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STATE-OWNED ENTERPRISES IN GEORGIA AND THEIR EFFICIENCY

THE ANALYSIS OF AGRICULTURE SECTOR

The research is prepared within the framework of the project “**State-owned Enterprises in Georgia and their Efficiency; focus: Agriculture Sector**”.

This project is conducted by the Institute for Development of Freedom of Information (IDFI) in cooperation with the Tax Payers Union (TPU), within the framework of the East-West Management Institute (EWMI) “Policy, Advocacy and Civil Society Development in Georgia” (G-PAC) project. This project was implemented with the generous support of the American people through the United States Agency for International Development (USAID).

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PROJECT OVERVIEW

The collapse of the Soviet Union was followed by several waves of privatization in Georgia; however the number of SOEs, even after years, remained high. According to the conclusion¹ of the Chamber of Control of Georgia (now the State Audit Office), by the October 1, 2009, only LEPL “Enterprise Management Agency” was still controlling 1426 enterprises². Regarding the same conclusion, only 317 enterprises out of 1426 enterprises were profitable in 2008, while total profit 98.3% (114.77 million GEL) was accounted to only 15 enterprises.

The above mentioned numbers raise lots of questions. The activities of state-owned companies are not transparent, which increases the risks of corruption and misappropriation of the state property. The information regarding the staff and salaries/bonuses is unavailable, as well as the obtaining the business-plans of these companies and the assessment of plan fulfillment is not easily possible. Finally, the effectiveness of their activities directly reflects on the budget and therefore is the burden to the taxpayers, which increases the requirement of these companies’ accountability to the public.

As the list of SOEs is quite long and diverse, only a specific sphere was determined to be the subject of the research. Since 2013, the government prioritized the agriculture sector. Namely in 2013 the state budget allocated GEL 170 335 000 for developing the sector, this number is planned to be increased to GEL 187 815 000 in 2014.³ The financial support of SOEs themselves is quite high, being discussed detailed in this document, while the assets of these SOEs encounter hundreds of millions of GEL; among them there are 2 biggest in terms of volume of assets: “Georgian United Melioration Systems Company” with GEL 310 mln assets and “Mekanizatori” with GEL 220 mln.⁴ Studying the SOEs in Agricultural sector was the reason of above-mentioned numbers and high public interest. Project, which aimed collecting the information regarding these enterprises and assessing their efficiency, was conducted with the joint effort of Institute for Development of freedom of information (IDFI) and Tax Payers Union (TPU). The project was realized with financial support of the United States Agency for International Development (USAID) “Policy, Advocacy and Civil Society Development in Georgia” (G-PAC)project, implemented by East-West Management Institute (EWMI), and with the help of the Ministry of Agriculture, N(N)LE Agricultural projects Management Agency, the State Audit Office, Ministry of Economy and Sustainable Development, LEPL National Agency of State Property and the Ministries of Agriculture of Latvia, Lithuania and Estonia.

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1. The Audit act N9/00, 08.04.2010 of Chamber of Control of Georgia
 2. Presently, LEPL National Agency of State Property is managing 380 companies established with government shareholdings. see the whole list on <http://nasp.gov.ge/res/docs/201405191721401604.pdf>
 3. Ministry of Finance of Georgia Website <http://www.mof.ge/5233> dated 25.08.2014
 4. As per information delivered form companies themselves.

The project team expresses gratitude towards above mentioned agencies and organizations for the assistance. The authors have also used the internal audit reports of the Ministry of Agriculture, reports of the State Audit Office and the Methodology of efficiency assessment.

In order to get the whole picture interviews were conducted with decision-making officials, politicians, directors of above mentioned enterprises and experts of the field. Additionally, to review the international project, the information was obtained from the Ministries of Agriculture of Lithuania, Estonia and Latvia.

THE POLICY TOWARDS THE AGRICULTURAL STATE-OWNED ENTERPRISES IN BALTIC STATES

Studying and sharing the international experience has a crucial importance in the process of increasing the efficiency of state-owned enterprises (SOEs) and implementing the future policy of their managing. Considering the historical similarity and country scale, Baltic States have been chosen in the present study, as these states are the best examples of successful reforms in various directions for Georgia, particularly in the way of agriculture and state-owned enterprises.

The analysis of provided documents by Lithuanian, Estonian and Latvian Ministries of Agriculture shows that problems regarding SOEs of agriculture and the solutions to these problems were basically the same in these countries.

In 2010 Lithuania implemented a reform, which aimed to enhance the transparency, accountability and efficiency of state-owned enterprises. The government of Lithuania approved new transparent standards for the state-owned enterprises within the frames of reform. According to the standards, all SOEs should prepare and publish on their web-pages⁵ the annual and quarterly reports covering the activities and financial indicators. In 2012 the government of Lithuania published new instructions, in order to restrict the formation of additional SOEs. The instructions strictly defined the necessary criteria that one had to comply with in case of establishing new enterprise⁶:

1. Effective and transparent supervisory board
2. Strong Management
3. Distinct goals and objectives

Nowadays, as a result of conducted reforms, privatization and legislative acts, only 19 agricultural profile SOEs exist in Lithuania. Most of the enterprises are formed as agencies responsible for ensuring standards and agricultural products or food safety control instead of producing.

Currently, in Lithuania, as well as in Latvia, state-owned agricultural companies, which produce, process and provide services no longer exist after privatization.

As it is found out, the government of Estonia does not manage agricultural enterprises. It only owns small agricultural lands, which are related to the State Education system and they are being utilized by agricultural research institutions.

