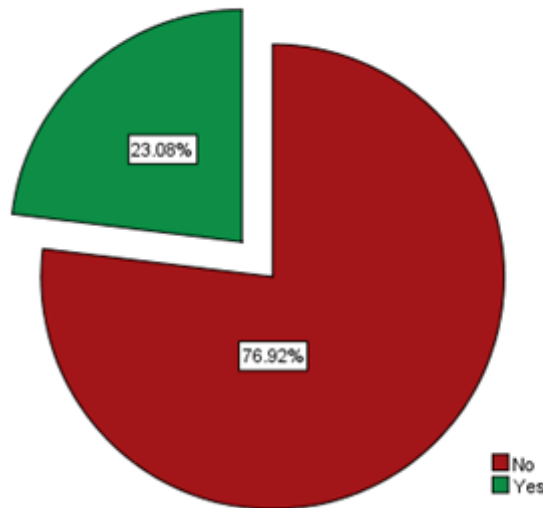


Figure-6. Membership of the export development Association

### LEVEL OF ACTIVITIES TO ACCESS TO NEW MARKETS

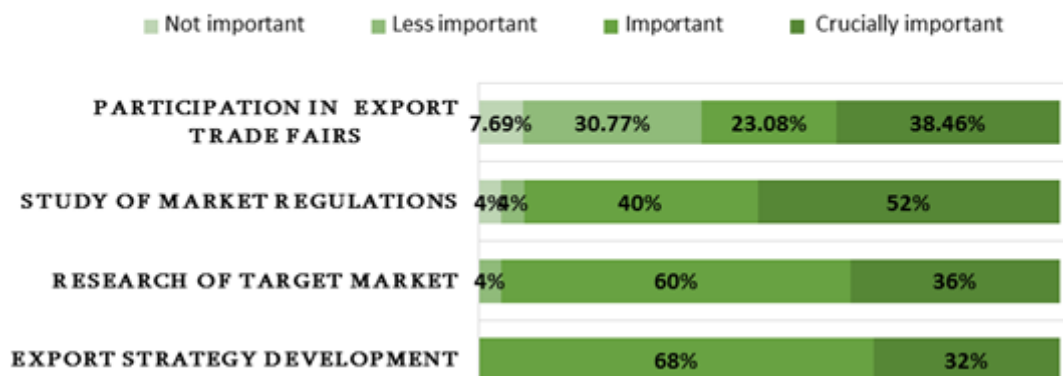


Figure-7. Level of Activities to Access to New Markets

**IMPORTANCE OF ACTIVITIES TAKEN BY THE GOVERNMENT**

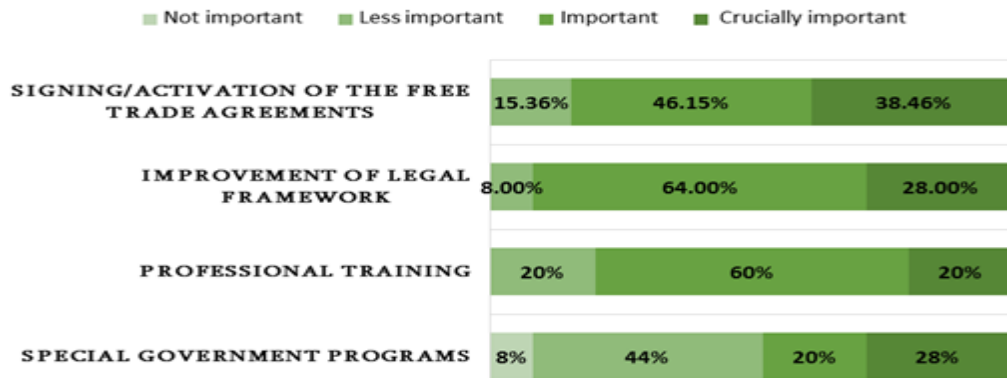


Figure-8. Importance of Activities Taken by the Government

**IMPORTANCE OF THE INFORMATION TO ACCESS TO NEW MARKETS**

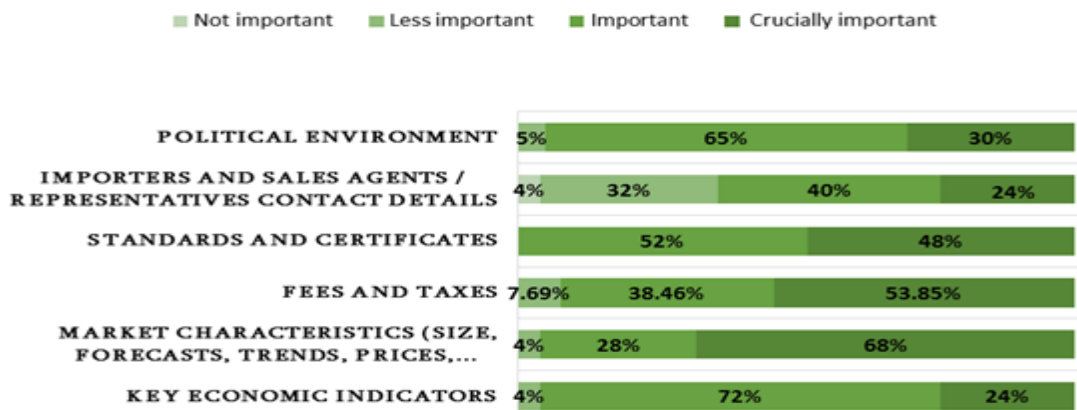


