

BAG INDEX

Index for the Business Association of Georgia

**III QUARTER
2020**



Research

BAG INDEX

III QUARTER, 2020

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The Business Association of Georgia (BAG) Index is a joint product of the Business Association of Georgia, PMC Research Center and the ifo Institute for Economic Research. The BAG Index summarizes the BAG Business Climate and BAG Employment Barometer, which are calculated according to the assessments of the top managers of BAG member businesses. PMC Research Center publishes the BAG Index on a quarterly basis.

BAG BUSINESS CLIMATE

The BAG Business Climate is based on the responses of BAG member businesses. Companies assess their current business situation and outline their expectations for the next six months. They can describe their current business situation as “good,” “satisfactory” or “bad” and their expectations for the next six months can be categorized as “more favorable,” “unchanged” or “less favorable.” The BAG Business Climate is a transformed mean of the balance values¹ of the current business situation and the expectations for the next six months. For the purposes of this index, BAG members are divided into the following four sectors: trade; manufacturing; construction; and service.

Apart from assessing their current business situation and expectations for the next six months, BAG member businesses are also asked to assess their situation regarding sales prices, sales/turnover/demand, and the number of employees for the last quarter and the next quarter. Moreover, businesses are asked questions related to factors hindering their business activity, access to finance, exchange rate expectations, and the judicial system.

BAG BUSINESS CYCLE CLOCK

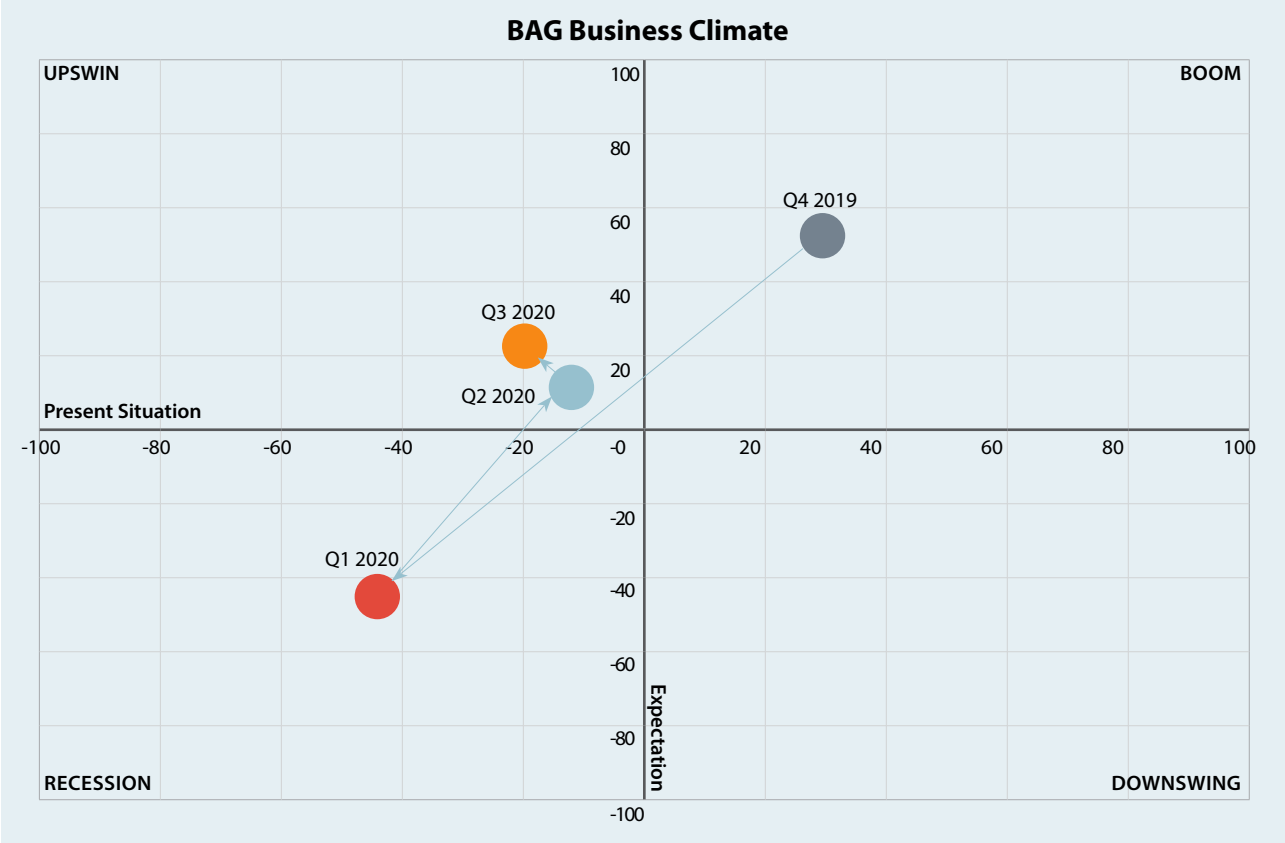
The BAG Business Cycle Clock depicts the relationship between the present business situation and business expectations for the next six months in a four-quadrant diagram. The quadrants are labeled “upswing,” “boom,” “downswing,” and “recession” and each of these are explained below:

- ✘ If survey participants assess the present business situation negatively but have positive business expectations for the next six months on balance, then the BAG business climate indicator falls in the **“upswing”** quadrant.
- ✘ If survey participants assess both the present business situation and business expectations for the next six months positively on balance, then the business climate indicator resides in the **“boom”** quadrant.
- ✘ If survey participants assess the present business situation positively but have negative business expectations for the next six months on balance, then the BAG business climate indicator is in the **“downswing”** quadrant.
- ✘ If survey participants assess the present business situation negatively and also have negative business expectations for the next six months on balance, then the BAG business climate indicator is placed in the **“recession”** quadrant.

¹ The balance value for the current business situation is the difference in the percentage shares of the “good” and “bad” responses, and the balance value for the expectations for the next six months is the difference in the percentage shares of the “more favorable” and “less favorable” responses. The BAG Business Climate can be between -100 and +100. +100 means that all surveyed businesses assess the business climate positively, while -100 means all surveyed businesses assess the business climate negatively.

IN Q3 OF 2020, BAG MEMBER BUSINESSES ASSESSED THEIR PRESENT BUSINESS SITUATION **NEGATIVELY**, WHILE THEIR EXPECTATIONS FOR THE NEXT SIX MONTHS WERE **POSITIVE**. ACCORDINGLY, IN Q3 OF 2020, THE BAG BUSINESS CLIMATE INDICATOR AMOUNTED TO 0.11 POINTS, WITH THE PRESENT BUSINESS SITUATION INDICATOR SITTING AT -19.04 AND THE BUSINESS EXPECTATIONS INDICATOR AT 21.8 POINTS.

It should be noted that in Q3 of 2020, compared to Q2 of 2020, the BAG member businesses' assessment of the present business situation worsened, while their business expectations improved.

