SME Policy Index

Eastern Partner Countries 2016

ASSESSING THE IMPLEMENTATION OF THE SMALL BUSINESS ACT FOR EUROPE

OECD

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European Bank for Reconstruction and Development

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Foreword

The Eastern partner (EaP) region comprises six countries (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine). Despite different economic structures, they share a number of common strengths, including a highly educated workforce, a strategic geographic position and a recognition of the importance of improving the business environment. To leverage these strengths, the EaP countries are progressively opening up their economies to trade and investment opportunities and are making efforts to converge with best policy practices and global standards.

Today, all six countries are striving to strengthen competitiveness, diversify their economies, boost growth and increase resilience against external shocks. Small and medium-sized enterprise (SME) policies are a fundamental component of this reform agenda. SMEs are major contributors to sustainable and inclusive growth and job creation. They account for 60% to 70% of employment and generate more than 60% of total value-added in OECD countries. Dynamic and growth-oriented SMEs integrated into global value chains are key to boosting productivity, innovation and competitiveness. Yet SMEs everywhere continue to be constrained in their access to finance, skills' level, innovative capacity, access to business support services and opportunities for internationalisation.

The *SME Policy Index: Eastern Partner Countries 2016 – Assessing the Implementation of the Small Business Act for Europe* offers policy makers and other stakeholders in the EaP countries a framework to assess progress in designing and implementing effective SME policies. It is the second report of its kind, following the first assessment published in 2012. This 2016 edition takes stock of progress made in the EaP countries since 2012. It uses an enhanced methodology to identify strengths and weaknesses in relevant policies, compares performance across countries and policy areas, and measures convergence towards the policy principles of the Small Business Act for Europe. The analysis is supplemented by country-level policy recommendations and a dedicated policy roadmap to address persistent challenges since the first round of assessment.

The 2016 assessment reveals significant, albeit uneven, progress. Many of the recommendations made in 2012 have been implemented. Despite country variations, the overall implementation of business environment reforms is a necessary step towards a level playing field for all businesses. Moreover, it is encouraging to observe greater attention being given to the institutional aspects of SME policy making, with a clear drive towards introducing medium-term SME strategies and setting up dedicated agencies. However, targeted support measures are still needed to enhance SME competitiveness, innovation and internationalisation, and boost entrepreneurial human capital; while monitoring and evaluation systems must be considerably strengthened to capture the impact of policies on businesses and provide grounds for calibration where needed.

This publication is the result of co-operation between the OECD, the European Commission (DG Internal Market, Industry, Entrepreneurship and SMEs), the European Training Foundation and the European Bank for Reconstruction and Development, in partnership with the governments of the six EaP countries and in consultation with experts, stakeholders, and representatives of the SME sector. We look forward to continuing this very fruitful collaboration on SME policy reforms as an important driver for growth, job creation and social cohesion in the EaP region. In particular, we believe that the dedicated Eastern Partnership SME Panel will be instrumental in monitoring and discussing further progress and possible challenges in SME policy-making in EaP countries through continuous policy dialogue.

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The report was written under the guidance of Marcos Bonturi, Director for Global Relations, OECD; Daniel Calleja, former Director-General, and Lowri Evans, new Director-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) of the European Commission; Madlen Serban, Director, ETF; and Philippe Le Houérou, Vice President, Policy and Partnerships, EBRD; as well as Anthony O'Sullivan, Deputy Director for Global Relations, OECD; Antonio Somma, Acting Head of Division and Head of the Eurasia Competitiveness Programme, OECD; Christos Kyriatzis, Deputy Head of the International Affairs Unit, DG GROW, European Commission; Anastasia Fetsi Head of Operations Department, ETF; Xavier Matheu de Cortada, Head of Thematic Policy Unit, ETF; Andrew Kilpatrick, Director for Project and Sector Assessment and Charlotte Ruhe, Director for the Small Business Support Programme, EBRD.

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The methodology of this report was developed jointly with the OECD South East Europe Division and benefitted from the experience of similar policy assessments carried out previously in the Eastern partner countries, Western Balkans and the Euro-Med region. These reviews measure country convergence with the Small Business Act for Europe.

In the EaP countries, the following SBA co-ordinators led their countries' participation in all stages of the project: Gayane Gevorgyan (Armenia), Elcin Ibrahimov (Azerbaijan), Irina Babachenok and Yulia Mamontova (Belarus), Lali Gogoberidze (Georgia), Lilia Palii and Valentina Veverita (Moldova), and Tatiana Borisiuk (Ukraine). In particular, the SBA co-ordinators led the countries' self-assessment and co-ordinated the contributions of different government institutions and other national stakeholders.

The independent assessments were conducted with the support of local consultants: EV Consulting (Armenia), Yulia Aliyeva (Azerbaijan), UNITER (Belarus), ISET Policy Institute (Georgia), CIVIS (Moldova) and GfK (Ukraine). Country surveys were carried out with the support of: EV Consulting (Armenia), ACT (Azerbaijan and Georgia), UNITER (Belarus), CIVIS (Moldova) and GfK (Ukraine).

The final report was edited and prepared for publication by Vanessa Vallee, Marianne Aalto, Global Relations Secretariat, OECD; and Fiona Hinchcliffe. The implementation of the project was assisted by Elisabetta Da Prati, Jolanta Chmielik and Mariana Tanova, Global Relations Secretariat, OECD.

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Abbreviations and acronyms

ADA	Armenia Development Agency
ADF	Armenia Development Fund
AITT	Agency for Innovation and Technology Transfer
AMD	Armenian dram (currency)
ASAN	Azerbaijan Service and Assessment Network
AZN	Azerbaijani manat (currency)
AZPROMO	Azerbaijan Export and Investment Promotion Agency
BBTC	Baku Business Training Centre
BDS	Business development services
BEEPS	Business Environment and Enterprise Performance Survey
BFSSE	Belarusian Fund of State Support of Entrepreneurs
BYR	Belarusian ruble (currency)
CIS	Commonwealth of Independent States
COSME	EU Competitiveness of Enterprises and Small and Medium-Sized Enterprises Programme
DCFTA	Deep and Comprehensive Free Trade Area
DG GROW	Director-General for Internal Market, Industry, Entrepreneurship and SMEs
EA	European Co-operation for Accreditation
EaP	Eastern partner (country, region)
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Europe and Central Asia
EUR	Euro (currency)
EEU	Eurasian Economic Union
EIA	Export Insurance Agency of Armenia
ETF	European Training Foundation
EU	European Union
FDI	Foreign direct investment
FTA	Free trade agreement
GDP	Gross domestic product
GEL	Georgia Lari (currency)

GeoSTM	Georgia's Agency of Standardisation and Metrology
GITA	Georgia's Innovation and Technology Agency
GNI	Gross national income
GNP	Gross national product
GPA	Global Procurement Agreement
GVC	Global value chain
HEI	Higher education institutions
IDF	Industrial Development Fund of Armenia
IFC	International Finance Corporation
IFI	International financial institution
IMF	International Monetary Fund
IT	Information technology
ICT	Information and communications technology
M&E	Monitoring and evaluation
MDL	Moldovan leu (currency)
MIEPO	Moldova Investment and Export Promotion Organisation
NCFA	National Competitiveness Foundation of Armenia
NCFM	National Commission of Financial Markets, Moldova
NGO	Non-governmental organisation
ODIMM	Organization for SME Sector Development of Moldova
PPC	Public-private consultation
PPP	Purchasing power parity
R&D	Research and development
RIA	Regulatory impact analysis
SARPED	State Administration of Ukraine for Regulatory Policy and Entrepreneurship Development
SBS	Small Business Support, EBRD
SLA	Savings and loan association
SME	Small and medium-sized enterprise
SME DNC	SME Development National Center of Armenia
SOE	State-owned enterprise
SPS	Sanitary and phytosanitary standards
UAH	Ukraine hryvnia (currency)
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USD	United States dollar (currency)
VET	Vocational education and training
WTO	World Trade Organisation
VAT	Value-added tax
y-o-y	Year-on-year

Executive summary

The Eastern partner (EaP) region – made up of Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine – is home to 75 million people, and had a combined nominal GDP of USD 315.7 billion in 2014. The region benefits from a vast agricultural land area and considerable energy and natural resources, as well as a comparatively well-educated workforce. Georgia, Moldova and Ukraine have recently signed bilateral Association Agreements with the EU, including Deep and Comprehensive Free Trade Areas (DCFTAs), creating new opportunities for greater economic integration and trade. The region's location close to the world's largest single market (the EU), to Russia and to important economies in the Middle East and Asia also gives it a pivotal role in transport and energy networks.

Although the pace of structural reform varies from country to country, the region as a whole is going through a process of economic transformation, moving progressively away from a growth model based on large enterprises specialised on intermediary outputs and commodity transformation, towards a more diversified and open economic structure. The pace of structural transformation varies considerably within the region.

Since 2012, when the previous report was published, the macro-economic situation has changed significantly. All six EaP countries are struggling with serious economic challenges as a result of lower commodity prices and a slowdown in main trading partners. The result has been significant currency depreciation, rising inflationary pressures, and a credit contraction which has damaged output. While the drivers and impacts vary by country, these developments highlight these countries' vulnerability to external events and the importance of strengthening economic competitiveness and diversification in the region.

Given this context, bolstering the region's small and medium-sized enterprises (SMEs) is more important than ever. SMEs can facilitate the shift from mass production to a more diverse, demand-driven and market-oriented supply of products, being well-positioned to react quickly to changing market conditions, introduce product and market innovation and challenge inefficient incumbents. With SMEs acting as an engine for employment generation and sustained growth, they offer a significant opportunity for economic recovery in the short term and increased resilience over the medium to long term. Yet the potential of SMEs remains largely untapped in the region. Despite making up between 83 and 99% of all firms, they account for only about half of all employment and one-third of value-added. The vast majority of SMEs are subsistence micro-entrepreneurs operating in low-added-value sectors.

This SME Policy Index report assesses the progress of SME policies in all six EaP countries towards the ten principles of the Small Business Act for Europe (SBA). The second such assessment (the first was in 2012), this 2016 report highlights progress made since 2012 and the challenges that remain. For each EaP country it analyses the SME policy strengths, weaknesses, opportunities and threats, and suggests a roadmap for policy reform.

Since 2012, EaP countries have progressively acknowledged the importance of SME development for economic growth and started to tackle some of the main constraints for the creation and growth of small businesses. Building on ongoing efforts to improve the broader investment climate and operational environment for businesses, EaP countries have become more proactive in developing an adequate institutional environment for SME policy making and have started to introduce targeted support measures to facilitate SME access to finance, markets (including domestic and export markets), skills and innovation. Many recommendations of the 2012 assessment have been implemented or are currently being implemented. These efforts have translated into improved scores across most dimensions, although progress is uneven across countries and dimensions.

The way forward

Despite this encouraging progress, much of it remains small-scale and localised. The challenge now is to scale up the good examples and step up policy commitment to SMEs at all stages of development. The diversity of the region's geographies, economic structures, comparative advantage and broader policy priorities precludes a single blueprint for SME growth. Chapters 11 to 16 of this report therefore contain tailored policy roadmaps for each country. In general, each country can do more in the following five areas:

a. Strengthening the institutional, regulatory and operational environment for SMEs

- build on progress in developing comprehensive medium-term SME strategies and, as fiscal resources permit, set up autonomous implementation agencies;
- collect and disseminate better statistical data to support policy making;
- bring regulatory impact assessment methodologies in line with international standards; and
- institutionalise public-private consultation mechanisms across the region.

b. Facilitating SME access to finance

- address the current decline in lending to SMEs;
- work toward a regulatory framework that facilitates banks' access to longer term and local currency funding and promote competition in the banking sector to encourage banks to offer more competitive rates and reach out to new segments;
- support viable alternatives to bank financing by putting in place adequate legal frameworks for the provision of non-bank financial products and services;
- promote financial literacy among the public and build financial management and business planning skills among small business owners.

c. Promoting skills and entrepreneurship development

- integrate entrepreneurship within the national curriculum;
- connect women's entrepreneurship more tightly with countries' growth agendas; and
- improve SME skills upgrading programmes, training needs analysis and quality assurance measures.

d. Enhancing SME competitiveness

- make public SME support mechanisms more effective and better tailored to the needs of different SME segments and do more to promote the emergence of private markets for business support services;
- adapt public procurement frameworks to promote SMEs access to this important market; and
- broaden innovation policy beyond ICT, emphasising non-technological innovation and commercialisation.

e. Supporting SME internationalisation

- step up export promotion and support by adding more sophisticated products (e.g. market intelligence and training), building capacity in export promotion agencies and increasing access to working capital;
- continue aligning technical and quality standards with international and EU rules, supported by capacity building and outreach; and
- be more proactive in promoting the integration of SMEs into global value chains, such as by facilitating links between FDI and SMEs.

Overview:

2016 Small Business Act assessment of Eastern partner countries

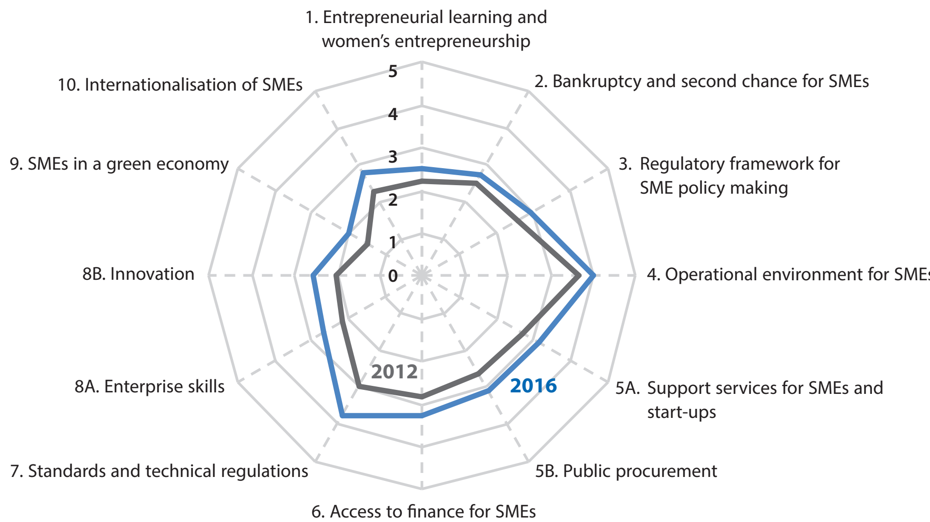
The SME Policy Index has been jointly developed by the Organisation for Economic Co-operation and Development (OECD), the European Commission, the European Training Foundation (ETF) and the European Bank for Reconstruction and Development (EBRD) as a benchmarking tool for emerging economies to monitor and evaluate progress in SME development policies (see Annex B). The SME Policy Index is structured around the ten principles of the Small Business Act for Europe (SBA; see the Policy Framework and Assessment chapter). The SBA provides for a wide range of pro-enterprise measures to guide the design and implementation of SME policies based on good practices promoted by the EU and the OECD.

The first SBA assessment of the Eastern partner (EaP) region was carried out in 2012 (OECD, 2012). This assessment identified significant levels of policy development in the dimensions relating to the overall business environment, as well as a series of challenges in developing a comprehensive approach towards the SME sector. In particular, the 2012 assessment found the main challenges for EaP policy makers to be the widely diverging levels of institutional development across countries, incipient but still piecemeal efforts to introduce targeted support measures for SMEs, and a scarcity of statistical data on the SME sector in most countries.

This second assessment report provides an update on the current status of SME development policy in all six EaP countries, highlighting key developments and outstanding challenges compared to the 2012 SBA assessment. It also compares countries against the ten SBA principles. Finally, it assesses the strengths and weaknesses of SME policy frameworks in each EaP country and outlines a potential roadmap for policy reform over the short, medium and long term. The analysis covers the policy environment for micro, small, and medium-sized enterprises. For reasons of convenience, these three categories are jointly referred to in this report as “SMEs.”

This chapter provides an overview of the key findings of the 2016 SBA assessment across 12 policy dimensions (Figure 0.1), as well as the key findings for each country. Full details of the methodology and the background to this assessment are contained in Annex A. Complete scores per dimension and sub-dimension can be found in Table 0.22 in the chapter titled SME Policy Index Scores: 2016. A detailed analysis and cross-country comparison of each dimension is presented in Part I of this report. Part II contains full country profiles.

Figure 0.1. **Progress towards SME-supportive policies in Eastern partner countries, 2012 and 2016**



Notes: Overall dimension scores are calculated based on five levels of policy reform, with 1 being the weakest and 5 being the strongest. Dimension score levels can be broadly described as follows: **Level 1**: There is no framework (e.g. laws, institutions, projects, initiatives, etc.) in place to cover the area concerned; **Level 2**: A framework is at the early stages of development (e.g. draft, pilot), and there are some signs of government activity to address the area concerned; **Level 3**: A solid framework is in place for this specific policy area although implementation may contain significant gaps; **Level 4**: Level 3 applies, plus some concrete indications of effective policy implementation of the framework; **Level 5**: Level 4 applies, plus some significant record of concrete and effective policy implementation of the framework, including monitoring and evaluation. This level comes closest to good practices based on the Small Business Act for Europe and the OECD Bologna Process on SME & Entrepreneurship Policies. The methodology for calculating these scores is described in Annex A. The 2012 results for Dimension 9 have been recalculated based on the updated methodology to allow for direct comparison between the two assessments. The 2012 and 2016 scores for Dimension 6 are not directly comparable due to changes in methodology.

Key findings for each policy dimension

Dimension 1: Entrepreneurial learning and women's entrepreneurship

An education system which includes entrepreneurship, and an environment which supports female entrepreneurs, are key aspects of the broader agenda of job creation and economic competitiveness. The first dimension assesses collaboration among the various parts of the national administration in each country to strategically promote entrepreneurship at all levels of the education system. The dimension also explores how each country is supporting women's entrepreneurship.

Most of the EaP countries have strengthened policy partnerships for entrepreneurial learning since the 2012 assessment, resulting in a modest improvement in scores across the region (Table 0.1), with government departments, business and civic interest groups increasingly mobilising behind entrepreneurial learning. The newly created Enterprise Georgia is one leading example of such policy partnerships. Moldova stands out due to its progress in adding entrepreneurship as a key competence in curricula at several levels of formal education, backed up by clearly defined learning outcomes and support tools for pupils and teachers. Entrepreneurship promotion in vocational education and training is well developed across the region, although entrepreneurship career guidance is still weak. Higher education systems, on the other hand, generally lack specific frameworks for co-operation between businesses and universities, while monitoring and evaluation is generally not given sufficient attention across all levels. Finally, women's entrepreneurship is receiving more attention in each country's policy agenda (with Armenia, Georgia, Moldova and Ukraine increasing their efforts in particular), but policies are generally defined in equity terms rather than recognising women's entrepreneurship for its direct contribution to the country's wider drive for competitiveness, innovation and jobs.

Going forward, countries should:

- Step up their efforts to include entrepreneurship as a key competence in their education systems, and as part of wider efforts to develop national qualifications frameworks. In doing so, EaP countries could refer to the "European Entrepreneurship Competence Framework", to be published by the European Commission in early 2016.
- Pay more attention to integrating entrepreneurship into higher education by strengthening and widening regional and national policy networks.
- Consider setting up a body to oversee policy development and monitoring and evaluation for women's entrepreneurship (including through sex-disaggregated data), as well as to connect women entrepreneurs more tightly to the EaP countries' growth and job creation agenda.

Table 0.1. **Progress in Dimension 1: Entrepreneurial learning and women's entrepreneurship**

Dimension 1	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**2.63**	**2.59**	**2.39**	**2.70**	**2.57**	**2.25**	**2.52**
2012 average	2.40	2.45	1.60	3.15	2.10	1.65	2.23

Dimension 2: Bankruptcy and second chance for SMEs

Given their limited resources compared to larger firms, SMEs (as both debtors and creditors) especially benefit from cost-effective bankruptcy systems. Dimension 2 assesses whether countries have effective and efficient insolvency frameworks with streamlined bankruptcy procedures that make it easier for business to exit and re-enter the market. The dimension also assesses the ease with which entrepreneurs whose businesses have failed in the past can start afresh (Table 0.2).

All EaP countries have laws and procedures governing distressed companies, receivership and bankruptcy. Azerbaijan, Belarus, Moldova and Ukraine have amended their legal frameworks over the past three years to simplify insolvency procedures, strengthen the protection of creditors or improve the regulation of insolvency administrators. Belarus has had an online insolvency registry since 2013 and a similar system is being developed in Ukraine.

Despite these developments, there is significant room for improvement across the EaP region. The indicators of the World Bank's *Doing Business* report for the average duration, cost and debt recovery rate of insolvency procedures in most countries show little improvement; some have even deteriorated. The average recovery rate in EaP countries now varies between 39.3% of the estate in Azerbaijan and just 8.6% in Ukraine (World Bank, 2014).

The rhythm of reform is slower than in other business environment areas. This is partly explained by the complexity of this field and the importance of wider factors, such as the capacity of the overall justice system and other actors in the insolvency ecosystem. Insolvency frameworks are still well behind international good practice in areas such as the suspension of court proceedings against a debtor (e.g. in Georgia), creditor participation and creditor rights (e.g. in Armenia, Azerbaijan, Belarus and Moldova), and the definition of maximum times for full discharge (e.g. in Belarus). The following steps are needed:

- Shift legal frameworks away from the current focus on liquidation to promoting rehabilitation and restructuring, including through special, fast-track rehabilitation procedures for SMEs, given the significant costs of these procedures.
- Consider early warning systems and out-of-court settlements – these can avoid costly judicial procedures or even bankruptcy altogether, but are largely absent from the EaP region.
- Take a proactive approach to promoting a second chance for bankrupt entrepreneurs. In addition to shortening the maximum periods for full discharge of an insolvent entrepreneur to no more than three years, governments may want to consider active outreach, training and dissemination campaigns to avoid stigma and promote a fresh start.

Table 0.2. **Progress in Dimension 2: Bankruptcy and second chance for SMEs**

Dimension 2	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.16**	**2.87**	**2.57**	**2.94**	**2.68**	**2.05**	**2.71**
2012 average	3.17	2.50	2.11	2.94	2.53	1.94	2.53

Dimension 3: Regulatory framework for SME policy making

Effective institutional and regulatory frameworks are the cornerstone of all other SME support initiatives. Dimension 3 measures progress towards developing an institutional framework for SME policy making, including reforms to simplify business legislation and promote effective public-private consultations.

Back in 2012, SME policy frameworks for all six EaP countries were largely non-existent, scattered around different instruments, or structured as government programmes but falling short of a comprehensive strategy. The 2016 assessment has identified growing attention across EaP countries to developing comprehensive SME institutional and policy frameworks (Table 0.3). Two groups of countries can be identified:

- Armenia, Moldova and Georgia. Armenia and Moldova have the main building blocks for an SME policy in place or in progress, including an SME policy implementation agency and a strategy for SME development. Georgia has recently joined this group with the creation of a dedicated agency (Enterprise Georgia) in 2014 and is developing a medium-term SME strategy to be ready in early 2016. Georgia and Moldova organised participatory processes preceding the adoption of SME strategies, while Armenia's SME Development Council offers a good consultation platform (though currently underused).
- Azerbaijan, Belarus and Ukraine. As of June 2015 these countries did not have a comprehensive SME strategy or an agency responsible for SME policy implementation; their institutional frameworks for public-private dialogue on

SME-related issues are less developed. However, new SME frameworks are currently being developed in Belarus and Ukraine.

All EaP countries have undertaken reforms to simplify their legislation. For instance, Armenia is currently implementing a regulatory guillotine process (see Chapter 3) covering over 3 000 rules across 25 sectors. Only Moldova and Armenia implement regulatory impact analysis (RIA), although Georgia, Azerbaijan and Ukraine have plans to introduce new RIA methodologies. The definition of the SME sector in most EaP countries is converging with the EU approach – which uses turnover, balance sheet and employment criteria – ultimately improving data comparability and policy consistency across different areas (e.g. tax, targeted support, statistics collection). Armenia, Ukraine and Azerbaijan have strengthened their definitions of the SME sector since 2012, bringing them closer to EU standards. Yet, the limited availability of internationally comparable and up-to-date statistical data on the small business sector (which remain largely limited to structural business statistics and, in three out of six EaP countries, also business demographics) remains a barrier to better policy making in all EaP countries.

SME policy making continues to follow a largely top-down approach in most countries, as private-public consultations tend to be ad hoc and sporadic. While good practices have been observed in specific cases (e.g. Georgia's SME strategy process), these should be leveraged to create formal dialogue structures to increase SME participation in the policy-making process.

Policy makers in EaP countries should consider the following priorities:

- Continue making progress towards developing comprehensive medium-term SME strategies and, as fiscal resources permit, spin off policy implementation functions to autonomous SME agencies in Belarus and Ukraine. Azerbaijan may want to consider following the same approach.
- Prioritise the collection and dissemination of more qualitative and up-to-date statistical data to improve the evidence base for policy making.
- Upgrade RIA methodologies in line with international good practice, incorporating an SME test to assess the impact of new laws and regulations on small businesses.
- Institutionalise public-private consultation mechanisms across the region. The participatory processes preceding the adoption of SME strategies in Georgia and Moldova, as well as the Armenia SME Development National Center (SME DNC), are good platforms upon which to build.

Table 0.3. **Progress in Dimension 3: Regulatory framework for SME policy making**

Dimension 3	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.38**	**2.47**	**2.41**	**3.48**	**3.51**	**2.45**	**2.95**
2012 average	3.00	1.95	1.89	3.23	3.45	2.13	2.61

Dimension 4: Operational environment for SMEs

An enabling business environment for SMEs involves clear and straightforward regulations, low administrative costs and simple procedures for starting and operating a business. Examples include one-stop-shops for company registration and e-government solutions, which lower transaction costs for SMEs. Dimension 4 assesses the extent to which public administrations have simplified regulations and reduced costs and procedures for SMEs.

Performance in this dimension was already relatively high in 2012, and EaP countries have continued to make progress (Table 0.4). All countries have taken steps to streamline their business regulations so as to lower market entry barriers and reduce the costs for businesses in their interaction with government agencies. E-government portals and services have been dramatically expanded in most EaP countries, with the Azerbaijan Service and Assessment Network (ASAN) being the most developed. Online filing of tax and social security returns is now widely available across the region. E-signature is available in all EaP countries apart from Moldova, where it is under development. One-stop-shops for starting a business are in operation throughout the region, while online company registration is possible in all countries apart from Moldova, which is expected to follow suit in the near future. Georgia's Public Service Halls are recognised globally as best practice. The World Bank's *Doing Business* report confirms the impact of these developments (World Bank, 2014). Today it takes an average of 7.7 days to start a business in the EaP region (2.5 days less than in 2012). The average costs involved are lower than those of OECD countries, and the number of procedures has also been reduced from 5.5 in 2012 to 3.8 in 2015 (while the OECD average is 4.8).

EaP countries are invited to keep up this momentum by concentrating on the following:

- Fine-tune company registration procedures in those countries where performance is comparatively lower (e.g. Ukraine, Moldova, Belarus).
- Increase SMEs' currently relatively poor awareness of existing e-services.
- Improve interconnections among government databases to further reduce transaction costs.
- Address other bureaucratic hurdles to business, such as onerous license and permit requirements, which continue to be a major constraint in certain economic sectors.

Table 0.4. **Progress in Dimension 4: Operational environment for SMEs**

Dimension 4	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**4.05**	**4.23**	**4.09**	**4.33**	**3.56**	**3.81**	**4.01**
2012 average	3.64	3.70	3.73	4.30	3.28	3.41	3.68

Dimension 5a: Support services for SMEs and start-ups

Business support services allow SMEs to compete more effectively, access new markets and operate more efficiently and profitably. Dimension 5a measures the availability and quality of targeted support services for SMEs and start-ups in the form of information, training and consulting. The dimension evaluates both government-sponsored business support infrastructure, as well as public initiatives to promote the development of private markets for business support services.

EaP countries have made considerable progress in Dimension 5a since the 2012 assessment, expanding the provision of business support services (e.g. training, consultations, workshops etc.) to SMEs (Table 0.5). However, the policy response has largely taken the form of public and donor-funded programmes, while relative little attention is paid to promoting the development of private markets for business development services.

Armenia and Moldova have accumulated substantial experience in the provision of information, training, consulting and consulting services through their dedicated SME agencies (SME DNC and the Organization for SME Sector Development of Moldova, ODIMM). Since its creation in mid-2014, Enterprise Georgia has launched two major programmes for consulting support and financial assistance. Public provision of business development services is less developed in Azerbaijan (where the Baku Training Centre is the main actor), Belarus (where most activities are carried out at the local level through subsidised service providers) and Ukraine (where lack of funding continues to be a major obstacle). Incubators are popular in the region, although their effectiveness has rarely been evaluated. Dedicated websites are also an important source of information for SMEs in Azerbaijan and Moldova.

Going forward, governments should:

- Make their existing public support mechanisms more effective and better tailored. Challenges for existing public schemes include: *(a)* building awareness amongst SMEs of available services and their benefits; *(b)* matching supply and demand by adapting business support services to the specific needs of each SME segment (e.g. high-growth start-ups, growth-oriented medium-sized firms, exporters); *(c)* introducing quality control systems and comprehensive monitoring and evaluation tools to evaluate the effectiveness of support schemes; and *(d)* ensuring the sustainability of donor-supported programmes.
- Develop new programmes to promote the emergence of private markets (e.g. through databases of providers or targeted voucher initiatives). The EBRD's Small Business Support Programme is a good example of an effective approach.
- Consider the provision of free services carefully as there is a significant risk of crowding-out private providers. Agencies should therefore be selective and provide free services only where market failures have been identified.

Table 0.5. **Progress in Dimension 5a: Support services for SMEs and start-ups**

Dimension 5a	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.93**	**2.98**	**2.99**	**3.69**	**3.35**	**1.84**	**3.13**
2012 average	3.28	2.12	2.41	2.92	3.79	1.77	2.71

Dimension 5b: Public procurement

Government contracts offer a major business opportunity for SMEs in EaP countries but procurement frameworks need to be adapted to facilitate SME access. Dimension 5b focuses on policy tools to put SME participation in public procurement on an equal footing with larger companies.

Progress in this dimension varies widely across countries (Table 0.6). All EaP countries have legislation to allow large contracts to be cut into lots. While this does seem to happen in practice, it is unclear to what extent. Information on public procurement opportunities is generally openly available and centralised, but is not always in electronic format or free of charge. Contracting authorities in Azerbaijan, Armenia, Georgia and Moldova can allow companies to bid jointly, while this is not yet the case in Belarus and Ukraine. A key development has been the increased use of electronic tools in public procurement. For instance, e-procurement has fully replaced the paper-based system in Georgia. Armenia and Moldova have made the biggest leap forward in terms of overall scores. Armenia has reduced its use of non-competitive simplified procurement procedures and increased the share of open tenders, while Moldova has further opened its public procurement market to international participation by concluding an Association Agreement with the EU in June 2014.

A number of challenges remain. Governments may want to focus on the following actions:

- Establish impartial and independent review bodies in Armenia, Azerbaijan, Belarus and Moldova.
- Address the problem of late payments to contractors (including SMEs), which is common in all EaP countries, although only Armenia has adopted specific legislation to regulate this. Adoption of a law setting strict deadlines and penalties for late payments from the public sector would be an important first step.
- Use proportionate qualification levels and financing requirements for SMEs through procurement legislation and consider expanding the criteria used for awarding contracts beyond price, which remains by far the main or even the only criterion (in the case of Georgia). SMEs tend to be more competitive on quality, so broader criteria (e.g. most economically advantageous tender) could boost SME participation in public procurement.

Table 0.6. **Progress in Dimension 5b: Public procurement**

Dimension 5b	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.42**	**2.42**	**3.21**	**4.04**	**2.89**	**2.73**	**3.12**
2012 average	2.14	2.29	3.14	4.14	1.43	2.57	2.62

Dimension 6: Access to finance for SMEs

Financial resources are necessary for SMEs at all stages of the entrepreneurial process, from starting up, to financing investments and innovations, and for expanding businesses. Dimension 6 assesses whether countries' policies encourage SME access to finance, as well as the quality of the regulatory and legislative framework for both bank and alternative sources of finance. While 2012 and 2016 scores are not directly comparable, the review did find that SME access to finance had improved across all countries, albeit to varying degrees (Table 0.7).

Many countries already had functioning legal frameworks for secured transactions in place in 2012; however, further improvements have been introduced, such as better credit information systems and stronger legal frameworks for taking collateral. Domestic credit to the private sector as a share of GDP has increased in Armenia, Azerbaijan, Georgia and Moldova, but there is room for improving access to bank financing across the region. Between 35% and 76% of firms needing a loan report credit constraints and high interest rates and collateral requirements continue to pose a problem for SMEs (EBRD, 2014). Most countries try to counter these issues with support programmes, some of which have been expanded since 2012 (e.g. in Moldova), or newly introduced (e.g. in Azerbaijan and Georgia).

Bank loans remain the main source of finance across the EaP region, while the majority of small businesses (between 66% and 80%) rely on internally generated cash to finance investments (EBRD, 2014). Governments should therefore try to support the development of external financing opportunities for SMEs. More sustainable access to finance for SMEs can be achieved in the long term through the following actions:

- Implement policies that encourage a sustainable funding base for banks in both foreign and local currency.
- Support competition in the banking sector to create incentives for banks to offer more competitive rates and reach out to new segments.

- Minimise market distortions (e.g. avoid subsidising interest rates on a large scale). For instance, targeted credit guarantee schemes can encourage banks to finance SMEs on commercial terms.
- Encourage the use of moveable assets as collateral by improving accuracy and (online) accessibility of registers for related security interests.
- Facilitate viable alternatives to bank financing in the form of non-bank financing instruments such as leasing and factoring.
- Build financial literacy among the public. While most countries have conducted some form of financial literacy assessment and training, programmes are not generally assessed or evaluated and often lack a specific focus on SMEs and businesses in general.

Table 0.7. **Progress in Dimension 6: Access to finance for SMEs**

Dimension 6	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average*	**3.53**	**2.70**	**3.08**	**3.76**	**3.40**	**3.22**	**3.28**
2012 average	3.00	2.74	2.50	3.52	2.65	2.59	2.83

Note: Substantial methodological changes to Dimension 6 do not allow for direct comparison between 2016 and 2012 scores.