5. See the web-page: <http://vkc.vtf.lt/valdymo-ir-skaidrumo-politika/informacijos-pateikimo-terminai>
6. Implementation of the Reform of State-Owned Enterprises; http://ec.europa.eu/europe2020/pdf/nd/nrp2013_lithuania_en.pdf p. 17-18

THE ANALYSIS OF GEORGIAN FINANCIAL AND LEGAL REGULATIONS REGARDING STATE-OWNED ENTERPRISES

The legislative regulations of the enterprises, with state shareholding, require drastic improvements in regards of international obligations in Competition Law. According to the amendments, the reduction of obligations of the appropriate financial and legal privileges, so called “types of exclusive services”, should be determined, particularly in the “State procurement” section. It is required to establish the direct control, such as credit limits, cutting the subsidies and salary control. The latter is vital, as the heads of SOEs are less motivated to limit their salaries. The limitation of salaries is desirable to be conducted by the supervisory administrative body or the appropriate supervisory authority.

The paragraph 8 of article 9 of the “Entrepreneurs Law” deserves special attention: the provision about the formation of a supervisory board, which will enroll the public servant as the state representative, in the enterprise with more than 50% of state shareholding, is insufficient. The law should clearly specify whether the election of public servant as a chairman of the supervisory board is possible. Improving the activities of state representatives’ institute, within the enterprises, is of great importance. The member of the supervisory board is not an agricultural worker, as he pursues the policy of government within the enterprise. Thus, his involvement in the functions of executive activity, or passiveness and falling under the influence leadership, is unacceptable.

According to the part v¹ of paragraph 7, article 55 of Law on Entrepreneurship, in enterprise, where the state owns more than 50% of total number of votes, the supervisory board should agree the appointment and reassignment of directors with shareholder, owning more than 50% of votes. In case of disagreement between the supervisory board and shareholders, decision regarding the appointment and reassignment of the director, is made during the joint meeting. In addition, considering the interests of minority shareholders is a problem in relation to the indicated circumstances.

In accordance with the paragraph 5 of article 14 of this law, the enterprise, with state shareholding of over 50%, may use the funds deposited to the account of the enterprise to cover the necessary expenses of liquidation. If the partners decide to distribute the assets by dividing them in kind, they shall be obliged to maintain the assets at their own expense in their original form by assigning them to one of the partners during the period from deciding on initiating liquidation to the division in kind. It is noteworthy, that assigning the discretion to the leadership of SOEs within the process of liquidation – covering of “necessary” expenses from the budgetary funds, is a legal risk, referring its purpose and legal issues.

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According to the paragraph 8, article 1 of Georgian Law of Securities market, state agencies and/or enterprises, with state shareholding of over 50%, are not allowed to own the shares in financial institutions. Accordingly, the forecast of cash flow has a positive influence on the perspective planning of procurement program. In case of appropriate use, it enables the leadership to foresee the requirements and examine the availability of short-term loans and other sources of funds. It also provides the possibility to calculate the duration of loans and to negotiate about the most appropriate and favorable financial agreement. Based on the above, the forecasting of cash funds requires a plan of sales forecast to be drawn in terms of total cash income, and it should be recognized as a compulsory by the current Georgian legislation.

THE ASSESSMENT METHODOLOGY OF STATE-OWNED ENTERPRISES' EFFICIENCY

For the purpose of this study, on the initial stage project team defined the “Agricultural SOEs”. The following enterprises were regarded the agricultural SOEs: all registered companies that have defined their profiles and activities related to either producing agricultural products, delivering agro services or being engaged into sales of preliminary (raw) agricultural products and at the same with the 50% or more shareholdings of the state.

According to the website of The State Audit Office of Georgia: In 2011 the State Audit Office (SAO), with the support of Swedish National Audit Office (SNAO) and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), developed and approved Performance Audit Manual, which is based on international standards of Public Audit (ISSAIs 3000 – 3100). Performance Audit is one of the modern types of public sector audit, which is essential tool for assessing public management economy, efficiency and effectiveness. Performance Audit is focused on assessing whether the relevant value for the price was achieved⁷.

The assessment of enterprise efficiency is a combination of three components: Economy, Efficiency and Effectiveness (known as 3E – Economy, Efficiency, Effectiveness) as shown in the flowchart.



Considering the abovementioned, while evaluating the effectiveness of SOEs, the following questions should be answered:

1. Are the SOEs being managed with the principle of maximum cost saving and if all

7. State Audit Office, Performance Audit: <http://sao.ge/files/kanonmdebloba/PA%20Leaf-let%20GEO.pdf>

necessary measures are taken to save resources;

2. Are resources being utilized with maximum productivity? In other words, is it possible to achieve better results with same number of resources spent or achieve the same results with smaller resources? Resource implies both financial and human resources.

3. Regardless of the financial success or failure, are the objectives of the SOEs met and how existing management and structure contribute to this process?

Having the complete information about the research object is necessary for the effective use of methodology, which in many cases was unavailable to the authors of the research for various reasons. It was extremely difficult to obtain the financial data of the companies. Besides, purpose of establishment of some enterprises is unknown and researchers have to define it on the base of conducted interviews. Accordingly, the complete use of the methodology will be difficult; however it will give us a general picture regarding the certain enterprises.