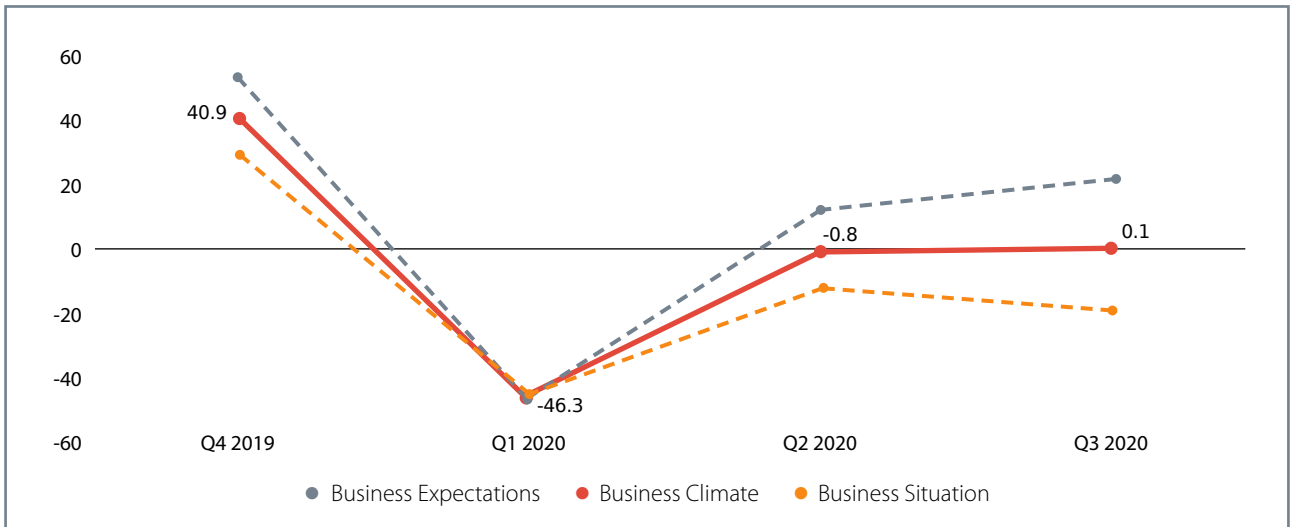


Graph 1: BAG Business Climate

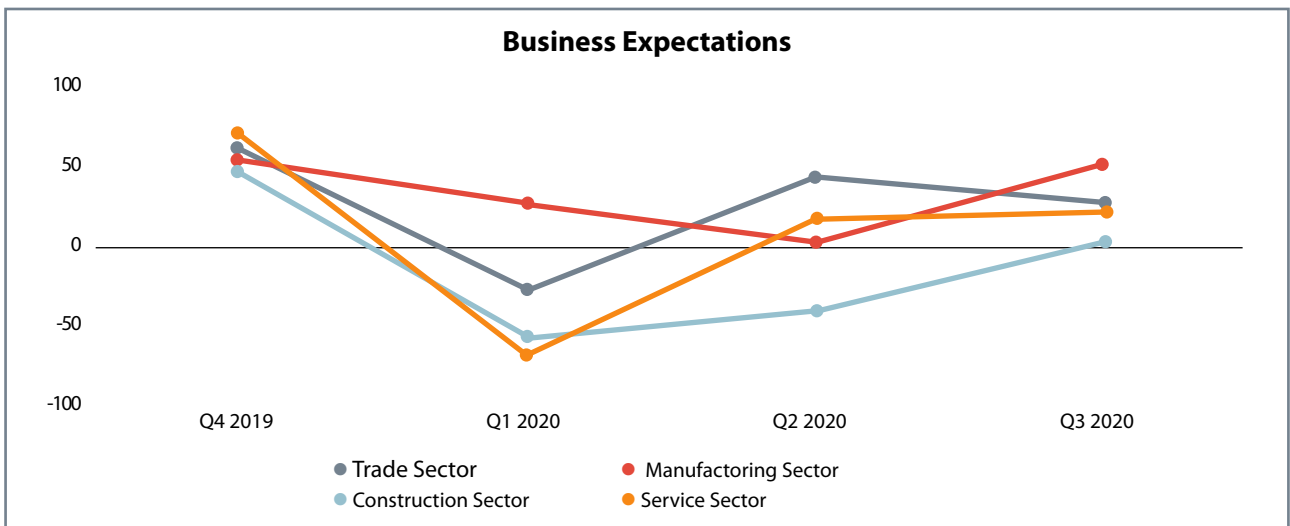
In the third quarter of 2020, the BAG Business Climate indicator is positive for all sectors except the service sector. The BAG business climate indicator is slightly negative in the service sector, which is a result of a negative assessment of the present business situation. However, the business expectations for the next six months in the service sector are positive. Similar to the service sector, the present business situation was assessed negatively in the trade and manufacturing sectors, while the business expectations were positive for the next six months. However, unlike the service sector, the optimism of the business expectations outweighs the negative assessment of the present business situation, meaning that the overall Business Climate indicator is positive for both trade and manufacturing. For the construction sector, in Q3 of 2020, compared to the previous quarter, the assessment of the present business situation and business expectations for the next six months both improved to a neutral position (0.0).

Table 1: Balance values by sector in the third quarter of 2020

	Business Climate	Present Business Situation	Business Expectation
Trade Sector	0.8	-20.8	25.0
Manufacturing Sector	12.1	-20.0	50.0
Construction Sector	0.0	0.0	0.0
Service Sector	-3.8	-25.0	20.0



Graph 2: BAG Business Climate, Business Expectations, and Present Business Situation



Graph 3: Expectation for the next six month



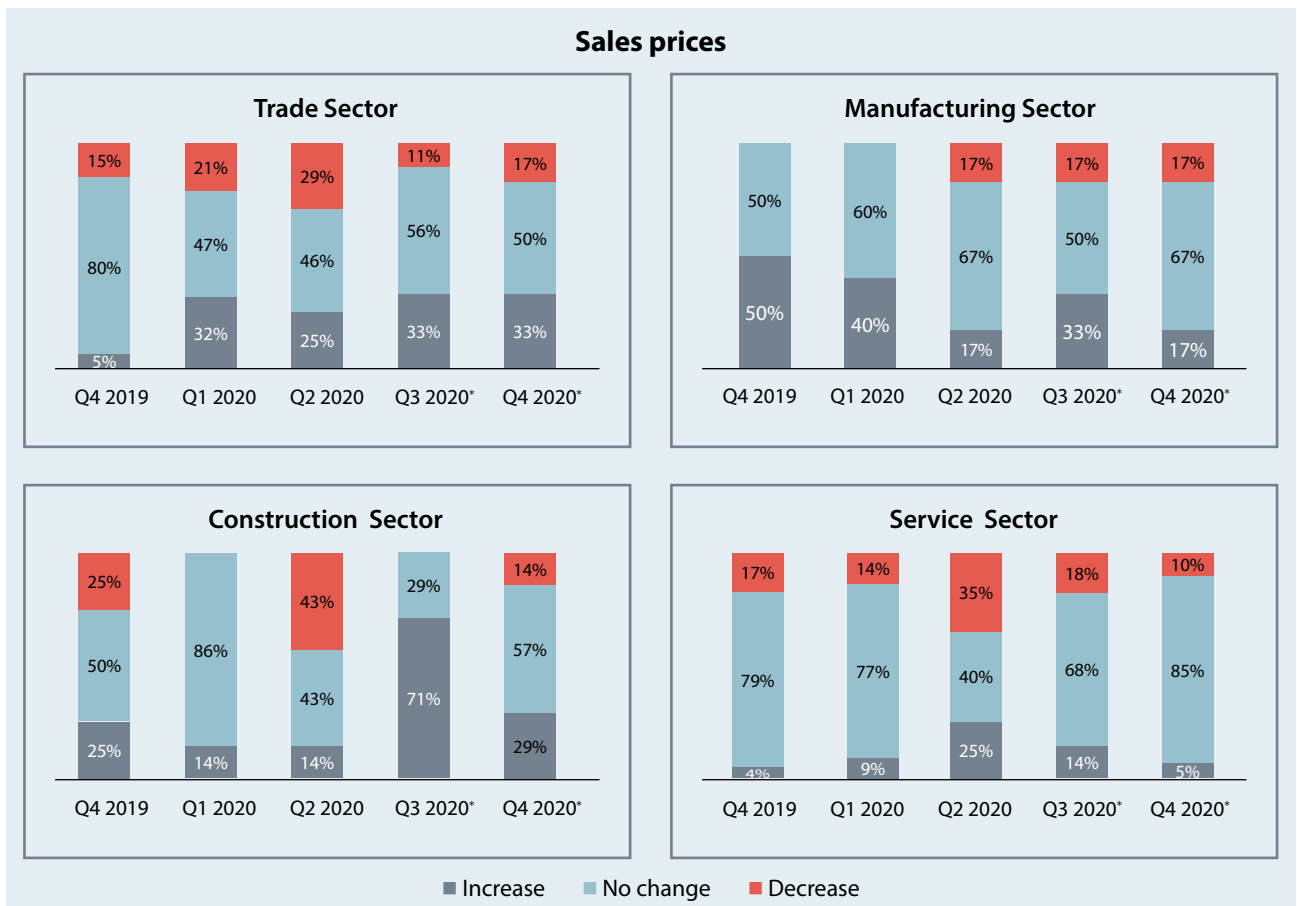
Graph 4: BAG Business Climate, Business Expectations, and Present Business Situation in Trade, Manufacturing, Construction, and Service Sectors