Dimension 7: Standards and technical regulations

Inadequate or excessively burdensome technical regulations and standards can become severe barriers to trade by hindering access to international markets, protecting domestic producers and discriminating between domestic and foreign producers. Technical barriers to trade thus represent one of the most important obstacles to the liberalisation of trade between the EU and the EaP countries. Dimension 7 of the SBA assessment evaluates countries' progress in eliminating technical barriers to trade for industrial products and aligning with international and EU norms.

The EaP region is quite heterogeneous – some countries are not yet members of the World Trade Organisation (i.e. Azerbaijan and Belarus), while Georgia, Moldova and Ukraine have signed Association Agreements with the EU to become part of Deep and Comprehensive Free Trade Areas (DCFTAs). Belarus and Armenia are part of the Eurasian Economic Union (EEU), which has different technical regulations and standards to the EU, although some alignment is occurring. Nonetheless, all the EaP countries have started an approximation process with international and EU rules in the area of technical regulations and standards.

The EU Association Agreements oblige signatory countries to align their quality infrastructure and sectoral legislation with the EU's. This has spurred on Georgia, Moldova and Ukraine's alignment efforts; their scores have improved significantly (Table 0.8). Azerbaijan continues to improve its technical regulation framework with a view to meeting international benchmarks.

Going forward, governments should consider the following actions:

- For DCFTA countries, continue upgrading technical regulations and quality infrastructure in line with their strategies in this area and their commitments under the relevant agreements. Capacity building and outreach efforts (particularly targeting SMEs) are likely to be crucial for the successful implementation of the new frameworks.

- For Armenia, Azerbaijan and Belarus, focus on strengthening the overall strategic framework, including monitoring and evaluation, and continue enhancing quality infrastructure (e.g. accreditation, conformity assessment and standardisation).

Table 0.8. **Progress in Dimension 7: Standards and technical regulations**

Dimension 7	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.33**	**3.32**	**3.22**	**4.22**	**4.12**	**4.34**	**3.76**
2012 average	2.38	2.13	3.75	2.88	3.38	3.25	2.96

Dimension 8a: Enterprise skills

Upgrading enterprise skills is key for boosting firm-level productivity and innovation. Dimension 8a assesses human capital policy development measures and practices in the SME sector, including the availability and quality of training, its relevance to SME needs, and how well targeted it is to both new and growing enterprises.

Compared with the 2012 assessment, scores have increased across the region, reflecting steady progress (Table 0.9). Georgia and Azerbaijan have made the greatest headway in setting up a national training needs analysis framework through their specific institutions (Enterprise Georgia and Baku Business Training Centre). Moldova and Armenia systematically collect data on SMEs' training needs using standardised data collection instruments. Ukraine and Georgia have improved their quality assurance of SME training, while Azerbaijan's e-training facility is the most developed in the region. Pre-start-up and start-up training is also widely available in the region and EaP countries are paying more attention to skills development for enterprise growth and internationalisation. Monitoring and evaluation of existing initiatives is limited, however.

Building on the above progress, EaP countries need to:

- Better target SME skills upgrading programmes, training needs analysis (including both entrepreneurial skills and technical skills required for specific sectors) and quality assurance measures.
- Sharpen SME training, support policies and institutions and develop integrated approaches to labour and training needs analysis.
- Improve systematic collection of quality data necessary for monitoring and evaluation, as well as quality assurance measures.
- Analyse SME training needs and client satisfaction for each target group so as to ensure access to adequate training services and a cost-effective use of resources.

Table 0.9. **Progress in Dimension 8a: Enterprise skills**

Dimension 8a	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**2.67**	**2.94**	**2.28**	**3.00**	**2.50**	**2.56**	**2.66**
2012 average	2.13	2.19	1.69	2.69	1.75	2.44	2.15

Dimension 8b: Innovation

A favourable environment for innovative SMEs requires institutional co-operation; a strategic approach to innovation policy that targets SMEs; and a broad range of infrastructure, technical and financial support services. Dimension 8b provides a framework to evaluate policies to support SME innovation and technology transfer.

This is one of the least developed SBA dimensions in the EaP region (reflected in the low average scores; Table 0.10). However, governments have started to pay increasing attention to innovation frameworks in general and, to a more limited extent, the role of SMEs in this area. Moldova has adopted a national innovation strategy for the period 2013-20 and new innovation strategies are being developed in Armenia and Georgia. Cluster frameworks are in place in Moldova and Belarus, while policy co-ordination institutions (such as the Georgia National Innovation Council) are being introduced. Georgia also created a dedicated innovation agency in 2014. Government support remains largely limited to innovation infrastructure (such as technological and industrial parks, and innovation-oriented incubators), although some early steps towards developing financial incentives are being taken. For instance, Belarus has a series of financial assistance products (grants, loans and voucher schemes) for different stages of the innovation process, while Azerbaijan has launched a fund dedicated to the ICT sector.

These steps, while commendable, are still not enough to ignite the innovation process amongst SMEs in EaP countries. Firm-level survey data suggest that innovation levels amongst SMEs remain lower than in other emerging regions (EBRD, 2014), while SMEs across the EaP region surveyed by the OECD as part of the SBA assessment process cite poor access to financial resources as the number one barrier to innovating. The EaP region has two fundamental challenges:

a. Most countries' innovation policies define innovation narrowly (as scientific and technological research and development). This results in an excessive focus on the information and communication technologies (ICT) sector without recognising explicitly the enabling nature of ICT and its potential for promoting innovation and competitiveness in other industrial sectors.

b. Research, development, innovation and uptake of technologies are constrained by top-down government interventions, non-transparent funding decisions, and a legacy of public research institutes that continue to operate in isolation from the private sector.

Governments should therefore:

- Develop a comprehensive innovation framework in those countries where it is absent or outdated (e.g. Azerbaijan, Ukraine).
- Take a broader policy approach to innovation which places more emphasis on non-technological innovation and on commercialisation.
- Progressively become "innovation matchmakers" to build and promote partnerships and linkages across the myriad actors comprising the "innovation ecosystem", especially academia and SMEs. This will ensure that innovation is market-oriented, driven by private sector demand.
- Ensure a specific focus on SME innovation needs; most innovation support schemes continue to be general in scope, with state-owned enterprises the major beneficiaries.
- Scale up financial and non-financial support services.

Table 0.10. **Progress in Dimension 8b: Innovation**

Dimension 8b	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**2.91**	**2.47**	**2.91**	**2.70**	**2.54**	**1.86**	**2.57**
2012 average	1.79	1.29	2.83	1.91	2.13	2.37	2.05

Dimension 9: SMEs in a green economy

SMEs often suffer from limited capacity (lack of resources, time and expertise) to absorb environmental requirements and to comply with them. In addition, they are often not aware of the economic opportunities presented by green business practices. Dimension 9 assesses government support available to help SMEs benefit from green growth opportunities and policy frameworks for eco-innovation and eco-efficient business.

Countries have made very modest improvements since 2012 and scores continue to be low across the region (Table 0.11). EaP countries have historically given little consideration to greening small businesses, and generally lacked the legal, policy and institutional means to enhance the environmental performance of SMEs. However, governments are increasingly realising the importance of SME support policies in the context of greening the economy. The ministries of economy in both Moldova and Armenia are planning to introduce environmental considerations into their strategic documents on SME support activities, though they have not yet started developing specific policy measures. While there are a few examples of regulatory incentives for companies to adopt certified environmental management systems (e.g. in Belarus), compliance and promotion activities are generally underdeveloped. Governments play a largely passive role in promoting environmental sustainability and best practices, with their involvement generally limited to hosting international donor-funded projects. Financial support for green practices, in particular for smaller firms, is largely absent. Some countries (e.g. Armenia, Azerbaijan), however, have taken initial steps to match their environmental permitting and compliance monitoring regimes to the level of environmental risk, lessening the regulatory burden on SME.

Much remains to be done in this dimension:

- Reduce the administrative burden of environmental regulation on SMEs (which generally represent a low level of environmental risk) by simplifying environmental regulatory requirements.
- Scale up government outreach activities substantially, in partnership with trade and business support associations, emphasising the business benefits of improved environmental performance (in terms of increased efficiency and competitiveness). The most appropriate communication channels are likely to be sector-specific, reflecting the different business models and activities within different sectors.
- Offer government support in the form of technical assistance, tax benefits (e.g. accelerated amortisation, reduced property or corporate taxes) and favourable financing terms for SMEs willing to invest in green technologies.

Table 0.11. **Progress in Dimension 9: SMEs in a green economy**

Dimension 9	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**2.39**	**1.54**	**2.10**	**2.48**	**2.19**	**1.22**	**1.99**
2012 average	1.84	1.20	1.97	1.97	1.27	1.20	1.47

Note: The 2012 results have been recalculated based on the updated methodology (see Annex A) to allow for direct comparison between 2016 and 2012 scores.

Dimension 10: Internationalisation of SMEs

Policy interventions are needed to help SMEs overcome the barriers for internationalisation, such as meeting quality standards, lack of market intelligence and finding working capital. Dimension 10 assesses government support (both financial and non-financial) for helping export-oriented SMEs to access international markets and to become integrated into global value chains.

Overall scores for this dimension remain low across all EaP countries, reflecting a limited level of development of financial and non-financial support for SME internationalisation. Nevertheless, there has been some progress since 2012 (Table 0.12). Armenia, Azerbaijan, Georgia and Moldova now have specialised export promotion agencies, although targeted assistance for SMEs is largely limited to supporting participation in trade fairs and training. Export strategies are in place in Armenia, Ukraine and Belarus. Many countries have recognised the challenge of building institutional capacity in this area and have either restructured their agencies (e.g. Moldova's MIEPO and Azerbaijan's AZPROMO), or created new export promotion bodies (the Armenian Development Fund and Enterprise Georgia). DCFTA countries (e.g. Georgia and Moldova) have started to develop targeted programmes to disseminate the potential benefits of the new trade regime and upgrade SME capacity for exporting to the EU. These initiatives remain limited in scope, however. A progressive acknowledgement of the role of trade finance is also reflected in the establishment of an export insurance agency in Armenia in 2014 and Georgia's plans to set up an export credit facility in the near future.

Despite this progress, export promotion efforts are still nascent and small in scale. The difficulties SMEs face in achieving the necessary economies of scale to produce for international markets and build relevant networks; the relatively small size of the domestic markets (except Belarus and Ukraine); and the signing of recent trade agreements (including the DCFTAs), all underscore the importance of stepping up support. EaP countries may therefore want to:

- Consider creating dedicated export promotion institutions to improve the co-ordination and effectiveness of existing support in countries where these do not exist (i.e. Belarus and Ukraine).
- Enhance existing export promotion efforts by *(a)* scaling up existing support services and adding more sophisticated products (e.g. market intelligence, as well as training and consulting on quality standards in key export markets); *(b)* building capacity in existing export promotion agencies; *(c)* developing monitoring and evaluation mechanisms; and *(d)* promoting trade finance options (access to working capital is cited as the biggest constraint by potential exporters in the OECD company surveys carried out as part of the SBA assessment).
- Develop a more proactive approach to promoting the integration of SMEs into global value chains, such as by facilitating links between FDI and SMEs and, more generally, ensuring the link between investment attraction and SME development policies. Existing initiatives in the region remain largely donor-supported.

Table 0.12. **Progress in Dimension 10: Internationalisation of SMEs**

Dimension 10	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine	EaP average
2016 average	**3.37**	**2.50**	**2.59**	**3.60**	**3.07**	**1.63**	**2.79**
2012 average	2.50	2.07	1.86	3.14	2.29	1.93	2.30

Overview of regional performance

Table 0.13 provides an overview of the region's progress compared to the 2012 assessment for each SBA dimension. Table 0.14 summarises each country's performance in terms of areas of relative strong performance and remaining challenges.

Table 0.13. **Summary of regional progress in SME policy development**

Policy dimension	2012 EaP average	2016 EaP average	Change 2012-16
1. Entrepreneurial learning and women's entrepreneurship	2.23	2.52	+0.29
2. Bankruptcy and second chance for SMEs	2.53	2.71	+0.18
3. Regulatory framework for SME policy making	2.61	2.95	+0.34
4. Operational environment for SMEs	3.68	4.01	+0.33
5a. Support services for SMEs and start-ups	2.71	3.13	+0.42
5b. Public procurement	2.62	3.12	+0.50
6. Access to finance for SMEs	2.83	3.28	+0.45
7. Standards and technical regulations	2.96	3.76	+0.80
8a. Enterprise skills	2.15	2.66	+0.51
8b. Innovation policy for SMEs	2.05	2.57	+0.52
9. SMEs in a green economy	1.47	1.99	+0.52
10. Internationalisation of SMEs	2.30	2.79	+0.49

Note: The darker the shaded cells, the higher the level of policy development in the relevant dimension. The 2012 results for Dimension 9 have been recalculated based on the updated methodology (see Annex A) to allow for direct comparison between 2016 and 2012 scores.

Table 0.14. **Summary of country progress and remaining challenges for each SBA dimension**

Country	Stronger performance	Main areas for improvement
Armenia	Dimension 4 (operational environment): 4.05	Dimension 9 (SME greening): 2.39
	Dimension 5a (SME support services): 3.93	Dimension 1 (entrepreneurial learning): 2.63
	Dimension 6 (access to finance): 3.53	Dimension 8a (enterprise skills): 2.67
Azerbaijan	Dimension 4 (operational environment): 4.23	Dimension 9 (SME greening): 1.54
	Dimension 7 (technical regulations): 3.32	Dimension 5b (public procurement): 2.42
	Dimension 5a (SME support services): 2.98	Dimensions 3, 8b (regulatory framework, innovation): 2.47
Belarus	Dimension 4 (operational environment): 4.09	Dimension 9 (SME greening): 1.79
	Dimension 7 (technical regulations): 3.22	Dimension 8a (enterprise skills): 2.28
	Dimension 5b (public procurement): 3.21	Dimension 1 (entrepreneurial learning): 2.39
Georgia	Dimension 4 (operational environment): 4.33	Dimension 9 (SME greening): 2.48
	Dimension 7 (technical regulations): 4.22	Dimension 1 (entrepreneurial learning): 2.70
	Dimension 5b (public procurement): 4.04	Dimension 8b (innovation): 2.70
Republic of Moldova	Dimension 7 (technical regulations): 4.12	Dimension 9 (SME greening): 2.19
	Dimension 4 (operational environment): 3.56	Dimension 8a (enterprise skills): 2.50
	Dimension 3 (regulatory framework): 3.51	Dimension 8b (innovation): 2.54
Ukraine	Dimension 7 (technical regulations): 4.34	Dimension 9 (SME greening): 1.22
	Dimension 4 (operational environment): 3.81	Dimension 10 (internationalisation): 1.63
	Dimension 5b (public procurement): 2.73	Dimension 5a (SME support services): 1.84

Key findings for each country

Armenia has continued to improve its policy framework for SME development since 2012. Building on a strong entrepreneurial culture, the country has implemented effective business environment reforms and created a well-developed system of business support infrastructure co-ordinated by SME DNC (one of the region's most dynamic SME agencies). However, the country's vulnerability to regional dynamics (for example, with Russia accounting for a quarter of its exports) and dependence on remittances (contributing 18-20% of GDP) calls for further efforts to boost SME development and improve the business environment (Table 0.15).

Table 0.15. **Overview of Armenia's key reforms and recommendations**

Key reforms	Key recommendations
• Launch of comprehensive guillotine process to streamline business legislation • Expansion of e-government services and the introduction of a one-stop-shop for business registration • Development of financial support measures for innovation • Creation of a new export promotion body and an export insurance facility • Implementation of financial education programmes and adoption of strategy and action plans to support women's entrepreneurship	• Finalise the preparation of a medium-term SME strategy to improve policy co-ordination • Revitalise public-private dialogue through the SME Development Center (SME DNC) • Develop a stronger monitoring and evaluation framework based on better quality SME statistics • Improve the insolvency, collateral and leasing frameworks to facilitate access to finance • Strengthen existing capacity and develop a comprehensive export promotion programme • Integrate entrepreneurship key competence into formal education; establish a national quality assurance framework for SME training

Azerbaijan continues to be largely dependent on oil and gas extraction and related services, which represent about 36% of GDP and over 92% of exports. In contrast, small businesses only represent 3% of GDP and less than 8% of employment. As part of its efforts to promote economic diversification, the government has been proactive in reforming its business environment, making significant progress in global competitiveness benchmarks such as the World Bank *Doing Business* report. However, despite improvements, doing business in Azerbaijan continues to be challenging, particularly outside the oil sector. To fully leverage the potential offered by SMEs for economic diversification, the government should adopt a more strategic approach to SME policy and increase its targeted support tools for SMEs (Table 0.16).

Table 0.16. **Overview of Azerbaijan's key reforms and recommendations**

Key reforms	Key recommendations
• Introduction of a one-stop-shop for company registration • Launch of best practice e-government portal providing over 400 services online • Establishment of government fund to promote the ICT sector • SME capacity building through the Baku Business Training Centre, including a new pilot incubator for start-ups	• Develop an SME strategy, co-ordination structure and implementation body • Reinforce public-private dialogue in all areas • Develop financial infrastructure to encourage SME access to bank loans as well as to alternative sources of finance, including capital markets • Strengthen monitoring and evaluation for existing support schemes • Create export finance tools • Develop entrepreneurship as a key competence at all levels of formal education; step up women's entrepreneurship support and SME training intelligence framework

Belarus is the second largest economy in the EaP region. The economy is made up primarily of large industrial enterprises inherited by the state from the Soviet Union; large-scale privatisation has not yet started. State-owned enterprises generate over 50% of output and 65% of employment, while the SME sector remains underdeveloped. The creation of a level playing field for all businesses, regardless of their size and ownership structure, will be key for Belarus to achieve sustained economic growth in the medium to long term. While the government has paid more attention to SME development in recent years, further constraints to SME development in the country need to be addressed (Table 0.17).

Table 0.17. **Overview of Belarus' key reforms and recommendations**

Key reforms	Key recommendations
• Introduction of online business registration and other electronic services • Introduction of a new insolvency law • Expansion of the public credit registry coverage • New financial support scheme by the Development Bank of the Republic of Belarus	• Develop medium-term SME strategic framework for SME policy; create a dedicated SME agency to diversify the existing menu of support services • Continue economic liberalisation efforts to create the conditions for SME growth • Improve the legal framework for secured transactions; operationalise a collateral registry covering moveable assets • Encourage the development of a private market for business support services • Build all the pillars of entrepreneurship key competence

Building on a solid track record as a top reformer, **Georgia** has made considerable progress since 2012 in adopting a more proactive approach to SME development through targeted initiatives. However, despite strong economic growth in recent years, the SME sector accounted for only 20% of value added and 18.3% of total turnover in 2013, while the portion of total employment accounted for by SMEs actually decreased between 2010 and 2013 (GeoStat, 2013). To take full advantage of the opportunities offered by the Association Agreement and DCFTA signed with the EU in June 2014, Georgia should address some remaining weaknesses in its SME policy framework (Table 0.18):

Table 0.18. **Overview of Georgia's key reforms and recommendations**

Key reforms	Key recommendations
• Creation of a dedicated agency in charge of implementing SME policy (Enterprise Georgia), and a new innovation agency (Georgia's Innovation and Technology Agency, GITA) • Continued progress in business registration (the best-practice Public Service Halls) and e-government services • Launch of new targeted support programmes by both Enterprise Georgia and GITA • Drafting of comprehensive SME development strategy and action plan, as well as an innovation strategy	• Build capacity in existing institutions and improve inter-agency co-ordination to implement the new SME strategy • Expand statistics collection and adopt a consistent SME definition that recognises micro-enterprises • Further develop targeted support to exporting SMEs and upgrade quality infrastructure in line with EU rules • Reform insolvency framework • Promote competitiveness in the banking sector; develop capital markets as an alternative to bank finance • Introduce targeted support measures for women entrepreneurs

Moldova is a relatively small, landlocked country with few natural resources apart from its agricultural land. In 2013, SMEs contributed slightly less than 30% of the country's GDP, still below their potential. The relative weight of SMEs in turnover and employment has actually decreased since 2010. Nevertheless, the country has made considerable progress in developing a comprehensive institutional framework for the SME sector, and was already performing well in the 2012 assessment. However, SMEs continue to face challenges due to the volatile macroeconomic environment, which is vulnerable to internal and external shocks, including structural challenges in the financial sector and regional geopolitical instability. In order to foster SME competitiveness and reap the benefits of new trading opportunities with the EU, the government needs to address the remaining challenges confronting SMEs (Table 0.19).

Table 0.19. **Overview of Moldova's key reforms and recommendations**

Key reforms	Key recommendations
• Adoption of the "Small and Medium Enterprise Sector Development Strategy for 2012-20" • Growing digitalisation of governmental services (e.g. Digital Moldova 2020) • Development of new innovation strategy (2013-20) • Streamlining of business registration processes • Systematic measures to develop human capital	• Address regulatory shortcomings, e.g. customs, permits and licenses, inspections • Address structural shortcomings in the banking sector (transparency, corporate governance) • Develop non-banking sources of financing for SMEs (e.g. venture capital, leasing, microfinance) • Upgrade skills and innovation through training and other business support infrastructure, including the development of a private market for business development services • Undertake more effective export and investment promotion efforts; upgrade quality infrastructure

Ukraine is the largest country in the EaP region. SME development has a major role to play in Ukraine, not only for enhancing economic competitiveness and restoring sustainable growth, but also for levelling the playing field for business and investment in the country. Ukraine's economy has been stagnant since 2012 and in deep recession since mid-2014; the resulting fiscal constraints are a major constraint for the development and implementation of SME support policies. Progress since the 2012 SBA assessment has therefore been modest across most areas and scores for some dimensions have actually deteriorated. In order to diversify the country's sources of economic growth, SME policies should be developed further (Table 0.20).

Table 0.20. **Overview of Ukraine's key reforms and recommendations**

Key reforms	Key recommendations
• Business deregulation and simplification of administrative procedures • Extension of e-government services • Legal reforms in areas such as licensing, insolvency and secured lending • Upgrade of the country's quality infrastructure • Implementation of measures to develop non-formal entrepreneurial learning	• Adopt a viable and realistic SME strategy over the short term • Create an agency or structure in charge of SME policy implementation, as fiscal resources permit • Adopt legal and regulatory reforms and consider credit guarantees to improve access to finance • Progressively introduce selected support measures to promote skills development, innovation and SME internationalisation • Introduce entrepreneurship key competence into the national curriculum

References

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2016 SME Policy Index scores for Eastern partner countries

The SME Policy Index is a benchmarking tool (Box 0.1) to help emerging economies monitor and evaluate progress in policies that support small and medium-sized enterprises (SMEs). The index was developed in 2006 by the OECD in partnership with the European Commission, the European Bank for Reconstruction and Development (EBRD), and the European Training Foundation (ETF) (the "partner organisations"; see Annex B). It has been applied to several regions which fall under the European Neighbourhood Policy and the Enlargement Policy: the Western Balkans (in 2006, 2009, and 2012, which included Turkey for the first time); the EaP countries (in 2012); and the Middle East and North Africa (in 2008 and 2013). This 2016 report presents the findings of the second assessment of the Eastern partner (EaP) countries.

The main objective of the SME Policy Index is to provide governments with a framework for assessing policies targeting SME development. The index identifies strengths and weaknesses in policy design, implementation, monitoring and evaluation; allows for comparison across countries; and measures convergence towards European Union SME policy standards. It aims to support governments in setting targets for SME policy developments

Box 0.1. **Scoring SME policy development**

The SME Policy Index assesses both quantitative and qualitative policy indicators. The quantitative indicators include data from the European Bank for Reconstruction and Development's Business Environment and Enterprise Performance Survey (BEEPS) and the World Bank's *Doing Business* reports, while the qualitative indicators assess the policy development path in a certain area, such as the establishment of a regulatory impact assessment or a credit guarantee scheme. Scores between 1 and 5 are used to assess the level of policy reform for each sub-dimension and dimension, with 1 being the weakest and 5 being the strongest level. For qualitative indicators, the scores typically correspond to the levels of policy development shown in Table 0.21.

Table 0.21. **Policy development scale**

Level 1	Level 2	Level 3	Level 4	Level 5
There is no law, institution, tool or (information) service in place for the area concerned	There is a draft law, institution, tool or (information) service and there are some signs of government activity to address the area concerned	A solid legal and/or institutional framework is in place for this specific policy area, tool or (information) service	Level 3, plus some concrete indications of effective policy implementation of the law, institution or tool	Level 4, plus some significant evidence of concrete and effective policy implementation of the law, institution, tool or service. This level comes closest to good practice identified for OECD countries

A detailed description of the policy framework underpinning the assessment, the scoring methodology and the assessment process is provided in the Policy Framework and Assessment Process chapter and the Technical Annex (Annex A).

and strategic priorities to further improve their business environments. It also engages governments in policy dialogue and facilitates the exchange of experiences within the region and with the partner organisations.

Table 0.22 displays the SME Policy Index scores in the EaP countries according to the Small Business Act assessment. The cut-off date for the assessment process was 30 June 2015, so scores reflect the situation of SME policy in the six EaP countries and reforms introduced by that date.

Table 0.22. **SME Policy Index scores**

		Scores							Weights
		ARM	AZE	BLR	GEO	MDA	UKR	EaP	
I	**Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded**								
1	**Entrepreneurial learning and women's entrepreneurship**	**2.63**	**2.59**	**2.39**	**2.70**	**2.57**	**2.25**	**2.52**	
1.1	Policy partnership	2.00	3.00	3.00	4.00	3.00	3.50	3.08	*11%*
1.2	Policy development process	3.00	2.00	2.00	3.00	3.00	3.00	2.67	*4%*
1.3	Monitoring and evaluation	2.00	2.00	3.00	2.00	3.00	2.00	2.33	*7%*
1.4	Non-formal learning	2.00	2.00	2.00	2.00	2.00	3.00	2.17	*4%*
1.5	Good practice exchange	2.00	2.00	2.00	3.00	2.00	2.00	2.17	*4%*
1.6	Entrepreneurship key competence in lower secondary education	3.00	2.50	3.00	2.00	3.50	2.00	2.67	*7%*
1.7	Entrepreneurship key competence in upper secondary education	3.00	2.50	2.00	2.00	3.50	2.00	2.50	*7%*
1.8	Entrepreneurial experience for young people	2.00	2.00	2.50	3.00	3.50	2.00	2.50	*4%*
1.9	Entrepreneurship promotion in vocational education and training	1.50	1.50	2.50	2.50	2.50	2.00	2.08	*7%*
1.10	Good practice in entrepreneurial learning in higher education	2.00	2.00	2.50	2.00	2.50	2.00	2.17	*4%*
1.11	Higher education co-operation with the world of business	3.00	3.50	3.00	3.00	2.50	2.00	2.83	*7%*
1.12	Entrepreneurial learning in higher education	2.00	2.00	3.00	2.50	2.00	2.00	2.25	*7%*
1.13	Policy support framework for promotion of women's entrepreneurship	4.00	3.00	1.50	3.00	2.00	2.50	2.67	*11%*
1.14	Institutional support for policy improvement in women's entrepreneurship	2.00	4.00	1.50	2.50	2.00	1.50	2.25	*7%*
1.15	Good practice in women's entrepreneurship	3.50	3.50	2.50	1.50	2.00	2.00	2.50	*4%*
1.16	Women's entrepreneurship training	4.00	2.50	2.00	3.50	2.00	2.00	2.67	*7%*
II	**Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance**								
2	**Bankruptcy and second chance for SMEs**	**3.16**	**2.87**	**2.57**	**2.94**	**2.68**	**2.05**	**2.71**	
2.1	**Laws and procedures**	**3.38**	**3.20**	**2.88**	**3.17**	**3.05**	**2.08**	**2.96**	***65%***
	Implementation	3.50	2.81	3.50	2.69	3.19	3.33	3.17	*25%*
	Performance	3.33	3.33	2.67	3.33	3.00	1.67	2.89	*75%*
2.2	**Promoting second chance**	**2.75**	**2.25**	**2.00**	**2.50**	**2.00**	**2.00**	**2.25**	***35%***
III	**Design rules according to the "think small first" principle**								
3	**Regulatory framework for SME policy making**	**3.38**	**2.47**	**2.41**	**3.48**	**3.51**	**2.45**	**2.95**	
3.1	**Institutional framework**	**3.47**	**2.54**	**2.79**	**4.41**	**4.22**	**2.20**	**3.27**	***40%***
	Planning & design	3.85	1.87	3.26	3.68	4.67	2.91	3.37	*35%*
	Implementation	3.00	3.00	3.00	5.00	3.89	1.89	3.30	*45%*
	M&E	3.85	2.70	1.52	4.33	4.19	1.67	3.04	*20%*
3.2	**Legislative simplification and Regulatory Impact Analysis**	**3.14**	**2.41**	**1.88**	**2.08**	**2.94**	**2.39**	**2.47**	***30%***
	Planning & design	2.33	3.00	1.80	2.20	2.60	1.80	2.29	*35%*

Table 0.22. **SME Policy Index scores** *(continued)*

		Scores							Weights
		ARM	AZE	BLR	GEO	MDA	UKR	EaP	
	Implementation	3.53	2.58	2.13	2.47	3.87	2.67	2.87	*45%*
	M&E	3.67	1.00	1.44	1.00	1.44	2.78	1.89	*20%*
3.3	**Public-Private Consultations (PPCs)**	**3.50**	**2.42**	**2.42**	**3.65**	**3.13**	**2.85**	**3.00**	***30%***
	Frequency and transparency	3.71	2.81	2.42	3.04	3.87	3.10	3.16	*40%*
	Private sector involvement	3.87	2.73	3.13	4.27	2.80	3.53	3.39	*40%*
	M&E	2.33	1.00	1.00	3.67	2.33	1.00	1.89	*20%*
IV	**Make public administration responsive to SMEs**								
4	**Operational environment for SMEs**	**4.05**	**4.23**	**4.09**	**4.33**	**3.56**	**3.81**	**4.01**	
4.1	**Interaction with government services (e-government)**	**3.37**	**4.13**	**3.72**	**4.01**	**3.87**	**3.82**	**3.82**	***45%***
	Planning & design	3.67	4.67	5.00	4.56	4.75	4.33	4.50	***35%***
	Implementation	2.87	3.33	3.93	3.58	3.13	3.33	3.36	*45%*
	M&E	4.00	5.00	1.00	4.00	4.00	4.00	3.67	*20%*
4.2	**Company registration**	**4.60**	**4.30**	**4.40**	**4.60**	**3.30**	**3.80**	**4.17**	***55%***
	Implementation	5.00	4.00	5.00	5.00	3.00	4.00	4.33	***40%***
	Performance	4.33	4.50	4.00	4.33	3.50	3.67	4.06	*60%*
V	**Adapt public policy tools to SME needs**								
5a	**Support services for SMEs and start-ups**	**3.93**	**2.98**	**2.99**	**3.69**	**3.35**	**1.84**	**3.13**	
5a.1	**SME support services by the government**	**4.05**	**3.96**	**3.36**	**3.73**	**3.73**	**2.43**	**3.54**	***50%***
	Planning & design	4.40	3.20	4.20	3.80	4.20	3.00	3.80	*35%*
	Implementation	4.06	4.43	3.39	3.82	3.16	2.61	3.58	*45%*
	M&E	3.40	4.20	1.80	3.40	4.20	1.00	3.00	*20%*
5a.2	**Government initiatives to stimulate private business support services development**	**3.81**	**2.00**	**2.62**	**3.64**	**2.97**	**1.26**	**2.72**	***50%***
	Planning & design	2.67	1.67	2.33	4.33	4.00	1.00	2.67	*35%*
	Implementation	4.71	2.71	3.57	3.57	2.86	1.57	3.17	*45%*
	M&E	3.80	1.00	1.00	2.60	1.40	1.00	1.80	*20%*
5b	**Public procurement**	**3.42**	**2.42**	**3.21**	**4.04**	**2.89**	**2.73**	**3.12**	
	Planning & design	3.95	2.14	2.43	2.90	1.86	1.86	2.52	*35%*
	Implementation	4.08	3.27	3.60	4.50	3.94	3.00	3.73	*45%*
	M&E	1.00	1.00	3.67	5.00	2.33	3.67	2.78	*20%*
VI	**Facilitate SME access to finance and develop a legal framework and business environment supportive of timely payments in commercial transactions**								
6	**Access to finance for SMEs**	**3.53**	**2.70**	**3.08**	**3.76**	**3.40**	**3.22**	**3.28**	
6.1	**Legal and regulatory framework**	**4.08**	**3.05**	**3.41**	**4.34**	**3.73**	**3.70**	**3.72**	***60%***
	Creditor rights	4.15	2.95	2.91	4.64	4.52	3.85	3.84	*24%*
	Register	4.50	2.83	3.00	4.90	4.60	3.49	3.89	*24%*
	Credit information bureau	4.54	4.05	4.53	4.42	3.78	4.31	4.27	*24%*
	Banking regulations	3.50	2.00	3.50	4.00	2.00	3.50	3.08	*14%*
	Stock market	3.01	2.89	2.97	3.06	2.53	3.00	2.91	*14%*
6.2	**Bank financing**	**2.71**	**1.67**	**2.52**	**3.27**	**2.67**	**2.06**	**2.48**	***20%***
	Banking statistics	2.82	2.12	3.53	4.04	2.70	2.32	2.92	*60%*
	Credit guarantee schemes	2.56	1.00	1.00	2.11	2.63	1.67	1.83	*40%*