AGRICULTURAL PROFILE OF STATE-OWNED ENTERPRISES AND THEIR EFFICIENCY

According to the research, Nowadays 71 agricultural profile SOEs are registered in Georgia. These enterprises are owned and supervised by 3 institutions:

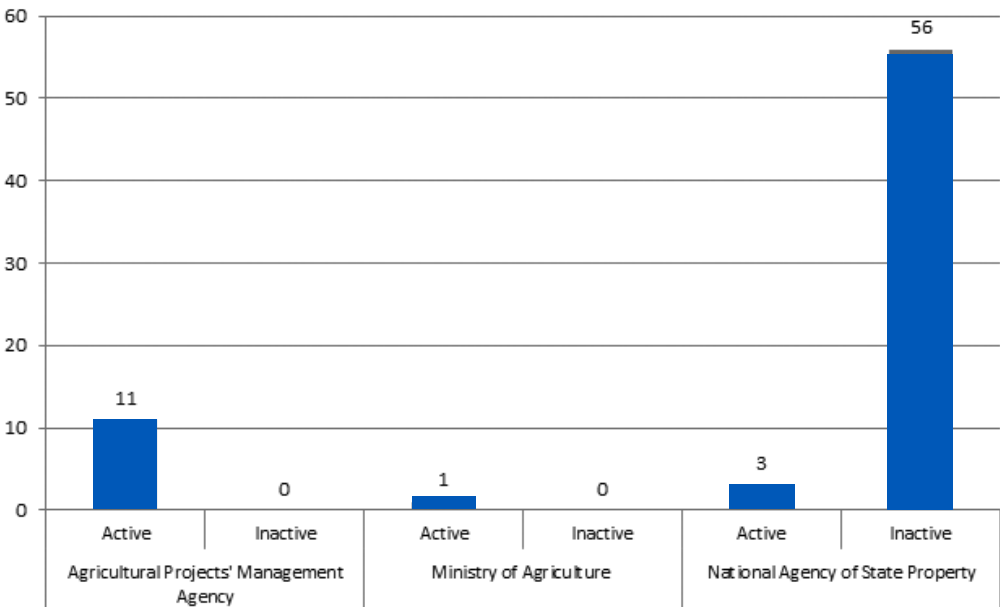
N(N)LE “Agricultural Projects’ Management Agency” (APMA) – 11 enterprises

Ministry of Agriculture – 1 enterprise

LEPL “National Agency of State Property” – 59 enterprises

In total, only 15 enterprises are active out of 71.

The Number of Agriculture Profile SOEs according to their Owners and Status



The information, received from the APMA, shows that only 3 agricultural profile enterprises are active out of 59, enlisted on its balance:

1. Ltd Kareli Agriculture market
2. Ltd Bolnisi Agriculture market
3. JSC Food Factory of Central Union of Zugdidi

Based on the obtained information, in 2013 the profit before taxation of JSC “Zugdidi Food Factory” was 28 080 GEL. In the same year Ltd “Kareli Agriculture Market” received minimum profit at the amount of 186 GEL, while Ltd “City Bolnisi Agriculture Market” did not provide the accounts of profit-loss.

	Zugdidi Food Factory	Kareli Agriculture Market	City Bolnisi Agriculture Market
Net Profit Margin Rate	18%	3%	N/A
Gross Profit Margin Rate	N/A	N/A	N/A
Operating Profit Margin Rate	N/A	N/A	N/A
Return on Assets (ROA) -Margin Rate	5%	1%	N/A
Return on Equity (ROE) – Margin Rate	5%	2%	N/A
Total Assets' Turnover Rate	26%	37%	N/A
Long-term/Fixed Assets' Turnover Rate	27%	75%	N/A

The main source of income of food markets located in regional centers is rent of spaces, which should be profitable activity. However the situation is different, which points out not only the ineffective activity and negative use of assets, but raises serious doubts regarding the concealment of income.

According to the accounts of *Bolnisi Agriculture Market*, by December 31, 2013 the total assets are over 27,280.00 GEL, while the retained earnings are negative -3,292.00 GEL, which displays that the company is unprofitable⁸.

The case of JSC “Zugdidi Food Factory” is interesting, where unlike the previous two companies, the state owns 51% of shares. The accounts of profit-loss provided by the agency shows that the factory’ profit in 2012 was increased to 15,366 GEL (220% increase), whereas in 2011 it was only 4,802 GEL. In terms of revenue growth, in the same period of the year, it was 120% and in 2012 the income reached 84,554.00 GEL (unlike the income of 2011 – 38,438.00 GEL). The fact that the company is profitable, unlike the other two, strengthens the hypothesis that the existence of private ownership motivates the profitability of the enterprise activity.

Besides these companies, project team does not possess the information on profit-loss and balance accounts over the last few years of the remaining 56 invalid or suspended enterprises, enlisted on the balance of APMA. Thus, it is impossible to estimate the scale of assets enlisted on the balance of these enterprises and accordingly, the lost revenues due to the omission of assets. Documentary disorder and related problems had been noted during the interview conducted in the State Audit Office.⁹ Naturally, it is difficult to judge the efficiency and optimality of recourse use.