EXPECTATIONS FOR THE FOURTH QUARTER OF 2020

- ✘ In Q4 of 2020, compared to Q3 of 2020, 12.3% of the surveyed BAG members expect an increase in the number of employees, while 82.4% do not expect this figure to change, and 5.3% expect a decrease.
- ✘ In Q4 of 2020, compared to Q3 of 2020, a large proportion of the respondents in the construction (85.7%), service (85%), manufacturing (83.3%), and trade (79.2%) sectors do not expect a change in the number of employees.
- ✘ In Q4 of 2020, compared to Q3 of 2020, 21.1% of the surveyed companies expect sales prices to increase, while 64.9% do not expect this figure to change, and 14% expect a decrease.
- ✘ In Q4 of 2020, compared to Q3 of 2020, the majority of the respondents in the service (85%), manufacturing (66.7%), construction (57.1%), and trade (50%) sectors do not expect a change in sales prices.
- ✘ In Q4 of 2020, compared to Q3 of 2020, 42.9% of the surveyed companies in the construction sector expect sales (building) to increase.
- ✘ In Q4 of 2020, compared to Q3 of 2020, 66.7% of the surveyed businesses in the manufacturing sector expect a decrease in domestic production.
- ✘ In Q4 of 2020, compared to Q3 of 2020, 55% of the surveyed businesses in the service sector expect an increase in sales, while only 13% in the trade sector expect orders to increase.

DEVELOPMENTS IN THE SECOND QUARTER OF 2020

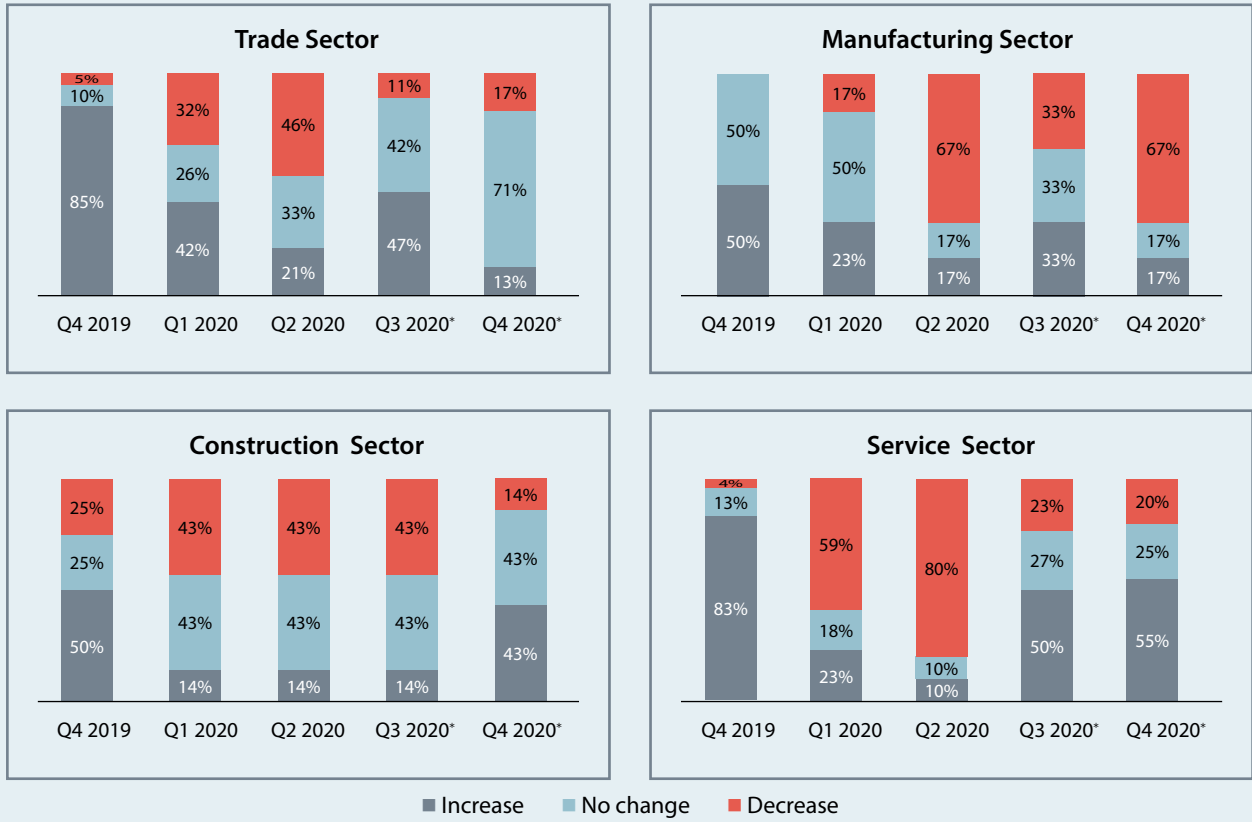
- ✘ 7% of the surveyed BAG members stated that the number of employees increased in Q2 of 2020, compared to Q1 of 2020, while for 68.4% the number of employees was unchanged, and for 24.6% the number decreased.
- ✘ 35% of the surveyed businesses in the service sector stated that the number of employees in Q2 of 2020, compared to Q1 of 2020, was decreased. This figure in the trade, manufacturing, and construction sectors is 16.7%, 16.7%, and 28.6%, respectively.
- ✘ 22.8% of the surveyed companies stated that sales prices increased in Q2 of 2020, compared to Q1 of 2020, while for 45.6% of them sales prices were unchanged, and for 31.6% sales prices decreased.
- ✘ 80% of the companies in the service sector stated that their turnover decreased in Q2 of 2020, compared to Q1 of 2020.



