

George Abuselidze, Giorgi Katamadze

The importance of legal forms of business subject for formation of business environment in Georgia

The business can be organized and registered in one of several ways and form, and this form which was chosen by owners will affect the company's future and its development also. One of the first decisions that company must have is how the business organization should be structured.

All firms had to adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, life span, and financial structure. This decision will have long-term implications, so they must consult with a financial manager and other componentized people to choose right organizational structure. In making a choice, they must consider the following info:

- the size, organizational structure and nature of business,
- the level and methods of control of business,
- expected profit (or loss) from the business,
- future plan about investment into the business,
- general development plan of business.

It is important to note that the emergence of the supply-side effects of new business formation does not necessarily require the newcomers to be successful

and to survive. As long as entry induces improvements on the side of the incumbents, it will generate positive supply-side effects, even if most of the new businesses fail and have to exit the market soon after entry. Therefore, even the failed start-ups may make a significant contribution to the improvement of supply and competitiveness [Fritsch, 2008].

The article aims to analyze the dynamics of registration of the organizational-legal forms of business entities, to define the target group with the changing number of registration within the period identified and the case-study of the business entities, that includes the analysis of the state policy carried out towards such business entities and supposed impacts of external factors. The results of the analysis will enable us to understand:

- the reasons of selection of one or another organizational-legal form by the business entities;
- whether the organizational-legal forms have the impact on the economic situation of the country.

The present article is based on the official data of Ministry of Economy and Sustainable Development of Georgia, Ministry of Finance of Georgia, National Statistics Office of Georgia, National Agency of Public Registry of Georgia, the World Bank.

Research methods. In the process of preparation of the present article the quantitative qualitative, statistical, synthetic, component analysis and comparison method have been used.

Organizational-legal forms of business entities

The organizational-legal forms of business entities in Georgia is defined under the Law on Entrepreneurs, Article 2 *Business entities shall be: an individual entrepreneur, a general partnership (GP), a limited partnership (LP), a limited liability company (LLC), a joint-stock company (JSC, corporation), and a cooperative* [Law of Georgia, 1994].

Law of Georgia [1994] on entrepreneurs regulates the legal forms of the subjects of entrepreneurial activity. According to this law, business entities shall be: an individual entrepreneur, a general partnership (GP), a limited partnership (LP), a limited liability company (LLC), a joint-stock company (JSC, corporation), and a cooperative.

The trends of increasing number of registrations of business entities in Georgia

is appropriate to the evaluation of the business environment in the country. In the *Ease of Doing Business Index 2018* Georgia's ranking among the 190 countries covered by the World Bank annual report slipped to the 9th position from the 16th position last year. The latest report of the World Bank showed that Georgia's distance to frontier (DTF) is slightly improved – from 79.92 in the 2017 to 82.04 in 2018 edition [The World Bank, 2018].

According to the *Doing Business* report, the top 10 countries where it is easiest to do business are: New Zealand, Singapore, Denmark, Korea, Hong Kong, China, USA, Great Britain, Norway, Georgia, Sweden. The rank of Georgia improved from position 16 in 2008 to 9 in 2017, also – according to the *Economic Freedom of the World Index* – Georgia's rank is 8 [Frazer Institute, 2017].

In order the business environment evaluation in Georgia to be adequate and perfect, it is necessary to study not only the stages of business registration and cancellation (so called start and liquidation processes) but also the existing prob-

Table 1 **Business entities registrations in Georgia from 2007 to 2017**

Organizational – legal form	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Limited liability company	7951	8786	7834	1144	1407	15013	1771	1758	1843	2126	2553
Joint-stock company	54	39	35	34	56	37	55	64	104	81	105
General partnership	58	40	25	12	5	2	5	1	2	–	–
Limited partnership	16	8	7	2	–	–	1	–	–	–	1
Cooperative	73	38	12	16	23	18	42	587	952	534	250
Individual entrepreneur	43712	2990	3008	3407	3714	25776	2703	2720	2451	2351	2420
Foreign enterprise branch	78	61	58	65	105	100	111	162	121	223	145
Total	51942	3887	38058	45645	51404	40946	44965	45605	44125	45613	5023
		4	8	5	4		5	5	5	3	4

lems in the process of business activity, which detains the company and leads to critical situations and finally to the liquidation/reorganization [Abuselidze, Kata-madze, 2017].

In order to define the target group, we used the dynamics of the number of business entities registrations in Georgia within the period of time from 2007 to 2017 [National Statistics Department of Georgia, 2017] in particular the indicator of sharp change in the number of registrations – see Table 1.