8. LEPL National Agency of State Property under the Ministry of Economy and Sustainable Development of Georgia – Letter and its enclosure №5/17509 MAY 19, 2014

9. George Kekelashvili, Deputy Head of Economic Activities Audit Department, State Audit Office of Georgia – 08.04.14

ENTERPRISES OF N(N)LE “AGRICULTURAL PROJECTS MANAGEMENT AGENCY (APMA)”

According to the information from the Ministry of Agriculture received on January 13, 2014, number of enterprises, established with the shareholdings of N(N)LE “APMA” and existed under its managing, equals 11:

#	Name	ID code	Sphere of Activity	Shareholdings of Agency
1	Ltd “Gruzvinprom”	231289290	Production of wine materials, wine, brandy alcohol and grape concentrate	100%
2	JSC “Akura”	231165583	Production of wine materials, wine and brandy alcohol	99.14%
3	Ltd (LLC) Mekanizatori	206348736	Agricultural work (plough, sowing etc.)	100%
4	Ltd Gori Greenhouse	406068589	Greenhouse Agriculture	100%
5	Ltd Georgian Greenhouses Company	404908007	Greenhouse and Seedlings Agriculture	100%
6	Ltd Grain Logistics Company	404904458	Testing grain cultural variety and trading with corn seed and fertilizer	100%
7	Ltd Grain Storage Centers	404948321	Service of drying-storage of corn	Subsidiary of Ltd Grain Logistics Company
8	Ltd Land Rehabilitation Agency	404406013	Rehabilitation of plots covered with wild plants	100%
9	Ltd Food producing Company	404928174	Production of frozen vegetables and fruit	58.75%
10	JSC Agriculture Corporation	404858285	Project Management	100%
11	Ltd Georgian Vegetable	404928469	Vegetable and fruit’s demonstration plots	Subsidiary of JSC Agricultural corporation

Although, the official status of above mentioned enterprises is “operational”, the level of loading and working concept differ from each other. Most of these companies were established in 2010-2012 and the plan of their privatization is under discussion of the current leadership of the ministry as well as the agency¹⁰. Nowadays¹¹, only number of greenhouse constructions are privatized and the rest of the enterprises are still remaining under the management of the state and are still using state financial resources.

10. Davit Natroshvili (Deputy Minister of Agriculture of Georgia) date of interview: 04.02.2014; Archil Melikadze (Deputy Director of NNLE APMA) date of interview: 25.02.14

11. 07.17.2014

According to the report of 2013 of the Internal Audit Department of the Ministry of Agriculture, the business-plans of enterprises in 2012, had been planned on losses, however the real loss in many cases, exceeded the planned ones. The given table clearly shows the difference:

Company	Plan (2012)	Fulfillment (2012)
“Mekanizatori” Ltd		
income (GEL)	12 709 550	7 624 893,59
expense (GEL)	16 844 550	21 743 424,60
balance (GEL)	- 4 135 000 (loss)	- 14 118 531,01 (loss)
Akura		
income (GEL)	4 015 268	5 013 810
expense (GEL)	6 949 323	8 302 160
balance (GEL)	- 2 934 055 (loss)	- 3 288 349 (loss)
Land Rehabilitation Agency		
income (GEL)	1 959 543	759 501,03
expense (GEL)	1 813 614	1 168 319,04
balance (GEL)	145 929 (profit)	- 408 818,01(loss)
Georgian Agriculture Corporation		
income (GEL)	6 384 328	2 579 547
expense (GEL)	11 219 666	3 552 585
balance (GEL)	- 4 835 338 (loss)	- 973 038 (loss)
Georgian Greenhouses Company		
income (GEL)	2 144 000	506 653
expense (GEL)	2 295 987	1 808 347
balance (GEL)	- 151 987 (loss)	- 1 301 694 (loss)
Gruzvinprom		
income (GEL)	Not provided	12 724 929
expense (GEL)	Not provided	18 155 130
balance (GEL)	Not provided	- 5 430 201 (loss)
Food producing Company		
income (GEL)	Not provided	628,81
expense (GEL)	Not provided	450 089,94
balance (GEL)	Not provided	- 449 461,13 (loss)
Grain Logistics Company		
income(GEL)	2 163 852	1 692 869
expense (GEL)	2 098 131	1 586 682
balance (GEL)	65 721 (profit)	106 187 (profit)

Wine Factories: Ltd “Gruzvinprom” and JSC “Akura”

The activities of both companies are almost identical. Both of them own the wineries in Kakheti region and purchase the part of the grape harvest. “Akura” does not own wine bottling lines and the company just produces so called “bulk wine” as well as alcohol.

“Gruzvinprom” provides service to those companies that cannot afford wine bottling. The latter also produces alcohol and provides its realization to local companies. Ltd “Akura” permanently employs 37 people, while “Gruzvinprom” employs 64 persons.

According to the financial information, provided by Agricultural Projects Management Agency, activities of both enterprises during 2013 had been unprofitable. Based on the interviews, as well as on the provided financial information, it is obvious that both companies’ products selling price is lower than its cost price. Hence, it is logical that companies are not profitable.

It is noteworthy, that for many years government used these companies as the tools of managing the grape market; these enterprises are beneficiaries of grape subsidy program. However, the activities of these enterprises over the last year had been unprofitable. According to the report of the Ministry of Agriculture in 2013, these enterprises received a quarter of the paid 15.86 million GEL, as a subsidy from the government. The report shows, that grape purchasing-processing involved 91 wine companies, including 89 private and 2 state-owned enterprises. State-owned companies have purchased and processed only 15.6 thousand tons of grapes, which is 16.8% of the total amount. (*Inter alia*, in 2012 these companies purchased and processed more than 34 thousand tons of grapes – 65% of total amount.) The policy of purchasing the excess and low-quality grapes explains the unprofitability of these enterprises.

LTD “MEKANIZATORI”

Ltd “Mekanizatori” was founded in 2010 and nowadays it is the most large-scale state-owned agricultural enterprise. Ltd “Mekanizatori” aims to serve the farmers with agricultural equipments. The reason of creating this type of enterprise was eradicating the so-called “gap” in the existing market, which was caused by the lack of necessary equipments. The source (research or calculation) of the analysis of demand-supply is unknown and such document does not exist.