Graph 5: Sales prices in trade, manufacturing, construction, and service sectors

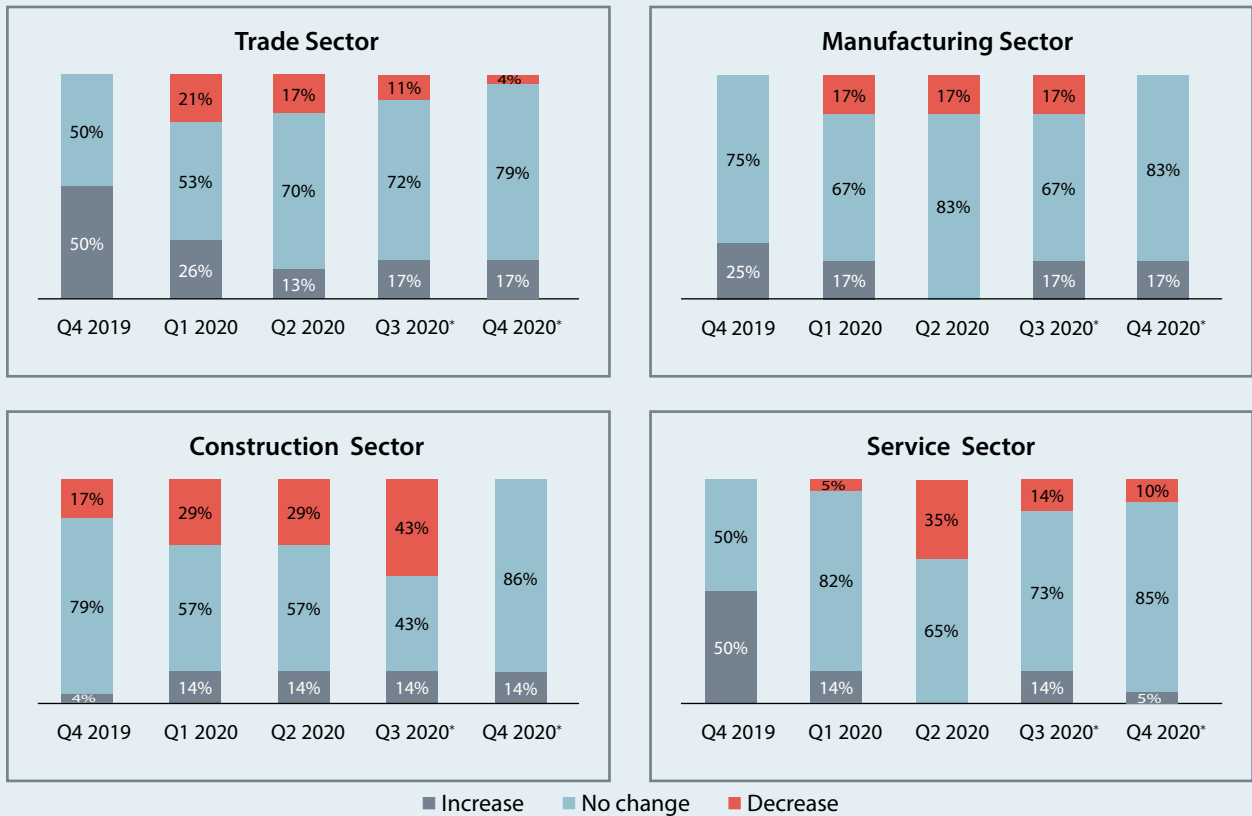
* - Expectation

Demand



Graph 6: Demand in trade, manufacturing, construction, and service sectors

Number of employees

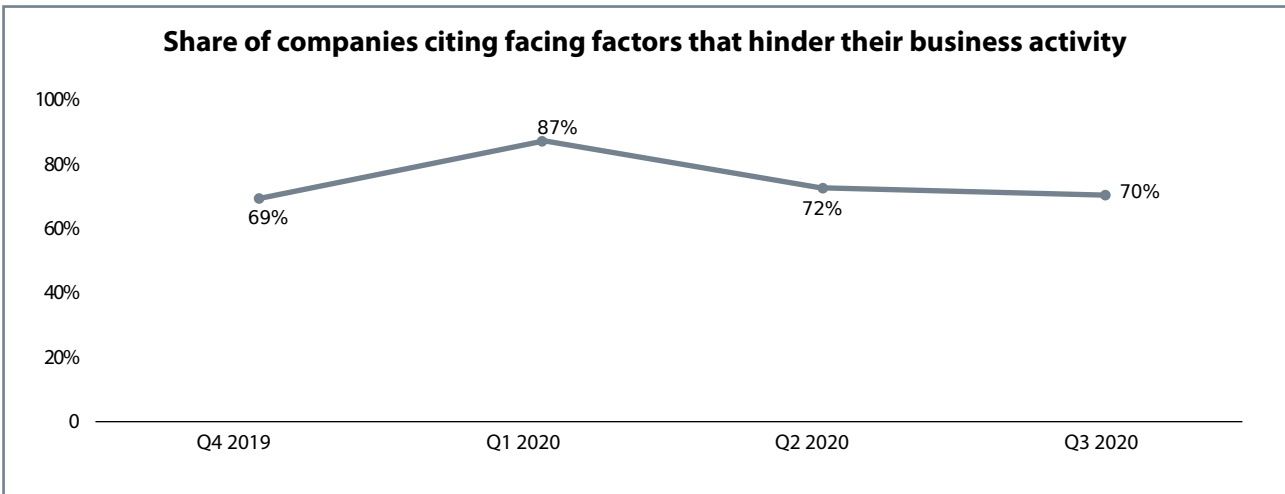


Graph 7: The number of employees in trade, manufacturing, construction, and service sectors

* - Expectation

FACTORS HINDERING BUSINESS ACTIVITY

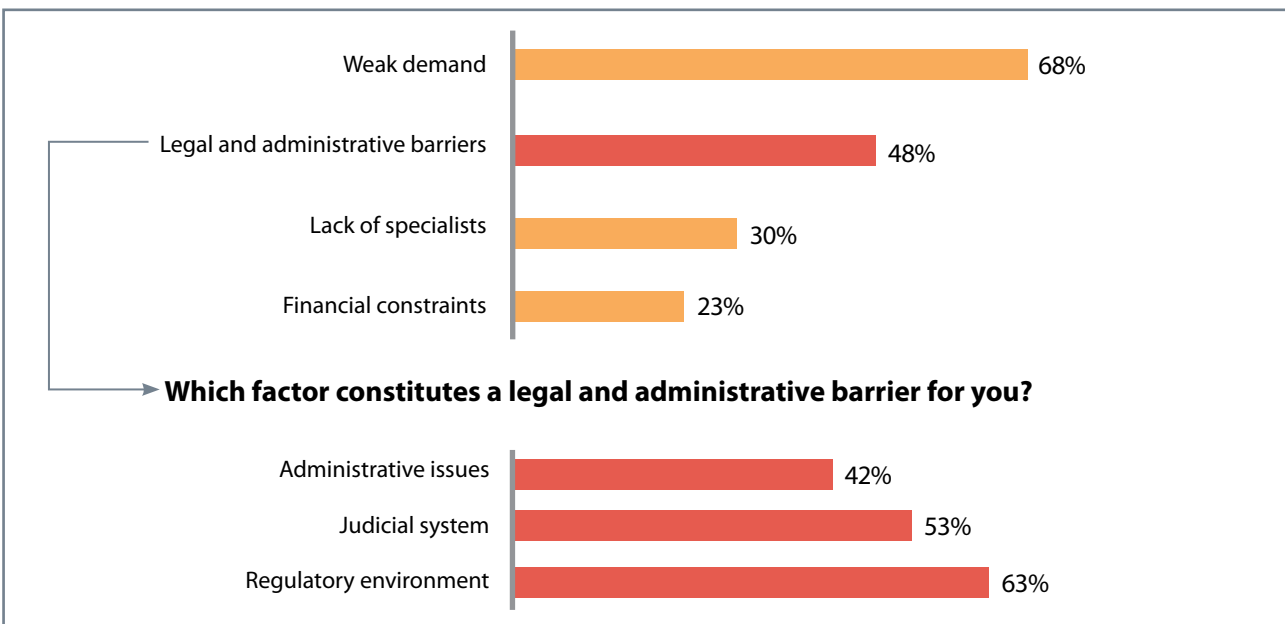
With respect to the challenges that businesses face, in Q3 of 2020, 70.2% of the surveyed businesses claimed that there are factors that hinder their business activity, while 29.8% stated that no such factors affected them.