Table 0.22. **SME Policy Index scores** *(continued)*

		Scores							Weights
		ARM	AZE	BLR	GEO	MDA	UKR	EaP	
6.3	**Non-bank financing**	**2.79**	**3.33**	**2.94**	**3.71**	**3.52**	**3.54**	**3.31**	***10%***
	Microfinance	3.33	4.67	3.67	4.67	4.33	3.00	3.94	*25%*
	Saving and loan associations (SLAs)	3.00	4.33	1.00	5.00	5.00	3.67	3.67	*25%*
	Leasing	2.50	2.00	3.42	2.83	2.42	3.50	2.78	*25%*
	Factoring	2.33	2.33	3.67	2.33	2.33	4.00	2.83	*25%*
6.4	**Venture capital**	**2.28**	**1.36**	**2.20**	**1.71**	**1.50**	**1.38**	**1.74**	***5%***
	Legal framework	3.11	1.33	2.78	2.33	1.33	1.45	2.06	*35%*
	Design and implementation	2.20	1.53	2.29	1.54	1.86	1.49	1.82	*45%*
	M&E	1.00	1.00	1.00	1.00	1.00	1.00	1.00	*20%*
6.5	**Financial literacy**	**2.90**	**2.65**	**2.60**	**1.00**	**3.97**	**3.29**	**2.74**	***5%***
	Design and implementation	2.71	2.40	2.33	1.00	4.05	3.86	2.72	*80%*
	M&E	3.67	3.67	3.67	1.00	3.67	1.00	2.78	*20%*
VII	**Help SMEs to benefit more from the opportunities offered by the Single Market**								
7	**Standards and technical regulations**	**3.33**	**3.32**	**3.22**	**4.22**	**4.12**	**4.34**	**3.76**	
7.1	**Overall co-ordination and general measures**	**3.67**	**2.11**	**1.00**	**4.33**	**3.00**	**3.89**	**3.00**	***14%***
7.2	**Technical regulations**	**4.73**	**1.67**	**3.40**	**4.20**	**4.47**	**4.80**	**3.88**	***14%***
7.3	**Standardisation**	**3.57**	**3.52**	**3.14**	**4.43**	**4.43**	**4.29**	**3.90**	***14%***
7.4	**Accreditation**	**2.97**	**3.56**	**3.88**	**3.96**	**4.20**	**4.20**	**3.80**	***14%***
7.5	**Conformity assessment**	**2.67**	**3.83**	**3.75**	**4.50**	**4.67**	**4.67**	**4.01**	***14%***
7.6	**Metrology**	**2.33**	**4.56**	**4.33**	**4.33**	**3.44**	**4.33**	**3.89**	***14%***
7.7	**Market surveillance**	**3.33**	**4.00**	**3.00**	**3.78**	**4.67**	**4.22**	**3.83**	***14%***
VIII	**Promote the upgrading of skills and all forms of innovation**								
8a	**Enterprise skills**	**2.67**	**2.94**	**2.28**	**3.00**	**2.50**	**2.56**	**2.66**	
8a.1.1	Training needs analysis	2.50	3.00	2.00	3.00	2.50	2.00	2.50	*33%*
8a.1.2	E-training for SMEs	2.00	3.00	2.00	2.00	2.50	2.50	2.33	*11%*
8a.1.3	Quality assurance	2.00	2.00	1.50	3.50	1.50	3.50	2.33	*11%*
8a.1.4	Training for start-up firms	4.00	3.50	3.00	3.50	2.00	2.50	3.08	*11%*
8a.1.5	Training for enterprise growth	2.50	3.00	2.00	3.00	3.00	2.50	2.67	*11%*
8a.1.6	Training for internationalisation of SMEs	3.00	3.00	3.00	3.00	3.00	3.00	3.00	*22%*
8b	**Innovation**	**2.91**	**2.47**	**2.91**	**2.70**	**2.54**	**1.86**	**2.57**	
8b.1	**Policy framework for innovation**	**2.93**	**2.01**	**2.47**	**2.86**	**2.39**	**1.48**	**2.36**	***60%***
	Planning & design	3.51	1.51	3.49	2.89	3.46	2.37	2.87	*35%*
	Implementation	3.33	2.83	2.33	3.67	2.17	1.00	2.56	*45%*
	M&E	1.00	1.00	1.00	1.00	1.00	1.00	1.00	*20%*
8b.2	**Government institutional support services for innovative SMEs**	**2.84**	**2.47**	**3.61**	**2.21**	**2.82**	**3.27**	**2.87**	***20%***
	Planning & design	3.67	2.17	3.83	3.33	4.67	4.33	3.67	*35%*
	Implementation	1.83	2.17	4.60	1.87	1.60	2.87	2.49	*45%*
	M&E	3.67	3.67	1.00	1.00	2.33	2.33	2.33	*20%*
8b.3	**Government financial support services for innovative SMEs**	**2.93**	**3.87**	**3.51**	**2.73**	**2.71**	**1.60**	**2.89**	***20%***
	Planning & design	2.69	3.69	4.56	2.75	2.69	2.19	3.09	*35%*
	Implementation	2.20	4.40	3.80	2.60	2.60	1.40	2.83	*45%*
	M&E	5.00	3.00	1.00	3.00	3.00	1.00	2.67	*20%*

Table 0.22. **SME Policy Index scores** *(continued)*

		Scores							Weights
		ARM	AZE	BLR	GEO	MDA	UKR	EaP	
IX	**Enable SMEs to turn environmental changes into opportunities**								
9	**SMEs in a green economy**	**2.39**	**1.54**	**2.10**	**2.48**	**2.19**	**1.22**	**1.99**	
9.1	**Environmental policies targeting SMEs**	**3.69**	**1.95**	**1.68**	**3.55**	**3.60**	**1.42**	**2.65**	***40%***
	Planning & design	4.60	2.20	1.00	4.20	5.00	2.20	3.20	*35%*
	Implementation	3.00	1.00	2.50	3.00	3.67	1.00	2.36	*45%*
	M&E	3.67	3.67	1.00	3.67	1.00	1.00	2.33	*20%*
9.2	**Incentives and instruments**	**1.51**	**1.26**	**2.39**	**1.77**	**1.26**	**1.09**	**1.55**	***60%***
	Planning & design	1.00	1.00	3.00	1.00	1.00	1.00	1.33	*35%*
	Implementation	2.14	1.57	2.52	2.71	1.57	1.19	1.95	*45%*
	M&E	1.00	1.00	1.00	1.00	1.00	1.00	1.00	*20%*
X	**Encourage and support SMEs to benefit from growth markets**								
10	**Internationalisation of SMEs**	**3.37**	**2.50**	**2.59**	**3.60**	**3.07**	**1.63**	**2.79**	
10.1	**Export promotion**	**3.97**	**2.87**	**2.75**	**4.10**	**3.51**	**1.79**	**3.16**	***80%***
	Planning & design	4.33	2.78	2.33	5.00	3.67	1.89	3.33	*35%*
	Implementation	4.11	3.11	3.40	4.33	3.61	2.07	3.44	*45%*
	M&E	3.00	2.50	2.00	2.00	3.00	1.00	2.25	*20%*
10.2	**Integration of SMEs into global value chains**	**1.00**	**1.00**	**1.96**	**1.58**	**1.30**	**1.00**	**1.31**	***20%***
	Planning & design	1.00	1.00	3.75	2.67	1.00	1.00	1.74	*35%*
	Implementation	1.00	1.00	1.00	1.00	1.67	1.00	1.11	*45%*
	M&E	1.00	1.00	1.00	1.00	1.00	1.00	1.00	*20%*

Note: Scores have been generated using the methodology of the SBA assessment, with certain differences between Dimensions 1 and 8a, on the one hand, and the rest of dimensions on the other (see chapter on Policy Framework and Assessment Process). Policy questionnaires were used in the latter case to calculate overall scores per sub-dimension and thematic block. The weight of each of those sub-dimensions and thematic blocks for calculating the overall dimension scores is expressed in percentages. For Dimensions 1 and 8a, performance has been assessed based on a series of separate indicators and reflected in a single 1-5 score for each indicator. For all dimensions, figures presented in white cells are the scores received, while the figures in grey cells are their weighted averages. Dimension scores are presented based on the five levels of policy reform (see Table 0.21). For further information please see the Technical Annex (Annex A).

Policy framework and assessment process

The SME Policy Index assessment framework aims to assess, independently and rigorously, SME-related policy settings and reforms against European Union (EU) and international best practice, and to provide guidance for policy reform and development.

While there are a number of other indices and benchmarking reports that assess the business environment in the Eastern partner (EaP) countries, the SME Policy Index adds value through its holistic approach to SME development policies, providing policy makers with a single window through which to view progress in a specific context. It also:

- focuses on a specific region where shared history, culture and geography allow for more relevant benchmarking between countries
- takes a participatory approach to evaluation and measurement involving a tripartite of government, private sector and partner organisations (i.e. OECD, European Commission, ETF and EBRD; see Annex B)
- evaluates the SME policy environment comprehensively around the ten key principles of the Small Business Act for Europe (see below)
- provides guidance on how to improve policy frameworks through good practice examples and policy recommendations presented as country-level reform roadmaps
- incorporates relevant data by other organisations (e.g. World Bank's *Doing Business* report, EBRD-World Bank Business Environment and Enterprise Performance Survey, BEEPS)
- uses country context and broader factors affecting SMEs and policy developments to complement the analysis reflected in the scores.

However, the SME Policy Index methodology also presents some limitations:

- Despite improvements in methodology, measuring effective implementation and outcomes of government policy can be difficult.
- The weighting system used based on expert opinion can be open to challenge.
- Shortage of national statistics on SMEs in the EaP region and diverging definitions of SMEs undermine the comparability of data across countries.
- The assessment framework is focused on the areas covered by the Small Business Act for Europe, rather than all aspects of SME policy.
- As the same set of indicators and weights is applied to all countries of the region, certain country-specific characteristics might not be given full consideration in the scoring.
- Intra-country differences (e.g. differences in the level of SME activity in capitals and regions) may not be adequately captured in the analysis.

The SBA assessment framework

The SME Policy Index for the EaP countries records countries' progress against a framework of 12 SME policy dimensions (built around the 10 principles of the SBA). These policy dimensions are further broken down into 32 sub-dimensions that capture the critical policy elements in each area (Table 0.23).

Table 0.23. **The SBA assessment framework and its links to the Small Business Act principles**

SBA principle	SME Policy Index dimension	Related sub-dimensions
1. Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded	1. Entrepreneurial learning and women's entrepreneurship	*Lifelong entrepreneurial learning* *Women's entrepreneurship*
2. Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance	2. Bankruptcy and second chance for SMEs	*Laws and procedures* *Promoting second chance*
3. Design rules according to the "think small first" principle	3. Institutional and regulatory framework for SME policy making	*Institutional framework* *Legislative simplification and regulatory impact analysis* *Public-private consultations (PPCs)*
4. Make public administration responsive to SMEs	4. Operational environment for SMEs	*Interaction with government services (e-government)* *Company registration*
5. Adapt public policy tools to SME needs	5a. Support services for SMEs and start-ups	*SME support services by the government* *Government initiatives to stimulate private business support services development*
	5b. Public procurement	*Public procurement*
6. Facilitate SME access to finance and develop a legal framework and business environment supportive of timely payments in commercial transactions	6. Access to finance for SMEs	*Legal and regulatory framework* *Bank financing* *Non-bank financing* *Venture capital* *Financial literacy*
7. Help SMEs to benefit more from the opportunities offered by the Single Market	7. Standards and technical regulations	*Overall co-ordination and general measures* *Technical regulations* *Standardisation* *Accreditation* *Conformity assessment* *Metrology* *Market surveillance*
8. Promote the upgrading of skills and all forms of innovation	8a. Enterprise skills	*SME skills*
	8b. Innovation policy for SMEs	*Policy framework for innovation* *Government institutional support services for innovative SMEs* *Government financial support services for innovative SMEs*
9. Enable SMEs to turn environmental challenges into opportunities	9. SMEs in a green economy	*Environmental policies targeting SMEs* *Incentives and instruments*
10. Encourage and support SMEs to benefit from growth markets	10. Internationalisation of SMEs	*Export promotion* *Integration of SMEs into global value chains*

Source: European Commission (2008), *Think Small First – A Small Business Act for Europe*

A detailed description of the assessment methodology, including changes since the 2012 assessment, is provided in Annex A.

The assessment process

The SME Policy Index is based on the results of two parallel assessments. A self-assessment is conducted by governments, and involves the country SBA co-ordinator – the government official assigned to lead the policy assessment – collecting inputs from the various agencies and ministries involved in SME policy development and implementation. In addition, an independent assessment is conducted by the OECD and its partner organisations, which is based on inputs from a team of local experts who collect data and information and conduct interviews with key stakeholders and private sector representatives.

The final scores are the result of the consolidation of these two assessments, enhanced by further desk research by the four partner organisations, country missions and consultations with government representatives. A series of stakeholder meetings is subsequently held in each country to discuss and compare the two parallel assessments and help to reduce bias and misjudgements. These meetings are typically attended by 30-50 SME policy stakeholders, including representatives of ministries and government agencies, international donors, civil society, the academic community, NGOs and the private sector. At the meetings, discrepancies between the two parallel assessments are discussed, information gaps filled, and draft scores presented. Based on the information gathered at the stakeholder meetings, the partner organisations then decide on the final results and present them to the SBA co-ordinators in a regional meeting at the end of the assessment process.

Timing of the 2016 assessment

The 2016 SBA assessment was carried out between March 2014 and November 2015 in three phases:

- Design phase (March 2014-October 2014): The methodology and assessment framework was updated through two regional workshops held in May 2014 and July 2014, with the participation of EaP countries and partner organisations. To ensure synergies in assessment tools used, as well as to promote cross-regional SBA co-operation, the regional workshops also included policy specialists and experts with experience in the SBA assessment exercise in the EU's pre-accession region. The finalised methodology was endorsed by all stakeholders at an EU SME Panel meeting in Kvareli, Georgia in October 2014.
- Evaluation phase (October 2014-March 2015): EaP countries carried out a self-evaluation of their policy frameworks (through the assessment questionnaires and other materials), which was complemented with independent assessments carried out by the OECD, the European Commission, ETF and EBRD with the support of local experts. Stocktaking missions and country workshops were held in all six countries to support the data collection exercise. For Dimensions 1 and 8a, focus groups were organised to build upon the self-evaluations. Desk research and follow-up with relevant stakeholders were used to fill information gaps and resolve inconsistencies. Finally, a seminar on SME statistics and policy monitoring was organised in April 2015 in Brussels with participants from the six EaP countries.
- Consolidation phase (April 2015-November 2015): A series of bilateral stakeholder meetings was held in each of the six countries between April and June 2015 to consolidate the findings. The final report was prepared following a regional

workshop involving government representatives and other stakeholders in July 2015 in Brussels in the context of an Eastern Partnership SME Panel meeting. The report – *SME Policy Index Eastern Partner Countries 2016: Assessing the Implementation of the Small Business Act for Europe* – was launched in November 2015 in Paris during the OECD's Eurasia Week.

Policy framework: the Eastern Partnership and the Small Business Act for Europe

The 2016 SBA assessment has been carried out in the context of the Eastern Partnership, the political framework of co-operation between the EU, its Member States and the six Eastern partner countries. The policy framework used for the assessment is the SBA, the key policy tool for implementing SME policy in EU Member States.

The Eastern Partnership

Political framework

The Eastern Partnership was launched in 2009 at a summit held in Prague. It is a political initiative joining the EU, its Member States and the Eastern European partners (Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova and Ukraine) in an effort to promote political, economic and social reforms, bringing the EaP countries closer to the EU. The Eastern Partnership supports and encourages reforms in the EaP countries for the benefit of their citizens. It is based on a shared commitment to international law and fundamental values – including democracy, the rule of law and respect for human rights and fundamental freedoms – as well as the market economy, sustainable development and good governance. The partnership is founded on mutual interests and commitments as well as shared ownership and mutual accountability. The main goal of the Eastern Partnership is to create the conditions for accelerating political association and deepening economic integration between the EU and the Eastern European partner countries. The Eastern Partnership is part of the EU Neighbourhood Policy.

The Association Agreements, including DCFTAs, concluded in 2014 have brought the relations between the EU and Georgia, the Republic of Moldova and Ukraine, respectively, to a new level. These agreements constitute a plan of reforms that will bring the partner countries closer to the EU by aligning their legislation and standards with the EU *acquis*. The Eastern Partnership will continue to be inclusive by providing a more differentiated and tailored approach to relations with Armenia, Azerbaijan and Belarus, in line with their sovereign choices. The EU is negotiating a new agreement with Armenia to enhance political relations and comprehensive economic co-operation. At the same time, the EU is also discussing a closer relationship with Azerbaijan, which reflects respective interests and values, and is deepening its critical engagement with Belarus.

The 2015 Riga Summit concluded that co-operation within the Eastern Partnership should in the future focus on: *(a)* strengthening institutions and good governance; *(b)* enhancing mobility and contacts between people; *(c)* developing market opportunities; and *(d)* ensuring energy security and improving energy and transport interconnections (EC, 2015).

Multilateral track: Platform 2 and the SME Panel

The Eastern Partnership involves two complementary work streams: the bilateral and multilateral tracks. The numerous challenges which EaP countries share are jointly addressed through the multilateral track through co-operation, networking and the exchange of best practice. Multilateral co-operation work is guided by four thematic platforms, supported by various expert panels, flagship initiatives and projects. These platforms cover the following themes:

- democracy, good governance and stability (Platform 1)
- economic integration and convergence with EU policies (Platform 2)
- energy security (Platform 3)
- contacts between people (Platform 4).

DG Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) of the European Commission co-ordinates and chairs Platform 2. This platform covers a wide range of sectorial policies. Policies and planned activities include enterprise and SME policies; trade and trade-related regulatory co-operation linked to the DCFTAs; co-operation over transport, environment and climate change, agriculture and rural development, statistics, harmonisation of digital markets, taxation and public finances, labour market and social policies, and macroeconomic and financial stability.

A dedicated SME Panel was launched in 2010 in order to support the development of SMEs in EaP countries, which are hindered by an inadequate regulatory and policy framework, a lack of advisory services, limited access to finance and a lack of interregional and international networking mechanisms. The SME Panel provides partner countries with the opportunity to stay informed about SME policies in the EU, as well as progress in the region. The panel is particularly directed towards government officials, the appointed SBA co-ordinators, and business and SME associations. Support is offered on three levels:

- Policy: the EU works with the OECD, EBRD and ETF to assist EaP countries draw up effective SME policies. This is done through the SBA assessment and the implementation of its recommendations. The EU also co-finances a World Bank project (STAREP) which aims to improve financial reporting in partner countries.
- Business support: the EU has initiated a vast networking programme – East Invest. It aims to promote trade and investment through networking between business support organisations in EU Member States and in EaP countries, as well as to consolidate business and SME associations in EaP countries.
- SMEs: to support SMEs directly and to provide them with better access to finance, a wide range of programmes involving European Financial Institutions (the EBRD, the European Investment Bank and the German development bank, KfW) has been developed under the umbrella of the Neighbourhood Investment Facility. Additionally, the DCFTA Facility for SMEs has been established for the three countries which have signed a DCFTA with the EU. It aims to finance investments necessary for SMEs to comply with the provisions of the DCFTA, to seize trade opportunities with the EU and within the region which have been opened up due to the DCFTA, and to benefit from the inflow of foreign direct investment.

The SBA assessment is a key tool to improve the business environment for SMEs and businesses in EaP countries, as well as strengthen institutions and good governance. These three aspects are priorities for the future work of the Eastern Partnership, as outlined in the Declaration of the Eastern Partnership Summit in Riga (EC, 2015). The SBA assessment is one of the SME Panel's key projects. The panel will also follow up implementation of the SBA assessment recommendations and policy roadmap and measure progress.

Small Business Act for Europe: A key policy tool for EU Member States

SMEs are the backbone of Europe's economy. They represent 99% of all businesses in the EU. Between 2010 and 2014, they created around 85% of new jobs and provided two-thirds of all private sector employment. The European Commission (EC) considers support to SMEs and entrepreneurship as key for ensuring economic growth, innovation, job creation, and social integration in the EU.

The SBA, which was adopted in June 2008, reflects the EC's political will to recognise the central role of SMEs in the EU economy. It aims to improve the approach to entrepreneurship in Europe, simplify the regulatory and policy environment for SMEs, permanently anchor the "Think Small First" principle in policy making and remove the remaining barriers to SME development. Built around ten principles and several concrete policy and legislative actions to implement them (Table 0.23), the SBA invites both the EC and EU Member States to tackle the obstacles that hamper SMEs' potential to grow and create jobs. The main priorities of the SBA are: *(a)* promoting entrepreneurship; *(b)* reducing the regulatory burden; *(c)* increasing access to finance; and *(d)* increasing access to markets and internationalisation.

The SBA Review, launched in February 2011, was a major landmark in tracking the implementation of the Small Business Act. It aimed to integrate the SBA with the Europe 2020 strategy (EC, 2010). This review presented an overview of progress made in the first two years of the SBA, set out new actions to respond to challenges resulting from the economic crisis, and proposed ways to improve the uptake and implementation of the SBA through a clear role for stakeholders – with business organisations on the frontline.

Within the EU, the SME Performance Review is one of the main tools used by the EC to monitor and assess countries' progress annually in implementing the SBA. The review brings in comprehensive information on the performance of SMEs in EU Member States and other countries participating in the EU's dedicated programme for SMEs – COSME (Programme for the Competitiveness of Enterprises and SMEs; Box 0.2). It consists of two parts – an annual report on European SMEs, and SBA country fact sheets. The SBA fact sheets assess national progress in implementing the Small Business Act. The fact sheets focus on indicators and national policy developments equivalent to the SBA's 10 policy dimensions.

Box 0.2. **COSME**

The SME Performance Review, as well as other actions supporting the implementation of the SBA in EU Member States, are undertaken through COSME. COSME is the EU Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises. The programme started in 2014 and will run until 2020. DG GROW is responsible for the implementation of this EU Programme. COSME's objectives are as follows:

a. improving the framework conditions for the competitiveness and sustainability of EU enterprises, including in the tourism sector

b. promoting entrepreneurship, including among specific target groups

c. improving access to finance for SMEs in the form of equity and debt

d. improving access to markets inside the EU and globally.

COSME is also open to non-EU Member States. Like most other EU programmes, it allows EaP countries to participate provided that a Protocol or a Framework Agreement on the general principles for the participation of the respective country in EU programmes is in place. Participation in EU programmes is meant to facilitate the political association and economic integration of partner countries.

References

EC (2015), *Joint Declaration of the Eastern Partnership Summit (Riga, 21-22 May 2015)*, European Commission, Brussels.

EC (2010), *Communication from the Commission: Europe 2020*, European Commission, Brussels.

EC (2008), *Think Small First – A Small Business Act for* Europe, European Union, Brussels.

Economic context and the role of SMEs in the Eastern partner countries

The Eastern partner (EaP) region is composed of six countries (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine), which together cover 1.03 million km^2 and contain 75.4 million people. The region is strategically located close to some very large markets (including the European Union, Russia and Turkey) and has a well-educated population (literacy is close to 99%). In 2014, the EaP countries generated a nominal gross domestic product (GDP) of USD 315.7 billion. Ukraine is by far the largest EaP country, accounting for 40% of the region's GDP in 2014, followed by Belarus and Azerbaijan, with 24% and 23.5% respectively in 2014 (IMF, 2015a).

In 2014, an economic slowdown in Russia (a significant source of foreign direct investment, remittances and export revenues for most EaP countries), regional geopolitical tensions surrounding the conflict in eastern Ukraine, as well as declining commodity prices, all negatively affected the economic outlook for the EaP region. As of June 2015, GDP growth was expected to contract in all countries (except Azerbaijan and Georgia), with a particularly deep recession forecast in Ukraine (IMF, 2015a). These developments have also revealed structural weaknesses in the countries' economies, characterised by low levels of competitiveness and limited diversification.

Small and medium-size enterprises (SMEs) play a significant role in the economic structure of the six EaP countries, but their potential remains largely untapped. SMEs account for between 83 and 99% of all private sector enterprises, but their contribution to GDP, value added and employment is significantly below OECD and European Union (EU) averages. SME development is especially inhibited by pervasive market failures, lack of supporting structures and omnipresent regulatory barriers. Addressing these constraints is a pre-condition for developing a vibrant private sector, ultimately enhancing economic competitiveness and boosting inclusive and sustainable economic growth.

A heterogeneous region with a diverse economic structure

The EaP's geographical position – with one foot in Europe and the other in Asia – makes it an important transit corridor. Georgia and Ukraine have access to international sea trading routes through the Black Sea, while Azerbaijan has a coast on the Caspian Sea. Belarus, Moldova and Ukraine all border the EU. In June 2014, three countries of the EaP region (Georgia, Moldova and Ukraine) concluded Association Agreements with the EU that included Deep and Comprehensive Free Trade Areas (DCFTAs). These raise their relationship with the EU to a new level, bringing the legislation and standards of these countries closer to EU *acquis* and constituting a comprehensive reform agenda. The DCFTAs should also boost trade and investment flows between these countries and the EU. The DCFTAs have been under provisional application since September 2014 in Georgia and Moldova, while provisional application has been postponed until January 2016 in Ukraine.

The EaP region's six countries vary significantly in their population levels, resource endowments and economic structures (Table 0.24 and Box 0.3). All EaP countries except Azerbaijan have limited natural resource endowments. Total natural resource rents as a percentage of GDP range from 8% in Ukraine to 0% in Moldova. In Azerbaijan, natural resource rents represent 36% of GDP (World Bank, 2015a) and the vast majority of exports. Armenia is the tenth largest exporter of unrefined copper in the world (accounting for 1.2% of world's exports), while Ukraine exports 17% of the world's semi-finished iron products.

Agricultural production is important in all six countries, but particularly in Armenia and Moldova, where it accounted for 22% and 15% of value added in 2014 (World Bank, 2015a). Ukraine is a large exporter of cereals, with Ukrainian maize and barley accounting for one-tenth of world exports. Belarus is the world's fifth largest fertiliser exporter (ITC, 2015).

The region has a highly literate population (literacy is close to 99% in all countries and secondary school enrolment is over 90% in all countries except Moldova). Unemployment rates range between 6% in Azerbaijan and Belarus to 18.5% in Armenia (World Bank, 2015a). The limited evidence available suggests that the size of the informal sector is relatively large in most EaP countries, especially in the agricultural and service sectors. Labour force participation among women, while lower than among men, is close to or surpasses 50% in all EaP countries, which is not far from the OECD average of 62%.

All EaP countries are classified by the World Bank as middle-income economies, based on their gross national income (GNI) per capita (World Bank, 2015a). Azerbaijan and Belarus are considered upper middle-income economies (GNI per capita between USD 4 126 and USD 12 735; Table 0.24). Armenia, Georgia, Moldova and Ukraine are classified as lower middle-income economies as their GNI per capita does not exceed USD 4 125.

Table 0.24. **Key data for the Eastern partner countries, 2014**

	Total area (km²)	Population (million inhabitants)	GNI per capita, PPP (current USD)	Arable land (% of land area)	Rural population (% of total population)
Armenia	29 740	2.98	3 810	16	37
Azerbaijan	86 600	9.54	7 590	23	46
Belarus	207 600	9.47	7 340	27	24
Georgia	69 700	4.50	3 720	6	47
Moldova	33 850	3.56	2 550	55	55
Ukraine	603 550	45.36	3 560	56	31

Note: GNI: gross national income; PPP: purchasing power parity; USD: United States dollars

Source: World Bank (2015). *World Development Indicators Database*, World Bank, retrieved on 14 August 2015, available at: http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

Box 0.3. **Economic snapshot of the EaP countries**

Armenia, a landlocked and mountainous country, is the smallest of the EaP countries. Armenia has been a member of the Eurasian Economic Union (EEU) since January 2015. It is highly reliant on remittances (21% of GDP in 2013), particularly from Russia (accounting for approximately 64% of all Armenia's remittances in 2014; World Bank, 2015b). The economy also heavily depends on the agricultural sector, which contributed 22% of GDP in 2014 (World Bank, 2015a). Another important sector is the extraction and processing of metals and ores, representing 38% of total merchandise exports in 2014 (World Bank, 2015a).

Box 0.3. **Economic snapshot of the EaP countries** *(continued)*

Azerbaijan's economy is largely dominated by the oil industry, which accounted for around 34% of total GDP in 2013 (World Bank, 2015a) and 94% of total exports (IMF, 2015b). This makes the country vulnerable to volatile oil prices. Efforts to boost gas exports are underway with the launch of the Shah Deniz II gas field planned for late 2018. Azerbaijan's key trade partners are the EU, Turkey and Russia. Exports to the EU, mostly oil, increased ten-fold between 2004 and 2014, from EUR 1 292 to EUR 13 159 million. Azerbaijan's imports from Russia and Turkey are substantial, with each accounting for 14% of total imports in 2014 (ITC, 2015).

In **Belarus**, the economy is dominated by large state-owned enterprises. The private sector remains underdeveloped, accounting only for about 30% of GDP (EBRD, 2010). The largest sectors of the economy are the manufacturing and agricultural sectors, representing 42% and 26% of GDP respectively in 2014 (World Bank, 2015a). A member of the EEU, Belarus is largely dependent on trade with Russia, which accounts for 42% of total Belarusian exports (ITC, 2015). The Belarusian economy also benefits from access to Russian energy at subsidised prices and preferential access to Russian markets.

Georgia's economy is mainly based on a relatively small industrial sector and agricultural processing, which accounted for 24.4% and 9.2% of GDP respectively in 2014 (World Bank, 2015a). The country imports most of its supplies of natural gas and oil products. Georgia is located at the centre of an important regional transit corridor, and its transport services accounted for 33% of commercial service exports in 2014 (World Bank, 2015a). Construction of the Baku-Tblisi-Ceyhan oil pipeline, the South Caucasus gas pipeline, and the Kars-Akhalkalaki Railroad are expected to strengthen Georgia's role as a transit point for gas, oil, and other goods.

Moldova is the poorest economy in the EaP region with a GNI per capita of USD 2 550 in 2014 (World Bank, 2015a). Exports of basic agricultural products contribute 25% of the total export product basket, making the country particularly vulnerable to variations in food prices in key export markets, such as Russia and Ukraine. The Moldovan economy is highly dependent on remittances (25% of GDP in 2013; World Bank 2015a), particularly from Russia, which represented 9% of Moldova's GDP in 2012 alone (World Bank, 2015b).

In spite of a deep economic recession, **Ukraine** remains the largest EaP economy, contributing to over 40% of the region's GDP. Industry and agriculture continue to drive the Ukrainian economy and represented 25% and 12% of GDP respectively in 2014 (World Bank, 2015a). Ukraine's key trade partners are the EU and Russia, which absorb 31.5% and 18% of Ukrainian exports respectively (EBRD, 2015).

Regional developments are damaging macroeconomic performance

Though the EaP region quickly recovered from the hit it took during the 2008 crisis, the steady growth trend between 2010 and 2013 was reversed in 2014/15. The region's average annual growth experienced a marked slowdown, from an average of 3.8% in 2013 to just 1.7% in 2014. Ukraine saw its real GDP contract by -6.8% in 2014, while instability spread to most other EaP countries in the final months of 2014. In 2015, the situation is expected to deteriorate further, with all EaP countries, except Azerbaijan and Georgia, forecast to experience negative growth (Figure 0.2). The situation is especially severe in Ukraine, where a confidence crisis related to the armed conflict in the eastern part of the country is the key factor behind a significant recession – with negative GDP growth of -5.5% forecast as of May 2015 (IMF, 2015a). This decline is exacerbated by the tight fiscal and monetary policies that were implemented to address macroeconomic imbalances.

The factors behind this situation are complex and interlinked. In addition to a decline in commodity prices and sluggish growth in the Eurozone, two main events have created instability in the EaP region: *(a)* geopolitical tensions triggered by the conflict in Eastern Ukraine, which may undermine consumer and, crucially, investor confidence in a region that is yet to recover the levels of foreign direct investment prior to the global financial crisis of 2008; and *(b)* a deep recession in the Russian Federation, which is a key export market and source of remittances for most EaP countries.

The impact of these external shocks has been amplified by certain structural weaknesses in many EaP countries, including Ukraine's adjustment after years of accumulating significant imbalances, a crisis in the Moldovan financial sector and structural rigidities in the Belarusian economy. The continuing turbulence underscores the importance of economic competitiveness and diversification as part of a broader reform agenda for EaP countries.

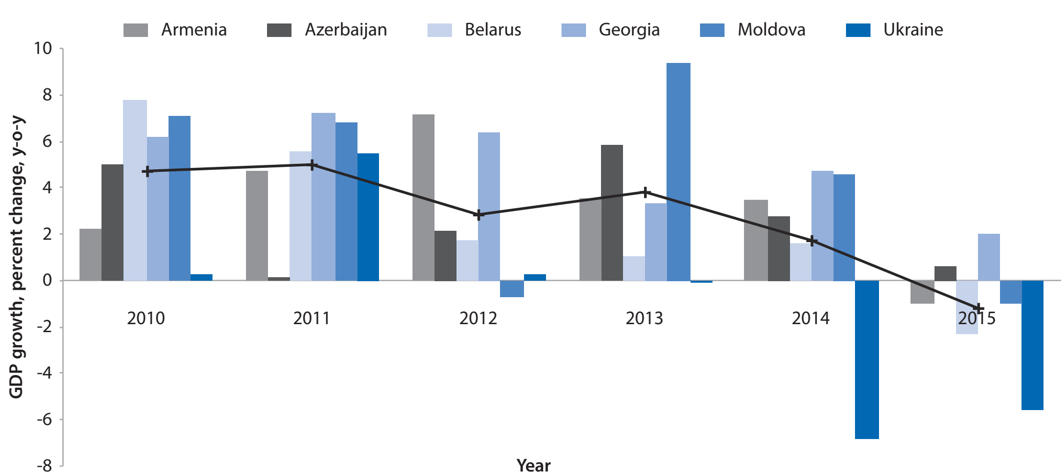
Table 0.25. **Key macroeconomic indicators for Eastern partner countries, 2014**

Indicator	Unit of measurement	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
GDP growth [a]	%, y-o-y	3.4	2.8	1.6	4.7	4.6	-6.8
Inflation	%, average	3.1	1.4	18.1	3.1	5.0	12.1
Government balance	% of GDP	-2.1	0.4	-3.3	-1.8	-1.7	-3.1
Current account balance	% of GDP	-7.9	13.6	-6.7	-9.7	-5.5	-4.0
Export of goods and services	% of GDP	31.3	43.3	57.2	42.9	42.1	49.2
Imports of goods and services	% of GDP	51.2	26.2	57.9t	60.4	78.9	53.2
Net FDI [b]	% of GDP	n.a	n.a	2.6	6.5	2.5	0.1
Unemployment [c]	% of total labour force	18.0	6.0	5.2	12.4	4.0	10.5
Nominal GDP [d]	USD billion	10.3	74.1	76.1	16.5	7.9	130.7

Notes: **a.** IMF projections; **b.** Georgia's net FDI figure is from GeoStat; **c.** 2014 figures for Georgia (source: GeoStat); 2013 for Belarus, Moldova and Ukraine; 2011 for Armenia; 2009 for Azerbaijan; **d.** IMF projections; **y-o-y**: year-on-year.

Source: EBRD (2014), *Transition Report 2014*, European Bank for Reconstruction and Development, London; GeoStat (2013), Business Statistics, dataset available at http://geostat.ge accessed July 2015; IMF (2015), *World Economic Outlook*, May 2015, International Monetary Fund, Washington, DC; World Bank (2015a), *World Development Indicators Database*, World Bank, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators (accessed 14 August 2015).