As shown in the Table 1, the number of the registrations of limited liability companies increased in 2010 (about 46%), as well as the 20% increase is monitored within the period of time from 2016 to 2017. There are some essential and important changes relating to the cooperatives, in particular within the period of time from 2007 to 2013 only 42 entities had been registered, and from 2014 some sharp increase is monitored – in 2014 year 952 cooperative entities were registered, in 2015 – 534 cooperative entities, in 2016 – 534 cooperative entities and 250 cooperative entities in 2017. In these two categories, important increase dynamics was monitored and both were selected for our case study.

The second target category is the business entities with decreased number of registrations, in our case it is individual entrepreneurs. In particular, according to the data of 2007, the number of registered individual entrepreneurs was 37 145. This number decreased to 25 776 for 2008 year (30% decrease). Almost the same dynamics with 31% decrease was monitored in 2011-2012 in this category (of individual entrepreneurs) – in 2011 year 37 145 individual entrepreneurs were registered and in 2012 the number of registrations decreased to 25 777. Considering the above-mentioned increase and decrease of registrations, we defined the following target groups:

- limited liability companies;
- individual entrepreneurs;
- cooperatives.

In order to identify the reasons causing the changes, on the first stage we analyzed the amendments to the Tax legislation in that period, and on the second stage, we analyzed the political and economic decisions made by the government during that period of time, besides analyzed were the interstate processes that might have caused the increase of the number of registrations of the specific organizational-legal forms.

In relation to the Limited Liability Companies for 2009-2010

Since 2004, Georgia had a period of steady growth of GDP but the process was hindered in 2009 as a result of Russian-Georgian war in 2008 and the world crisis. In 2009 decrease (3.8%) was monitored, though since 2010 the average economic growth in Georgia was 7%. The revival of economy definitely had an effect on dynamics of the registrations of business entities and specifically during that period (since January 1st, 2010) the activities of the registry of entrepreneurial and non-entrepreneurial legal entities were included into the Public Registry and the registration procedure in general was simplified by the amendments cast to the registration requirements. The registration procedures of LLC-s were also simplified with the following amendments: the templates of shareholders meetings and charters were introduced and the amount of foundation capital was minimized. LLC-s became to have the most flexible and simple registration procedure among all legal forms.

In relation to the Individual Entrepreneurs

The decreased registrations were monitored as a result of Georgian-Russian

war in 2008, when the population actually avoided any registrations at all. As for 2011-2012 period, the decreased number of registrations was caused by the Decree N999 of the Minister of Finance of Georgia (December 31, 2010), according to which introduced and adopted were the micro and small business statuses granted to those natural persons meeting the following requirements:

- a) does not use hired personnel,
- b) independently carries out the economic activity, and his total yearly income does not exceed Gel 30 000.

As an instance, before this status was introduced the bakeries or barber's shops were registered as individual entrepreneurs and had to pay 20% income tax, after the amendments cast in accordance with the abovementioned document they have to pay fixed tax being 50% less than income tax. Their tax and accounting procedures were also simplified. In particular, the natural persons for tax purposes are entitled to account for incomes and expenses on a cash basis [Law of Georgia, 2012]: accounting, reporting and audit, if they are granted the status of micro (Tax code §84) or small (Tax code §88) taxpayer status and don't maintain bookkeeping [Law of Georgia, 2012, §4 §4.6] or maintain cash accounting, while the legal persons (entities) shall maintain the bookkeeping in accordance with the international standards [Law of Georgia, 2012, §4]. It means, that the legal entities shall use the accrual basis of accounting for their accounting and tax purposes.

The only exception is the entity registered as the fixed taxpayer (Georgian Tax Code, § 951), which is entitled to use cash accounting for tax purposes (Accounting, §4.6. §3.a.) provided the entity conducts only the fixed taxpayers' activities.

In the same time the Georgian government introduced the institution of Honest Taxpayer, that facilitated the

establishment of the principle of good faith and gave the opportunity to release the taxpayers from the penalties for the unintentional mistakes. Under the Tax Legislation (Tax Code §286.7) the persons with micro and small business status, as well as with the fixed taxpayer's status shall not be imposed the penalties defined under the Article 286.1-4 of Tax Code. The action resulted in increased number of such business subjects, the category without long-term experience in financial administration and with the opportunity of being released from the liability caused as a result of lack of knowledge in regulations of business activities.

In this period, the Revenue Service also established the Institute of Initial Decision opportunity, having the great importance for the business entities those trying to conduct their business activities basing on the fair, clear and agreed conditions.

Besides, the natural person having the status of micro business is free from tax, as for the natural persons with small business status having the low taxes 3%-5% of their turnover depending on the nature of their activities (the tax is far lower than those in case of individual entrepreneurs). For instance, the owner of the bakery had the yearly income in amount of Gel 10.000 during the period from 1st of January to 31st of December, and his expenses amounted to Gel 7000. In general, if the bakery were registered as the individual entrepreneur, then the owner would have to pay 20% of the actual difference between the income and expenses – in this case the difference is Gel 3000 and the tax amount payable would be Gel 600. With the micro entrepreneur status, the payable fixed tax would be Gel 500. With the creation of these two categories, the segment of business subjects expanded.