Graph 8: Existence of factors hindering business activity

In Q3 of 2020, four factors were named as the most hindering for business activity: weak demand; legal and administrative barriers; lack of specialists; and financial constraints. Weak demand was the most prominent hindering factor and was named by 68% of respondents, followed by legal and administrative barriers, which were emphasized by 48% of the surveyed businesses.

It is worth noting that, according to the survey conducted at the end of Q4 of 2019, weak demand was cited by only 16% of surveyed businesses, while after March 2020, when the COVID-19 pandemic broke out, it became the most prominent problem.

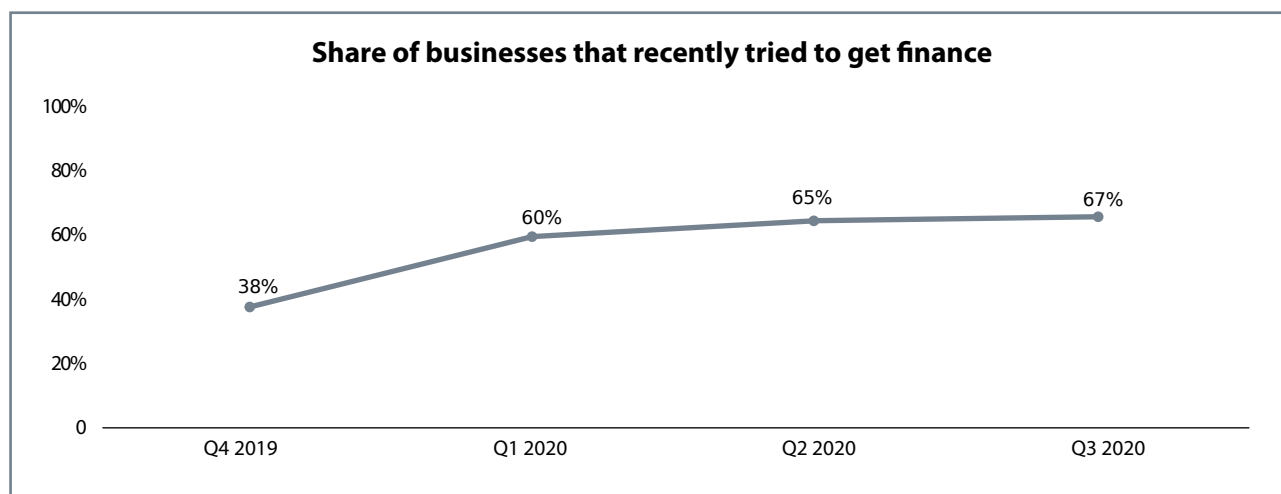


Graph 9: The main challenges that BAG businesses faced in Q3 2020

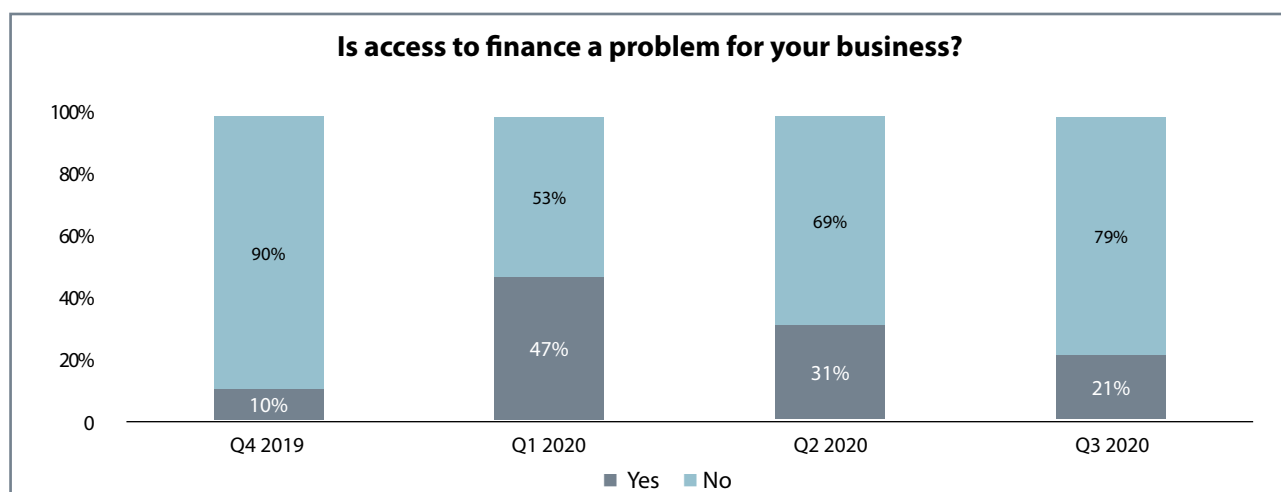
In Q3 of 2020, the majority of the surveyed BAG businesses (*only those that named "legal and administrative barriers" as a factor hindering their business activity) cited "regulatory environment" as the

most important factor contributing to the legal and administrative barriers that hinder their business activity. It is worth noting that “judicial system” was cited by a significant amount of respondents too.