Figure-9. Importance of the Information to Access to new markets

**Impact of Export Promotion Programs**

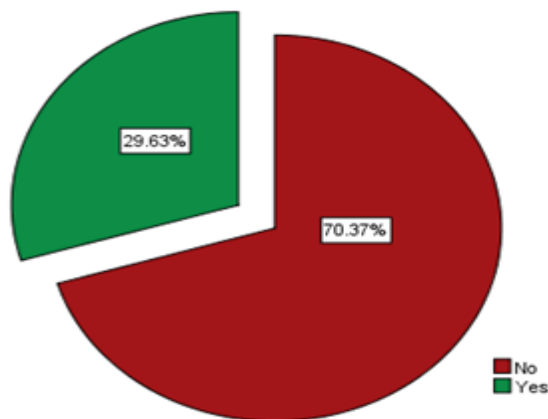


Figure-10. Impact of Export Promotion Programs

Quality of the services of the Ministry of Economy and Sustainable Development Export Promotion Programs

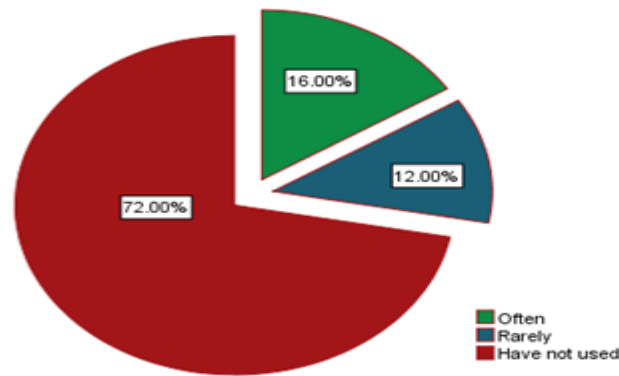


Figure-11. Quality of the services of the Ministry of Economy and Sustainable Development Export Promotion Programs