Figure 0.2. **GDP growth trends in Eastern partner countries, % year-on-year change, 2010-15**



Source: OECD calculations based on data from IMF (2015), *World Economic Outlook,* May 2015, International Monetary Fund, Washington, DC.

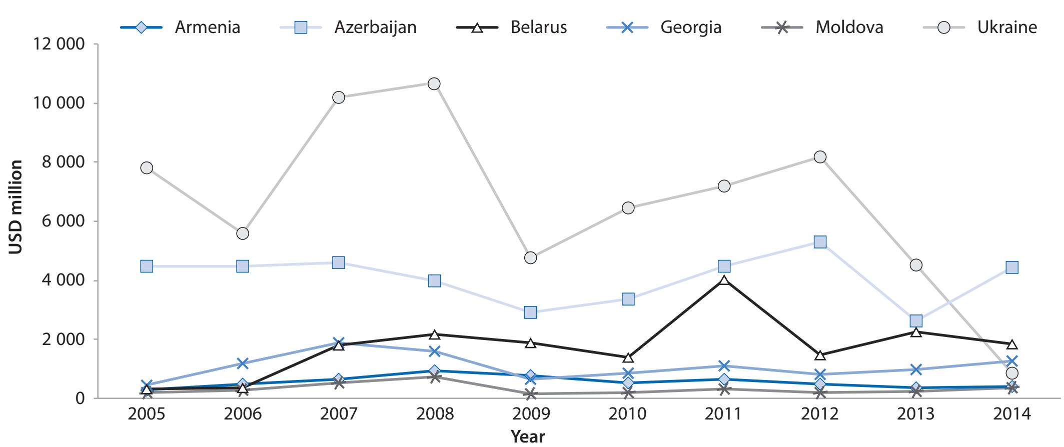
Geopolitical tensions undermine investor confidence

The geopolitical tensions in the region are already having an impact in EaP countries. A particular area of concern is the flow of FDI into the region, which was a key driver of economic growth in most EaP countries prior to 2008. FDI flows into EaP countries have yet to recover their pre-crisis levels (Figure 0.3). For instance, in 2014, FDI inflows to the Ukrainian economy were 90% lower than in 2012. Belarus, the largest recipient of Russian investment, has also witnessed a decrease in FDI flows, but to a lesser extent. Georgia, Armenia and Moldova have been relatively less exposed to FDI volatility.

Russian FDI is of particular interest. In 2013, the total amount of Russian FDI in the EaP region reached USD 1 538 million (equivalent to 68.9% of Russian FDI in the Commonwealth of Independent States as a whole). In 2014, this proportion fell substantially, to 23.4% of Russian FDI in CIS countries (Central Bank of Russia, 2015). Most EaP countries witnessed a negative net flow of Russian FDI in 2014, with the most dramatic outflows occurring in Ukraine and Moldova (USD 493 million and USD 212 million respectively). At the same time, FDI from Russia to Armenia almost tripled in 2014 compared to the previous year (USD 272 million in 2014).

Overall, the instability in the region is a significant obstacle to increasing both domestic investment and FDI; yet investment is crucial – not only as a source of economic growth, but also of knowledge and innovation and as a potential catalyst of SME development.

Figure 0.3. **Inflows of foreign direct investment to EaP countries, 2005-14**



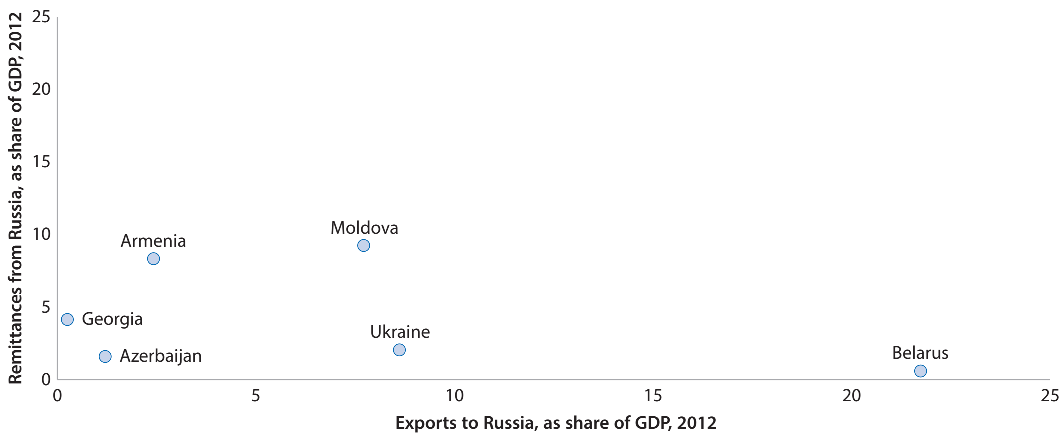
Source: OECD calculations based on data from World Bank (2015), *World Development Indicators Database*, World Bank, http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators (accessed 14 August 2015).

Russia's recession is generating negative spillovers across the EaP region

In 2014, Russia experienced a significant slowdown, with GDP growing by a meagre 0.6%. A fully fledged recession is forecast for 2015, with negative growth of -3.8% (IMF, 2015a). The significant reduction in oil prices (Russia's main export) in 2014/15 and the implementation of economic sanctions have had a significant impact on output and real wages. Significant capital outflows and a depreciation of the rouble have prompted interventions to tighten monetary and fiscal policies.

Economic downturn in Russia is having sizeable negative spillover effects on those EaP countries with strong economic links with Russia (Figure 0.4). The main channel of transmission throughout the region has been significant currency depreciations and inflationary pressures in a context of decreasing exports and remittances.

Figure 0.4. **Reliance of EaP countries on Russian trade and remittances, 2012**



Note: Statistics for exports in Moldova are calculated from data provided by National Bureau of Statistics of Republic of Moldova.

Source: OECD calculations based on ITC (2015), *Trademap. Trade statistics for international business development,* database, www.trademap.org/Bilateral_TS.aspx (accessed July 2015); World Bank (2015b), *World Development Indicators Database*; World Bank (2015), *Bilateral Remittance Matrix, Migration and Remittance Factbook,* database, http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/0,,contentMDK:22759429~pagePK:64165401~piPK:64165026~theSitePK:476883,00.html (accessed July 2015).

The depreciation of the Russian rouble in 2014 put added pressure on EaP currencies. Between 2010 and 2014, Azerbaijan, Georgia and (to a smaller extent) Moldova maintained a stable exchange rate, but the other three EaP countries experienced significant depreciations over this period. In Ukraine, the currency remained stable between 2010 and 2013 but depreciated by 50% in 2014. The Belarusian currency depreciated by 243% between 2010 and 2014. Further instability in the foreign exchange markets continued in 2015. Belarus, Georgia and Moldova experienced the largest depreciations against the US dollar, at around 15 to 25% between January and May 2015 (EBRD, 2015). The Azerbaijani central bank responded to pressures from lower oil prices with a 25% devaluation of the manat in February 2015. Other EaP countries (e.g. Armenia, Georgia, Moldova) have reacted to limit currency depreciations through interest rate increases and interventions in the foreign exchange markets.

Despite a significant decline in oil prices since early 2014, the pressures on exchange rates are having a significant impact on inflation. In 2015, inflation was expected to increase in all EaP countries (except Georgia) reaching 33.5% in Ukraine and 22.1% in Belarus.

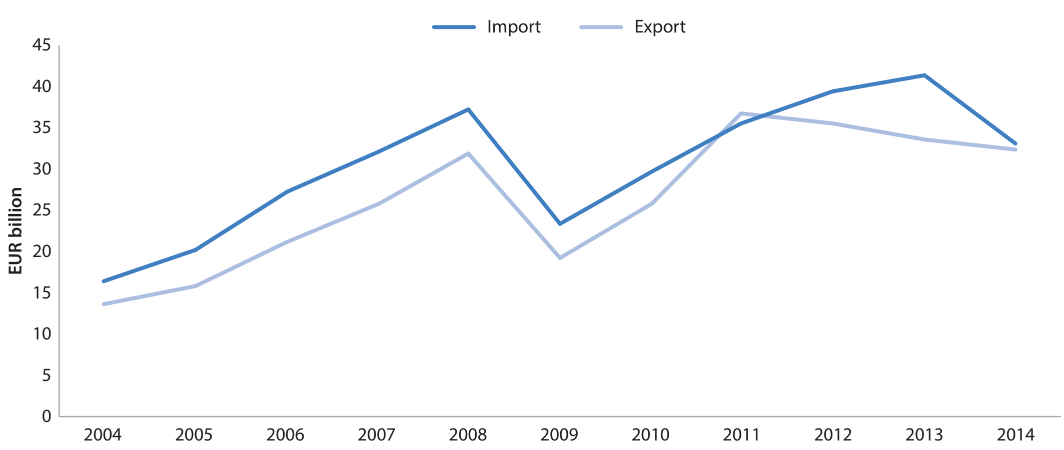
Economic stagnation in Russia also prompted a significant decrease in remittances to EaP countries in 2014 (except Azerbaijan and Belarus, where Russian remittances grew by 8.7% and 3.6% respectively) (World Bank, 2015b). This is a significant reversal from the steady growth seen from 2010 to 2013, when remittance flows more than doubled in Armenia (from USD 567 to 1 402 million) and Georgia (from USD 503 to 1 152 million). In Belarus and Ukraine, remittance inflows from Russia grew by 72.4% and 60.5%

respectively over the same period, with Moldova and Azerbaijan experiencing more modest growth (27.8% and 13.6% respectively). The situation changed in 2014 when Armenia, Georgia and Moldova witnessed a drop in Russian remittances of 1.6%, 2.6% and 0.2%, respectively. The decline in remittances from Russia to Ukraine was the most significant, at 27.4% compared to 2013 levels, although in nominal terms, Ukraine remains by far the largest recipient of remittances from Russia (USD 3 936 million in 2014). Moldova and Armenia remain the most dependent on Russian remittances, representing close to 10% of their annual GDP (Figure 0.4).

Finally, Russia is an important destination for exports from EaP countries. Weak growth in Russia has therefore also affected EaP countries through the trade channel. In 2014, total exports from EaP countries to Russia decreased by 12% in value terms compared to the previous year, driven primarily by a sharp decline (35%) in Ukrainian exports (ITC, 2015). Nevertheless, Russia remains the second biggest importer after the EU of EaP goods, accounting for 25.2% of EaP exports. In 2012, Belarus (at nearly a quarter of GDP), Ukraine and Moldova were the most dependent on trade with Russia (Figure 0.4).

Some EaP countries (e.g. Ukraine, Moldova) have responded by re-directing their exports to the EU. For example, Moldova increased its exports to the EU by 30% in 2014. The EU is a key trading partner for all EaP countries except Belarus: in 2014, 30% of total EaP exports went to EU Member States. Between 2004 and 2014, trade flows between EU and EaP countries more than doubled (Figure 0.5). In 2014, the EU was the destination of 53% of Moldovan exports, followed by Ukraine (31%), Belarus (30%) and Armenia (29%). From the EU's perspective, energy remains the main product imported from the EaP region (EUR 15.4 billion or 47% of the total in 2014), followed by manufactured goods other than chemicals and machinery (EUR 6.3 billion or 19%) (Eurostat, 2015).

Figure 0.5. **Evolution of EaP-EU exports and imports, 2004-14**



Source: Eurostat (2015), "Facts and figures about the Eastern Partners of the European Union", *Eurostat News release*, May 2015, Luxembourg, http://tinyurl.com/o59n5sj.

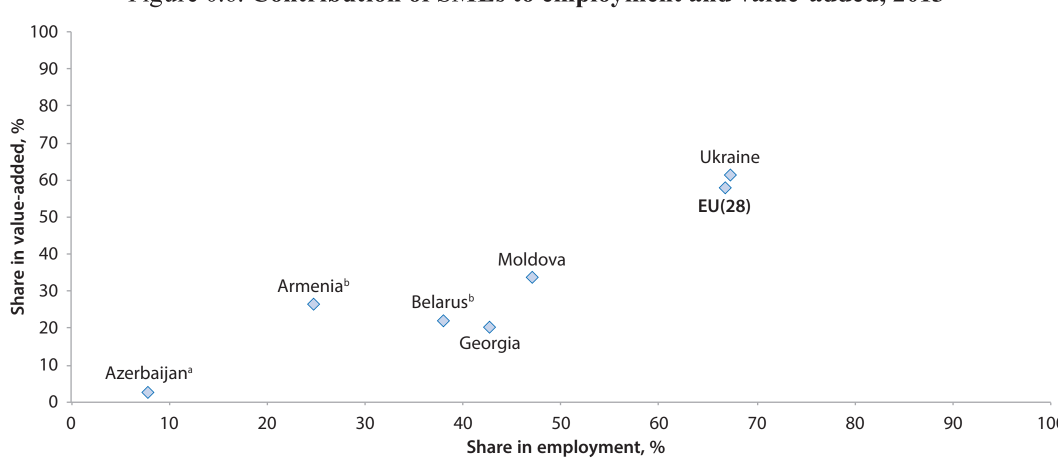
Policy barriers are limiting SME's potential for economic competitiveness and inclusive growth

In 2013, SMEs represented 97-98% of the business population in Armenia, Belarus, Moldova and Ukraine. These figures were slightly lower in Georgia (91.4%) and Azerbaijan (83.3%, but including only small enterprises). SMEs are unequally distributed within the countries, with most firms being concentrated in the capital cities. For instance, in 2013, more than 50% of SMEs in Armenia, Georgia and Moldova operated in the capitals.

Over the past few years, the SME sector has been growing across the region, albeit slowly, particularly in Armenia, Moldova and Ukraine. SME sectors in most EaP countries continue to be dominated by micro-enterprises, with a relative fall in the share of medium enterprises compared to smaller entities between 2010 and 2013 in some EaP countries (e.g. Georgia). In 2013, micro-enterprises accounted on average for 80-90% of total business population in Armenia, Belarus, Moldova and Ukraine.

Most SMEs in EaP countries continue to operate in low value-added sectors of the economy, with retail, trade and agriculture being their main activities, followed by manufacturing, construction and transportation. This concentration in low value-added sectors accounts for their limited contribution to GDP and employment, which remains well below EU averages in all EaP countries except for Ukraine (Figure 0.6). In 2013, the contribution of SMEs to employment in the EaP region was on average about 38% (compared to 67% in the EU). SME contribution to value-added is, on average, just 28%, significantly lower than in the EU (58.1% in 2013). While these figures should be approached with caution, as they are based on widely diverging definitions of the SME sector across countries, they suggest that the SME potential for economic competitiveness and job creation remains largely untapped. In some countries, the relative weight of SMEs in value added, turnover and/or employment has actually decreased over time. For instance, in Georgia there has been a slight decrease in SME employment relative to larger enterprises, largely driven by a reduction of the weight of medium-sized enterprises, suggesting problems for businesses to scale up. Similar slight negative trends in turnover and employment are reported in Moldova (see Part II of this report).

Figure 0.6. **Contribution of SMEs to employment and value-added, 2013**

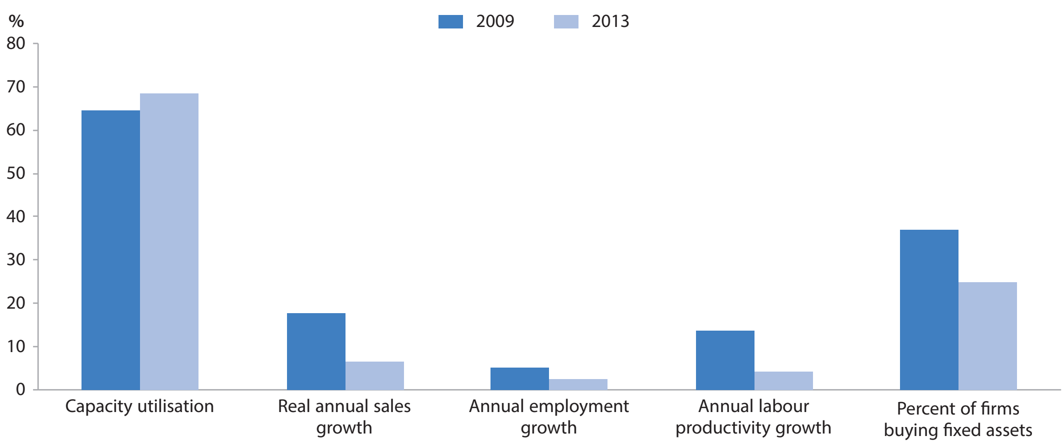


Note: **a.** The data for Azerbaijan include only small enterprises; **b.** for Armenia and Belarus GDP data is used instead of value-added.

Source: OECD calculations based on data from SME DNC (Armenia); State Statistical Committee of the Republic of Azerbaijan (Azerbaijan); Belstat (Belarus); GeoStat (Georgia); National Bureau of Statistics of the Republic of Moldova (Moldova); State Committee of Ukraine for Statistics (Ukraine); Eurostat (EU).

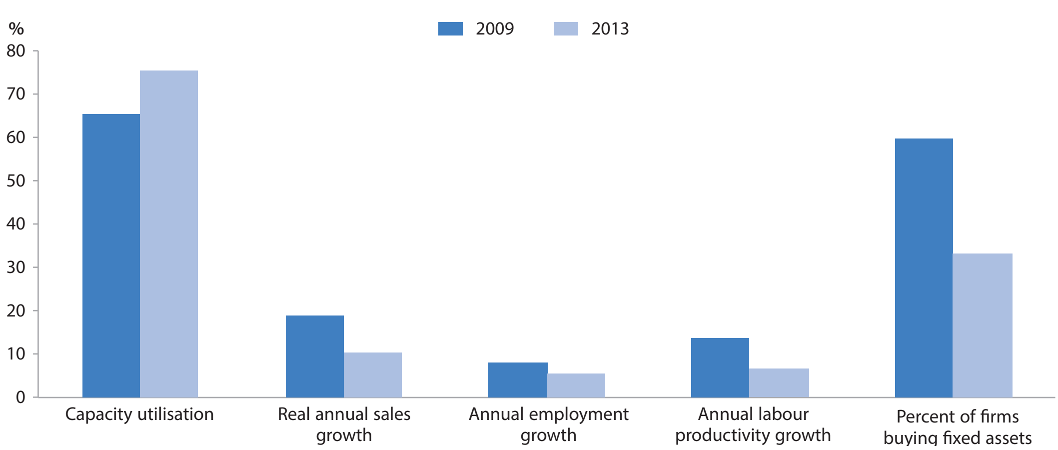
Moreover, the last round of the Business Environment and Enterprise Performance Survey (BEEPS), conducted in 2013 (EBRD, 2014), identified a slowdown in the growth of SMEs' annual sales, employment and productivity, as well as lower levels of investment by SMEs in the EaP region compared with 2009, when the previous round of surveys was carried out (Figures 0.7 and 0.8). While similar patterns are also observed for larger firms (reflecting the general macroeconomic environment in 2008 and 2012, the last years surveyed companies were asked to report on), these figures suggest that SMEs in the EaP region are experiencing substantial obstacles to growth. In Ukraine (the largest EaP economy), for instance, surveyed small businesses reported negative annual sales growth, employment growth and labour productivity in 2012 (EBRD, 2014). Data also point to lower investment levels in Ukraine compared with regional peers: the percentage of small and medium firms buying fixed assets (15.1% and 22.8%) is also substantially smaller than the respective Europe and Central Asia averages (33.6% and 45.4%).

Figure 0.7. **Evolution of small companies' performance in EaP countries, 2009 and 2013**



Source: OECD calculations based on data from EBRD (2014), *Business Environment and Enterprise Performance Survey, BEEPS V* (2011-2014), dataset available at http://ebrd-beeps.com (accessed July 2015).

Figure 0.8. **Evolution of medium-sized companies' performance in EaP countries, 2009 and 2013**



Source: OECD calculations based on data from EBRD (2014), *Business Environment and Enterprise Performance Survey, BEEPS V* (2011-2014), dataset available at http://ebrd-beeps.com (accessed July 2015).

The data suggest that SMEs in the EaP region are not only performing below their potential (compared to their peers in EU or OECD countries), but have also been struggling to catch up in recent years. This relatively weak performance can be largely explained by the significant structural and policy obstacles that SMEs face in EaP countries. According to the results of the BEEPS V survey, small and medium-sized businesses identified access to finance as one of their main obstacles, although its relative importance varies across countries (Table 0.26; EBRD, 2014). A majority of medium-sized enterprises in Azerbaijan (29.8%) and Ukraine (32.9%) mention access to finance as the biggest business constraint. This might indicate that financial access is a particular problem as firms grow in size and no longer rely on public support schemes. Access to finance is mentioned as the second most important obstacle by small firms in Azerbaijan (31.7%), Georgia (21.3%) and Ukraine (15.1%).

Table 0.26. **Main business constraints in EaP countries, 2013**

Firm size (employees)	Top three constraints (according to BEEPS respondents)					
	Armenia	**Azerbaijan**	**Belarus**	**Georgia**	**Moldova**	**Ukraine**
Small (1-49)	1. Tax rates 2. Tax administration 3. Political instability	1. Practices of the informal sector 2. Access to finance 3. Tax rates	1. Access to finance 2. Tax rates 3. Inadequately educated workforce	1. Political instability 2. Access to finance 3. Tax rates	1. Corruption 2. Inadequately educated workforce 3. Political instability	1. Corruption 2. Access to finance 3. Political instability
Medium (50-99)	1. Tax administration 2. Tax rates 3. Customs and trade regulations	1. Access to finance 2. Practices of the informal sector 3. Tax rates	1. Inadequately educated workforce 2. Tax rates 3. Access to finance	1. Political instability 2. Tax rates 3. Access to finance	1. Political instability 2. Inadequately educated workforce 3. Corruption	1. Access to finance 2. Corruption 3. Tax rates
Large (100+)	1. Tax rates 2. Access to finance 3. Tax administration	1. Practices of the informal sector 2. Customs and trade regulations 3. Access to finance	1. Tax rates 2. Inadequately educated workforce 3. Political instability	1. Political instability 2. Access to finance 3. Tax rates	1. Political instability 2. Access to finance 3. Transportation	1. Corruption 2. Access to finance 3. Political instability

Source: EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset available at http://ebrd-beeps.com, accessed July 2015.

Tax rates and, in certain countries, political instability, also feature prominently among the three main obstacles cited by SMEs in EaP countries. Tax rates seem to be a slightly more serious obstacle for medium-sized firms, especially in Armenia, Belarus and Georgia, where 23.1%, 24% and 20.5% of medium-sized companies respectively mentioned tax rates as the second most significant obstacle to doing business (Table 0.26). Political instability was reported to be a constraint by both SMEs and large companies in Moldova and Georgia, and by small companies in Armenia and Ukraine in 2013. While this obstacle has been cited recurrently by surveyed companies in certain countries (e.g. Moldova) in previous BEEPS series, in most cases it tends to be highly dependent on the specific political situation when each survey is conducted. Other important obstacles include corruption and an inadequately educated workforce. The latter is a particular problem for SMEs in Belarus (as reported by 26.3% of medium and 18.8% of small firms) and Moldova (21.8% of medium and 12.7% of small firms). Perceived corruption is the biggest obstacle for small companies in Moldova (25.4%) and Ukraine (17.9%). Finally, high levels of informality in most EaP countries represent a significant problem as they have an impact on the availability of reliable statistical data and the reach and effectiveness of government SME policy.

Unleashing the potential of SMEs

The macroeconomic challenges currently facing the region underscore the importance for EaP countries to enhance economic competitiveness and diversification. The low level of economic and export diversification and a focus on low added-value sectors make EaP countries vulnerable to external shocks (e.g. commodity price fluctuations and macroeconomic performance of key trading partners). In all EaP countries, the potential of the SME sector to generate jobs, innovation, value-added and economic growth remains largely untapped.

Government can and should play the role of enabler and facilitator to help SMEs to tackle the above challenges and policy barriers. This includes creating robust strategic frameworks, effective and well-co-ordinated support institutions, and fluid public-private dialogue. A comprehensive SME policy framework requires attention to two complementary and mutually reinforcing priorities: *(a)* horizontal reforms that create a favourable business environment for all enterprises; and *(b)* proactive targeted support measures for SMEs in particular.

Most EaP countries have recognised the importance of reducing regulatory and administrative barriers. As a result, EaP countries have improved on their rankings in the World Bank's *Doing Business* report, although progress is somewhat uneven (World Bank, 2014). While Georgia is among the world's top 15 performers, the rest of the EaP region is still lagging behind. Armenia, Moldova and Belarus rank respectively 45th, 63rd and 57th out of 189 countries. Azerbaijan and Ukraine rank 80th and 96th, but have made considerable progress over the years. Armenia and Georgia feature among the world's top five performers for the ease of starting a business. On the other hand, all countries are still lagging behind in other indicators, including trading across borders (except Georgia) due to burdensome customs and trade regulations, and dealing with insolvency.

Meanwhile, efforts continue to simplify business-related legislation. Guillotine-like exercises have been undertaken in all countries except for Belarus, although sometimes in an ad-hoc manner. Use of e-government services has considerably reduced transaction costs, with Azerbaijan's platform representing best practice in the region and beyond. The streamlining of technical barriers to trade, largely driven by the DCFTA processes and a broader drive to adopt international standards, is one of the areas where EaP countries have made the most progress since 2012. Further progress has also been made in some countries in upgrading the legal and regulatory environment in the financial sector. This has been done through enhanced legal frameworks governing collateral (e.g. in Georgia), upgraded immovable and movable collateral registries (e.g. in Armenia, Belarus and Moldova), and enhanced credit information systems with expanded coverage (e.g. in Georgia). While empirical data suggest that this progress has not directly translated into increased access to finance by SMEs due to a confluence of countering factors (e.g. macroeconomic dynamics), reforms in these areas are expected to bear fruit when the external environment improves.

Compared with these horizontal reforms, targeted support mechanisms are historically less developed in EaP countries. However, since 2012, EaP countries have progressively acknowledged the importance of SME development for economic growth and started to tackle some of the main constraints for the creation and growth of small businesses. EaP countries have become more proactive in developing an adequate institutional environment for SME policy making and started to introduce targeted support measures to facilitate SME access to finance, markets (including domestic and export markets), skills and innovation. Many recommendations of the 2012 SME Policy Index have been implemented or are currently being implemented. Yet, regional disparities in most countries in terms of SME presence and dynamism (typically between the capital and the region) suggest that different approaches to SME policy at the local level may be required. Likewise, the limited contribution of SMEs to employment and value-added calls for a particular policy focus to promote the growth of medium-sized enterprises and the development of high-growth start-ups.

The development of a vibrant SME sector through comprehensive reforms should be considered by the EaP governments not as a standalone policy initiative, but rather as part of a broader agenda to build stronger, more diversified and more resilient economies. Creating an enabling policy environment in which entrepreneurs can thrive is a first step towards developing a sustainable private sector. A combination of horizontal reforms to create a favourable business environment for all enterprises, and targeted support measures for SMEs is therefore needed to unleash the potential of SMEs in addressing the main objectives of governments across the EaP region, such as job creation, economic inclusion and poverty reduction.

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Part I

Small Business Act assessment: Findings by SBA dimension

Chapter 1

Entrepreneurial learning and women's entrepreneurship (Dimension 1) in Eastern partner countries

Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded (Small Business Act Principle 1)

Promoting entrepreneurship across the education system is considered increasingly important in a country's drive to build competitive, job-creating economies. Likewise, the fullest integration of women into the entrepreneurship drive will also boost the economy and jobs. The SBA assessment has noted policy improvements in all countries in bringing forward entrepreneurial learning. However, greater policy commitment, particularly in higher education, is still required. A particular challenge at all levels of education is integrating entrepreneurship as a key competence within the national curriculum. Given that this is an uncharted, developing area, all countries would do well to share experiences and learn from developments in the European Union, where the issue is now receiving considered attention. While women's entrepreneurship is increasingly on the policy radar in the Eastern partner region, governments should ensure that it is more tightly connected to countries' economic growth agenda and that human capital policies are fully tuned to the needs of women.

Introduction

As the world's developed economies emerge from a global financial crisis, weak growth and persistent unemployment – particularly amongst young people and women – are prompting governments to seek new solutions for a sustainable recovery. Introducing entrepreneurship into education and training is increasingly part of the policy conversation (Valerio, Parton and Robb, 2014). Transition economies are similarly encouraged to give priority to entrepreneurship promotion as they move towards market economies (Gribben, 2013).

A particular challenge in the Eastern partner (EaP) region is getting buy-in to the systematic development of the entrepreneurial learning agenda, particularly by ministries of education. Difficulties in understanding the concept of entrepreneurship as a key competence (which focuses on cognitive issues like creativity, opportunity identification and risk taking) raises challenges for teaching and learning. This is reflected in a reluctance to embed this key competence into national curricula. Moreover, the higher education community remains on the sidelines of the wider entrepreneurship drive, despite the fact that universities are essential for building a high-skills economy.

In its bid to encourage European Union (EU) countries to embrace the entrepreneurial learning agenda, the European Commission has developed policy guidance for promoting entrepreneurship in primary and secondary education (EC, 2012), vocational education and training (EC, 2009; EU, 2015), and higher education (EC, 2008a). These documents are all important policy references for EaP countries; especially at a time of closer co-operation (European Council, 2013).

A more comprehensive engagement of women entrepreneurs in a country's economic development is considered imperative in the bid for sustainable growth and employment (Bekh, 2013). Barriers to the more strategic engagement of women in a country's entrepreneurship drive include cultural mores, policy blind-spots and weak policy-relevant data. Further, a lack of direct support that adequately reflects the interests and circumstances of women entrepreneurs (e.g. for training and access to finance) is a common concern in most countries.

This chapter considers developments in lifelong entrepreneurial learning since the 2012 assessment. It also examines progress on women's entrepreneurship. In both cases a more developed set of indicators has been employed in the assessment (see Annex A). The chapter concludes with a number of follow-up recommendations.

Assessment framework

Entrepreneurial learning

In this assessment entrepreneurial learning is defined as "all forms of education and training, formal and non-formal, which contribute to entrepreneurial spirit or behaviour with or without a commercial objective". This definition goes beyond the classic notion of entrepreneurship as a purely business phenomenon and in which learning focuses on start-up training. It includes entrepreneurship as a key competence (EU, 2006), whereby the teaching and learning process helps to generate the cognitive and behavioural traits required for entrepreneurs. The key competence approach addresses issues like opportunity identification, risk taking, creativity and resource management. The SBA assessment breaks down entrepreneurial learning into two sub-dimensions (Figure 1.1):

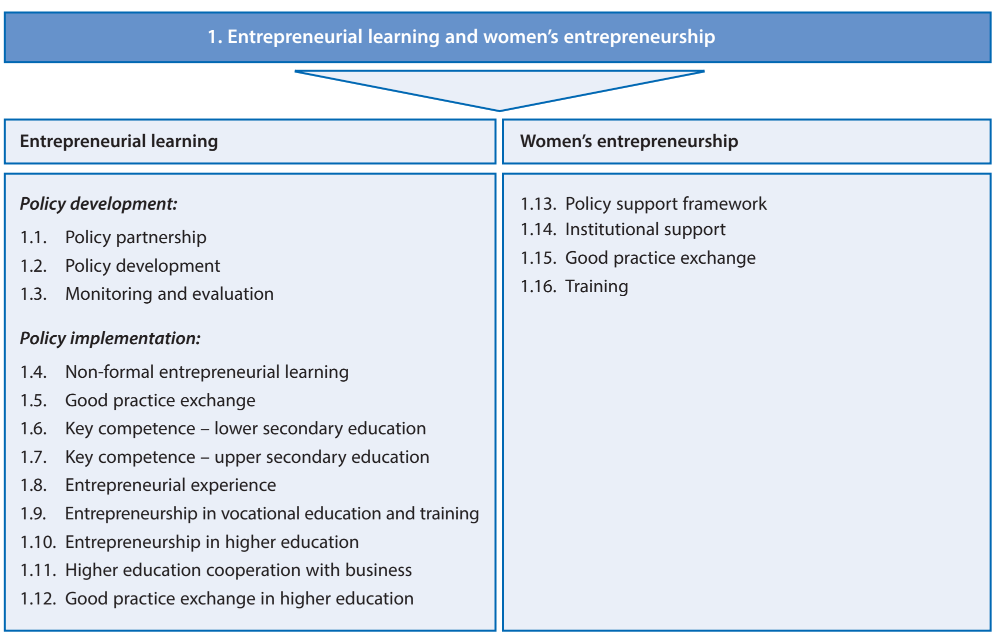
a. Policy development: the policy arrangements to support entrepreneurial learning, including non-formal entrepreneurial learning (i.e. education and training that is not subject to formal assessment or examination). Given that entrepreneurial learning is still relatively fresh in policy terms, the assessment also looks at good practice. Learning from good practice is considered important in raising awareness, informing and inspiring existing policy and practice.

b. Policy implementation: in particular how entrepreneurship is promoted in secondary, vocational and tertiary education.

These two sub-dimensions are assessed using 12 indicators (Figure 1.1 and Table 1.1). These include eight new indicators added since the 2012 assessment. The additional indicators, as well as minor adaptations to the four indicators included in the 2012 assessment (policy partnership, non-formal learning, good practice and entrepreneurship promotion in upper secondary education), reflect issues and recommendations arising from an EU expert working group on lifelong entrepreneurial learning (EC, 2014a).

These indicators reinforce the assessment of: *(a)* the policy environment, in particular through interfacing entrepreneurial learning policy with a country's wider entrepreneurship policy drive; and *(b)* policy implementation, with more specific attention to entrepreneurship promotion in secondary, vocational and tertiary education.

Figure 1.1. **Assessment framework for Dimension 1**



Overall, the upgraded indicator package on entrepreneurial learning makes for a more comprehensive policy reference for the countries engaged in the SBA assessment. In particular, through their five-scale structure (see Table 0.21 in the chapter on SME Policy Index scores), the indicators provide the countries with policy steps to build the systems and delivery arrangements for lifelong entrepreneurial learning.

More specifically, on the policy environment, the indicators assess how the range of stakeholders co-work the policy agenda (Indicator 1.1, see Figure 1.1) and how policy on entrepreneurial learning evolves set against a country's wider policy entrepreneurship framework (Indicator 1.2). This includes monitoring and evaluation arrangements specifically for entrepreneurial learning developments (Indicator 1.3).