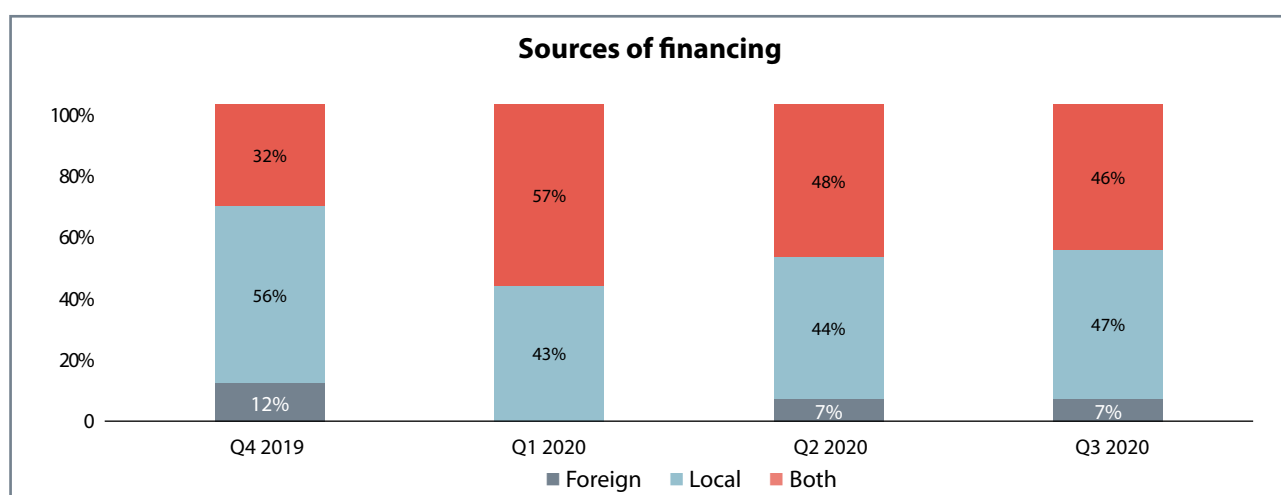
FINANCING



Graph 10: Businesses that recently tried to get finance



Graph 11: Access to finance²



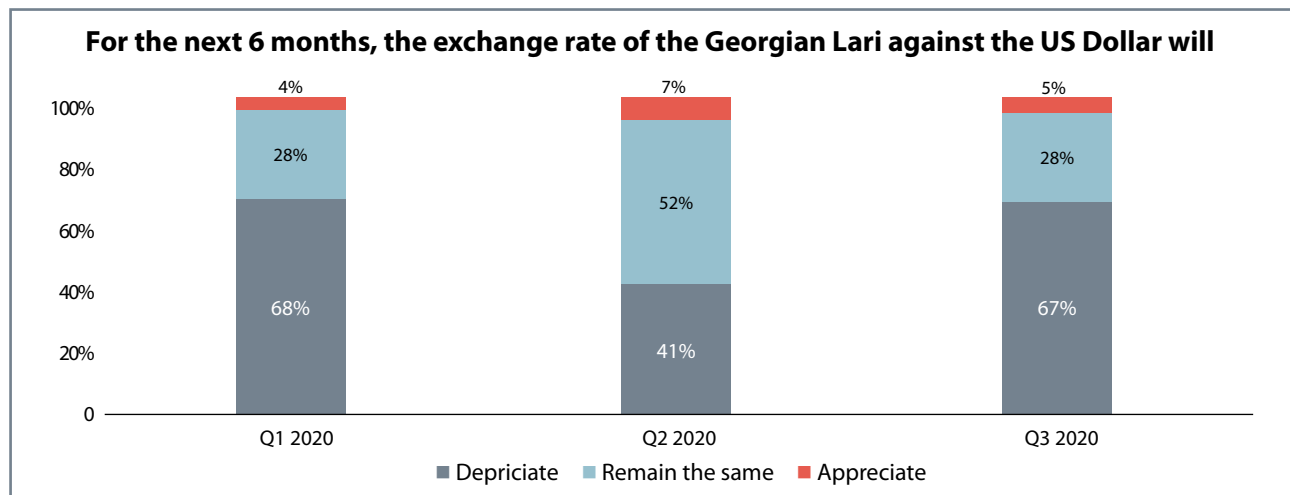
Graph 12: Sources of financing

² The question was only answered by those companies that stated they had recently sought finance.

In Q3 of 2020, 79% of companies that have recently sought finance claimed the access to finance was not a problem for them, while 21% considered the access to finance to be a problem. It is worth noting that during the period of Q4 2019 - Q3 2020, the share of companies stating that access to finance was a problem peaked in Q1 of 2020 (47%).

Furthermore, from Q4 of 2019 to Q3 of 2020, the share of the surveyed BAG members stating that they had recently tried to get finance increased (Graph 10). Moreover, the share of businesses stating they do not have a problem regarding the access to finance also increased.

EXCHANGE RATE EXPECTATIONS



Graph 13: Exchange rate of the Georgian Lari against the US Dollar

The dynamics of the expectations for the national currency's exchange rate is the same as the exchange rate itself. In Q3 of 2020, compared to Q2 of 2020, the percentage share of the surveyed companies expecting currency depreciation increased from 41% to 67%. It is also important to note that the percentage share of surveyed BAG members thinking that the exchange rate of the Georgian Lari against the US Dollar will not change decreased sharply from 52% to 28%.

JUDICIAL SYSTEM

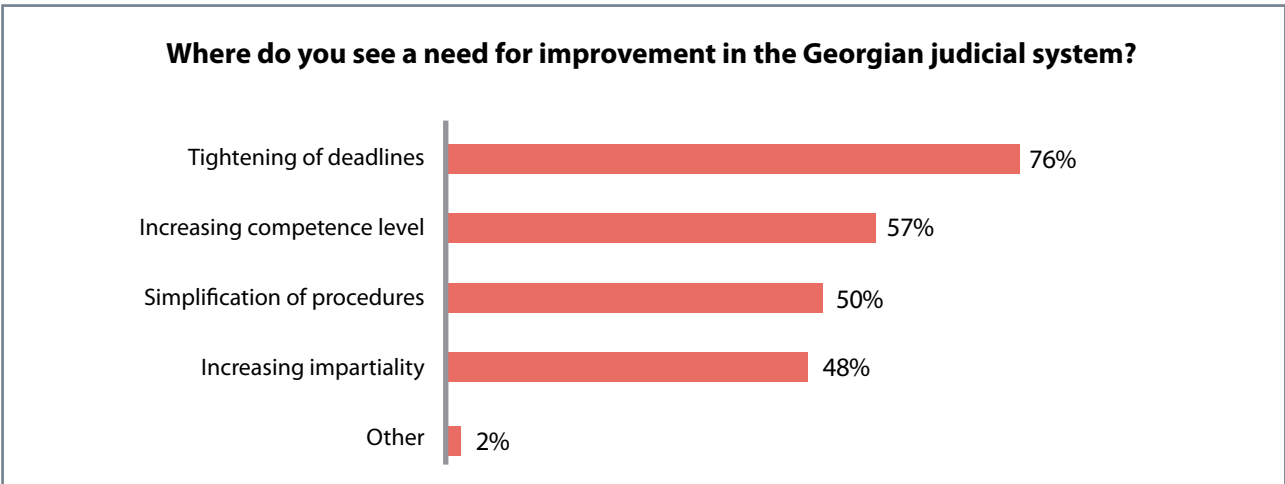
In the course of the BAG Index survey, legal and administrative barriers were cited as one of the main factors hindering business activity, with the judicial system highlighted by many as a sub-factor within this category. The current survey allowed the companies to express their views about the effectiveness of the Georgian judicial system and to identify possible areas for improvement.



