

# FEATURED ARTICLE

## LOGISTICS IS TURNING INTO THE KEY ENABLER OF GEORGIAN ECONOMY

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### Global Logistics Trends

Development of logistics services and communication technologies have dramatically changed production and distribution processes and created the *global market*. In parallel with increasing global competitive pressures, suppliers and vendors require efficient logistics services that can move their goods to the right place, at the right time, in the right condition, and for the right price.

It is therefore of great importance that regional linkages in Georgia are strengthened in order to facilitate trade, enhance regional economic integration and develop logistics for better access to the *global market*. Logistics is emerging as a new development priority in Georgia. An efficient logistics system can support Georgia's economic integration and strengthen its competitive position in the global economy.

Logistics has been becoming an important part of a global economy. In 2011, the total revenue of the logistics market in the EU reached Euro 800 billion. Germany is ranked first in the logistics industry EU-wide, with Euro 223 billion revenue and 2.8 million employees. An annual growth rate of logistics in the western EU countries amounts 5% and 15% in the eastern EU countries, which is 3-4 times higher than the GDP growth in this region. Logistics turns out to play a major role in the international competitiveness between the regions and companies which influences their strategic positioning on the global market.

### Globalization Trends and Role of Logistics

The globalization of trade and production is creating challenges and opportunities for all countries including Georgia. Those countries that create most favorable conditions for trade and investment will facilitate growth of companies that will connect domestic production to global value chains. This is particularly important for developing countries and countries with small economies since access to world markets is an absolutely critical part of their economic expansion and associated increases in overall prosperity.

In the globalization process, companies make conscious decisions as to where to produce their goods, where to sell them, and how to move them from one place to another. There are many aspects to that decision, but one important aspect is the quality and cost of logistics. It is useless to have low production costs if the finished product cannot be moved easily, cheaply, and reliably to the customer. There are two principal aspects to good logistics. The first is cost: lower costs are self-evidently attractive to firms. The second is quality: logistic reliability is paramount for many companies.

### The Role of Logistics in the Georgia's Economy

Georgia's strategic location at the crossroads between Europe and Asia makes the country an important transit route in the Caucasus Transport Corridor, which is the world's fastest growing corridor.

Logistics is a key pillar of Georgia's competitiveness, with the share of the logistics industry in the country's Gross Domestic Product (GDP) amounting to 12%.

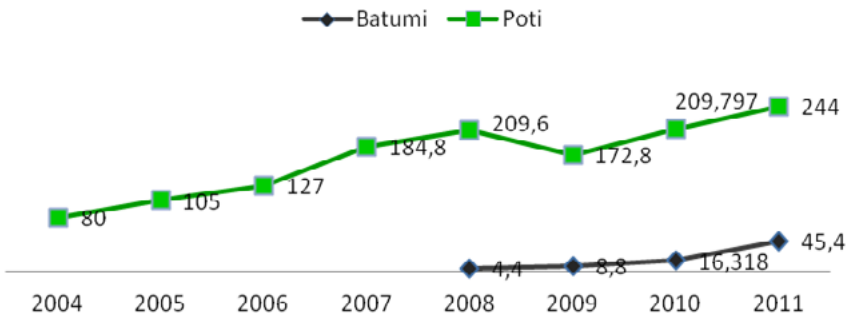
The globalization and growing economic integration between the companies in East and West and the further internationalization of the markets creates unique opportunity for Georgia to be integrated in the international trade. Sophisticated logistics improves effectiveness of the supply chain and makes it cheaper, which is an important factor for strengthening of the country and company competitiveness.

The development of the logistics plays an essential role in the prosperity of Georgia's most important industries such as agriculture, manufacturing, trade and tourism. Post harvest spoilage of fruits and vegetables in Georgia amounts to 40-50% which is caused by absence of the appropriate cold storage and warehouse infrastructure and logistics capabilities, such as refrigerated trucks. Logistics plays a key role in the supply chain of the modern agriculture industry. Its efficient management defines product quality at the international market. Logistics is therefore a decisive factor for establishment of the Georgian agricultural; products on the international market.

### Growing Georgian Transport and Logistics Market

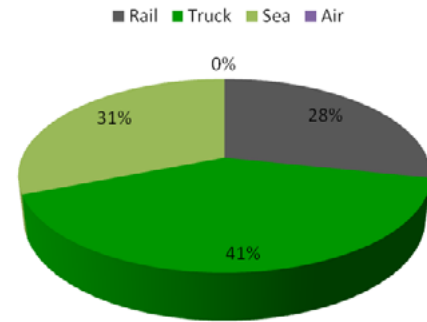
The freight transport in Georgia has grown dynamically since 2009. An average annual

Container Revenue in the Georgian Ports, TEU/tsd



Source : Georgian Logistics Association

Modal Split of Freight Transport, 2011 (mln t)



growth rate amounts 10%, which is almost two times higher than GDP growth. According to the forecast of the Georgian Logistics Association (GLA) this trend will continue in the future. In 2011 total freight in Georgia reached 49 million tons. The growth of the container transportation in the Georgian ports are significant and 2011 was a record-breaker for both the Poti and Batumi ports. The number of handled containers reached around 300,000 TEU, an increase of 33% over 2010. The number of handled containers is forecasted to be 370,000 TEU in both ports in 2012.