In terms of policy implementation, the indicators focus on entrepreneurship promotion in general secondary and vocational education (Indicators 1.6, 1.7, 1.8, 1.9) including how schools support the development of entrepreneurial experience for young people (EC, 2013). Three indicators track progress towards entrepreneurship promotion in tertiary education (Indicators 1.10, 1.11, 1.12). Finally, the assessment includes developments in non-formal learning (Indicator 1.4) and good practice sharing (Indicators 1.5, 1.10).

Women's entrepreneurship

Progress towards women's entrepreneurship is measured using four indicators, three of which are new to the 2016 assessment:

- the policy support framework for promoting women's entrepreneurship (Indicator 1.13), also included in the 2012 assessment
- institutional support for policy improvement in women's entrepreneurship (Indicator 1.14)
- good practice in women's entrepreneurship (Indicator 1.15)
- women's entrepreneurship training (Indicator 1.16).

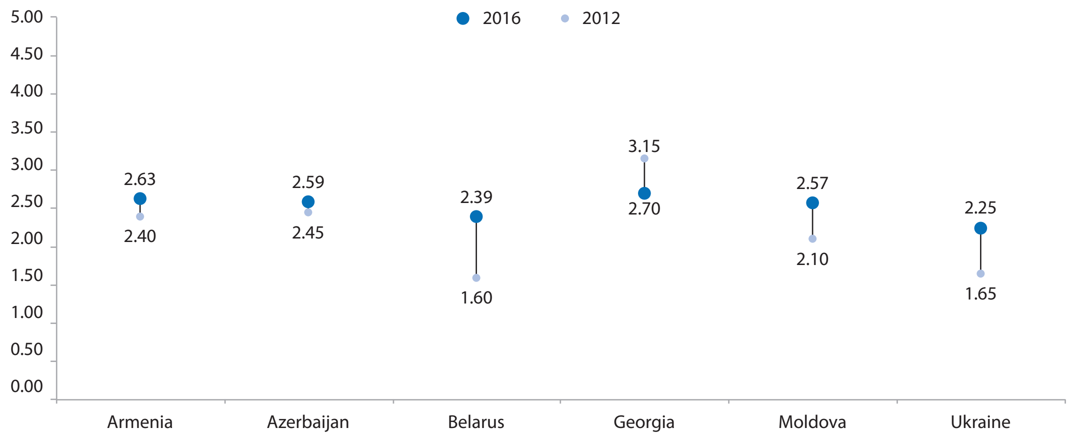
In the 2016 assessment, the policy indicator (1.13) was revised considerably, resulting in a lighter set of criteria to ease the assessment process.

Analysis

Entrepreneurship key competence should be systematically integrated into education

Overall, the assessment points to good progress by most countries on policy partnership since the 2012 assessment, with government departments, business and civic interest groups increasingly mobilising behind entrepreneurial learning (Figure 1.2). This is reflected in the way in which entrepreneurial learning is increasingly more present in the wider policy environment, interfacing with other policy areas (e.g. employment, SME policies). While entrepreneurship as a key competence in secondary education is better understood by policy makers, embedding it within the curriculum is still a challenge for most countries. Meanwhile, entrepreneurship promotion in vocational education and training (VET) is well developed across the region, particularly in terms of more business-oriented skills. Entrepreneurship careers guidance is weak all round, however. The assessment highlights excellent examples of non-formal entrepreneurial learning in all countries, but there is little effort to share and compare experience in both formal and non-formal entrepreneurial learning. This undermines the value and potential of these good practice examples. Finally, despite its potential for boosting local, regional and national economies, entrepreneurship in higher education remains considerably underdeveloped in all countries.

Figure 1.2. **Weighted scores for Dimension 1 compared to 2012**



Policy partnership and policy development process

In this section policy partnership and policy development indicators are considered together, given the interdependence of the issues they address.

Firstly, all countries demonstrate better engagement and co-operation among the range of stakeholders involved in entrepreneurial learning. A more leading role by ministries of education is critical to sustainable developments in this area. Nonetheless, the assessment found that it is the ministries of economy (or their executive agencies) which are primarily leading the dialogue, debate and partnership building process. For example, in Georgia, which tops the SBA policy partnership ranking, Enterprise Georgia co-ordinates all partners working on entrepreneurial learning (ministries of education, employment and economy, executive agencies and the private sector). Likewise, the State Administration of Ukraine for Regulatory Policy and Entrepreneurship Development (SARPED) has played an important role in policy partnership building. It will be important for this function to continue once responsibility for Ukraine's wider entrepreneurship agenda transfers to the Ministry of Economic Development and Trade.

With ministries of economy (or their agencies) essentially co-ordinating entrepreneurial learning, the assessment found a dis-equilibrium in engagement and contribution, particularly by the education authorities. Given the critical role that formal education has to play in building an entrepreneurial culture in all countries, a more direct and sustained commitment by the ministries of education to a country's entrepreneurship promotion is imperative. This will ensure synergy between education and training policies, and companion policy areas (e.g. employment, economy, innovation), and bring greater value and efficiency through mutually reinforcing efforts. Belarus offers a good example of an effective interface between education and companion policy areas in its National Programme of Social and Economic Development, which incorporates entrepreneurial learning. Similarly, Ukraine's "Strategy for Sustainable Development until 2020" and an upcoming SME strategy give specific attention to entrepreneurial learning.

Entrepreneurship promotion in lower and upper secondary education

While policy partnerships are important in building the wider entrepreneurial learning ecosystem, "internal partnership" is also crucial (Gribben, 2013). This involves the various parts of the formal education system connecting and ensuring the sequenced development of entrepreneurial attitudes and skills, from primary through to tertiary education. Two issues were addressed in the assessment. Firstly, how countries had progressed on promoting entrepreneurship as a key competence. Secondly, if and how specific entrepreneurial experience was included in the learning process in schools.

Moldova stands out for its progress on entrepreneurship key competence, including clearly defined learning outcomes in the curriculum, and support tools both for pupils and teachers (Box 1.1). Key competence issues are addressed within the specific subject of entrepreneurship in the curriculum. The next step will be to teach these key competences in other subjects in the curriculum.

Box 1.1. **Entrepreneurial learning in Moldova**

Inspired by the SBA, the government of Moldova has made human capital development and particularly entrepreneurial learning one of its top priorities. It is implementing a comprehensive set of policy measures to build the next entrepreneurial generation. Four factors in particular stand out in Moldova's efforts to promote entrepreneurial learning:

a. Its entrepreneurial learning policy partnership is led by the Ministry of Education, which works closely with other government and non-government partners.

b. The promotion of entrepreneurship key competence is a cross-cutting feature of different policies and strategy documents (SME, education, employment, as well as local initiatives).

c. Entrepreneurship key competence training has been built into the system of teacher training and development, and is supported by special toolkits.

d. Entrepreneurship key competence is an integral part of the formal curriculum – ranging from being a compulsory course to an optional element at various levels of education.

These first steps give Moldova a prominent position in implementing policy and practice for entrepreneurial learning.

Source: Ministry of Economy (2015), "Business environment", website, available at: www.mec.gov.md/en/content/business-environment accessed July 2015; Ministry of Education (2012), *Education 2020 Strategy.*

Financial literacy has been identified as a core component of entrepreneurship key competence (EC, 2014a). Most countries are addressing some aspects of financial literacy (either through the curriculum or outside the curriculum). Armenia has fully integrated financial literacy into the national curriculum. In other countries, efforts are being made by employers' organisations and non-governmental organisations to promote financial literacy amongst young people. The experience, in terms of learning outcomes, teaching and assessment materials, could be easily adapted and embedded within national curricula. To ensure commitment by ministries of education and follow-up of non-formal financial literacy initiatives, agreements should be reached with education ministries prior to implementing the work in schools.

Moving forward on entrepreneurship key competence, those countries already developing or intending to develop a national qualifications framework should ensure they include entrepreneurship key competence within the qualifications' reforms. A "European Entrepreneurship Competence Framework" being developed by the European Commission is a good opportunity for all countries to determine what can feasibly be adapted to their own curricula. Full-system key competence provisions take time, in terms of establishing appropriate learning outcomes, assessments and a teaching and learning process which ensures implementation. Strategic piloting and evaluation are therefore recommended. Sharing experiences among countries in the region on what works well and at what cost, will also help the policy learning curve. This will be particularly important for teacher training, where a significant effort towards pre-service and in-service training of teachers will be important (EC, 2014a).

Finally, the assessment examined how entrepreneurial experience (learning by doing) is addressed in secondary education. This area, which can involve both formal and non-formal learning exercises, is generally under-developed and confined to school-based projects. For example, the school "mini-company" is a common approach in Belarus and Georgia, in which young people simulate a business start-up. In both countries, this is an extra-curricular activity, though efforts are being made in Georgia to integrate it into the mainstream curriculum. Moldova offers an innovative example through its blend of mini-company experience and computer-simulated business experience, involving all secondary schools pupils.

Entrepreneurship in vocational education and training

Entrepreneurship skills (e.g. business planning, finance, sales, etc.) are generally well addressed in vocational schools, notwithstanding the key competence challenges addressed above. These equally apply to vocational education (EC, 2015). Nevertheless, the scores for this indicator (Indicator 1.9) are generally low. This reflects the indicator's demands, as it assesses: *(a)* tracking systems to determine the extent to which vocational graduates chose self-employment, business start-up or salaried employment; and *(b)* how entrepreneurship is addressed in career guidance.

A strategic initiative in Azerbaijan provides an opportunity to build a tracking system for VET graduates. This involves both VET and higher education institutions, and focuses particularly on developing more innovative ways of identifying and developing entrepreneurs. Other countries could develop tracking mechanisms as part of a wider monitoring and evaluation drive.

The assessment highlights that promoting entrepreneurship as a career option is still a policy blind-spot in wider entrepreneurial learning developments. School careers services should upgrade their information and guidance services to ensure that young people are aware that entrepreneurship can be considered at any point in their professional career. Career guidance services should work closely with SME advisory services to ensure consistency, coherence and additionality.

Entrepreneurship promotion in higher education

Of the three higher education areas addressed in the assessment (policy, university-business co-operation and good practice exchange), education-business co-operation is the best performing area. Most countries already have a regulatory framework requiring universities to co-operate with business. The impact of this regulation, however, is difficult to assess in the absence of monitoring or evaluation arrangements to determine impact.

The "cross campus" promotion of entrepreneurship (EC, 2008a), where all faculties ensure entrepreneurial learning for all students, remains poorly understood. The predominant paradigm still focuses on entrepreneurship promotion as part of a business studies or economics course. Meanwhile, the sharing of good practice in entrepreneurship activities among higher education institutions is generally low-profile and a small part of a wider activity (e.g. a national science conference). It therefore has little impact.

Overall, those involved in the SBA assessment – both the government services co-operating with the assessment and the international organisations conducting it – found it difficult to engage the higher education communities in the process. At best, representation in the SBA assessment workshops and intelligence gathering was confined to one or two universities and/or a representative from the ministry of education working on higher education issues (this was also true of the SBA 2012 assessment). Yet, given the potential of universities to contribute to local, regional and national economies, higher education is too important to stay on the sidelines of a nation's entrepreneurship development efforts. A fuller dialogue on strategic entrepreneurship promotion between government and the higher education community is overdue. The argument about higher education's autonomy from government and policy processes also needs rethinking given the potential for higher education to contribute to national economic policy objectives.

To move forward, the ministries of education and economy, together with business, should establish a specific co-operation framework for entrepreneurship promotion in higher education. This may take time to develop, but leadership will be an important factor in setting the dialogue in motion, be it from government, business or higher education interest organisation (e.g. rectors' conferences). A conference organised by the Belarus education authorities to generate understanding and discussion about the "entrepreneurial university" offers a good example for others to follow. The European Commission, in co-operation with the OECD, has developed a self-assessment tool for higher education institutions (HEIs) wishing to explore and develop their entrepreneurial and innovative potential.[1] The tool helps HEIs to identify challenges and opportunities set in their local and national environments. It also allows them to plan future actions. In addition to government-supported actions, bottom-up initiatives could also be considered by individual universities or teaching staff, e.g. networking, knowledge sharing and policy advocacy by university staff with an interest in entrepreneurship promotion. A good example of this is the Entrepreneurship Educators United Kingdom (EEUK) initiative.[2]

Non-formal entrepreneurial learning

Non-formal learning represents an important opportunity to develop entrepreneurial mindsets and specific entrepreneurship skills. The "non-formal" nature of learning means that the learning is not subject to the rigours of formal assessment, such as public examination. This allows for flexibility and innovation in the teaching and learning process.

The assessment demonstrates that most countries are still not leveraging the experience of entrepreneurship promotion in non-formal learning into policy and wider practice. Doing so will be important in the wider effort to build a sustainable entrepreneurial learning ecosystem. Ukraine's School Academy of Entrepreneurship is a good example of a high-profile non-formal entrepreneurial learning initiative which builds bridges with the formal education sector. It offers a support framework for schools to road-test entrepreneurship key competence, skills and wider governance issues. With financial and technical support from the Polish government, the academy is being closely monitored by officials from the education and economy ministries and other interest organisations within the wider SBA entrepreneurship tracking framework.

Monitoring and evaluation

Entrepreneurial learning is relatively new on the policy agenda; most efforts to promote it tend to be pilot in nature. This underscores the importance of regular and systematic monitoring and evaluation to determine effectiveness and to allow for corrections and improvements, when necessary.

Overall, the assessment highlights that monitoring and evaluation are not being given sufficient attention, either by policy makers or education and training providers. Invariably, monitoring and evaluation are more likely to happen in non-formal learning and when an external partner (e.g. funding agent or technical assistance) is involved in the initiative. Nonetheless, Moldova has critically reviewed its entrepreneurship promotion in compulsory education, while Belarus's evaluation of entrepreneurship in vocational education and training is an important step for evaluating formal entrepreneurial learning.

Policy partnerships should give more attention to building a culture of monitoring and evaluation in the wider entrepreneurial learning effort. Donor organisations would do well to support governments in building wider monitoring and evaluation systems and capacity beyond the projects that they directly support.

Good practice exchange

Good practice sharing not only allows for efficiencies in the design and delivery of entrepreneurial learning, but also has the potential to inform and shape policies. Knowing what works best, under what conditions and at what cost, are important factors in the policy-making process. The good practice indicator, therefore, encourages policy makers and practitioners to regularly exchange good practice.

The assessment finds that education and training providers from across the learning spectrum rarely come together to share their know-how. Good practice sharing is confined to conferences and generally occurs at only one level of formal education – although different levels of education may be part of the proceedings. This undermines the wider drive to establish a lifelong entrepreneurial learning framework. Secondly, the learning value of good practice examples is rarely made explicit. Good practice developments in all countries should include critical analysis of their potential for improving policy and practice more widely in the country, and beyond. The Georgian education authorities are building on entrepreneurship teaching and learning tools borrowed from Norwegian good practice, while financial literacy is promoted in selected secondary schools, drawing on the know-how of specialist NGOs.

Women's entrepreneurship is receiving increased attention

This section considers developments in women's entrepreneurship and specifically focuses on policy, institutional support, good practice and training.

Policy development and institutional support

Overall, women's entrepreneurship is acquiring more attention in each country's policy agenda (Figure 1.2), but policies are invariably defined in equity terms, i.e. as part of a wider equal opportunities drive. Women's entrepreneurship should also feature in the broader policies promoting competitiveness. Gender stereotypes in the policy world need also to be addressed. This requires consolidated efforts by entrepreneurs, policy makers and civic interest groups to raise awareness and understanding of the potential of women entrepreneurs as innovators and job creators, and their contribution to the national economy. Ukraine is already addressing the equity-competitiveness nexus through the state programme Ensuring Equal Rights and Opportunities for Men and Women (2013-16). This includes measures to improve women's access to markets, provide business services as well as explore wider issues for the economic empowerment of women. Similarly, through its gender equity legislation and action plan, there is now more support for innovative women's businesses in Georgia. Meanwhile, Belarus's 2014 Women's Entrepreneurship Policy Forum is a good example of how women's entrepreneurship is being raised up the national policy agenda.

Policy support in Armenia has been boosted by the government's new policy framework for women's entrepreneurship, resulting in the new 2013 Women Entrepreneurship Strategy. The government has mobilised assistance from the Asian Development Bank and provides institutional support and matching funds from the state budget. In Moldova, a cross-stakeholder National Council on Development of Women's Entrepreneurship now oversees the implementation of an action plan (2015-17) under the "National SME Strategy".

Obtaining data on women's entrepreneurship remains a significant challenge in most countries. Until regular and reliable statistics are available, policy and financing priorities for women's entrepreneurship will be undermined. Azerbaijan's National Statistics Office has made a head start by tracking women's entrepreneurship in key sectors of the economy (Box 1.2), while Georgia is working on sex-disaggregated statistical data. Overall, all countries should adopt a common definition of a woman entrepreneur as a starting point.[3] This will ensure good quality and comparable data across the region, and with the EU.

Box 1.2. **Building intelligence on women's entrepreneurship in Azerbaijan**

In Azerbaijan, women's entrepreneurship is now mainstreamed within various policy areas (e.g. economic, employment, regional and agriculture), and is co-ordinated by the Department for Entrepreneurship Policy at the Ministry of Economy and Industry. The co-ordination function ensures synergy among the various policy lines and allows for a more comprehensive policy picture of developments in the country. Azerbaijan's data on women-owned businesses, gathered by the State Statistical Committee, provide an excellent reference for policy makers. For example, the data demonstrate that the lion's share of women-owned businesses is in trade, services and agriculture. Such statistics provide a starting point for policy makers to move forward in the bid to upgrade the contribution of women to the country's entrepreneurship development. Other partners are also involved in intelligence gathering, including the National Confederation of Employers' organisation (ASK), which co-ordinates a Women's Entrepreneurship Commission, as well as regional training centres. A next step will be to build synergies among the data sources to allow for more developed policy analysis. Meanwhile, training provision is also well developed, with priority given to areas such as training and micro-finance, financial literacy and quality management. Azerbaijan's good practice in micro-finance support for women was recognised at an international conference in Turkey in 2014, and has generated interest from foreign delegations visiting Azerbaijan.

Source: State Statistical Committee of the Republic of Azerbaijan (n.d.), *Gender Indicators*, dataset, available at: www.stat.gov.az/source/gender/indexen.php, accessed July 2015.

Good practice

Good practice remains confined to ad hoc initiatives, with little effort to promote systematic knowledge exchange. However, Moldova's Organisation for Small and Medium Enterprises Sector Development (ODIMM) has launched a women's entrepreneurship platform for promoting good practice exchange and the systematic engagement of policy partners and experts in women's entrepreneurship support. Good examples of high-profile events promoting women's entrepreneurship include Ukraine's "UkrainaFest", and conferences organised by the Armenian Young Women's Association during Women's Entrepreneurship Week in 2015. These conferences allowed policy makers, experts and practitioners to consider national developments in women's entrepreneurship, networking and international co-operation; they recommend more investment in women's enterprises.

Women's entrepreneurship training

While all countries provide training on women's entrepreneurship, training efforts tend to be piecemeal. A more systematic approach is required. Nonetheless, since the last SBA assessment there has been an increase in training programmes dedicated to women's entrepreneurship in Armenia, Georgia, Moldova and Ukraine.

Moldova demonstrates good practice in building up intelligence on women's entrepreneurship training; this is part of a wider network of countries focusing on training needs analysis.[4] Ukraine has placed particular emphasis on the role of municipalities in women's entrepreneurship training, led by the Association of Cities of Ukraine. This includes considering how public-private partnerships can bring value to the training effort. In Armenia, women's entrepreneurship training is implemented through various public and private programmes. This includes training and mentorship programmes provided by civic interest organisations like the Women's Entrepreneurship Network, Armenia Young Women Association and the Armenian International Women's Association.

Table 1.1. **Scores for Dimension 1: Entrepreneurial learning and women's entrepreneurship**

		Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
1.1	Policy partnership	2.00	3.00	3.00	4.00	3.00	3.50
1.2	Policy development process	3.00	2.00	2.00	3.00	3.00	3.00
1.3	Monitoring and evaluation	2.00	2.00	3.00	2.00	3.00	2.00
1.4	Non-formal learning	2.00	2.00	2.00	2.00	2.00	3.00
1.5	Good practice exchange	2.00	2.00	2.00	3.00	2.00	2.00
1.6	Entrepreneurship key competence in lower secondary education	2.00	2.00	2.00	3.00	2.00	2.00
1.7	Entrepreneurship key competence in upper secondary education	3.00	2.50	3.00	2.00	3.50	2.00
1.8	Entrepreneurial experience for young people	3.00	2.50	2.00	2.00	3.50	2.00
1.9	Entrepreneurship promotion in vocational education and training	2.00	2.00	2.50	3.00	3.50	2.00
1.10	Good practice in entrepreneurial learning in higher education	1.50	1.50	2.50	2.50	2.50	2.00
1.11	Higher education co-operation with the world of business	2.00	2.00	2.50	2.00	2.50	2.00
1.12	Entrepreneurial learning in higher education	3.00	3.50	3.00	3.00	2.50	2.00
1.13	Policy support framework for promotion of women's entrepreneurship	2.00	2.00	3.00	2.50	2.00	2.00

Table 1.1. **Scores for Dimension 1: Entrepreneurial learning and women's entrepreneurship** *(continued)*

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
1.14 Institutional support for policy improvement in women's entrepreneurship	4.00	3.00	1.50	3.00	2.00	2.50
1.15 Good practice in women's entrepreneurship	2.00	4.00	1.50	2.50	2.00	1.50
1.16 Women's entrepreneurship training	3.50	3.50	2.50	1.50	2.00	2.00
Weighted average	4.00	2.50	2.00	3.50	2.00	2.00

Note: See "Policy Framework and Assessment Process" chapter for further information.

The way forward

A number of areas are proposed to address the challenges in promoting entrepreneurial learning and women's entrepreneurship:

- **Follow all EU developments and guidelines on entrepreneurial learning**, especially the European Commission's forthcoming "European Entrepreneurship Competence Framework". This will allow all countries to determine the value and appropriateness of the competences and learning outcomes, and to develop their own approach based on the new framework. Experience should be shared between countries and results evaluated before formal integration into national curriculum. Countries should ensure that entrepreneurship key competence is part of the wider effort in each country to establish a national qualifications' framework. They should also address digital key competences alongside entrepreneurship key competence to add value and innovation to the education agenda (EC, 2013b).
- **Establish a multi-country forum on entrepreneurship in higher education**, including a series of policy conferences and educator workshops in each country. The objective should be to kick-start higher education engagement in the SBA assessment. Simultaneously, individual universities and teachers should begin establishing their own networks, both nationally and regionally. Where possible these should connect into wider networks in Europe, such as the European Foundation for Entrepreneurship Research, with its strong networking and capacity-building function. The countries, groups of HEIs and/or individual HEIs should consider using European Commission's self-assessment tool (HEInnovate) to determine ways forward for more entrepreneurial and innovative HEIs.
- **Develop monitoring and evaluation systems.** All countries would benefit from guidance and support by an international partner for developing analytical skills and capacity to effectively monitor and evaluate entrepreneurial learning activities (at all levels of formal education as well as non-formal). Specific emphasis should be placed on how to turn around existing policies despite a lack of resources, while improving the interface between policy makers and practitioners (teachers and trainers).
- **Continue to build comprehensive women's entrepreneurship policy and support frameworks in each country**. This will require multi-stakeholder co-operation as well as a body overseeing policy development (e.g. a women's entrepreneurship commission), statistics and wider intelligence, monitoring and evaluation. Policy advocacy networks are required, including "role models" of women entrepreneurs to counteract stereotyping.

- **Develop better intelligence on the training needs of women entrepreneurs** at all stages (from start-up to high growth). This will require a concerted effort by training providers, SME support organisations and women's entrepreneurship organisations to build reliable data to ensure that training (and mentoring) support meets the needs of women-owned businesses.

Table 1.2. **Dimension 1: Challenges and policy instruments**

Challenges	Policy instruments
Poor integration of entrepreneurship as a key competence in national curriculum	Promote entrepreneurship, and especially entrepreneurship as a key competence, at all levels of education.
Weakness by higher education communities in addressing entrepreneurship promotion	Teach entrepreneurship education in higher education institutions (across all faculties)
Failure to learn from good practice	Learn from others' experience in promoting entrepreneurial learning – this saves time and money and creates opportunities for innovation
Lack of policy focus on women's entrepreneurship	Adopt comprehensive women's entrepreneurship policy and institutional frameworks through a collaborative, cross-stakeholder policy development process Sensitise other policies to the needs of women's entrepreneurship support
Lack of sex-disaggregated statistics	Collect sex-disaggregated statistical data consistently and analyse it for evidence-based policy making purposes Improve the methodology and adopt a definition of women's entrepreneurship which is comparable regionally and with the EU
Training and support poorly tailored to the needs of women entrepreneurs	Implement training, support and financial literacy Promote role models of women's entrepreneurship to see beyond stereotypes Systematise training needs analysis and address women's entrepreneurs' specific training needs
Low level of systematic good practice exchange	Exchange good practice systematically

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Notes

1. See www.heinnovate.eu.
2. See www.enterprise.ac.uk.
3. The SBA assessment framework defines a "woman entrepreneur" as a woman who has created a business with at least one employee, in which she has a majority shareholding and takes an active interest in the decision making, risk taking and day-to-day management.
4. Moldova participates in an international women's entrepreneurship project managed by the South East European Centre for Entrepreneurial Learning; see www.seecel.hr/UserDocsImages/Documents/WETNAS.pdf.

Chapter 2

Bankruptcy and second chance for SMEs (Dimension 2) in Eastern partner countries

Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance (Small Business Act Principle 2)

Given their limited resources, SMEs benefit – as both debtors and creditors – from cost-effective bankruptcy systems. Dimension 2 analyses progress towards effective and efficient insolvency frameworks which facilitate the market exit and re-entry of businesses. The dimension also assesses efforts to actively promote a fresh start for entrepreneurs who have failed in the past.

Since the 2012 assessment, Azerbaijan, Belarus, Moldova and Ukraine have amended their legal frameworks in this area, for example by introducing statutory time limits for insolvency procedures, strengthening creditors' rights and improving the regulation of insolvency administrators. Even so, in most countries performance indicators of the duration and cost of insolvency procedures and recovery rates have not improved – and in some countries have deteriorated. Governments should promote early warning and out-of-court settlement systems as viable alternatives to costly in-court procedures, and introduce fast-track liquidation and restructuring for SMEs. Finally, in addition to shortening the maximum periods for the full discharge of honest entrepreneurs to no more than three years, governments may want to consider active outreach, training and dissemination campaigns to counter stigma and promote a fresh start.

Introduction

In efficient markets, the exit of inefficient or unviable firms is a natural part of the competitive process. An estimated 50% of enterprises across the EU do not survive the first five years, while 15% of business closures take the form of bankruptcies (EC, 2011a). Yet this exit must take place in an orderly fashion, in a way that protects the interests of both debtor and creditors so as to maximise the preservation of productive assets. Efficient and effective insolvency procedures and mechanisms that regulate business wind-up and allow honest entrepreneurs to start afresh are therefore key ingredients of a robust SME development policy.

Efficient insolvency frameworks must promote the re-organisation of viable firms and the liquidation of unviable ones at the lowest possible cost, while preserving principles of fair and equal treatment of all parties involved (Cirmizi, Klapper and Utammchandani, 2011). Losses are typically incurred through inefficient proceedings that are lengthy and burdensome. In addition to opportunity costs and the direct costs associated with the proceedings, long insolvency procedures also reduce the net value of the estate, reducing the prospects of a successful company re-organisation and, from a creditor's perspective, the expected debt recovery rate. Hence, the existence of effective and speedy procedures to handle insolvency is therefore important for SMEs, whether debtors or creditors.

Striking the right balance between the interests of debtors and creditors also depends on a country's level of economic development (IFC, 2011). In high-income countries, re-organisation is the best option for maintaining the activity of an insolvent company and the value of the estate. In middle-income countries, however – such as those in the EaP region – legal frameworks must also protect the rights of creditors so as to develop a sound and active credit market. Indeed, a number of studies show that the efficiency of bankruptcy procedures, in terms of the time and cost involved or the recovery rate for creditors, is correlated with the availability of credit for entrepreneurs and levels of investment (Succurro, 2012).

In general terms, a bankruptcy process involves four consecutive steps from the time a company starts experiencing financial problems until it is eventually re-organised or liquidated (OECD, 2006):

a. **Early-warning systems** identify financially distressed companies at a point where additional support could help them avoid filing for bankruptcy.

b. **Out-of-court settlements** offer a less expensive and less burdensome alternative to filing for bankruptcy, especially for micro-enterprises, provided that creditors agree and their rights are protected.

c. **Court procedures** come into play if neither of the first two steps has been successful. Both creditors and debtors have the right to file for bankruptcy. Procedures may include the drafting of a re-organisation plan and allow the discharge of part of the debt through court ruling, leading either to the re-organisation and survival of the company or to its liquidation. Once started, bankruptcy proceedings should be fast and cost-efficient so that a reasonable proportion of the assets can be saved and any potential re-start will not be overly delayed.

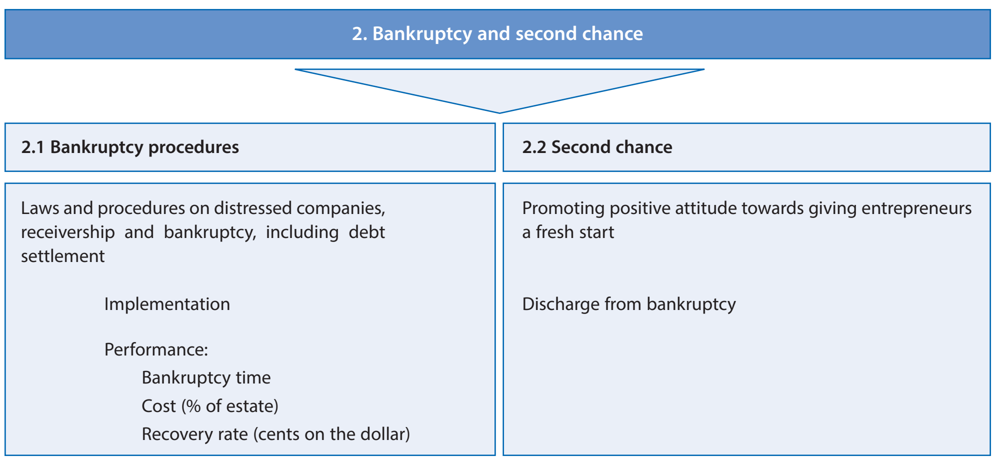
d. **Post-bankruptcy treatment** including liquidation and discharge from outstanding debts should be structured in a non-discriminatory manner. Long debt repayments, a lack of discharge or non-automatic removal from bankruptcy registers and national credit rating blacklists can prevent an entrepreneur from getting a second chance.

This chapter considers progress made in implementing these steps across the region since the 2012 assessment. It concludes with a number of follow-up recommendations.

Assessment framework

The framework for Dimension 2 is composed of two sub-dimensions which measure: *(a)* the effectiveness and efficiency of the insolvency legal framework; and *(b)* an environment which promotes a second chance for entrepreneurs (Figure 2.1). One minor change introduced to the framework since the 2012 assessment has been to include debt settlement procedures as part of the sub-dimension on assessing bankruptcy procedures.

Figure 2.1. **Assessment framework for Dimension 2**



Bankruptcy procedures

This sub-dimension measures the sophistication of bankruptcy laws and procedures (both on paper and in practice) and their alignment with international standards. The dimension looks first at the existence of alternatives to in-court bankruptcy processes, including early warning systems (such as self-tests, call centres, training courses, etc. for firms in or about to experience financial distress) and out-of-court settlement mechanisms, such as mediation and arbitration (EC, 2014). These mechanisms are known to be successful in reducing bankruptcy rates (EC, 2011b). The dimension also assesses the consistency of in-court procedures with international standards, including the protection of creditors' rights, the strength of re-organisation procedures as an alternative to liquidation, the availability of incentives for post-petition finance, and the existence of a temporary moratorium on other actions against firms undergoing bankruptcy.

In addition, this sub-dimension assesses the actual performance of insolvency frameworks in terms of the average time, cost and recovery rate of a typical bankruptcy case. This is measured using the "Resolving Insolvency" indicator of the World Bank's 2015 *Doing Business* report (World Bank, 2014). These figures are particularly useful for identifying potential weaknesses such as procedural and administrative bottlenecks in the bankruptcy process, and limited capacity or the complete lack of specialised courts or insolvency administrators to deal with them. Measures adopted in European countries to reduce the time and cost of bankruptcies include fast-track liquidation processes for honest entrepreneurs, special in-court procedures for SMEs, or expedited court approval of negotiated restructuring agreements or a pre-packaged insolvency (often referred to as hybrid procedures) (EC, 2014; Bergthaler et al., 2015).

Second chance

This sub-dimension looks at the measures in place to facilitate a second chance for entrepreneurs and to reduce the stigma attached to a failed business. The importance of giving honest entrepreneurs a second chance is based on the notion that bankruptcy cases should be seen as a learning experience for an entrepreneur rather than a reason for stigmatisation. Contrary to common misperceptions, business failure should be seen as an opportunity for a more reinvigorated re-start (Timmons and Spinelli, 2004). Existing evidence suggests that countries which favour second chance for failed entrepreneurs and encourage the risk taking necessary for a successful re-start of business activities also have higher levels of entrepreneurship (Armour and Cumming, 2008; Burchell and Hughes, 2006). Indeed, businesses that are set up by re-starters grow faster and create more jobs and turnover than first-timers (Stam, Audretsch and Meijaard, 2008). Nevertheless, it is important to systematically distinguish between honest but unlucky entrepreneurs and those who have undergone fraudulent bankruptcy, estimated at just 4-6% of total bankruptcies in the EU (EC, 2011a). While the former group should be encouraged to make a fresh start, effective measures must be taken to prosecute wrong-doers.

The second chance concept was first introduced by the European Commission through its Communication “Overcoming the stigma of business failure – for a second chance policy,” (EC, 2007) and reiterated as the second principle of the SBA in 2008. The principle has been further detailed in two new EC Communications – in 2012 and 2014. A review of insolvency frameworks in the EU suggests that Member States have not been very active in this area to date, however (EC, 2014b).