Graph 14: Assessment of the efficiency of the Georgian judicial system by all respondents³

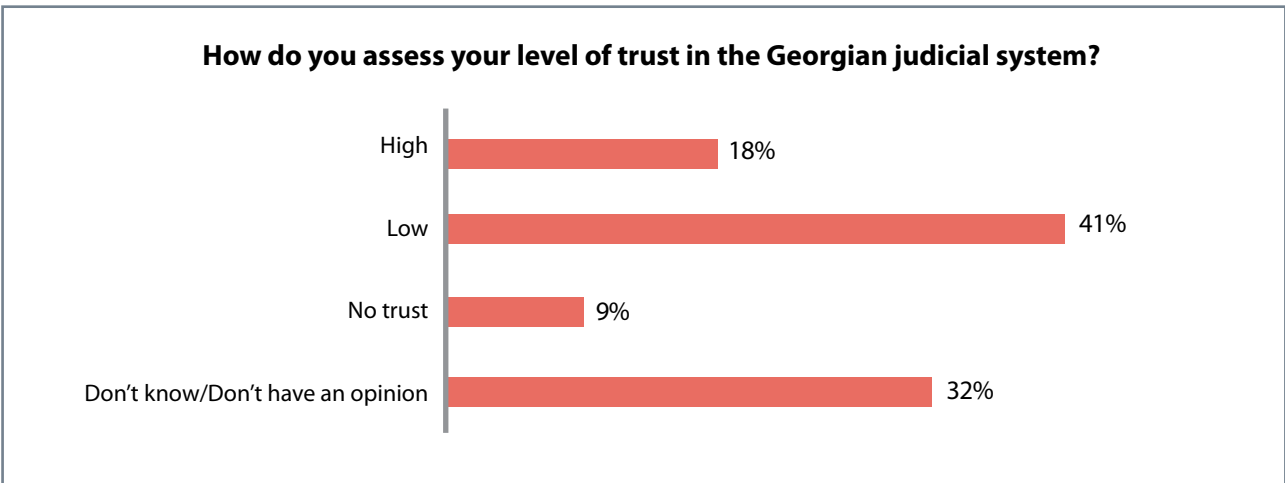
Most respondents saw a need for improvement with respect to tightening deadlines (76%) and increasing competence (57%). A large proportion of respondents also think that the judicial system will improve as a result of the simplification of procedures and an increase of impartiality.

³ Due to the rounding of numbers, the sum of the data on the graphs does not always equal 100%



Graph 15: Areas needing improvement in the Georgian judicial system

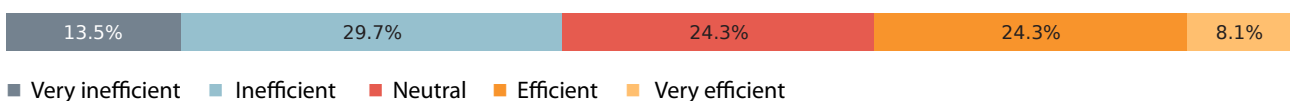
When asked about the trust in the Georgian court, only 18% of the surveyed businesses indicated a high level of trust in Georgian courts, while 41% indicated a low level of trust. Meanwhile, 9% of respondents said they had no trust in the Georgian judicial system, which is similar to the proportion of respondents who assessed the Georgian judicial system as “very inefficient.”



Graph 16: Trust in the Georgian judicial system

The opinions of the respondents who had direct contact with the Georgian court system deserve to be considered separately. In Q3 of 2020, the majority of respondents (68%) stated that they had had some interaction with the Georgian court system in the last five years. When respondents cite the judicial system as one of the impediments to doing business, it is interesting to see what the assessment is based on personal experience or public opinion.

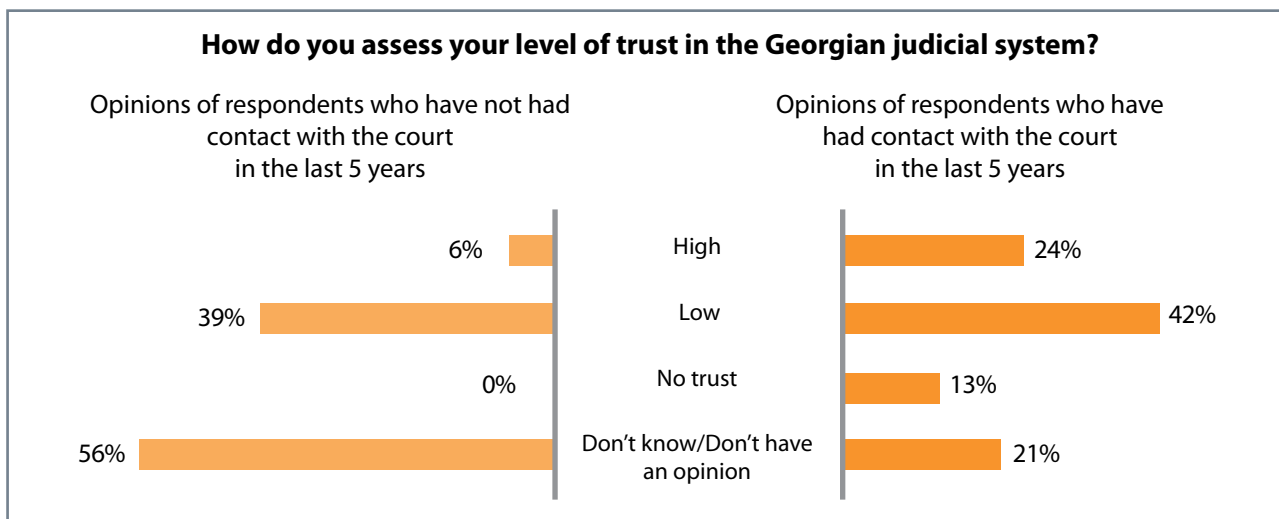
The responses of the above-mentioned groups were analyzed separately and it was found that the negative assessments of the judicial system mainly come from the personal experience. In particular, 43.2% of companies which have direct contact with the Georgian court system believe that this branch of government is ineffective or very ineffective.



Graph 17: Assessment of the efficiency of the Georgian judicial system based on the personal experience

As for the level of trust in the system, the results differ depending on whether the respondent has had direct contact with the court in the last 5 years. In particular, 55% of respondents with having direct contact with court in recent years (low trust - 42%, no trust 13%) have a negative attitude towards the Georgian judicial system. In addition, 56% of respondents who have not had direct contact with the court state they have no opinion on this branch of government. Consequently, it can be concluded that the negative responses to the overall results are mainly based on the personal experience of the respondents who have had direct contact with the court during the last 5 years.

It is also interesting to note that opinions on ways to improve the system are almost identical, regardless of whether respondents have had direct contact with the court in the last 5 years.



Graph 18: Trust in the Georgian judicial system based on experience

BAG EMPLOYMENT BAROMETER

The BAG Employment Barometer is derived from the responses of BAG member businesses. The companies were asked to outline their employment plans for the next three months.⁴

IN Q3 OF 2020, THE SURVEYED BAG MEMBER BUSINESSES HAD A POSITIVE OUTLOOK REGARDING EMPLOYMENT. THE BAG EMPLOYMENT BAROMETER AMOUNTED TO 6.2 POINTS. THIS FIGURE IS HIGHER COMPARED TO THE PREVIOUS QUARTER. IN Q2 OF 2020 THE BAG MEMBER BUSINESSES HAD MORE NEGATIVE OUTLOOK TOWARDS EMPLOYMENT AND THE BAG EMPLOYMENT BAROMETER RECORDED -2.8 POINTS.

