

Position Paper: Current Situation of the SME Sector in Georgia – Civil Society Perspective

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Introduction

Reforms undertaken during the course of the past years and steps taken towards EU integration involved significant changes for entrepreneurs and SMEs operating in Georgia. These changes brought simplification and improvement of business environment and presented opportunities by opening of new markets and new possibilities. However, further reforms and steps need to be taken towards achieving increased capacity of Georgian entrepreneurs and SMEs to become sources of innovation, job creation and sustainable economic development.

Arguments

Notwithstanding the fact that in parallel to the reform process the number and turnover of SMEs in Georgia have substantially increased, it is still arguable whether these firms play an important economic role as agents of change through entrepreneurial and innovative activities. Composition of SMEs in Georgia, as well as characteristics of the self-employed, show high concentration of their activities in “unproductive” entrepreneurship. These “unproductivity” characteristics are low income generation, low growth potential, low innovation and value added, low job creation potential.

Potential of SMEs in Georgia is yet to be exploited in the following directions: diversification of economic structure; identification and emergence of new sectors and new markets; internationalization and integration into the global economy; establishment of SMEs as sources of innovation; strengthening research and development component; contribution to economic development through linkages with other businesses and through inter-firm level cooperation; acting as suppliers to larger firms; and increased collaboration with academia. The country’s western orientation and EU aspirations will play a positive role in the development processes.

Apart from the factors that are at the discretion of the government, there are a number of other external factors affecting entrepreneurship and SME development that are not solely dependent on governmental policy. These include impact of the external macroeconomic shocks and regional political and economic architecture.

Studies highlight challenges related to access to finance due to the high cost of capital, rigidity and risk assessment practices of bank institutions. These findings highlight that the perceived constraint of lack of finance is not the only problem. Major constraints present in Georgia are problems related to lengthy insolvency procedures, poor dispute settlement mechanisms, bottlenecks in the legislations related to the protection of property rights and business processes.

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The following **policy recommendations** can be provided:

- Improve regulatory framework and policymaking practices for businesses

Consistent economic policymaking practices are needed to overcome turbulent macroeconomic environment with unstable national currency and inflation risks.

Greater efforts are needed to create foreseeable business and investment environment. This includes provision of inclusive policymaking practices that are based on rigorous analysis and *ex ante* regulatory impact assessment for legislative changes having significant effect on private sector and economy.

Greater transparency and certainty must be ensured in the policymaking practices. The government should announce foreseen changes and give a possibility to the private sector to engage in the dialogue process and be on board as early as possible.

More specific reforms should be taken in the direction of improving exit procedures for businesses and the so-called “second chance” for entrepreneurs.

Reform of judiciary and establishment of trustworthy alternative dispute settlement mechanisms needs to become a priority for improving Georgia’s rankings for potential domestic as well as foreign investors.

Further steps are needed for improving protection of private property rights and the rule of law.

Along with the streamlining of tax administration, further reduction of tax burden seems to be a necessary precondition for achieving higher economic development. This specifically concerns indirect tax rates.

In order to foster entrepreneurial mindset in the society, relevant state agencies should pay particular attention to further displaying successful entrepreneurs.

- Improved access to information and capital

Steps need to be taken to ensuring equal access to information regarding the state funded programs and direct support measures. In order to streamline access to capital, the government can establish favorable financing programs for SMEs by developing early-stage risk capital with special emphasis on relatively innovative startups and SMEs. Along with the interest rate subsidy, further attention should be paid to the provision of the necessary collateral.

Reforms for creating alternative sources of capital are rather timely, yet need further economic advancement and development.

In line with the provision of second chances for entrepreneurs, post-petition financing mechanisms could be considered. The unavailability of post-petition financing is a limitation in the framework for reorganization for viable businesses. This mechanism could be additionally introduced during the reform process of the insolvency law.

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- Entrepreneurial learning and improvements in research and development

Business and managerial skills and lack of subsequent entrepreneurial knowledge represent a constraint in business growth and development. Additionally, skill mismatch is a frequently cited problem by entrepreneurs looking for human resource. Primary and higher education systems need to reorient to produce more industry-relevant skills.

At the basic education level, school curriculum needs to factor in prerequisites that encourage innovative thinking. In addition, more emphasis is needed on industry-relevant vocational training and education courses that cater to the technical needs of the various priority sectors identified by the government and the private sector.

Another important area is the provision of adequate managerial and marketing competencies, as the analysis showed that many founders had these skills, which possibly set them apart and provided them with the requisite skills to start their entrepreneurial activity.

Investments in research and development is practically nonexistent, even among high-growth firms, and there is virtually no industry-research collaboration. Synergies must be built between these two communities in the priority areas identified by the government.

Conclusions

Since gaining independence, the government of Georgia has been employing various public policy tools for fostering entrepreneurial activities in the country. However, one can argue the economic impact of these policies, especially when it comes to the so-called direct support measures is questionable. In line with the reforms undertaken by the government of Georgia over the course of past years, respondents believe that the overall business environment is gradually improving.

Indirect support measures fostering business environment have a larger effect on the entrepreneurial outcomes as compared to direct support measures that benefit only a handful of entrepreneurs. More efforts should be directed towards combating institutional weaknesses rather than to the provision of direct support measures that due to budgetary constraints have a limited impact. In practice, however these are not mutually exclusive approaches. Both can be used to promote entrepreneurship and SME development.

More Information

The Eastern Partnership Civil Society Forum (EaP CSF) is a unique multi-layered regional civil society platform aimed at promoting European integration, facilitating reforms and democratic transformations in the six Eastern Partnership countries - Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Serving as the civil society and people-to-people dimension of the Eastern Partnership, the EaP CSF strives to strengthen civil society in the region, boost pluralism in public discourse and policy making by promoting participatory democracy and fundamental freedoms. For more information, please visit the EaP CSF website at www.eap-csf.eu