Several public policy mechanisms can promote a second chance and encourage honest entrepreneurs to start again. This report measures two specific elements (Figure 2.1):

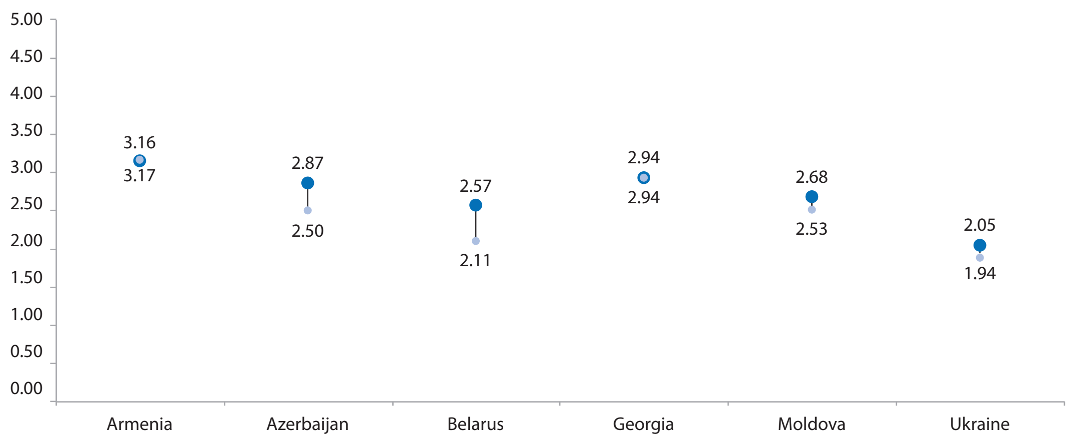
a. **Promoting a positive attitude towards giving entrepreneurs a fresh start**. Governments can play an active role in encouraging potential re-starters through training and information campaigns on second chance as well as targeted support measures. An effective second chance policy should send the message that entrepreneurship does not need to be a “life sentence” if things go wrong by removing any discrimination against bankrupt entrepreneurs and avoiding them suffering the stigma of business failure (EC, 2011a).

b. **Discharge from bankruptcy**. Including discharge procedures in bankruptcy laws and/or procedures is an important mechanism to release an entrepreneur from pre-bankruptcy debt within a given time frame following a final court decision. The 2014 EC Communication recommends a maximum limit of three years after which firms and entrepreneurs should be removed from bankruptcy registers and national credit rating black lists (EC, 2014a).

Analysis

Dimension 2 scores have experienced modest progress compared to 2012 across EaP countries (Figure 2.2), although resolving insolvency continues to be one of the weaker areas of the broader business environment in the region, compared in particular to starting a business. The relatively slow pace of reform in this area is partly due to the complex nature of insolvency frameworks, which include a variety of actors (e.g. insolvency administrators and the general judicial system) and links to other policy areas (e.g. corporate governance, accounting, financial sector reform, etc.).

Figure 2.2. **Weighted scores for Dimension 2 compared to 2012**



The EaP average score therefore remains below 3, compared to above 4 for Dimension 4 (Operational environment for SMEs). The degree of variation across countries is more limited than in other dimensions, with 5 out of 6 countries scoring between 2.5 and 3.2 (Figure 2.2 and Table 2.1). Ukraine is lagging behind, largely due to its weaker insolvency performance in terms of time, cost, and recovery rate. Azerbaijan, Belarus, Moldova and Ukraine have experienced a slight improvement in their scores, largely due to the introduction of amendments to their insolvency legal frameworks to bring them closer to international best practice. In contrast, the scores for Armenia and Georgia remain largely unchanged as no major reforms have been introduced, although in both cases governments are considering amending legislation in the short to medium-term.

The main outstanding challenges are as follows:

- National legislation in most countries is still significantly behind international best practice in certain areas, including the protection of creditor rights as an incentive for secured and unsecured lending (and thus access to finance), the availability of early warning and out-of-court settlements, as well as promoting re-organisation as a viable alternative to liquidation.
- Despite recent legislative reforms, there has been limited progress in reducing the time and cost of insolvency procedures and increasing recovery rates in most EaP countries. Rates continue to be below Eastern Europe and Central Asia regional averages, and well below OECD averages.
- Countries have yet to develop a proactive approach to promoting a second chance for honest entrepreneurs. Laws generally do not distinguish between honest and dishonest bankruptcies, the regulation of full discharge following bankruptcy needs to be clarified in most countries, and re-starters continue to face stigma and, in some cases, discrimination.

Further reforms are necessary to increase the effectiveness of insolvency laws and procedures

In 2009, the EBRD conducted a comprehensive Insolvency Sector Assessment to assess the strength of legal frameworks and the level of compliance with international standards across the entire Eastern Europe and Central Asia region (EBRD, 2009). This classified EaP countries into two groups according to their compliance with international standards: *(a)* medium compliance: Armenia, Belarus and Moldova; and *(b)* low compliance: Azerbaijan, Georgia and Ukraine.

While the pace and intensity of reform in this area is lower than for other aspects of business regulation (e.g. company registration), a number of reforms have been adopted since 2012 to strengthen in-court insolvency laws and procedures in EaP countries:

- Azerbaijan amended the Civil Procedure Code in 2013 and the 1997 Insolvency and Bankruptcy Law were amended in 2015 to reduce the length of in-court insolvency procedures.
- Belarus enacted a new law on economic insolvency, which came into force in January 2013. The new law strengthens the moratorium on legal actions against debtors, regulates shareholder and director liability as well as insolvency administrators, and reviews existing provisions for commencement and sale of assets. A new online insolvency register was put in place in 2013.
- Georgia has a new law on insolvency proceedings (2012) to streamline proceedings and allow for the electronic management of cases, which is expected to be operational in 2016.
- Moldova also introduced a new insolvency law in 2012, which made significant improvements to insolvency procedures, as well as a new law regulating the profession of insolvency administrators in 2014 (Box 2.1).
- Ukraine amended existing legislation in 2013 to improve the regulation of pre-insolvency transactions, introduce an expedited restructuring procedure, strengthen the protection of secured creditors, and reduce the overall duration of the typical insolvency procedure.

Yet, despite the above reforms, a number of persistent challenges remain. First, legal frameworks across the EaP region need to strengthen the regulation of rehabilitation and re-organisation procedures, as most bankruptcy cases are resolved through liquidation. This is a problem even in countries with more developed frameworks (e.g. Armenia and Georgia). Key priorities include: *(a)* encouraging and protecting post-petition financing to cover for working capital (relevant rules are either non-existent or deficient in Armenia, Azerbaijan and Georgia); and *(b)* introducing fast-track restructuring procedures, following the examples of Ukraine and Moldova.

Second, creditor rights need to be better protected in a number of EaP jurisdictions. In Belarus, for instance, there is no specific legal framework for secured transactions, and secured creditors are ranked only fourth on the priority list for debt settlement. Georgia's requirements and procedures for creditors opening an insolvency procedure are still burdensome. These gaps should be addressed as the level of protection of creditors' rights (particularly secured creditors) is a key determinant for banks and other financial institutions to provide credit to SMEs.

Third, the region falls behind international standards in other key areas, including measures to avoid pre-bankruptcy transactions (e.g. Armenia, Georgia), the requirement for an independent analysis of the re-organisation plan (e.g. Armenia), the existence of a temporary moratorium on actions against the debtor (e.g. Azerbaijan, Georgia), the application of insolvency frameworks to state-owned enterprises (in Belarus) and the regulation of insolvency office holders (e.g. Azerbaijan).

Fourth, alternatives to in-court insolvency procedures should be introduced and encouraged. At present, no EaP country appears to have put in place any early warning mechanism to avoid insolvency for SMEs that are experiencing financial problems. Out-of-court settlements are unavailable or at least largely unused in most EaP countries. In Azerbaijan, for instance, they are only available in "exceptional circumstances" and it is unclear to what extent they are used in practice.

Finally, data from the latest World Bank *Doing Business* report suggest very limited progress in improving the performance of insolvency systems (World Bank, 2014). The average time of a typical bankruptcy procedure has remained unchanged since 2012 in all six EaP countries (Figure 2.3), while average costs have actually increased in Georgia and Moldova (Figure 2.4). Recovery rates have improved slightly in Armenia, Azerbaijan and Georgia

Box 2.1. **Moldova's reforms of the insolvency legal framework**

Moldova's new Insolvency Act of March 2013 has introduced significant changes to the legal framework. Its aim is to improve procedural efficiency and introduce alternatives to liquidation, in particular out-of-court settlements and simplified re-organisation procedures. While it is still too early to evaluate the practical implementation of the law, the new provisions potentially offer great benefits for SMEs:

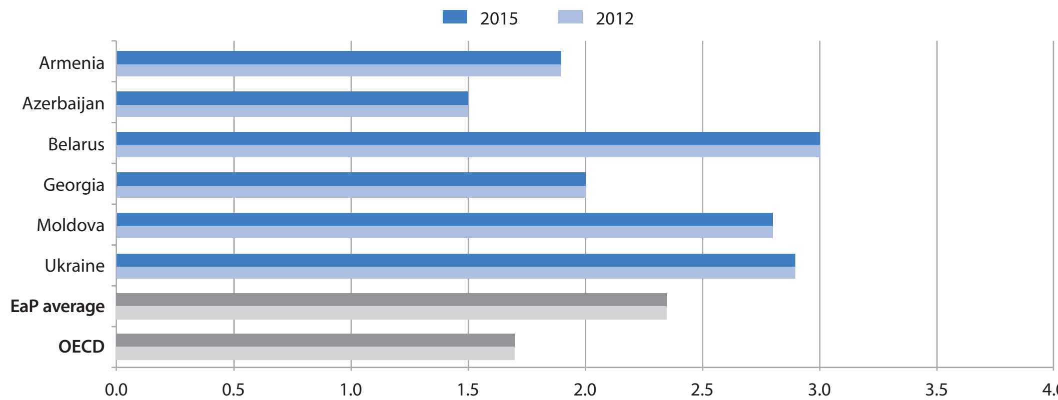
- **In-court proceedings are shorter.** The average length of an insolvency procedure in Moldova is 2.8 years, longer than the EaP average of 2.35 years. The new law reduces the timelines of a typical in-court insolvency procedure through strict statutory limits to reduce costs and increase the recovery rate. Liquidation procedures are capped at 2 years from commencement, while the maximum period for re-organisation is 3 years, with the possibility of an additional 2-year extension with the agreement of the creditors.
- **The liquidation procedure is simpler.** A new simplified liquidation procedure lasting 150 days has been introduced for certain categories of debtors, including individual entrepreneurs.
- **Re-organisation has been fast-tracked.** This procedure, available to all debtors, allows for a significant shortening of timelines by allowing the parties to move directly to the assessment and adoption of a restructuring plan.
- **Out-of-court settlements are possible.** The new law also gives the debtor, liquidator and the creditor assembly the possibility of entering into an extra-judicial settlement agreement at any phase of the procedure. The settlement must then be approved by the court.

Various studies have identified the need to strengthen the qualifications of Moldova's insolvency office holders (USAID, 2010; EBRD, 2014). The professional status of administrators was so unclear that official institutions sometimes refused to provide them with documents or information. A simple 100-hour course was sufficient to become an administrator. In July 2014, Parliament enacted Law No. 161 to address these problems by recognising the profession, providing a framework for a series of self-regulatory bodies, strengthening the training of administrators (through 12 months of study and an internship), defining the requirements and licensing procedures to become an administrator, providing for standards of conduct and instituting disciplinary sanctions against misconduct (including suspension).

Source: Insolvency Act No. 149 (2013) and Law on Authorized Administrators No. 161 (2014); EBRD (2014), *Assessment of Insolvency Office Holders: Review of the profession in the EBRD region*; USAID (2010), *Strengthening Moldova's Business Insolvency System: Assessment and reform options.*

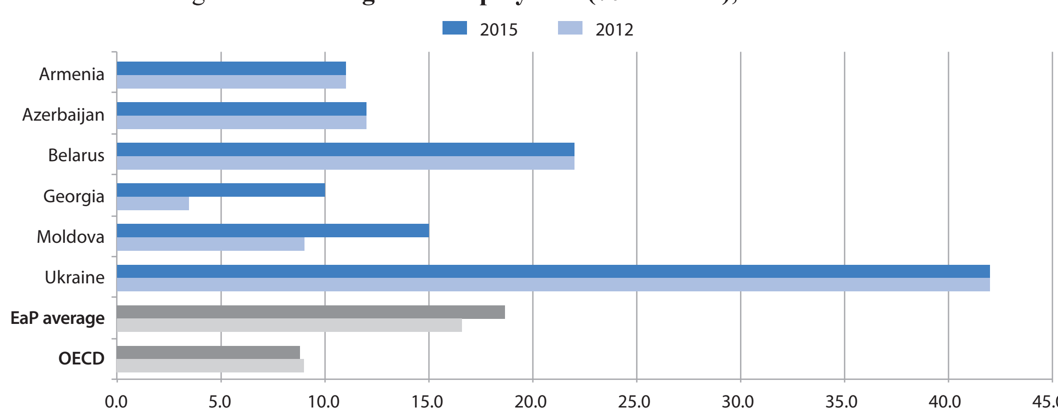
but worsened in Belarus, Moldova and Ukraine (Figure 2.5). Within the region, Armenia, Azerbaijan and Georgia generally perform above average, with Moldova and Belarus on a second tier. In Ukraine, the high cost of insolvency procedures (42% of the estate) and the very low levels of debt recovery (less than 9%) are of major concern.

Figure 2.3. **Average bankruptcy time (years), 2012 and 2015**



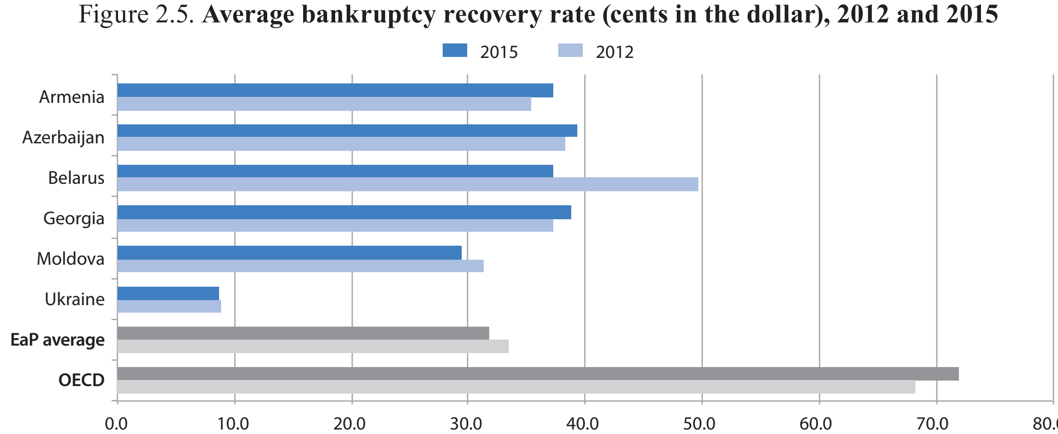
Source: World Bank (2014), *World Bank Doing Business Report 2015*, World Bank, Washington, DC.

Figure 2.4. **Average bankruptcy cost (% of estate), 2012 and 2015**



Source: World Bank (2014), *World Bank Doing Business Report 2015*, World Bank, Washington, DC.

Figure 2.5. **Average bankruptcy recovery rate (cents in the dollar), 2012 and 2015**



Source: World Bank (2014), *World Bank Doing Business Report 2015*, World Bank, Washington, DC.

A more proactive approach is needed to promote second chance for honest re-starters

No EaP country conducts specific information campaigns on second chance. There is also no evidence of any targeted support programme for honest entrepreneurs who have undergone non-fraudulent bankruptcy. EaP countries may want to fill this gap by building on a number of initiatives introduced over the last few years in some EU Member States (Box 2.2).

Box 2.2. **Supporting a second chance in the EU**

Several EU Member States have introduced programmes and initiatives to actively promote business re-entry and support previously failed entrepreneurs in their new ventures. A recent survey of 33 European countries assessed the ease of second chance and identified some good practices (EC, 2014b). While the study concludes that more needs to be done to promote second chance in EU Member States, at least one support measure per country was identified in over half of the countries surveyed, including:

- assistance with access to finance (Ireland)
- guidelines for re-starters (Germany)
- awareness-raising activities (Croatia, France, Germany, Lithuania)
- second chance coaching and education (Germany, Belgium, Luxembourg)

Many of these initiatives are delivered by associations or other non-governmental entities. For instance, in Belgium, free coaching for re-starters is provided by associations, while in Luxembourg the Chamber of Commerce organises regular seminars on business administration targeting re-starting entrepreneurs. In France, an association ("Initiative France") provides mixed financial services and mentoring for new ventures and re-starters.

Source: EC (2014b), *Bankruptcy and Second Chance for Honest Bankrupt Entrepreneurs*.

To allow failed entrepreneurs to start afresh without the burden of past debts, the period of time after which debts are discharged should be limited. The EC recommends a maximum period of three years for EU Member States: this could be a reference for EaP countries, which all need to make further progress on the definition of discharge procedures and the introduction of maximum timelines for the discharge and debt settlement process. Discharge may be automatic or subject to an application process. The latter is the case in Belarus, for instance, while in Georgia, despite the fact that the current law is silent on discharge procedures, debtors are reportedly discharged from any remaining debt after the final decision of the court.

Finally, while most countries do not explicitly discriminate against re-starters in accessing state support, public procurement, etc., stigma continues to be a major obstacle for starting afresh. Laws generally do not distinguish between honest and dishonest bankruptcies; perceptions by entrepreneurs suggest that proactive government campaigns should be developed to promote second chance (Box 2.3).

Box 2.3. **SME views on second chance in the EaP**

The company surveys carried out by the OECD in the six EaP countries (see Box A.3 in Annex A) offer some insights into SMEs' perceptions regarding business failure and the obstacles to re-starting throughout the region.

In general, the countries fall into two groups according to their SMEs' attitudes towards risk: *(a)* risk-averse: up to 53% of Georgian, 48% of Azerbaijani and 47% of Moldovan SMEs tend to agree that one should not start a business if there is a risk of failure; and *(b)* less risk-averse: the majority of surveyed companies in Armenia (78%), Belarus (71%) and Ukraine (66%) tend to disagree with this statement. Most SMEs across the region generally perceive that re-starting a business after failure was a "very difficult" or "somewhat difficult" venture. This perception is strongest in Moldova (88% of respondents agree with either categorisation), Georgia (85%), Armenia (77%) and Ukraine (75%), but still significant in Azerbaijan (66%) and Belarus (65%).

Access to finance is the most commonly perceived barrier to a fresh start in all six EaP countries (ranging from 40 to 75% of respondents), significantly ahead of other factors. Three out of four SMEs surveyed in Georgia are of this opinion. Government laws, procedures and regulations were listed as number two in Belarus, Ukraine and, especially, Moldova, where they are mentioned by 40% of respondents (compared with 41% mentioning access to finance). Finding partners and re-establishing contracts are perceived as a comparatively more significant constraint in Armenia and Georgia.

Table 2.1. **Scores for Dimension 2: Bankruptcy and second chance for SMEs, 2016**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Laws and procedures	***3.38***	***3.20***	***2.88***	***3.17***	***3.05***	***2.08***
Implementation	3.50	2.81	3.50	2.69	3.19	3.33
Performance	3.33	3.33	2.67	3.33	3.00	1.67
Promoting second chance	***2.75***	***2.25***	***2.00***	***2.50***	***2.00***	***2.00***

Note: See the chapter on "Policy Framework and Assessment Process" for further information.

The way forward

A new approach to insolvency frameworks is required across EaP countries – not only to enhance the effectiveness and efficiency of court procedures and their alternatives, but also to give honest entrepreneurs an opportunity to start afresh. The following priorities should be considered across EaP countries:

- **Strengthen legal frameworks to align with international best practice.** Despite progress in recent years, insolvency legislation is still lacking in various areas, including creditor participation, availability of incentives for post-petition financing, suspension of proceedings against the debtor, and the definition of maximum times for full discharge. Special attention should be placed on the protection of creditors' rights, given its fundamental role in encouraging financial institutions to provide credit to SMEs. In addition, reforms of insolvency laws should be undertaken in tandem with initiatives to improve the broader "insolvency ecosystem". These include strengthening the capacity of insolvency administrators and the general court system (e.g. by introducing specialised commercial or insolvency courts), as well as strengthening insolvency registries.

- **Strengthen bankruptcy prevention systems and encourage alternatives to costly judicial procedures.** Early warning systems can avoid bankruptcy altogether, while out-of-court settlements have proven to be a fast and cost-efficient way to restructure viable businesses at an early stage. These instruments, largely non-existent in the EaP region, may be particularly useful for SMEs, which generally lack the resources to deal successfully with long and formal restructuring procedures.
- **Promote restructuring of viable SMEs.** EaP countries should shift the current focus on business liquidation to rehabilitation and the restructuring of viable businesses. The introduction of fast-track restructuring procedures for SMEs is justified by the significant costs involved with this type of procedure relative to the small size of the estate, which would generally lead creditors to seek recourse to liquidation.
- **Actively promote second chance for honest entrepreneurs** by limiting maximum debt discharge periods to three years following bankruptcy, eliminating any discriminatory provisions against re-starters and developing programmes to support a fresh start and mitigate stigma. In this regard, public policy and legislation should progressively introduce a distinction between honest and dishonest entrepreneurs to ensure that the former are able to re-enter the market as soon as possible.

Table 2.2. **Dimension 2: Challenges and policy instruments**

Challenges	Policy instruments
Gaps in insolvency legislation and infrastructure compared with international best practice	Further shorten bankruptcy procedures, including liquidation, to not more than a year to reduce the costs and increase recovery rates (special procedures for SMEs can be envisaged)
	Strengthen creditors' rights to promote access to finance (e.g. reducing barriers for the initiation of procedures, enhancing participation in restructuring procedures, ensuring equitable treatment of all creditors, establishing a clear hierarchy of payments)
	Introduce a temporary stay on all enforcement actions against debtors
	Establish and improve reliability and accessibility of existing insolvency registries
	Improve the standards and qualifications of insolvency administrators
	Upgrade the capacity of the court system; consider court specialisation
Lack of preventative mechanisms to avoid bankruptcy (e.g. early warning systems)	Introduce diagnostic tools (e.g. Internet self-tests, call centres, credit scores/stress tests)
	Provide information and market-friendly support measures for enterprises in temporary difficulty
Few alternatives to formal judicial processes and a focus on liquidation instead of rehabilitation	Give businesses in financial difficulties the possibility of requesting a temporary stay (e.g. 4-12 months) to adopt a restructuring plan
	Promote out-of-court systems (mediation, arbitration) or "hybrid" systems
	Within formal court procedures, introduce flexible, fast-track restructuring/rehabilitation procedures for SMEs, including pre-pack arrangements
	Encourage and protect post-petition financing as a mechanism to finance working capital and support viable businesses
Poor promotion of second chance for honest entrepreneurs	Distinguish in the legislation between honest and dishonest bankruptcies (e.g. with civil/criminal liability for the latter, fast-track liquidation procedures for the former)
	Limit maximum discharge periods to 3 years
	Eliminate discriminatory provisions against re-starters (e.g. access to public procurement, support measures)
	Develop campaigns to counter stigma and implement targeted support measures for re-starters (e.g. training)

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Chapter 3

Institutional and regulatory framework for SME policy making (Dimension 3) in Eastern partner countries

Design rules according to the "think small first" principle (Small Business Act Principle 3)

The "think small first principle" requires public authorities to consider SMEs' interests early on in the policy-making process. A comprehensive and coherent policy and institutional framework is therefore necessary to ensure that laws and regulations are SME-friendly and that public initiatives address the needs of SMEs effectively. Dimension 3 assesses three interrelated aspects of the SME policy process: the institutional framework; the adoption of legislative simplification and regulatory impact analysis tools for SMEs; and the existence of participatory platforms for public-private consultations on SME-related topics.

The 2016 SBA assessment finds growing attention by most Eastern partner countries to SME policy development and institutional co-ordination – there is a trend towards developing strategic frameworks and dedicated implementation agencies. On the other hand, the limited availability of quality statistical data on the SME sector and of structured institutional arrangements for public-private consultations remains a major obstacle to effective SME policy making in the region.

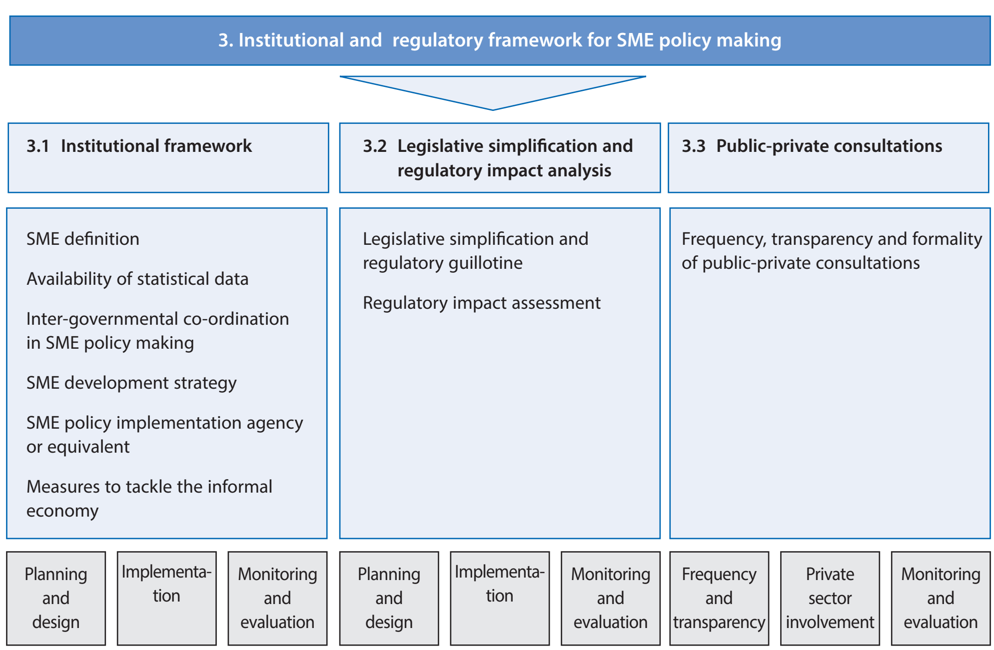
Introduction

Given that SMEs represent the largest share of companies in most economies, SME-friendly institutions and legislation, as well as regular consultations between government and the private sector (including SMEs), are important pre-conditions for a favourable business environment. The "think small first" principle of the European Union's Small Business Act requires public authorities to take into consideration the interests and needs of SMEs at an early stage of policy making.

Institutions, laws and regulations provide the "rules of the game" that constrain and encourage economic actors (North, 1990; Schmid, 2008; Williamson, 2000). A strong legal framework reduces the transaction costs of economic activities and ensures that the economic gains from starting and growing businesses are secured, providing the incentives for individuals to maximise profits. Strong property rights and contract enforcement are the foundations on which the SME sector is built (Aidis et al. 2012; Verheul et al., 2002). But SMEs have particular features which require a specific approach to policy making. For instance, SMEs face proportionally higher costs complying with regulations than larger firms (EC, 2007). Market failures justify proactive policies to encourage SME access to finance, skills upgrading and innovation development. Having a policy and institutional framework in place that tackles SME needs is an important pre-condition for a thriving SME sector.

This chapter assesses the extent to which the six Eastern partner (EaP) countries have the building blocks of a supportive SME framework in place, and compares their progress since 2012. It concludes with recommendations for the next steps.

Figure 3.1. **Assessment framework for Dimension 3**



Assessment framework

The assessment framework for Dimension 3 is composed of three sub-dimensions which analyse *(a)* the strength of the overall institutional framework for SME policy making; *(b)* the existence and effectiveness of legislative simplification and regulatory impact assessment (RIA) mechanisms; and *(c)* the degree of development of public-private consultations. Each sub-dimension is in turn structured into three thematic blocks covering the entire policy cycle, from planning and design to implementation and monitoring and evaluation (Figure 3.1).

Institutional framework

The first sub-dimension assesses the level of development of the institutional framework, which includes the systems of formal laws, regulations and procedures, as well as the government institutions that regulate socio-economic activity and behaviour. The "think small first" principle implies that governments must mainstream SME concerns within public policy, especially policies on the overall business enabling environment. This requires SME needs to be reflected in legislation, regulations, government structures, and policy documents. The following are the main pillars of a comprehensive institutional framework for SME development:

- **SME definition**. If SMEs are to be a target group for public policy, a clear and consistent definition must be enshrined in legislation. A single definition should be used across different policy areas, laws and regulations in order to improve the consistency and effectiveness of SME support measures. Clear distinctions between the various segments of the SME sector (from micro-enterprises to medium-sized businesses) are also key so that policy measures can be tailored to the specific needs of each type of enterprise. Moreover, international convergence in this area can facilitate benchmarking progress in policy reforms as well as the sharing of good practice. For instance, a single definition has been in place across all EU Member States since 2005.
- **Availability of statistical data**. The availability of extensive and accurate statistics on SMEs is an essential requirement for evidence-based policy making. Data on SME demographics (including enterprise births, deaths and churn rates), contribution to the economy (in terms of e.g. employment or value-added), broken down by enterprise size and sector, are important to measure the impact of reforms and identify needs for future interventions (EC, 2014). Likewise, specific statistics on SME performance in key policy areas (e.g. access to finance, exports, skills development, innovation, etc.), obtained through periodic firm-level surveys, are useful to design targeted support measures.
- **Inter-governmental co-ordination in SME policy making**. Given the cross-cutting nature of SME development policies, several government ministries, agencies and departments are involved in the design and implementation of SME policy. As a result, governments need to introduce formal co-ordination mechanisms to avoid policy fragmentation while ensuring effective communication and collaboration across institutions (OECD, 2010). This is typically done through inter-ministerial committees or working groups, or through a specialised SME development department (typically in the ministry of economy) with a co-ordination mandate.
- **SME development strategy**. A medium-term strategic framework for SMEs helps governments define policy priorities, targets and benchmarks. It allows for

co-ordination across public authorities and provides a platform for dialogue with the private sector, including SMEs themselves. Strategies should be based on a clear diagnosis of the main constraints confronting the SME sector and grounded in the country's broader socio-economic or development strategic framework. They should include prioritised and sequenced reforms and initiatives, a clear division of labour, and targets and performance indicators to monitor progress. Their implementation is ideally guided by regular action plans.

- **SME policy implementation agency or equivalent**. Separating SME policy design (typically carried out by the ministry of economy or similar central government entity) from policy implementation is crucial to promote transparency and accountability in the policy process. An autonomous agency or special department within the ministry of economy can be in charge of translating strategic directions into operational programmes and implementable measures. Strong political support, as well as adequate human and financial resources, are necessary for these entities to be able to deliver their mandate. SME agencies should establish partnerships with other stakeholders and rely on outsourcing for various forms of SME support initiatives (e.g. training, consulting, incubation, financing).
- **Measures to tackle the informal economy**. Informality has a detrimental effect not only on tax revenue collection, labour rights and the comprehensiveness of official statistics, but also on firm-level productivity. Informal firms may limit their size to below their optimal efficiency scale or give rise to inefficient competition by compensating for their low productivity with tax evasion and regulatory non-compliance (Andrews, Caldera and Johansson, 2011). The shadow economy affects SMEs and micro-enterprises in particular as they tend to operate in markets where informal firms are most active (the incidence of informality decreases with firm size since regulatory compliance costs proportionately more for smaller firms). As a result, it is important for governments to address this phenomenon by understanding its key drivers (e.g. through surveys), and by lowering the costs and increasing the benefits of formalisation. This includes not only business environment reforms (e.g. simplified enterprise registration or tax administration), but also targeted measures to encourage informal businesses to become formal.

Legislative simplification and regulatory impact analysis

The second sub-dimension assesses the mechanisms for legislative simplification and regulatory impact analysis, including an "SME test," to ensure that the impact of new laws and regulations on SMEs is properly measured and mitigated (EC, 2009). Regular reviews and elimination of redundant, outdated or burdensome legislation (often referred to as regulatory "guillotine" exercises) allow for a strong regulatory framework conducive to private sector development. While regulatory reviews focus on the simplification of existing legislation *ex post*, RIA operates as an *ex ante* mechanism to avoid the introduction of new rules overburdening businesses. RIA therefore refers to a process of systematically evaluating the likely costs, benefits and social impacts of adopting new legislation or regulations. RIA is both a tool and a decision-making process for helping policy makers decide whether and how to regulate (OECD, 2009a). Beyond analysing impact on the general business sector, RIA mechanisms should also explicitly consider the impact of the legislation on SMEs (the "SME test") as an integral part of the assessment. The SME test may lead to the exclusion of SMEs (often micro-enterprises) from the scope of regulations, or to the introduction of exemptions, transition periods or tailor-made provisions for SMEs (EC, 2011).

Public-private consultations (PPCs)

The third sub-dimension analyses the frequency, transparency, formal influence and inclusiveness of consultations between the public and private sectors. As small firms are less organised and their needs much more diverse than larger firms, their views may not be fully considered in the development of policies or legislation (EC, 2005). Consultations with the private sector, including SMEs, should take place in a formalised structure at all stages of policy making, from preliminary discussions on potential legislation to monitoring and evaluation of a given policy. Governments should also inform participants on how they use feedback received through consultations in order to ensure that the policy-making process is open and transparent (OECD, 2009b). Denmark's Business Forum for Better Regulation provides an example of a good practice in this area (Box 3.2).

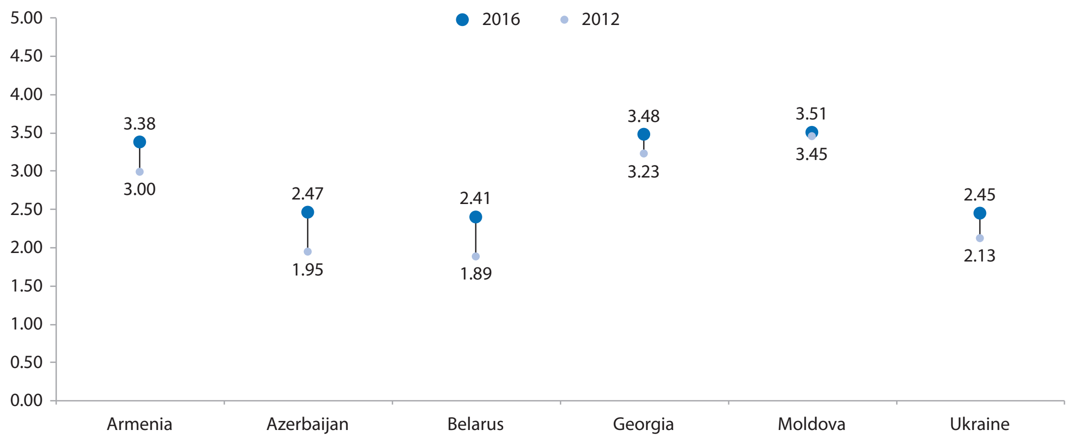
Analysis

Overall, the EaP countries have made progress in their institutional and regulatory environment for SME policy since the 2012 assessment, with Dimension 3 scores increasing across the region (Figure 3.2). This evolution reflects growing attention by most EaP countries to SME policy development and institutional co-ordination, reflected in a nascent trend towards creating strategic frameworks and dedicated implementation agencies. On the other hand, the limited availability of quality statistical data on the SME sector and of structured institutional arrangements for public-private consultations remain major obstacles to effective SME policy making in the region.