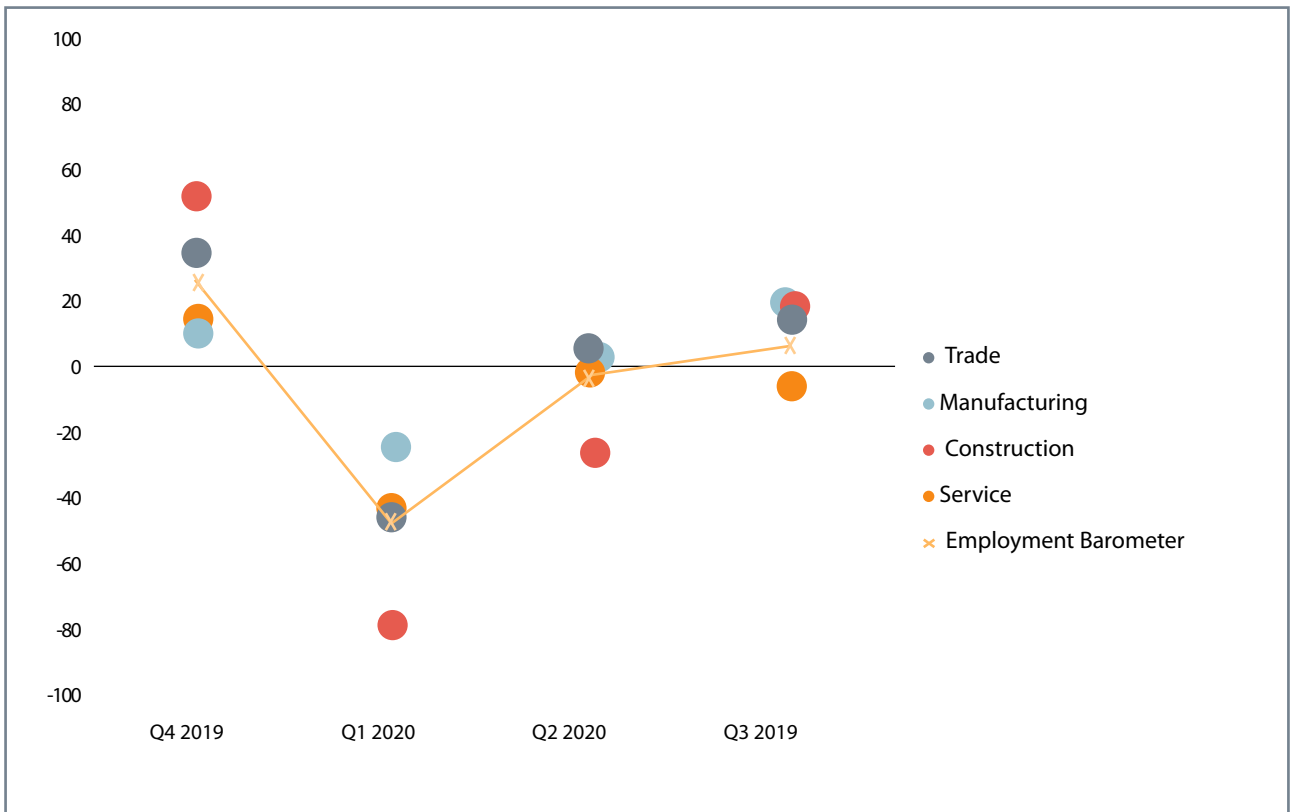
In Q3 2020, the overall negative employment expectations were only in service sector.

Table 2: Employment Barometer: Balance values by sector

BAG Employment Barometer by Sector (Balances)				
Sector	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Trade	33.3	-45.0	5.6	12.5
Manufacturing	11.1	-25.0	0	16.7
Construction	50.0	-80.0	-28.6	14.3
Service	14.6	-41.7	0	-5.0
BAG Employment Barometer	26.1	-46.7	-2.8	6.2

In the period of Q4 2019 – Q3 2020, the BAG Employment Barometer figure significantly worsened in Q1 of 2020, compared to Q4 of 2019. However, in Q3 the figure became positive, which indicates the cautious optimism of the companies.

⁴ Respondents can describe their plans regarding the number of employees for the next three months as “increasing,” “stable” or “decreasing.” The balance value of these plans is the difference in the percentage shares of the “increasing” and “decreasing” responses. The BAG Employment Barometer is a weighted mean of the balances in different sectors. The BAG Employment Barometer can be between -100 and +100. -100 means all surveyed businesses expect employment to decrease in the next three months, while +100 means all surveyed businesses expect employment to increase in the next three months.

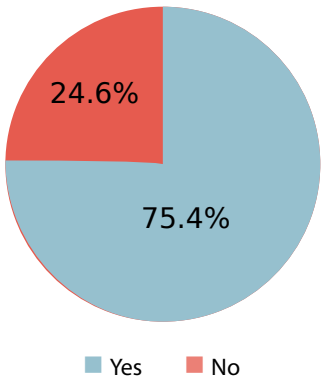


Graph 19: Balance values by sector and the BAG Employment Barometer

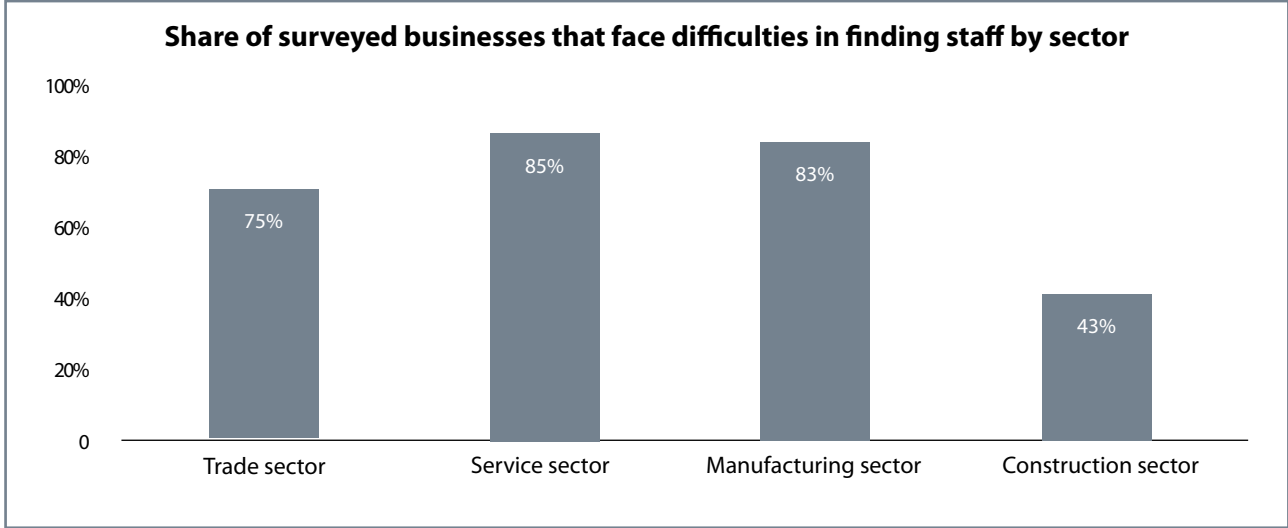
THE SURVEY OF THE NEED FOR HUMAN RESOURCES

As part of the Q3 BAG survey, the member businesses were surveyed about the need for human resources. The main result of the survey is that, more than 75% of surveyed companies claimed they faced difficulties while recruiting the staff needed. It is also worth noting that more than 80% of the surveyed businesses in the service and manufacturing sectors said they encountered difficulties when looking for the staff members, while finding staff is the least problematic for the construction sector. However, 43% of respondents from construction sector name this issue as problematic.

As for specific professions, according to the survey, the companies found it most challenging to find technical staff, technologists, developers and IT personnel, engineers, operators, and agronomists.



Graph 20: Do you face difficulties in finding staff?



Graph 21: Share of surveyed businesses facing difficulties in finding staff by sector

When recruiting personnel with the desired qualifications, 80% of surveyed businesses prefer to train new staff members in the workplace. Meanwhile, 38% of respondents also cooperate with higher and vocational education institutions (for example, as part of a “dual studying” program), while 18% of the surveyed BAG companies have established vocational training center to solve this problem.



Graph 22: Approaches to recruiting desired personnel



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