The modal split of the freight transport shows that road transport carries the greatest freight share in Georgia at 41%, followed by sea transportation at 31% and only then rail at 28%. The main reason of this development is the relatively high tariffs, inefficient rail infrastructure and low level of services of the Georgian Railway, which makes the road haulage more competitive than that by the rail.

The share of air cargo in freight transportation in Georgia is insignificant at not even reaching 1%. The main part of the cargo is domestic and belly freight (as part of regular passenger air cargo). However, air cargo is characterized by constant growth in recent years in Georgia. This positive trend will accelerate over the next five years.

### Main Bottlenecks in Georgian Transportation and Logistics Industry

Underdeveloped logistics infrastructure and lack of logistics knowledge are the main bottlenecks in the Georgian logistics industry. One of the main reasons of the inefficiency of the existing transportation infrastructure in Georgia is that it does not have a network effect.

Local logistics services are characterized with limited services and high costs. In Georgia, the term “logistics” only comprises transport. As a result, any complex logistics services such as warehousing, distribution, and supply chain management have been provided by the industries in-house which is creating significant costs to them as they are performing functions that are not part of their core business function. In Georgia, logistics standards have not been established yet, and there is a lack of logistics service providers. IT systems for the planning and monitoring of supply chains are still an exception. International companies in Georgia find it difficult to implement coherent strategies due to poor logistics know-how and infrastructure.

The main players in the Georgian logistics market are the classical freight forwarders, arranging mainly transport planning and road haulage. The service portfolio of these companies is very limited. There is an absence of logistics outsourcing and the contract logistics services (3PL). Given this fact, the

local companies (manufacturers, retailers and wholesalers) are forced to keep almost all logistics functions in-house. This makes cost of capital more expensive, services costly and supply chains inefficient. The logistics costs by those companies are enormous high (estimated at 40-60%) and services remain decentralized and underdeveloped. Therefore, it is difficult for local companies to gain a serious competitive advantage and good performance without effective logistics service.

The warehouse services in Georgia are very weak. Most of the existing warehouses are characterized by poor conditions and Soviet-style infrastructure, outdated equipment, low service levels and high service prices. The situation in the agricultural warehousing and cold chain segment is even more dramatic. The lack of cold storage and cold chain facilities are becoming one of the major bottlenecks in the export growth of national agriculture products in Georgia.

### Logistics Infrastructure and Know-How as Key Factors for Georgian Economic Development

The EU integration and globalization process requires a fundamental restructuring and reorientation of the transportation and logistics market in Georgia. With the increasing need for competitiveness, the ability of the country to reduce logistics costs through the provision of adequate and efficient logistics

system is more critical than ever.

*Development of the logistics system in Georgia without advanced logistics education is not possible. One of the main goals of the GLA is to create a powerful regional center of excellence for the logistics and supply chain industry and to set new standards in logistics to ensure improvement of the supply chain performance and more effective business output. Exactly that was the reason of the SCOR (Supply Chain Operations Reference) training provided by the US organization-Supply Chain Council in cooperation with EPI and the GLA in Tbilisi in November.*

### Development of Logistics Centers

The international experience shows that logistics centers are one of the most effective instruments to create efficient economic and transport cycles and increase competitiveness of the participating companies. Development of the network of logistics centers in Georgia will establish competitive intermodal transportation system, which will result in the improvement of the supply chain performance and reduction of logistics costs. Finally, logistics centers will strongly support Georgia's establishment as a logistics hub for the Caucasus and Central Asia.

The main benefits of the logistics centers in Georgia are:

- Development of efficient transportation system enabling Georgia to be integrated in the international logistics network

- Development of qualified and high-level logistics services and distribution efficiency for local businesses
- Attraction of international players into local market
- Quick access to the market for both suppliers as well as customers
- Provision of suitable conditions for the development of new business opportunities through the typical mixture of companies and the logistics-oriented services
- Direct time and cost savings which are achieved by cooperative purchases and pooling of resources

### Opportunities and Challenges

According to the GLA forecast, the freight transportation will achieve two-digit annual growth over next couple of years, which implies more outputs and more demand for specialized logistics services.

This demand will create opportunities to develop more efficient logistics system to Georgia to become a part of global logistics network and attract global players to the country. To realize this potential the following tasks have to be undertaken:

- Development of the long term logistics strategy to focus on the strengthening of competitiveness of Georgia as a logistics location and its integration in the global logistics network.

- Systematic development of transportation infrastructure to give the transportation system the network effect and increase its efficiency.
- Attraction of private investments in the development of transportation and logistics infrastructure through appropriate forms, such as *Public Private Partnerships*.
- Harmonization of the transport and trade legal framework to support trade facilitation and attraction of foreign direct investment.
- Development of cooperation and new partnership models between freight forwarders, carriers and infrastructure operators.
- Establishment of a powerful regional center of excellence for the logistics in Georgia through a Georgia-based Supply Chain Council chapter.
- Introduction of advanced logistics education programs at bachelor's, master's, and doctoral levels and development of short certification programs and trainings in logistics and supply chain management.

The GLA, supported by EPI, is already on track to implement some of these initiatives. A broader support by other private and public sector stakeholders will be needed to unleash to the potential of the logistics sector and its contributions to broader competitiveness of Georgian economy.