Currently, Ltd “Mekanizatori” owns 12 service-centers on regional scale in Georgia. The amount of accumulated assets purchased for the enterprise in different tenders is 300 million GEL, without taking into consideration depreciation and amortization. 411 people are permanently employed in the company.

The activities of Ltd “Mekanizatori” can be divided into two directions: (1) providing the

service for state programs and (2) providing the service for private orders. According to the Ministry of Agriculture of Georgia,¹² 80,661 hectare land was ploughed and 96,131 hectare land was harrowed in 2013 only by cards/vouchers within state programs.

Besides state program, the company cultivated land of 70,927 hectare from private orders in 2013. Private orders have been increased by 30% in comparison with the previous years.

According to 2013 net profit rate, “Mekanizatori” is unprofitable company considering end-year accounting balance. The reason of negative balance of net profit is high rate of accrued depreciation, as the serviceability deadline of purchased technique is not yet over. In the end, it can be said that the enterprise is profitable from the operational point of view at the current period, although the profit is low.¹³

The enterprise has several problems in regards of effectiveness. One of the problems is the erroneous planning of service-centers at the time, which was carried out without studying operational necessities. This is why nowadays, “Mekanizatori” has operational expenses regarding the location of agricultural technique and the existing long distance between plots.¹⁴ Besides huge expenses on fuel, the time assigned for the activities and its optimal use is the problem. As a result of long distance between plots, a lot of time is consumed for moving the technique from one plot to another.

Another problem refers to the method of calculation of service prices. The interviews of public officials and the company management reveal that the absence of pricing formula or methodology of Mekanizatori and fees are only socially-oriented¹⁵. The prices do not change in the regional context, where the demand, the scale of hardware necessity and its expenses are different. In fact, profitable service-centers subsidize non-profitable ones. Hence, the spending optimization policy of the company is doubtful.

The Greenhouses: Ltd “Gori Greenhouse agriculture” and Ltd “Georgian Greenhouses Company”

The profile of both companies is almost the same – producing vegetables and seedlings. 61 people are permanently employed in Ltd “Gori Greenhouses agriculture” and 22 people are employed in Ltd “Georgian Greenhouses Company”.

Despite the using of high level modern technologies in both companies (including Hydroponics and drip irrigation) their financial indicators are not good. At first sight,

12. The report of the activity of Ministry of Agriculture of Georgia in 2013 http://moa.gov.ge/contentimage/2013_angarishhi.pdf

13. The materials provided by the Agricultural Projects Management Agency.

14. Zviad Chkhaidze the director of Ltd “Mekanizatori”, the date of interview: 19.02.14

15. Pavle Mgeladze, the Adviser of the Department of Economic Development of the Administration of the Government of Georgia, the date of interview: 25.05.14

technologically advanced greenhouses located on wider areas are not profitable, comparing to other existing greenhouses in Georgia, even in the conditions of high demand on their products.

The main problem for both companies is the unfavorable location of their greenhouses. The severe climate, insufficient amount of sun, water quality and other factors, supposedly, were not considered during their planning process, which turned out to be harmful for the profitability of the greenhouses.¹⁶ The fact raises the doubt that the selection of their location was based on certain political goals rather than fundamental research. Namely, the selection of Tserovani Greenhouse location, supposedly, intended the employment of internally displaced persons; the Gori greenhouse regarding its adjacency with highway, which would make it easily visible for the passengers traveling to Tbilisi.

The Gori greenhouse mostly produces tomatoes. It can produce 1000 tons of tomato annually. In case of additional investment it is possible to double its production till 2000 tons annually. Despite this, the greenhouse managed to produce only 400 tons of tomatoes in 2013. The utilization of only less than a half of the processing capacity, when product demand is high and the product realization is not a problem, directly indicates to the ineffective use of resources.

LTD “GRAIN LOGISTICS COMPANY” AND LTD “GRAIN STORAGE CENTERS”

The activity of the enterprises implies producing of grain products, processing, trading and other related activities. The companies’ grain centers are located in the municipalities of Lagodekhi and Abasha. Nowadays, 30 persons are employed in Ltd “Grain Logistics Co” and 42 persons are employed in “Grain Storage centers”.

These companies are not distinguished by positive financial indicators from the above discussed enterprises. The given information makes clear that their income is low comparing to the scale of their assets, which points out that the capacity of the enterprises are not adopted and fully charged.

According to the report of ministry of agriculture in 2013¹⁷, the activities of grain storage centers during the year looked as follows:

- Drying-Storage service – Total 4,118 tons of grain was processed with the amount of 182,038 Gel within the mentioned service

16. The interview of Zurab Jirkvelishvili, Director of Ltd “Gori Greenhouse Agriculture”, date of interview: 11.03.14

17. The 2013 report of the Ministry of Agriculture of Georgia http://moa.gov.ge/contentimage/2013_angarishhi.pdf p.28

- Husking- Drying-Storage service –Total 235 tons of grain with the amount of 8,778 Gel was processed within the mentioned service
- Storage service – Total 6,244 tons of grain with the amount of 113,982 Gel was received for storage within the mentioned service.

1,295,550 kilograms of wheat, with the amount of 556,170 Gel, was grown at 594 hectares and sold by grain Logistics Company during 2013. Besides, the company realized the part of their supplies, namely: 2,838 sacks of corn seed with the amount of 681,120 Gel and 698 sacks of fertilizer, with the amount of 48,860 Gel.