Moldova continues to be the strongest performer, being the only country to have adopted a comprehensive medium-term SME strategy with periodic action plans implemented by a dedicated SME agency (Organisation for Small and Medium Enterprises Sector Development or ODIMM) and other stakeholders. Other top performers include Georgia and Armenia. Georgia has created a new SME implementation agency and, as of June 2015, was in the middle of a participatory process to prepare and adopt a comprehensive multi-year SME strategy (Box 3.1). Armenia continues its strong track record of SME policy implementation through the Small and Medium Entrepreneurship Development National Centre (SME DNC) and has undertaken a wide-scale regulatory simplification programme. Azerbaijan, Belarus and Ukraine remain on the second tier, although important progress has been made to close the gap with the region's frontrunners, particularly by Azerbaijan and Belarus. Despite these reforms, however, important challenges remain in the EaP region:

- The lack of a comprehensive medium-term framework, leading to policy fragmentation and overreliance on annual programmes. All countries, with the exception of Moldova and Georgia, still need to develop comprehensive SME strategies.
- The lack of an institutional separation between policy design and implementation (no implementation agency exists in Azerbaijan, Belarus and Ukraine).
- The limited availability and poor quality of SME statistics: this is a major obstacle for evidence-based policy making and for monitoring and evaluation of current initiatives.
- Limited systematic application of RIA and lack of formal RIA mechanisms in certain countries (e.g. Georgia, Azerbaijan). Where they do exist, SME issues are not explicitly addressed (e.g. in Belarus and Ukraine).
- Ad hoc, sporadic public-private consultations: most countries lack a structured institutional framework for public-private consultations for SME policy making.

Figure 3.2. **Weighted scores for Dimension 3 compared to 2012**



EaP countries are progressively adopting the building blocks of a comprehensive SME policy

SME development strategies are being defined

The development of strategic frameworks for SME policy is progressing, but remains uneven across the region. Moldova has approved an SME strategy for 2012-20 and implemented a first action plan during 2012-14. While most actions were successfully completed, several had to be postponed. A new action plan is being adopted for 2015-17. Georgia has launched a participatory process to develop a comprehensive SME strategy and an action plan for 2016-20 (Box 3.1). Armenia and Belarus continue to rely on annual and three-year SME support programmes respectively, although a medium-term SME strategy is currently under preparation in Armenia and is expected to be adopted in the autumn of 2015. In Belarus, work is ongoing to review the SME strategic framework, including a presidential directive to boost entrepreneurship and private sector development. In Ukraine, the Ministry of Economic Development and Trade is working on a Concept of Governmental Programme for SME Development. Finally, there is currently no SME strategy or programme in Azerbaijan, with entrepreneurship policy scattered across a number of state programmes.

Box 3.1. **Georgia's SME Development Strategy**

Since the early 2000s, Georgia has undertaken significant reforms to reduce government market intervention and to simplify business regulations. The country has become one of the region's best performers in developing a competitive business environment. However, Georgian SMEs continue to be concentrated in low value-added sectors, which explains their limited contribution to total value-added (see Part II, Chapter 14).

The two main strategic documents guiding current government action – "Georgia 2020: Socio-economic Development Strategy" and "Government Programme: For a Strong, Democratic and Unified Georgia" – emphasise the need for inclusive and sustainable economic growth and prioritise strengthening the private sector, developing human capital and deepening access to finance. After a wave of liberalisations and investment-friendly reforms in recent years, the Georgian government has recognised the importance of more proactive structured reforms to develop entrepreneurship and start-ups and build a competitive SME sector to drive growth. In October 2014, the government of Georgia, in co-operation with the OECD, EU and GIZ, began work on an SME Development Strategy and accompanying action plan.

Box 3.1. **Georgia's SME Development Strategy** *(continued)*

Strategy development process

The first step was for the government of Georgia and its partners to identify key strategic directions for SME development using the framework of the SME Policy Index. Next, a Steering Group and a Working Group were established to discuss each priority direction, co-ordinated by the OECD Eurasia Competitiveness Programme and the Georgian Ministry of Economy and Sustainable Development (MoESD). Several meetings in Tbilisi helped to draft the strategic document and design a reform action plan supported by OECD guidelines and recommendations.

This document was submitted for peer review in November 2015 at the third session of the OECD Eurasia Competitiveness Roundtable, a policy network that brings together high-level representatives and technical experts from Eurasian countries, OECD member countries and partner organisations. The peer review allowed Georgia to define further steps for policy reform implementation.

Strategy content

The public-private Working Group identified five main challenges to SME development in Georgia: *(a)* an incomplete institutional framework for SME policy; *(b)* limited access to finance; *(c)* skills mismatch in the labour market and low job creation; *(d)* few exports by Georgian SMEs; and *(e)* low innovation and expenditure by SMEs. These challenges formed the five strategic directions of the SME strategy, accompanied by priority actions:

a. **Improve further the SME legislative, institutional framework and operational environment** through *(i)* formal co-ordination mechanisms for SME policy amongst policy stakeholders; *(ii)* regular SME-specific RIAs; *(iii)* improved business closure and insolvency procedures; *(iv)* better SME statistics collection and dissemination; and *(v)* a single SME definition for statistics and policy making.

b. **Improve access to finance** by *(i)* amending the legal framework on public grants; *(ii)* improving supply-side financial skills to leverage the regional presence of banks; *(iii)* promoting demand-side financial education programmes targeting SME entrepreneurs; *(iv)* establishing a credit guarantee scheme as a risk-sharing mechanism; and *(v)* strengthening the venture capital environment.

c. **Promote skills development and entrepreneurial culture** through *(i)* a country-wide labour market and training needs analysis; *(ii)* strengthened stakeholders participation in VET policies; *(iii)* higher quality and more attractive VET institutions; *(iv)* greater access to non-formal training for SMEs; and *(v)* promoting entrepreneurship in formal education.

d. **Support SME internationalisation** through *(i)* better export promotion activities and export skills for SMEs; *(ii)* supporting SMEs' alignment with DCFTA requirements; *(iii)* targeted export financial support for SMEs; and *(iv)* FDI-SME linkage programmes to integrate SMEs in global value chains.

e. **Facilitate innovation and R&D in SMEs** by *(i)* amending the legal framework for innovation; *(ii)* fostering collaboration between industry and academia; and *(iii)* supporting SMEs financially for innovative activities.

Georgia's Department of Economic Analysis and Policy within the MoESD will co-ordinate the SME Development Strategy and Action Plan implementation, monitoring and evaluation. Taking into account the various stakeholders, a new inter-ministerial committee for SMEs will oversee developments, and present quarterly and annual progress reports to government and semi-annual meetings. Annual and twice-yearly public-private dialogue platforms will involve stakeholders in monitoring.

EaP countries present varying levels of SME policy co-ordination and implementation

The level of co-ordination and implementation of SME policy also varies widely across countries. Moldova, Georgia and Armenia all have SME implementation agencies (typically a dedicated department within the ministry of economy) that are operationally independent of policy-making bodies. The most recent is Enterprise Georgia, founded in February 2014, which is currently executing two government programmes for SME support. Armenia's SME DNC continues building on its solid track record of SME policy support since 2002 and co-ordinates actively with various government ministries, NGOs and the private sector. Moldova has also made progress with the implementation of its action plan for 2012-14. Its SME agency, ODIMM, continues providing training and other services to SMEs, though mostly with donor support. Policy design and implementation have not yet been separated in Azerbaijan, Belarus and Ukraine, and formal inter-ministerial co-ordination mechanisms are notably lacking. In these three countries, dedicated departments within the ministries of economy develop SME policy and are also responsible for implementation. Recent changes to mandates of government agencies in Ukraine have also been a barrier to effective policy implementation.

SME definitions are being revised

Since the previous assessment, Ukraine and Azerbaijan have improved their SME definitions to bring them closer to the EU definition (which uses employment, turnover, and total assets criteria) (Table 3.1). Ukraine adopted the EU definition (excluding the total assets criterion) in 2012. Azerbaijan introduced a new definition in June 2015, which distinguishes between small and medium enterprises and introduces consistency across sectors (previously different employment thresholds were used depending on the economic sector). However, the employment criterion continues to be in conflict with the thresholds for simplified taxation, and micro-enterprises are not recognised. Moldova (since 2006) and Armenia (since 2011) use all three of the EU criteria in their SME definitions. Meanwhile, Georgia has two separate SME definitions, one in law and another in the tax code, neither of which is consistent with EU criteria. This is one priority reform area in the draft SME strategy (Box 3.1). Finally, Belarus is considering a new definition to replace the existing one, which relies on a single employment criterion (Table 3.1).

In general terms, it is important to *(a)* ensure that a single definition is used across all policy areas (including taxation) in order to better ascertain the impact of different initiatives (e.g. special tax regimes) on the entire SME universe; and *(b)* expand the criteria beyond employment to at least turnover in order to provide an accurate picture of the SME population across all sectors, regardless of whether they are labour or capital-intensive.

Table 3.1. **EaP and EU SME definitions**

	Micro	Small	Medium	Source
EU	< 10 employees ≤ EUR 2 million turnover or ≤ EUR 2 million balance sheet	< 50 employees ≤ EUR 10 million turnover or ≤ EUR 10 million balance sheet	< 250 employees ≤ EUR 50 million turnover or ≤ EUR 43 million balance sheet	The new SME definition, European Commission (2005)
Armenia	< 10 employees ≤ AMD 100 million (EUR 187 000) turnover ≤ AMD 100 million (EUR 187 000) balance sheet	< 50 employees ≤ AMD 500 million (EUR 936 000) turnover ≤ AMD 500 million (EUR 936 000) balance sheet	< 250 employees ≤ AMD 1 500 million (EUR 2 808 000) turnover ≤ AMD 1 000 million (EUR 1 187 000) balance sheet	Amendments in the RA Law on State Support of Small and Medium Entrepreneurship (2011)

	Micro	Small	Medium	Source
Azerbaijan	Not defined	< 25 employees < AZN 120 000 (EUR 101 500) turnover	< 125 employees < AZN 1 250 000 (EUR 1 057 500) turnover	Decision of the Cabinet of Ministers (2015)
	Not defined	Self-employed (no hired labour) < AZN 120 000 (EUR 101 500) turnover	Not defined	Tax Code of Azerbaijan
Belarus	Up to 15 employees	16-100 employees	101-250 employees	Law of the Republic of Belarus of 1 July 2010, No. 148-31, On State Support for Small and Medium Entrepreneurship
Georgia	Not defined	≤ 20 employees ≤ GEL 500 000 (EUR 213 000) turnover	≤ 100 employees ≤ GEL 1 500 000 (EUR 640 000) turnover	Law of Georgia on Georgian National Investment Agency
	Self-employed (no hired labour) ≤ GEL 30 000 (EUR 12 800) turnover	Self-employed (no hired labour) ≤ GEL 100 000 (EUR 42 700)	Not defined	Tax Code of Georgia
Moldova	< 10 employees < MDL 3 million (EUR 182 000) turnover < MDL 3 million (EUR 182 000) total assets	< 50 employees < MDL 25 million (EUR 1.5 million) turnover < MDL 25 million (EUR 1.5 million) total assets	< 100 employees < MDL 50 million (EUR 3 million) turnover < MDL 50 million (EUR 3 million) total assets	Law No. 206-VXI of July 2006 on supporting the SME sector
Ukraine	≤ 10 employees ≤ EUR 2 million turnover	≤ 50 employees ≤ EUR 10 million turnover	All enterprises that do not fall into the category of small or large enterprises (large: > 250 employees; > EUR 50 million)	Commercial Code of Ukraine No. 436-IV of 16.01.2003 (as amended)

Note: Exchange rates as of June 2015.

Limited availability of SME statistics continues to be a major obstacle

Major gaps persist in the quality and availability of statistical data on SMEs in all six EaP countries (Table 3.2). Although all countries collect structural business statistics by size class, in some cases important variables – such as contribution to GDP, value added and exports – are missing. Moreover, micro-enterprises are not included in Azerbaijan and Georgia given their respective SME definitions, and official statistics in Armenia do not include individual entrepreneurs. Detailed business demography data (including birth, death, churn and survival rates) are collected only in Armenia, Azerbaijan and Moldova. Quality of data is a problem in certain countries – for example, in Armenia the figures published by SME DNC are based on secondary analysis. The limited availability and quality of SME statistics is a contributing factor to the weak monitoring and evaluation of SME policy across the EaP region, and is a challenge to the development of effective policy measures. In general terms, governments must intensify their efforts to increase the level of detail and quality of SME statistics, improve the accessibility of the data (e.g. by publishing regular updates on the websites of the national statistical offices), improve international comparability and use firm-level surveys of active companies to expand the information available on certain topics (e.g. SME internationalisation, innovation and access to finance). Governments are in particular invited to use the OECD-Eurostat methodology as a reference for measuring entrepreneurship (see the indicators used in the yearly *Entrepreneurship at a Glance* publication; OECD, 2014a), and the OECD scoreboard on financing SMEs and entrepreneurs (OECD, 2014b) to measure trends in SMEs' use of various financial instruments.

Table 3.2. **SME statistics collected in the EaP countries**

Country	Structural business statistics	Business demography data
Armenia	• Number/employment by sector and size class	• Birth/death/churn rate by size class • Enterprise survival rate by year and size class
Azerbaijan	• Number/employment by sector and size class • Value added by size class	• Birth/death/churn rate by size class • Enterprise survival rate by year and size class
Belarus	• Number/employment/volume of production by sector and size class • Export share and average value by size class	• Not available
Georgia	• Number/employment by sector and size class • Value added by size class	• Not available
Moldova	• Number/employment/turnover by sector and size class	• Birth/death/churn rate by size class • Enterprise survival rate by year and size class
Ukraine	• Number/employment/volume of production by sector and size class	• Not available

Note: The size class breakdown for Azerbaijan and Georgia does not include micro-enterprises.

Targeted measures to address the informal economy are largely missing

Finally, measures to tackle the informal economy in the EaP region remain largely limited to horizontal reforms of the business environment aimed at lowering the costs of formalising a business (e.g. streamlining business registration procedures, introducing favourable taxation regimes). The informal economy in most EaP countries continues to account for a sizeable portion of GDP. For instance, its size in Georgia has decreased considerably since 2013 following the simplification of business registration, the reduction of taxes for small businesses and other regulatory reforms, particularly targeting corruption and excessive regulation. All other EaP countries have adopted similar actions to simplify the regulatory environment for micro-enterprises and small companies, although there are no estimates of their impact on informality rates. These measures could be complemented with specific strategies for better understanding and tackling informality. These could include surveys of informal businesses to identify the main constraints and drivers of firm-level decisions over whether to stay in the shadow economy, as well as proactive measures to further reduce the costs of formalisation and, crucially, increase awareness of the benefits (e.g. securing access to collateral and finance, participation in government support programmes).

Table 3.3. **Scores for sub-dimension 3.1: Institutional framework**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.85	1.87	3.26	3.68	4.67	2.91
Implementation	3.00	3.00	3.00	5.00	3.89	1.89
M&E	3.85	2.70	1.52	4.33	4.19	1.67
Weighted average	3.47	2.54	2.79	4.41	4.22	2.20

Note: see “Policy Framework and Assessment Process” chapter for information on the methodology.

Legislative simplification efforts should be complemented by a more systematic use of RIA mechanisms

Business legislation is being simplified across the region

Large-scale reviews of legislation to eliminate unnecessary and burdensome business regulations have been carried out in Georgia, Armenia, Moldova, and Ukraine, while more general regulatory reform efforts to eliminate obsolete legislation have been undertaken in all countries. Georgia undertook a legislative guillotine process between 2006 and 2010, which eliminated 12 000 pieces of legislation. However, no formal mechanism has been established for future regulatory reviews.

Since the previous assessment, Armenia has also launched a programme to review and eliminate obsolete business-related legislation, inventorying 3 000 rules and regulations through an inter-ministerial review process involving 10 ministries. Moldova's review resulted in reducing permits and authorisations for businesses from 400 to 269. A structured "Guillotine 2+" process has been introduced, although the impact of these reviews on reducing the administrative burden is uncertain. Similarly, in 2014-15 Ukraine eliminated the need to acquire permits for 86 types of economic activities, and abolished 16 types of permits in agriculture, construction and machinery. Belarus and Azerbaijan have made efforts to simplify legislation through various general instruments, although they still do not have legislative review mechanisms specifically aimed at business-related regulations.

RIA progress is being made, but all countries need to include an SME test

Regulatory impact assessment has been applied in Armenia and Moldova since 2011 and 2008 respectively. In both cases it comprises a consultation mechanism with the private sector, including SMEs. Moldova's RIA mechanism is undergoing further reforms to align it with international good practice. Although Belarus has legislation requiring draft legal acts to be accompanied by a financial and economic assessment, the existing methodology for analysis is not compulsory and does not constitute a comprehensive RIA framework. In Ukraine, screening of new regulations currently includes a cost-benefit analysis although the quality and degree of implementation are unclear. The authorities are planning to develop a formal RIA mechanism aligned with international best practice. There is currently no formal requirement to conduct RIA in Georgia and Azerbaijan, although both countries are planning to introduce it in the short to medium term. Countries are advised to embed an SME test in their RIA methodologies – in line with the EU framework – to ensure that regulatory impact is assessed from an SME angle.

Table 3.4. **Scores for sub-dimension 3.2: Legislative simplification and regulatory impact analysis**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	2.33	3.00	1.80	2.20	2.60	1.80
Implementation	3.53	2.58	2.13	2.47	3.87	2.67
M&E	3.67	1.00	1.44	1.00	1.44	2.78
Weighted average	***3.14***	***2.41***	***1.88***	***2.08***	***2.94***	***2.39***

Note: see "Policy Framework and Assessment Process" chapter for information on the methodology.

Public-private consultations should be better institutionalised and formalised

Public-private consultations continue to lack a structured formal framework in most EaP countries, often taking place on an ad hoc, sporadic basis (Table 3.5). In particular, Azerbaijan, Belarus and Ukraine lack an institutional forum for consultations with the SME sector. In Georgia, a Steering Committee involving both public and private stakeholders has been established to develop the SME strategy, and is expected to serve as an institutional forum for SME policy co-ordination (Box 3.1). The SME Development Council in Armenia is the only SME-specific multi-stakeholder public-private consultation forum in the EaP region, although its activities have somewhat declined in recent years. The Economic Council chaired by Moldova's Prime Minister has been active in addressing specific constraints to the business enabling environment since 2014, although SME participation and influence remains limited. In Belarus, there is no systematic monitoring and evaluation of the effectiveness of advisory councils for various ministries and departments. In Azerbaijan a new law on public participation was adopted in 2014, but its degree of implementation in practice remains unclear and public-private dialogue is largely limited to ad hoc interactions between the National Confederation of Entrepreneurs and public institutions.

Table 3.5. **Scores for sub-dimension 3.3: Public-private consultations**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.71	2.81	2.42	3.04	3.87	3.10
Implementation	3.87	2.73	3.13	4.27	2.80	3.53
M&E	2.33	1.00	1.00	3.67	2.33	1.00
Weighted average	**3.50**	**2.42**	**2.42**	**3.65**	**3.13**	**2.85**

Note: see "Policy Framework and Assessment Process" chapter for information on the methodology.

Box 3.2. **Denmark's Business Forum for Better Regulation**

The Business Forum for Better Regulation was established by the Danish Minister of Business and Growth in 2012 to advise the government on reducing regulatory costs for businesses. Its role is to identify those areas that businesses perceive as the most burdensome and to propose simplification measures, such as amended regulations, new processes, or reducing processing timelines by public authorities. The Business Forum has 21 members representing business and workers' organisations, individual businesses and independent experts. The forum is chaired by the managing director of a leading Danish décor company and meets three times a year.

The proposals made by the Business Forum are subject to a "comply or explain" principle. The government is therefore obliged to either pursue the proposed initiatives or to explain why these are not being pursued. Concrete simplification targets have been set for the areas identified by the Business Forum, and the government regularly takes stock of progress. The list and status of the initiatives are published in a dedicated website (www.enklereregler.dk). The government has committed itself to fully or partially implementing 419 proposals from the Business Forum, with 169 of these proposals already fully implemented and 172 partially implemented as of July 2015.

Box 3.2. **Denmark's Business Forum for Better Regulation** *(continued)*

A Secretariat prepares and follows up on the forum's meetings. It is also responsible for the communication between the Business Forum and the public authorities. Prior to each meeting one or more working groups, consisting of members of the Business Forum supported by the Secretariat, prepare a package of proposals to be discussed at the meeting. The Business Forum is mandated to submit proposals on administrative obstacles and, since 2015, compliance costs. In April 2015, the Business Forum and the Ministry of Business and Growth prepared a list of 24 recommendations to simplify legislation at the EU level.

Source: Official website of the Danish Forum for Better Regulation, http://danishbusinessauthority.dk/business-forum-better-regulation; Ministry of Business and Growth of Denmark (2015), *Proposals for Simplification of EU Legislation*.

The way forward

In order to strengthen the effectiveness of SME policy making and ensure all the building blocks of a robust institutional framework are in place, EaP countries may want to:

- **Develop medium-term strategic frameworks for SME development policies** to identify concrete reform priorities and actions and introduce monitoring and evaluation mechanisms. Azerbaijan, Belarus and Ukraine are in particular invited to initiate participatory processes to develop medium-term strategies following the example of other EaP countries. For countries where an SME strategy has been or is in the course of being adopted, more emphasis must be placed on reform implementation, monitoring systems and maintaining the reform momentum.
- **Consider the establishment of independent policy implementation agencies** in countries where they do not exist (e.g. Azerbaijan, Belarus and Ukraine) to introduce more transparency and accountability into the policy process, and to facilitate inter-agency co-ordination. ODIMM, SME DNC and Enterprise Georgia are all sources of good practice ideas from which Azerbaijan, Belarus and Ukraine may want to draw. The creation of multi-agency committees, working groups or specialised SME development agencies with a mandate to liaise with all relevant government departments (science and education, innovation, finance and others) can ensure effective and consistent policy initiatives as well as a holistic approach to tackling the constraints to SME development.
- **Address the limited availability and quality of SME statistical data;** little progress has been made in this area since 2012. The first step will be to adopt a consistent SME definition (ideally in line with the EU's). Capacity building within the statistical agencies is likely to be needed to increase the availability of business demographics and structural statistics. Using the OECD-Eurostat methodology for measuring entrepreneurship indicators would allow for evidence-based policy making and benchmarking of policy outputs against international standards.
- **Introduce a formal requirement to conduct RIA for business-related legislation,** especially in Azerbaijan and Georgia, which lack this requirement. While Belarus and Ukraine have some form of regulatory pre-screening in place, it should be upgraded into a fully-fledged RIA mechanism, including a specific SME test. In Armenia and Moldova, where RIA is already mandatory, practical implementation

could be further strengthened in line with international good practice, and *ex post* impact analysis introduced.

- **Increase private sector, and in particular SME, participation in policy design, implementation and monitoring** to ensure that policy development is inclusive and meets emerging needs. In particular, formal requirements should be introduced to consult the private sector at every stage of the legislative process, and draft laws should be published online for comment. Regular public-private consultation meetings should be held, including business associations representing SMEs interests. The details of the consultations and their outcomes should be made public to ensure transparency and wide participation. Capacity support for business and SME associations will need to be provided in those countries where such associations are still weak. The collaborative effort leading to the adoption of SME strategies in Moldova and Georgia could be replicated elsewhere.

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Chapter 4

Operational environment for SMEs (Dimension 4) in Eastern partner countries

Make public administrations responsive to SMEs' needs (Small Business Act Principle 4)

Public administrations which are responsive to SMEs' needs tend to have simple and low-cost regulations and procedures. Dimension 4 assesses progress towards simplifying regulations and reducing compliance costs and procedures for SMEs, with a focus on business registration and e-government systems. EaP countries were already performing well against this dimension in 2012. They have continued to streamline business regulation, lowering market entry barriers and reducing transaction costs for businesses in their interaction with government agencies. E-government portals and services have been dramatically expanded in most EaP countries. Likewise, one-stop-shops for starting a business are available throughout the region and business registration procedures have been substantially simplified. Today, starting a business in the EaP region is, on average, cheaper and involves fewer procedures than in OECD countries.

EaP countries are invited to keep up this momentum by fine-tuning company registration procedures in those countries where performance is lagging behind (e.g. Belarus, Moldova and Ukraine), increasing awareness of e-services amongst SMEs, and improving the links between government databases to further reduce transaction costs. Governments may also want to look into other administrative barriers to business, such as licenses and permits, which continue to be a major constraint in certain economic sectors.

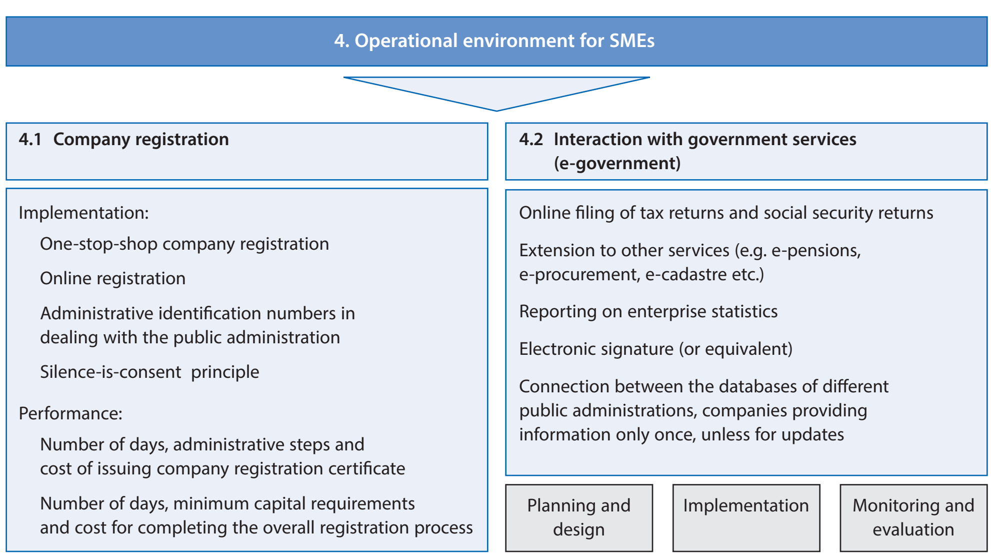
Introduction

Before an entrepreneur or a company can start operating they are usually required to register with the authorities. If these company registration procedures are lengthy and costly they can be a major business constraint, with a disproportionate impact on micro and small enterprises (van Stel and Stunnenberg, 2006; EC, 2007). They can act as a significant barrier for start-ups, ultimately discouraging entrepreneurial activity (Dickinson, 2008; Smallbone and Welter 2009). Studies show that clear and streamlined business start-up requirements facilitate formal entrepreneurship, while complex administrative procedures are associated with fewer legally registered firms, greater informality, a smaller tax base and more corruption (Audretsch et al., 2006; Klapper et al., 2009; Klapper et al., 2010).

Simplifying the operational environment and reducing the administrative burden on SMEs involve more than reforms to the company registration process. More and more governments are introducing e-government systems to deliver a variety of services online. Within the EU, for example, there is an increasing trend towards the adoption of sophisticated online support services (e.g. online filing of tax returns, social security returns, reporting on enterprise statistics, etc.; EC, 2015). By adopting information and communication technology (ICT), governments can reduce costs for SMEs, and simultaneously improve the quality and efficiency of their services. Furthermore, ICT plays an important role in reducing corruption and informal sector activities by improving enforcement mechanisms, increasing transparency, and reducing subjective decision making by government officials (OECD, 2005; ADB, 2001).

This chapter examines the steps being taken by EaP countries to make it easier for SMEs to start up, and to fulfil administrative and regulatory requirements once up and running. It compares progress since 2012 and concludes with recommendations for maintaining the positive momentum seen to date.

Figure 4.1. **Assessment framework for Dimension 4**



Assessment framework

The assessment framework for Dimension 4 involves two sub-dimensions: *(a)* analysing company registration procedures; and *(b)* developing e-government services (Figure 4.1). The framework for this dimension has not changed since the 2012 assessment.

Company registration

Simplifying company registration procedures encourages formal registration by companies, reducing the number of SMEs operating in the shadow economy. The first sub-dimension analyses the reforms undertaken by governments to make it simpler to start a business. The assessment framework for this sub-dimension is broken down into two thematic blocks:

a. **Implementation** of government measures to simplify business set-up by: *(i)* reducing the number of company identification numbers used in dealing with the public administration (ideally using a single number for tax, statistical collection and other purposes); *(ii)* establishing one-stop-shops for company registration where entrepreneurs can complete all formalities in a single location or with a single interface; *(iii)* offering online registration; and *(iv)* adopting the "silence-is-consent" principle (i.e. creating time limits following a request for business registration after which the request is considered accepted even if no formal decision is adopted by the relevant government body). These reforms affect the three phases of the business registration process: *(i)* company registration (all procedures necessary for the enterprise to obtain a company registration certificate); *(ii)* notifying various government bodies of the establishment of the new company (e.g. tax authorities, statistics offices, employment agencies, customs administration); and *(iii)* all the procedures necessary to comply with applicable laws and regulations.

b. **Performance** in reducing the barriers to starting a business, as measured by the World Bank's *Doing Business* indicators (World Bank, 2014):

   - the ease of obtaining the company registration certificate (in terms of days, number of administrative procedures and cost)
   - the ease of starting a business (the total number of days and total costs associated with all phases and administrative procedures necessary to commence operations, as well as any minimum capital requirements to register).

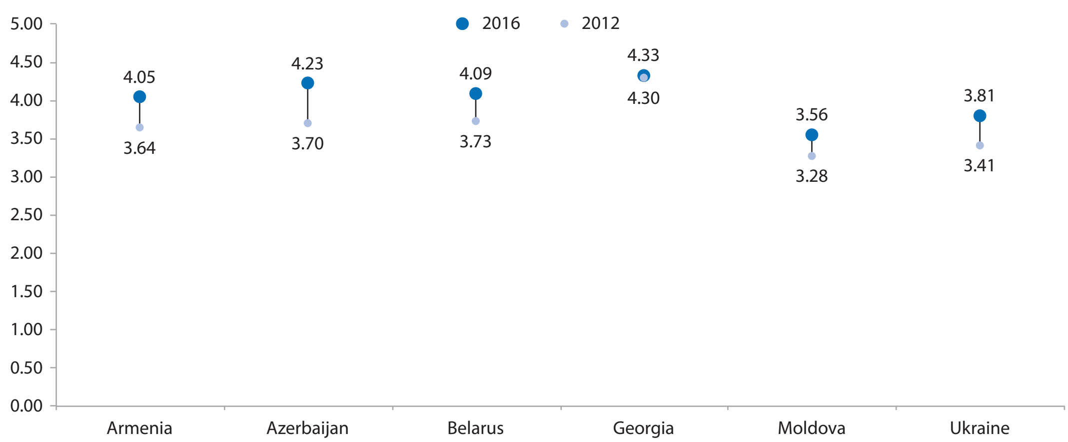
Interaction with government services (e-government)

Online access to government services is of particular importance to the small businesses sector, as entrepreneurs can rarely afford the time and resources required to interact in person with government agencies. The second sub-dimension measures the development of online support services for more efficient interaction between SMEs and the public administration. These include online filing of tax returns, social security returns, pensions and other services, as well as the establishment of an online cadastre or real estate registry, online reporting of enterprise statistics, collation of public databases to avoid replicating data collection, and use of electronic signatures.

Analysis

While they were already performing well in 2012, EaP countries have continued to streamline their business regulation to lower market entry barriers and reduce transaction costs. All countries have made progress in this dimension, with a majority scoring over 4, indicating an advanced level of policy development that is close to international best practice in some areas (Figure 4.2). Georgia remains the strongest performer in the region, currently ranking 5th out of 189 economies worldwide on the World Bank Doing Business "Ease of Starting a Business" indicator (World Bank, 2014). Azerbaijan has the second highest score among the EaP countries, with noteworthy performance in the roll-out of e-government infrastructure and services.

Figure 4.2. **Weighted scores for Dimension 4 compared to 2012**



Since the 2012 report, business registration procedures have been substantially simplified. One-stop-shops for starting a business are now available throughout the region, although their practical effectiveness varies from country to country. Online company registration is possible in Armenia, Azerbaijan, Belarus, Georgia and Ukraine. Georgia's Public Service Halls have received global recognition for their one-stop-shop structure (Box 4.1). The World Bank's *Doing Business* report confirms the impact of these developments – today it takes an average of 7.7 days to start a business in the EaP region (2.5 days less than in 2012). The costs and total number of procedures involved with setting up a business have also decreased, and are now better than the OECD average (Figures 4.3 to 4.5; World Bank, 2014). E-government portals and services have also been significantly enhanced in most EaP countries, with the Azerbaijan Service and Assessment Network (ASAN) being the most developed in the region.

While Dimension 4 is the area of strongest performance in EaP countries, governments still have several challenges to overcome:

- Beyond business registration, businesses are confronted with other bureaucratic procedures for starting a business, such as licencing and permitting requirements for specific economic activities, as well as inspections. Progress in these areas is relatively slower compared to business registration.
- Usage and awareness of e-government services is generally low among SMEs in the region, as suggested by the company surveys carried out by the OECD in the six EaP countries as part of the present SBA assessment.

- Data exchange between government agencies is yet to be implemented in many cases (e.g. Ukraine, Moldova, Armenia), and could be broadened in Georgia and Azerbaijan, to ensure that SMEs are not asked for the same information by multiple government agencies.
- An electronic access to the land registry is not yet operational in most countries or does not allow online registration of real estate (e.g. Belarus and Georgia). Efficient property registration is very important for SMEs, for example for using real estate as collateral.
- The "silence-is-consent" principle has not yet been adopted for business registration in some countries (e.g. Ukraine) or is not fully implemented in practice (e.g. Moldova).