Actually, every natural person which meets the abovementioned requirements

is being registered with micro or small business status, therefore since 2011 we monitor the decrease in number of registrations of individual entrepreneurs.

In relation to the cooperatives in 2013-2014

Under the Order N2-206 as of September 20, 2013 of the Minister of Agriculture of Georgia, the Agency of Agricultural Cooperatives Development was founded, which aims to support revival of the village and agriculture by means of developing of the agricultural cooperatives; it is planned to involve the owners of the cooperatives into the different programs, to support with the international grants and the most important – on 12th July, 2013 the Clause 41 was added to the Article 130 of Tax Code according to which dividends earned by a member of an agricultural cooperative from the cooperative up to 1 January 2017 shall not be taxed and shall not be included in gross income by the person earning the dividends. Therefore the foundation of the agency and presentation of the programs were the main reason causing the growth dynamics of registrations of this category.

Conclusions

Therefore, as a result of our case study it was revealed that the following factors impact the decision making process of selection of the organizational-legal forms for the business subjects, in particular:

- the strategic programs announced by the government,
- the factor of tax policy,
- the factor of flexible administration and registration of the business subjects.

As a result of analysis of all the factors it was revealed that the organizational-legal forms of the business subjects directly impact the economic climate and development of the country, since the go-

vernment intentionally makes fiscal or general political decisions, appropriate to the strategies and aims of development of the country, therefore the government intentionally supports the top priority business segments, contributing to the political strategy and development of the country.

Our research results evidence it as follows:

- In order to activate the cooperative, the government initiated the legislative acts and tax concessions. By doing so, the aim of the government was to support the agriculture and development of the village. As a result of increase of the number of registrations of cooperatives, we got rapid revival/strengthening of agricultural field, as well as this field was donated/subsidized with the special governmental and international projects.
- By simplifying the registration of the limited liability companies, the number of the most flexible and attractive organizational-legal form of the business subjects was increased. The taxes/payments of such companies represent an important part of the budget, in addition the foreign partner companies have the most flexible relationships with the LLC-s and the organizational structure of LLC-s is the institutional form of business. By increasing the number of such business subjects and by strengthening of this category, the country creates a stable institutional basis for perfection of business sector.
- By creation of micro and small business organizational-legal forms of business subjects, individual entrepreneurs and natural persons were granted the opportunity to register as simple business forms or to change their status and to facilitate the administration of their business, to cut their accounting service expenses, taxes and to increase their incomes. All this directly reflected

on wellbeing of the population, being the aim of the state policy.

On basis of research outcomes, it can be concluded that encouragement of increase/decrease of business subjects is an indirect tool to achieve the aims of eco-

nomic policy of the country, depending on which fields of economy is to be strengthened. Therefore, the role of business subjects in formation of economic climate is very important and often the most important tool for successful economic policy.

References:

1. Abuselidze G., Katamadze G. [2017], *International Experience Of Ranking Of Georgian Business Environment And Its Impact On Economic Activity*, "Archives of Business Research", 5(5). DOI: <http://dx.doi.org/10.14738/abr.55.3166>.
2. Agency of Agricultural Cooperatives Development [2013], Order N2-206 as of September 20, 2013 of the Minister of Agriculture of Georgia.
3. Frazer Institute [2017], *Economic Freedom of the World*, Annual Report 2017, Frazer Institute, Canada.
4. Fritch M. [2008], *How does new business formation affect regional development? Introduction to the special issue*, "Small Business Economics", Vol. 30(1), p. 1-14.
5. Law of Georgia [1994], *Law on Entrepreneurs*, October 28, 1994.
6. Law of Georgia [2010], *Tax code of Georgia*, 17 September 2010, No 3591– II S.
7. Law of Georgia [2012], *On Accounting and Financial Audit*, 29 June 2012, No 6598-ES.
8. Ministry of Economy and Sustainable Development of Georgia, <http://www.economy.ge>.
9. Ministry of Finance of Georgia, <http://mof.ge>.
10. National Agency of Public Registry of Georgia, <https://sda.gov.ge>.
11. National Statistics Department of Georgia [2017], The letter N6-395, 13/02/2018.
12. World Bank [2018], *Doing Business 2018, Report*, The World Bank, <https://data.worldbank.org>.

Prof. **George Abuselidze**, Batumi Shota Rustaveli State University, Department of Finance, Banking and Insurance.

Giorgi Katamadze, Batumi Shota Rustaveli State University, Department of Finance, Banking and Insurance.