It is obvious that the conducted activities during the year are of little scale considering more than 25 million assets of both companies, which indicates their ineffectiveness from every point of view. The tariff policy of storage centers is unclear for farmers, as on average drying of a kilogram of corn costs 10-12Tetri till the period when the highest selling price of corn is – approximately 40Tetri. Hence, the farmers are not ready to pay such price. It can be said that the effectiveness of both companies is low and their ownership by the state causes only the misuse of budget resources.

LTD “LAND REHABILITATION AGENCY”

Basically, the company’s function is the rehabilitation of the plots covered with wild plants with special technique. Nowadays the agency owns 636 ha of land, thereof it rehabilitated 225 ha. Besides possessing plots, the agency conducts plot rehabilitation and other types of services to individual and legal entities.¹⁸ In total 16 people are employed in Ltd “Land rehabilitation Agency”.

The financial indicators of the enterprise and the productivity of the assets owned by the company have one of the lowest benchmarks comparing to other companies. It is also noteworthy, that the depreciation cost of the company’s assets is almost twice as much of its revenues, not to mention the perspective of profit. The enterprise totally processed 204ha plots, with the amount of 128 896 Gel, in 2013.¹⁹

In addition to financial failure the essence of company’s activities is the subject of criticism. The effective utilization of already rehabilitated and refined lands owned by the company and creating additional values are not visible anywhere. It is seen from the profit-loss statement that private orders are not financially profitable. Consequently, raises the question: why does the company agree to conduct this service and does it hide the income?

18. The 2013 report of the Ministry of Agriculture http://moa.gov.ge/contentimage/2013_angarish-hi.pdf p.26

19. The 2013 report of the Ministry of Agriculture http://moa.gov.ge/contentimage/2013_angarish-hi.pdf p 28

Also, there is no clear answer about the necessity of creating separate legal entity to conduct the only one certain type of work. The integration of these services in the “Mekanizatori” would be the alternative of the legal entity.

LTD “FOOD PRODUCING COMPANY”

The company owns cold storage and rapid freezing installations In Natakhtari. Its activity includes receiving fruit and vegetable, freezing them rapidly and selling them in unseasonal period, but nowadays its activity has been suspended and the indicator of asset turnover makes it obvious. Its activity includes only realizing the remains of the supply. 16 people are employed in the company.

The enterprise oriented to process 15 thousand tons of raw materials, managed to process only 2000 tons during 2013. Despite the fact that the company is not profitable and production process is ceased, the salaries of the enterprise’s employees exceeded almost 4 times to its total incomes during 2013. Accordingly we must assume that “Food Producing Company” is another example of misusing the state investment and the negative outcome of the state’s participation in the business processes.

JSC “ GEORGIAN AGRICULTURE CORPORATION” AND LTD “GEORGIAN VEGETABLE”

The JSC “Georgian Agricultural Corporation” was established by the state to implement agricultural projects and to increase crop quality and quantity. Its name is related with the following unsuccessful²⁰ projects: supporting programs of producing wheat, corn, cranberries, grain drying centers and the program of fertilizer providing. The JSC “Georgian Agriculture Corporation” has Daughter Company Ltd “Georgian Vegetables” established in 2012 and later the corporation transferred to its daughter company former fruit and vegetables demonstration plots, irrigation systems and other inventories.

Nowadays, the selling volume of “Georgian Vegetables” is not equal even to its 1% of assets. It is difficult to talk about the company’s profit as in total the administrative expenses of both companies exceeded their income in 2013. Nowadays 7 people are employed in each of these companies, Ltd “Georgian Vegetables” and JSC “Georgian Agricultural Corporation”.

According to the corresponding audit of the State Audit office in 2012²¹ we face a lot of shortcomings and obvious violations referring to unproductive, ineffective and in most

20. The audit report N22/00 regarding the conducted activities during 2010-2011 years.

21. JSC “Georgian Agricultural Corporation”, The conducted activities’ corresponding audit report N22/00 of 2010-2011 http://sao.ge/files/auditi/auditis-angarishebi/2012/soflis-meurneobis-korporacia-2011_2011.pdf

cases, unreasonable work of JSC “Georgian Agriculture Corporation”.

One of the identified shortcomings is the signing of the contracts based on the company’s negotiations with one person about purchasing seed material for various projects, which was not adequate to the corresponding quality standards. Besides, the quantity of purchased materials exceeded the number of used and realized ones in the future. The Audit Office was not able to detect demonstration plots, where new seed varieties should be tested, although the company presented the expenses used for such demonstration plots.

LTD “GEORGIAN UNITED MELIORATION SYSTEMS COMPANY”

The (direct) founder of the enterprise is the state and it is under supervision of the Ministry of Agriculture. Nowadays it possesses all the irrigation and drainage channels all over the country.

According to the conducted activities, 74.3 thousand ha agricultural land was irrigated in 2013, which was obviously carried out on the expense of the budget money: “61 100 000 GEL was allocated to the “Georgian United Melioration Systems Company” to finance the rehabilitation of Melioration infrastructure and to procure hardware for Melioration in 2013”²². To compare, 227 000 ha had been irrigated during the Soviet Union, which clarifies the level of development of Melioration infrastructure and the scale of the investments that should be used for it. Nowadays, the company has 896 employees all over Georgia and it has regional offices besides the central one.²³

Financial Indicators of Georgian United Melioration Systems Company	
Net Profit Margin Rate	-352%
Return on Assets (ROA) Rate	-5%
Return on Equity (ROE) Rate	-6%
Total Assets' Turnover Rate	2%
Fixed Assets' Turnover Rate	2%

The assets of the company consisted of 310 533 280 Gel in 2012. The loss of the company exceeded 16 Million GEL, as the company’s operational income was 4 752 888 GEL and the expenses was 21 493 078 GEL during the same year. It is interesting that the expenses of the company exceeds its income, even without considering depreciation and amortization within the general expenses, with approximately 7 Million GEL thereof 2.5 Million GEL is only the salaries of their employees. It is noteworthy that the government increased the

22. The report of conducted activities by the Ministry of Agriculture of Georgia in 2013 http://moa.gov.ge/contentimage/2013_angarishhi.pdf p.30

23. The interview with Vaja Kirtava, the director of “Georgian United Melioration Systems Company” Date: 25.03.14

company's authorized capital with the amount of 13 600 000 GEL (budget allocations) in the same year and it reached the amount of 393 602 508 GEL.