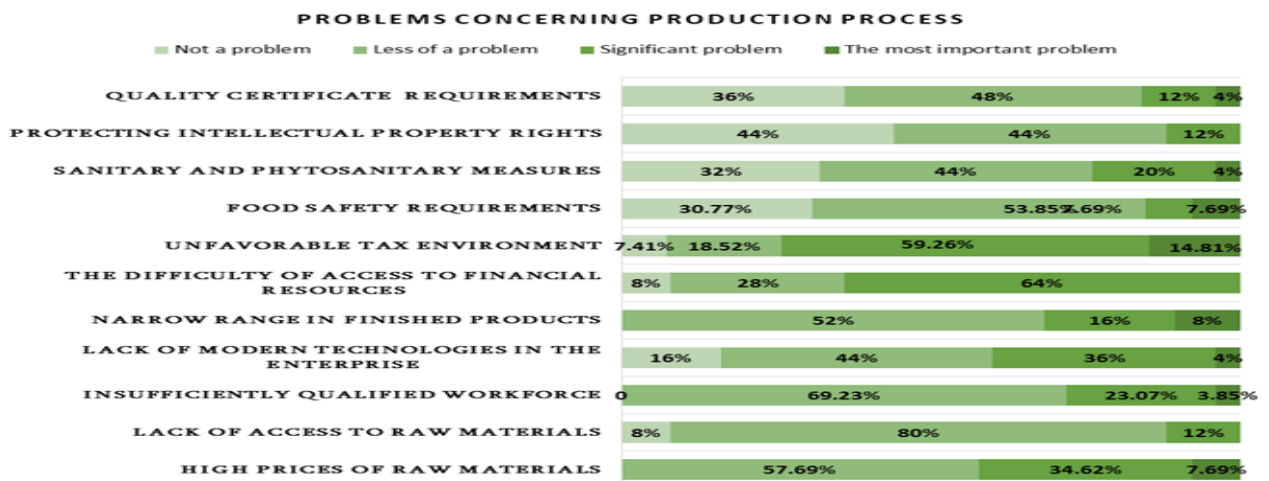


Figure-12. Problems Concerning Production Process



Figure-13. Problems of Exporting Process

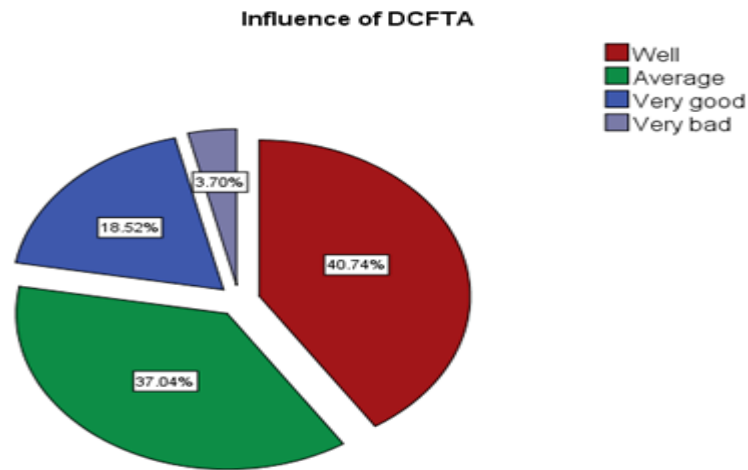


Figure-14. Influence of DCFTA

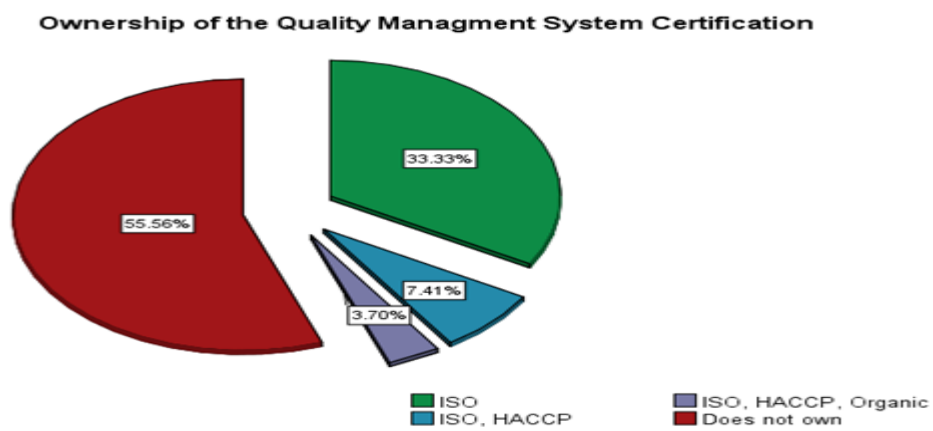


Figure-14. Ownership of the Quality Management System Certification

Table-2. Future plans of the surveyed companies in terms of export growth

EU Member State	Export Share
Germany	22%
France	11%
Poland	7%

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