The amount of corresponding tariffs of current melioration service fee is proved by the resolution of Georgian National Energy and Water Supply Regulatory Commission on February 1 2011: irrigation 75 GEL on a ha in a year, drainage 40 GEL on a ha in a year. It is clarified by the resolution that the tariff does not have economic calculation and supposedly, it is based only on a political decision. The existing tariff policy is not related to the quantity of consumed water, which does not motivate farmers to economize the use of water and causes extra expenses to the company.

The conducted financial auditing of the “Georgian United Melioration Systems Company” by State Audit Office of Georgia focuses on financial irregularities and several important factors regarding effectiveness, namely: according to the company the efficiency of irrigation systems is 85-90%, in reality the indicator turned out 50-55%. Consequently, the percentage of system loss is 30-35% instead of the standard stated in the report of State Audit Office, which should not exceed to 15%²⁴. Audit office recommends, that the rational plan of irrigation systems should be developed by the melioration service, which will refer to the proportional advantage of planned, acceptable, measurable outcomes within rehabilitation, regarding technical activities of necessary planned expenditures. The Audit Office focuses on the risks of the fixed tariff (75 GEL on a hectare in a year) – e.g. the use of water more than necessary by consumers or hidden use of surplus water for irrigating adjacent plots, when there is no proper registration system.

Displaying the facts of illegally consumed water resource and responding to those cases is ineffective, without proper registration system. According to the auditing estimation, the income from the penalties was only 1.5%²⁵ of total income in 2012, when the real amount of irrigating water loss is within 30-35%. It seems that the focus is on assigning ineffective examining expenses, instead of adjusting registration systems and saving water consumption, which does not have a real financial outcome. Nowadays the conducted activities of the company are oriented only on cleaning the systems and sectional growth of irrigation systems, which increases the misuse and unproductive utilization of water resources.

24. The auditing report N4/00 of the January 14, 2013 regarding financial reports of LTD “Georgian United Melioration Systems Company” including end-years 2008, 2009, 2010 and 2011 till March 12, 2012, pp13-14 http://sao.ge/files/auditi/auditis-angarishebi/2013/gaertianebuli-same-lioracio-sistemebis-kompania-2009-2012_03.pdf

25. Profit margin sheet of 2012 was delivered by Ltd “Georgian United Melioration Systems Company”.

CONCLUSIONS AND RECOMMENDATIONS

The problems related to the state companies and specifically to the state agricultural enterprises were identified by the conducted analysis and abovementioned examples within the project. Most of the problems are global and besides Georgia we face them in other countries. Hence, successful examples of developed countries should be used in the process of resolving them. On the basis of analyzed international practice within the research it can be said that the state is unsuccessful and ineffective regarding doing business and its main role is creation of favorable business environment in the process of economic development. The business activity of the state creates unhealthy competition in the market and prevents to strengthen the private sector.

In conclusion, the authors of the research pointed out main problems and prepared recommendations for Georgian government and corresponding institutions. According to the authors, considering the recommendations will increase the efficiency of state budget and will contribute to the wellbeing of the country.

1. The problem: Low quality of transparency

The lack of transparency is the first problem that was emerged from the research of state-owned enterprises. According to the existing legislation their activities are not public and they are accountable only to their founders.

The recommendation: To increase the transparency considering the experience of Latvia is desirable, where was made a political decision about the publicity of information regarding state-owned enterprises. The implementation of this is possible under the current legislation, if the state agencies and other public institutions possessing enterprises will have the obligation to publish the quarterly/annual reports regarding their companies. Reports should include company's financial statement, business plan and its analysis, also information about the management. The public institutions should be responsible for the correctness of the financial information provided by them.

2. The problem: Establishing of the SOEs as an attempt of solving a certain problem

The Georgian government justified creating business enterprises to improve the "fall" of agricultural market instead of supporting private initiatives in the previous years. On the one hand, the state prevents private initiative, competes with private sector and violations the laws of free market by establishing state-owned enterprises. On the other hand, decreases the effective use of the state resources, as its selected management is not oriented to the optimal use of the resources. Despite this, bureaucratic expenses are increased to control such enterprises.

The recommendation: The state should refuse establishing new enterprises and it should support development of private sector by creating corresponding business-environment. (regarding the existing enterprises read below) In this regard would be interesting to consider the experience of Baltic States. According to the example of these countries it is obvious that

they strictly defined the position of the state and created legal barriers to limit establishing state-owned companies, as they discovered the same risks.

3. The problem: Limited control

The State Audit Office, obliged to study and analyze the activities of state-owned enterprises, is unable to cover most of the enterprises, as the resources are limited. The selection of the auditing objects is based on the risk analysis and the focus is on the prioritized sectors during the year. Accordingly, the greater the number of the state-owned enterprises the larger resources is needed to control their activities.

The recommendation: The state-owned enterprises should be obliged to conduct annual financial auditing by hiring authoritative auditing company, which should be public, as the State Audit Office is able to audit only the small part of the enterprises. Consequently, public control will be enhanced to the abovementioned enterprises, which will increase the responsibility and accountability of the managers to the society.

4. The problem: High number of SOEs

The risks of ineffective use of budget funds and constraint of private sector development are caused by the high number of state-owned enterprises. On the other hand, it increases the state expenses necessary to control the activities of these enterprises.

The recommendation: Above all, nowadays all the existing companies directly or indirectly founded by the local or central state institutions should be listed and general list-register should be made. It is crucial to adopt general political document considering the state position towards the SOEs. The criteria should be listed in the document, which should be fulfilled by the existing enterprises and the companies established by the state. The criteria should include the following factors:

- √ Existing enterprise advisability;
- √ Analyzing its role in the market;
- √ Defining certain tasks and goals;
- √ Forming transparent and competent management.

On the basis of this document should be revised the activities of existing companies and estimated the issue of advisability of their existence. The abovementioned process should be open and all the interested parties should be involved in it.

5. The problem: Lack of transparency of procurement

The Georgian legislation of “State Procurement” applies to public organizations and to state enterprises of which 50% or more shares are owned by state or local institution (besides the exceptions stated in the Georgian law of “State Procurement”). However, the procurements of the daughter companies of state-owned enterprises are not regulated by the above cited legislation.

The recommendation: The Georgian legislation of “State Procurement” should be applied to all the legal entities, of which 50% or more shares are owned by the state, local authority or the legal entity established by them.

6. The problem: The enterprises enlisted on the balance of “Agricultural Projects Management Agency” and their low efficiency

According to the research, the effectiveness of the enterprises on the balance of “Agricultural Projects Management Agency” is low. However, the profiles of the enterprises are very different from each other and similar approaches should not be adopted to the enterprises. In the long-run, all the enterprises should be isolated, which will increase their profitability and reduce ineffective expense of state resources. Although, there are several enterprises and their immediate separation is impossible or will not have a desirable outcome.

The recommendation: The following companies and their assets should be sold to their future owners without additional obligations and preconditions: **Gruzvinprom, Akura, Gori Greenhouse Agriculture, Georgian Greenhouse Company, Grain Logistics Company, Grain Storage Centers, Food Producing Company** (State share is implied), **Georgian Agriculture Corporation and Georgian Vegetables.**

It is noteworthy, that the leadership of the Ministry of Agriculture and Agricultural Projects Management Agency expressed the desire to privatize these companies and nowadays an auction is declared on the assets of 3 companies: Ltd Grain Storage Centers, Ltd Grain Logistics Company, Ltd Georgian Greenhouse Company.

Ltd “Land Rehabilitation Agency” and the assets on its balance were mentioned above, should be privatized. The hardware on the company’s balance is expensive and it is unlikely that existing potential investors will be interested in the company of the local market. In accordance with the research the necessity of such hardware’s existence should be argued regarding the Georgian market demand and then all the necessary activities should be implemented to interest the private sector with the technique. To increase the effectiveness it should be given to one of the service-centers of “Mekanizatori” if there will not be such interest. It is better, to sell it in the international auction if the necessity of existing the equipment in the country will not be documented.

Another company – Ltd “Mekanizatori” – is under ownership of “Agricultural Projects Management Agency”. The company earned a great socio-economic importance in recent years and became a major player in the agricultural market. According to the above mentioned and considering its positive financial indicators comparing to other companies, the approach towards “Mekanizatori” should be different.

It is obvious, that the effectiveness of the company will not be improved under government management, as there are no preconditions. Therefore, the privatization of “Mekanizatori” is necessary, which includes two best ways:

1. The company will be managed by a private company interested in maximization of the profit by reducing the enterprise's expenses and increasing its income and the State will remain as a founder of the company. The management of the company should be free in the decision-making process including the tariffs of the service. It will be possible to interest and attract investors after the way of achieving company's optimization and selling state shares.
2. The company will be divided as legal entities according to its service-centers and each of them will be privatized individually. In such cases, the likelihood is high that private sector will be interested in purchasing profitable service-centers; it will be difficult to interest investors in purchasing unprofitable service-centers. The negative financial indicators of these centers, mostly, refer to high expenses caused by geographical conditions and the lack of solvent farmers. The government can use the subsidies mechanism in similar cases but it should be temporary. The final goal should be the policy based on market principles, which will not depend on the state subsidies.

7. The problem: Georgian United Melioration Systems Company and its low efficiency

Ltd "Georgian United Melioration Systems Company" is a different case, as it exclusively owns all the channels of irrigation and drainage within the territory of Georgia and it is only producer of melioration services in many regions.

The first problem related to this company is its legal status. Its commercial status is illogical due to the similarity of its activities to the standard sub institution and management based on the similar principles.

The second problem is the priorities of the company's management; they are mostly related to the development of melioration infrastructure and the growth of the irrigated area and the existing loss and disorder increase the inefficiency of the company.

The recommendation: The state should refuse managing the company and transfer it to the private company until its privatization. The new management should manage the company with business principles and maximize its healthiness. The main function of the management should be the saving resources and reducing the loss. It is necessary to create new tariff policy based on the new methodology, as the income of the company should be adequate to the expenses. The government can continue to finance rehabilitation of irrigation infrastructure, but all types of investment should contain consequent financial calculation and economical argumentation.