EaP countries continue to reduce barriers to company registration

One-stop-shops are available across the region

All EaP countries have one-stop-shops in operation, although their effectiveness varies across the region. Georgia, Azerbaijan, Belarus and Armenia do not require entrepreneurs to visit any other state agencies as part of the registration process, whereas in Moldova and Ukraine the function of the one-stop-shop remains more limited, although important progress has been made in both countries.

One key development since the previous assessment is Georgia's Public Service Halls. These offer citizens and businesses a one-stop-shop for about 300 different administrative procedures, and are widely regarded as an international best practice (Box 4.1). In Azerbaijan, company registration procedures have been further streamlined: registering for an electronic signature (ASAN-imza) and taxpayer's ID number can be done in tax offices and the one-stop-shops run by the State Agency for Public Services and Social Innovation (ASAN Service Centres). In Moldova, a one-stop-shop mechanism started functioning in July 2014, shortening the company registration procedure from five steps and five days to just one step and one day. However, by the end of 2014, only five one-stop-shops had

Box 4.1. **Georgia's Public Service Hall**

In 2012, Georgia established the Public Service Hall, an agency combining the functions and services of the Civil Registry Agency (for documents related to marriage, birth, etc.), the National Agency of Public Registry (for registration of property, real estate, documents, etc.), the National Archives, the National Bureau of Enforcement, and the Notary Chamber. The Public Hall operates as a one-stop shop for administrative procedures, simplifying the interaction between citizens and the government.

Between 2012 and 2014, the Public Service Hall opened 14 facilities in Batumi, Rustavi, Mestia, Kutaisi, Ozurgeti, Gurjaani, Kvareli, Telavi, Marneuli, Gori, Akhaltsikhe, Zugdidi, Poti and Tbilisi. The Public Halls offer about 300 different services altogether, including obtaining an electronic identity card, registering a marriage, passport procedures, birth registration and property registration. They serve up to 18 000 individuals a day with an average waiting period of 5 minutes and average service time of 6-7 minutes.

In 2012, the Public Service Hall received the United Nations Public Service Award in the category "Improving the Delivery of Public Services".

Source: Public Service Hall official website, http://psh.gov.ge.

been created, with some still not offering multiple services in a single place. Progress has also been made in Ukraine, with the creation of 661 Centres of Administrative Services which provide 52 services, including company registration, property-related transactions and permits. However, entrepreneurs must register with the State Fiscal Service separately.

Online company registration is increasingly available

The region has also made significant progress in developing online company registration. This service is currently available in Georgia, Armenia, Azerbaijan and Belarus. In Azerbaijan, online registration became free in 2014, further easing access for entrepreneurs. Belarus also expanded its online registration system nationwide in 2014; it was previously only available for enterprises in Minsk. Moldova expects to introduce an online registration platform in 2015.

Use of silence-is-consent is progressing

The majority of the EaP countries also have legal provisions for the silence-is-consent principle, which is in force in Armenia, Belarus, Ukraine, Georgia and Moldova. However, in Ukraine and Georgia it does not yet apply to business registration. In Moldova, the principle does not appear to be implemented in practice, with SMEs typically needing to resort to judicial review in order to obtain a formal authorisation if the state authority does not take a formal decision.

Company registration certificates are easier to obtain

The above reforms have had a significant impact on performance. The number of days, administrative steps and the official cost of obtaining a company registration certificate have been reduced in all EaP countries except for Belarus (Table 4.1). Georgia continues to have the simplest procedures, with only one step and one day involved in obtaining a registration certificate. Armenia and Azerbaijan are top reformers. Armenia has removed the fee for obtaining a registration certificate and reduced the time and number of steps from five days and three steps in 2012 to two days and one step in 2015. Azerbaijan has introduced free online registration for individual entrepreneurs and reduced the time required to obtain an electronic signature for online registration.

Table 4.1. **Ease of obtaining a registration certificate in EaP countries**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Number of days to obtain company registration certificate	2 days	3 days	5 days	1 day	2 days	5 days
Number of administrative steps to obtain company registration certificate	1 step	2 steps	2 steps	1 step	1 step	2 steps
Official cost of obtaining company registration certificate	Free	Free (entrepreneurs) ~EUR 10 (firms)	~EUR 23	~EUR 40	~EUR 68	~EUR 7

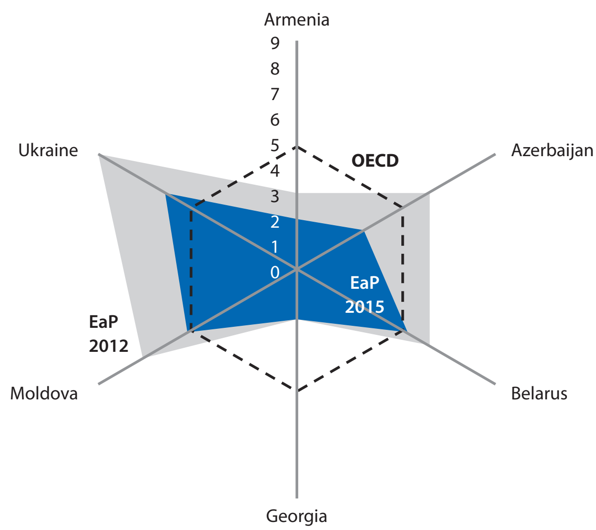
Source: World Bank (2014), *World Bank Doing Business Report 2015.*

EaP countries continue to reduce the time and cost of business registration

The performance of the entire registration process (not just obtaining a registration certificate) has also improved significantly, as measured by the World Bank's "Starting a business" indicator. This records all procedures officially required, or commonly done in practice, for an entrepreneur to start up and formally operate an industrial or commercial business, as well as the time and cost involved in completing these procedures. These procedures include obtaining all necessary licenses and permits and completing any required notifications, verifications or inscriptions for the company and employees with relevant authorities (World Bank, 2014).

Since 2012, the EaP countries have made significant progress in reducing the number of procedures, cost and time involved in starting a business, with many of the countries performing better than OECD averages. The average number of procedures involved in starting a business has been reduced from 5.5 in 2012 to 3.8 in 2015. Azerbaijan and Ukraine have made the most progress since 2012, although Ukraine is still below the OECD average (6 vs. 4.8). Armenia and Georgia have the simplest company registration procedures, involving only two steps (Figure 4.3).

Figure 4.3. **Number of procedures involved in starting a business in EaP countries, 2012-15**

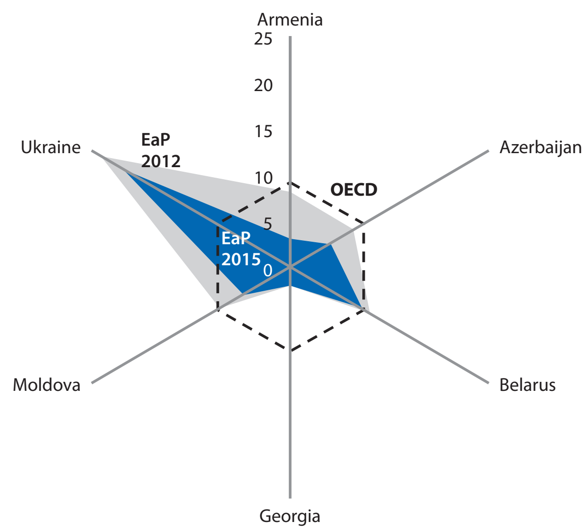


Source: World Bank (2014), *Doing Business 2015*; World Bank (2011), *Doing Business 2012.*

While the total time to start a business has also been reduced, the regional average (7.7 days) is still longer than the OECD average of 4.8 (Figure 4.4). This suggests that the efficiency of government registration systems can still be further improved in some countries. There is significant variation across the region, ranging from 2 days in Georgia to 21 in Ukraine. The strongest reformer since 2012 has been Armenia, reducing the total time from 8 days to 3 by establishing a one-stop shop merging the procedures for name reservation, business registration and obtaining a tax identification number.

With the exception of Azerbaijan, all EaP countries have reduced the cost of starting a business (Figure 4.5). In all countries except Moldova, the total costs adjusted by income per capita are lower than the OECD average of 3.4%. Ukraine has made the greatest reductions since 2012 by eliminating the fee for VAT registration. The most expensive country for starting a business is Moldova, at 4.6% of income per capita (approximately EUR 68). There is no longer a minimum capital requirement for starting a business in any EaP country, since Ukraine and Moldova have both eliminated this requirement.

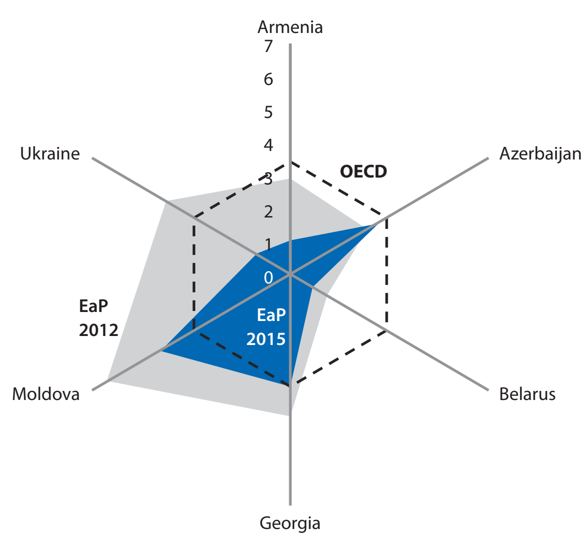
Figure 4.4. **Number of days required to start a business in EaP countries, 2012-15**



Source: World Bank (2014), *Doing Business 2015*; World Bank (2011), *Doing Business 2012*.

Figure 4.5. **Cost of starting a business in EaP countries, 2012-15**

% income per capita



Source: World Bank (2014), *Doing Business 2015*; World Bank (2011), *Doing Business 2012*.

Table 4.2. **Scores for sub-dimension 4.1: Company registration**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Implementation	5.00	4.00	5.00	5.00	3.00	4.00
Performance	4.33	4.50	4.00	4.33	3.50	3.67
Weighted average	***4.60***	***4.30***	***4.40***	***4.60***	***3.30***	***3.80***

Note: see “Policy Framework and Assessment Process” chapter for information on the methodology.

E-government infrastructure and services have been developed across the region, but awareness is low

All EaP countries have made significant progress in expanding e-government services. Key developments include the launch of Azerbaijan’s e-government portal in 2012, covering over 400 e-services, from filing of taxes to company registration (Box 4.2); and the introduction of an electronic platform for tax declaration and payments in Georgia in 2012. Today Georgia offers more than 100 different types of government service online, including

Box 4.2. **Azerbaijan’s e-government portal**

Azerbaijan’s programme “Electronic Azerbaijan”* has catalysed significant improvements in the country’s e-government infrastructure and services. In 2012, the state portal www.e-gov.az was created under the Data Processing Centre of the Ministry of Communications and High Technology. The portal provides access to 463 e-services offered by 41 state agencies, including company registration, issuing statements and certificates on real estate, declaring imported and exported goods, filing taxes (for 94 types of tax declaration) and social security. Initial registration of new property and re-registration (as a result of sale, gift, inheritance etc.) can be done online, and the real estate and the land cadastres are now being digitalised. Currently 45% of companies register online.

The portal also acts as an e-gateway to government agencies, ensuring the exchange of information. Currently 46 government agencies share their databases through the portal, including the Ministry of Internal Affairs, State Committee for Property Issues and the Social Protection Foundation.

Smart-card based electronic signature was introduced in 2011 by the Ministry of Communications and High Technologies. Close to 30 000 e-signatures were issued by the end of January 2015, mostly to public institutions, but some 5 000 went to legal entities and 7 000 to individuals (including individual entrepreneurs). Along with this, “ASAN-imza”, a SIM-card based electronic signature, has been introduced by the Ministry of Taxes. ASAN-imza uses and can be used through mobile phones for tax purposes, as well as for a range of other services on the e-government portal. It is mainly used by businesses, with 145 000 ASAN-imza certificates issued by March 2015.

Feedback on the e-government portal is collected by the Data Processing Centre of the Ministry of Communications and High Technologies through a specific section on the site. The Ministry of Economy and Industry informs entrepreneurs about its electronic services during training and other events in the capital and regions.

*Formally the “State Programme on Development of Communication and Information Technologies in Azerbaijan Republic in 2005-08”.

Source: Interview with the Ministry of Economy and Industry, plus the websites www.e-gov.az and www.mincom.gov.az/activity/information-technologies/e-government.

business registration, tax filing, customs declarations and payment. Considerable progress has also been made in Armenia, with functional e-services currently including online filing of tax returns and social security contributions, e-pension, e-procurement systems, and others. Since the previous assessment, Ukraine has also introduced a streamlined online platform for submitting tax and social contributions, and Belarus has simplified the filing requirements for corporate tax and VAT. There is currently no electronic system allowing online filing of tax returns in Moldova, although the government has ambitious plans to expand e-government services by 2020 based on the existing web portal, which provides access to 99 operational online services. All EaP countries also use e-signature, with the exception of Moldova, where it is being developed.

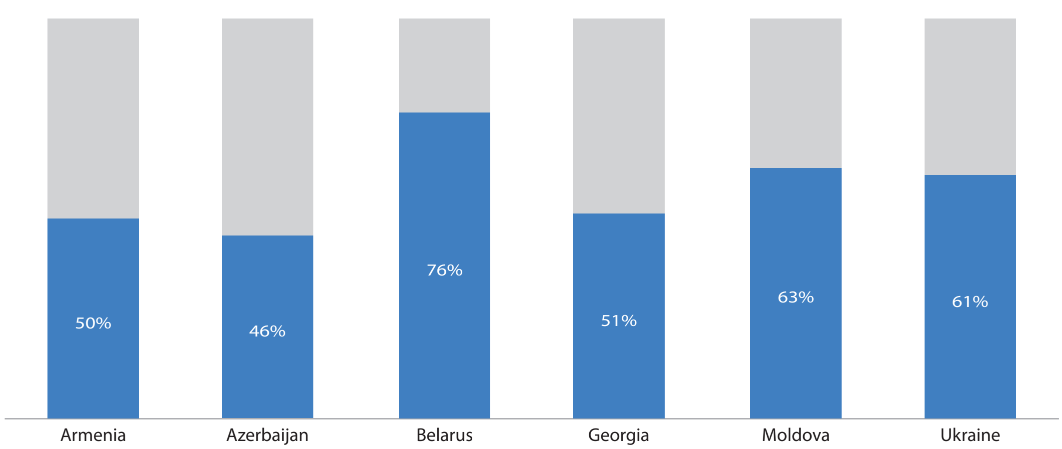
Since the 2012 assessment, e-reporting of business statistics has also been introduced in Azerbaijan (2012), Georgia (2013), Ukraine (2015) and Moldova (2015). However, in Ukraine statistics also have to be submitted separately to the State Statistical Service, while in Azerbaijan the service does not extend to individual entrepreneurs. Online statistics reporting is also limited in Belarus as it does not apply to all enterprise statistics. Currently a fully operational e-cadastre is available in Armenia, while Azerbaijan is currently piloting the digitalisation of the real estate cadastre, to be ready for complete public access by the end of 2015. Georgia and Belarus also provide online access to the cadastre, although real estate cannot be registered online. An e-cadastre is also being developed in Ukraine, although as of May 2015 only the cadastre map was accessible to the public.

The sharing of data among government agencies remains limited in most countries. Azerbaijan and Georgia are the best performers. In Azerbaijan, the databases of 46 public institutions have been integrated into the government web-portal for shared access (Box 4.2). The Georgian Data Exchange Agency also allows public institutions to share data electronically, although in practice only a few of them actually do so – GeoStat, the Revenue Service, and the National Agency of Public Registry.

Despite this progress, awareness and use of e-services remains low among SMEs in EaP countries. The 2015 OECD company surveys reported low use government websites across the EaP region (Figure 4.6).

Figure 4.6. **SMEs' use of government websites in EaP countries**

% of SMEs reporting use of government websites



Source: OECD 2015 company surveys in the six EaP countries (see Box A.3, Annex A).

Table 4.3. **Scores for sub-dimension 4.2: Interaction with government services (e-government)**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.67	4.67	5.00	4.56	4.75	4.33
Implementation	2.87	3.33	3.93	3.58	3.13	3.33
M&E	4.00	5.00	1.00	4.00	4.00	4.00
Weighted average	***3.37***	***4.13***	***3.72***	***4.01***	***3.87***	***3.82***

Note: see "Policy Framework and Assessment Process" chapter for information on the methodology.

The way forward

Despite the generally strong performance of the operational environment for SMEs across EaP countries, improvements can be made in the following areas:

- **Streamline further the company registration process** in those countries where the time and number of procedures (e.g. Belarus, Ukraine) or the cost of registering new businesses (e.g. Moldova) remain well above regional average. Regulatory requirements should be simplified in tandem with building capacity in delivering registration services. Generalising the "silence-is-consent" principle in those countries were it does not yet apply to business registration may push public authorities to achieve greater efficiency in processing applications. Finally, other administrative procedures related to starting a business, such as licencing and permitting, could be further simplified in most EaP countries.
- **Expand e-government beyond basic services** such as tax filing to include pensions, procurement, cadastre, customs and other administrative procedures. In countries where an e-cadastre is partially operational, such as Georgia and Ukraine, it could be further enhanced to allow land registration.
- **Introduce or extend online reporting of enterprise statistics, and join up the databases of public administrations** (e.g. company registration offices, tax administration, social security administration, labour authorities) to save duplicated effort by SMEs.
- **Promote SME awareness and use of e-government services**, providing training and workshops where necessary.

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Chapter 5

Support services for SMEs and start-ups and public procurement (Dimensions 5a and 5b) in Eastern partner countries

Adapt public policy tools to SME needs (Small Business Act Principle 5)

SMEs need government support to ensure they can access markets and build the skills they require to be competitive. Dimension 5 covers two specific areas. First, it evaluates government interventions to encourage the development of business support services for SMEs. Second, it assesses government efforts to adapt public procurement frameworks to make it easier for SMEs to participate on an equal footing with larger companies, giving them access to the significant opportunities available through public contracts.

EaP governments have progressively become more proactive in both areas. Support services for SMEs and start-ups are available across the region, as a combination of public and donor-funded programmes. More needs to be done, however, to match the supply and demand of business support services by adapting them to the specific requirements of each SME segment (e.g. start-ups, growth-oriented medium-sized firms, exporters), and to boost private markets for business development services (e.g. through databases of providers or targeted voucher initiatives). Progress in introducing SME-friendly policies for public procurement, such as joint bidding or e-procurement systems, is uneven across countries. Challenges include the introduction of independent review bodies to deal with potential appeals, the regulation of late payments to contractors and the use of SME-friendly criteria for awarding contracts.

Dimension 5A: Support services for SMEs and start-ups

Introduction

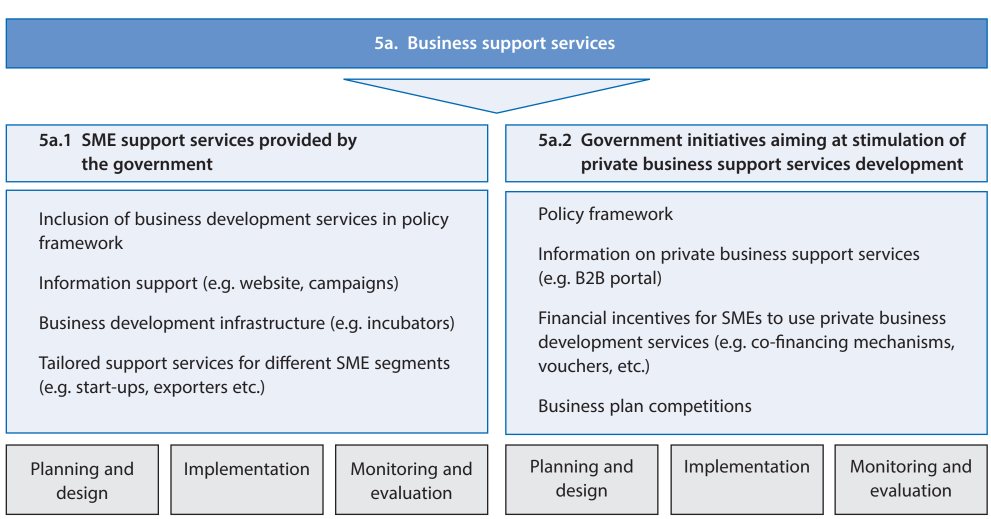
Business support services are usually defined as non-financial services that have the capacity to improve the functioning and competitiveness of companies across a wide range of activities. This includes enhancing their performance through the provision of specialist external advice and expertise on a temporary basis to supplement internal resources and capacities (OECD, 1995). Business support services allow businesses to compete more effectively, access new markets and operate more efficiently and profitably. Evidence suggests that businesses that do not draw on professional business support are more likely to fail than firms using professional advisors (Lussier and Halabi, 2010).

SMEs are often not able to develop their own internal services due to their complexity and associated costs (Auguste et al., 2006; Gebauer et al., 2010). External business development services (BDS) are therefore a solution for those SMEs that need professional guidance and training to scale up their capacities and enhance their performance. However, BDS markets generally suffer from gaps and information-related failures in both the demand and supply of BDS provision; these affect SMEs disproportionately.

On the demand side, SMEs often have limited knowledge of the availability, effectiveness and potential benefits of BDS for their competitiveness and productivity. Restrained in financial resources, SMEs also cannot invest in the external support services to the same extent as large companies. This market failure leads small firms to underinvest in these services (Carter and Jones-Evans, 2006). On the supply side, BDS providers often lack adequate and up-to-date information on SME training needs, preventing them from providing tailored and timely business support. Private BDS providers also often face significant insecurity regarding compensation as the funds of small business are quite limited.

Identifying these market failures should be the first step in designing policy frameworks for the provision of BDS to SMEs. Governments should only intervene to address the market failures, however; otherwise they risk crowding out private initiatives. Policy interventions are also required to ensure that SMEs are informed about the benefits

Figure 5.1. **Assessment framework for Dimension 5a**



and availability of support services (e.g. information campaigns, awareness raising) and, if needed, encouraged to make use of them (e.g. through co-financing mechanisms). This approach would also help to build a sustainable market for BDS providers and ensure that their services meet SMEs' needs and quality expectations.

Assessment framework

Dimension 5a is broken down into two sub-dimensions, which measure: *(a)* the availability, accessibility and effective implementation of targeted institutional support services for SMEs; and *(b)* public initiatives to promote the development of private markets for business development support (Figure 5.1).

SME support services provided by the government

The first sub-dimension assesses whether business support services are recognised in the overall SME policy framework (such as the national SME strategy or equivalent document). This is the first step in ensuring a co-ordinated and strategic approach to the provision of such services. In general, government (and donor) interventions should be carefully designed so as to avoid "crowding out" private markets, which would hinder their development, and to ensure that the support programmes are sustainable (UNIDO and OECD, 2004).

The next step is the selective provision of government-sponsored business development services to address market failures. The provision of free services should be considered carefully in order to avoid distorting the market or reinforcing SMEs' misperceptions about the intrinsic value of those services. Support services can generally be classified into information, training and consultancy, depending on the method of delivery (OECD, 2014). For example, information on starting and operating a business can be provided on a dedicated web portal, as well as directly by the relevant institutions. Services may cover different areas, from market access and infrastructure, to access to financial resources and policy advocacy. These services can be delivered through a dedicated SME agency (or equivalent, e.g. business incubator), or by outsourcing to private providers. To raise awareness among SMEs about support services and their benefits, information and outreach events can be organised. Services should be tailored to the specific needs of each SME segment (e.g. start-ups, exporting firms, high-growth SMEs). Systematic monitoring and evaluation of the services (e.g. through feedback surveys) can ensure quality control and help to tailor programmes to entrepreneurs' specific needs.

Government initiatives to stimulate private business support services

The second sub-dimension measures government mechanisms to promote the development of private markets for the provision of BDS, and to stimulate the use of private BDS by SMEs. These include both financial and non-financial incentives and instruments.

SMEs are often unaware of the availability of BDS or their providers. Governments can play an intermediary role by providing relevant information on a dedicated website (e.g. a list of private BDS providers) or through information campaigns. Likewise, governments may want to intervene to upgrade the capacity of private BDS providers to respond to the evolving needs of SMEs (OECD, 2014). Finally, governments also operate as regulators of BDS markets and may encourage their development, as well as ensure quality standards and clear regulatory frameworks in key BDS areas (e.g. accounting and legal services).

SMEs' limited financial resources, coupled with misperceptions about the value and benefits of BDS, often prevent them from contracting private consultancies. To correct for this market failure, governments might consider targeted financial incentives (e.g. co-financing mechanisms, vouchers for the purchase of private services, etc.). These instruments need to be designed carefully to avoid any market distortions and should take account of the capacity of entrepreneurs to pay. In addition to encouraging the use of BDS and the growth of those markets, these incentives may generate a peer-to-peer effect, whereby successful recipients of the incentives recommend BDS to other SMEs.

Box 5.1. **The UK's GrowthAccelerator**

GrowthAccelerator is a part of the Business Growth Service, the UK government-backed service supporting those SMEs with the potential to expand and grow. GrowthAccelerator targets functioning high-growth enterprises who want to enter their next growth phase. In particular, its Business Development programme aims to help businesses to identify barriers that are holding them back and define the critical steps that need to be taken to achieve the next phase of growth rapidly and sustainably. The programme helps SMEs to build a successful growth strategy, discover new routes to funding and investment, unlock innovation capacity, and harness the power of staff.

GrowthAccelerator is open to businesses registered in the UK and based in England that have less than 250 employees, generate less than GBP 40 million in annual turnover and meet the EU SME definition. Support is primarily focused on three core areas: *(a)* access to finance (including support for the preparation of business plans and investment pitches); *(b)* business development (e.g. support with market research and process improvements); and *(c)* innovation (including assistance with intellectual property rights). In particular, the Business Development stream is structured around the following components:

a. Identifying the growth needs of the SME:
   - reviewing business with a business growth manager and completing a diagnostic
   - identifying business barriers to growth and deciding how to overcome them and grow.

b. Applying a growth strategy guided by an expert coach:
   - defining the business growth strategy
   - meeting with expert coaches for regular one-to-one coaching.

c. Reaching growth targets:
   - attending masterclasses and workshops
   - accessing matched funding for leadership training
   - working with an expert growth coach.

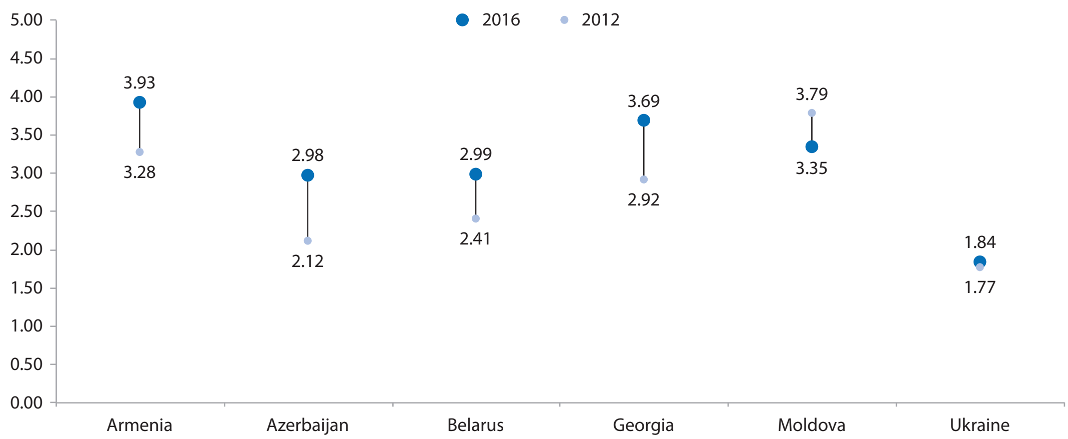
SMEs pay a one-off fee for the guidance and support offered by experts and coachers, as well as access to masterclasses and workshops. The fee depends on the size of business, and ranges between GBP 1 300 and GBP 3 700 (approximately EUR 1 800 to EUR 5 200). Senior managers of participating enterprises also have access of up to GBP 2 000 (EUR 2 800) matched funding to hone their leadership and management skills.

Source: Official website of Business Growth Service, www.ga.businessgrowthservice.greatbusiness.gov.uk.

Analysis

Overall, EaP countries have made considerable progress in Dimension 5a since the 2012 assessment, with score increases in all countries except Moldova (Figure 5.2).

Figure 5.2. **Weighted scores for Dimension 5a compared to 2012**



EaP governments have expanded the direct provision of business support services (e.g. training, consultations, workshops etc.). The top three performers in the region (Armenia, Georgia and Moldova) provide a rich palette of services to entrepreneurs through dedicated SME agencies (SME DNC, Enterprise Georgia and ODIMM, respectively). These include information, training and consulting services (e.g. management skills training, coaching, business advisory services). In Azerbaijan and Belarus, the provision of business support services is not so developed, while lack of funding for government programmes in Ukraine is a key factor in the country's low score. Provision of basic business information (e.g. starting and conducting business, existing government-run initiatives) to entrepreneurs exists in Azerbaijan and Moldova, but is less developed in the other countries.

EaP countries are starting to pay more attention to the promotion of private BDS. Co-financing mechanisms have been introduced in some countries (e.g. Georgia), while other countries are planning to provide a list of private providers online (e.g. Moldova). Donor-funded programmes (e.g. EBRD's Small Business Support programme) are active in all EaP countries and play a key role in encouraging the use of private BDS providers and building their capacity; however, their coverage is limited.

Despite this overall progress, BDS provision in the EaP region is still underdeveloped as a result of a number of challenges:

- Lack of a strategic and targeted approach. Often, government-sponsored services are launched without a proper identification of market failures or an assessment of SME needs. Similarly, training or consulting services may be designed without a defined target audience or consideration of the real requirements of the various SME segments (e.g. start-ups, high-growth enterprises, exporters etc.).
- Limited monitoring, evaluation and quality control of government programmes and private schemes in most EaP countries.
- Poor awareness amongst entrepreneurs of business support services (including existing government programmes), according to the OECD's 2015 company surveys.

- Insufficient attention to the role of government as a regulator and promoter of market-based support services. Generally, public efforts are largely concentrated on the direct provision of BDS. Support for the development of a private market is largely limited to indirect instruments, such as the contracting out of training for entrepreneurs to private providers.
- The significant reliance on donor funding for certain publicly-run business support services initiatives (e.g. in Armenia and Moldova), as well as the widespread use of free or heavily-subsidised training and consulting services.

Government-sponsored business support services require a demand-driven approach and quality control

BDS provision is increasingly seen as a pillar of SME policy

The provision of BDS has been increasingly recognised by EaP countries as a policy priority in various strategic documents (e.g. SME strategies and laws); however, actual implementation is uneven across countries.

Moldova's "Small and Medium Enterprise Sector Development Strategy for 2012-2020" defines the development of entrepreneurs' competencies and competiveness as one of its priority directions. A number of measures to strengthen SME support services are also listed in the 2012-14 action plan. In Belarus, the 2011 law on SME support provides a legal framework for BDS provision. It is complemented by state and regional programmes to provide SMEs with information and capacity-building support. Armenia, Georgia and Ukraine are in the process of drafting new SME strategies that are expected to prioritise business development (e.g. through consulting services, training etc.) as one of key pillars of SME support. In Armenia, BDS are mentioned in the "Concept of SME Development Policy and Strategy" and the SME law (both adopted in 2000), as well as SME DNC's annual programmes.

Despite these developments, in most countries these priority actions have been undertaken without a proper analysis of market failures and gaps.

Government business support programmes are widespread in the EaP region

At the implementation level, government-sponsored support programmes have been growing in the past few years, but still remain limited in size and coverage. Those countries with established SME agencies (Armenia, Georgia and Moldova) have been able to provide a relatively wide range of BDS programmes.

Georgia is one of the countries making the most progress in this sub-dimension, thanks to the activity of the newly created Enterprise Georgia and Georgia Innovation and Technology Agency (GITA), both of which have launched a series of BDS programmes for SMEs, often also involving financial support. The more conventional services provided by Enterprise Georgia include entrepreneurial learning, management, business planning and marketing, exporting, while GITA's services are targeted to innovative SMEs (e.g. training in intellectual property rights and project management).

The SME DNC in Armenia (Box 5.2) and ODIMM in Moldova have accumulated substantial experience in providing entrepreneurs with a variety of capacity-building services, including business information and consulting and training support. Many BDS are offered free of charge. Both agencies have well-established connections with donors and manage donor-funded BDS programmes.

Public provision of business development services is less developed in Azerbaijan and Belarus. Since 2011, business support infrastructure has grown in Belarus (e.g. business support centres and incubators), but a lack of co-ordination, monitoring and evaluation makes it difficult to assess their effectiveness. In Azerbaijan, the Baku Business Training Centre remains a key player in this field and has substantially expanded its activities since 2012. The centre is fully funded from the state budget and operates in seven regions. Finally, Ukraine's provision of business support services is limited to scattered regional and local initiatives (e.g. entrepreneurship training, information support for the unemployed, etc.) due to a lack of funding at the national level. Lack of resources has also led to the closure of a number of incubators across the country. The Ukrainian Government plans to soon open 15 regional business support centres across the country within the framework of the EU Support to Ukraine to Re-launch the Economy project (EU SURE); this will be a good step forward.

In general terms, formal monitoring and evaluation systems of business support measures are non-existent or ad hoc. This can potentially jeopardise their effectiveness. Further, there is a need to distinguish between different types of enterprises to design targeted programmes accordingly. For example, in Moldova, most existing programmes do not adequately differentiate between the various segments of the SME sector (e.g. start-up versus high-growth SMEs).

Box 5.2. **Business support services provided by Armenia's SME DNC**

Established in 2002, Armenia's SME Development National Centre (SME DNC) has accumulated substantial experience in the provision of information, training and consulting services to SMEs. Activities are defined in annual state programmes prepared jointly with the Ministry of Economy, and set out targets and budget allocations. SME DNC operates through 10 regional offices. In 2014 alone, support was provided to about 6 200 SMEs, 95% of which were located in the regions. SME DNC is primarily funded by the state, although it also co-ordinates a number of donor-funded programmes. Its support services include:

- A start-up business support programme operated in co-operation with the United Nations Development Programme (UNDP), which provides full-cycle support to local SMEs, including a two-month training course, consultations on developing business ideas, drafting feasible business plans, and support for implementation and financing.
- USAID's Partnership for Rural Prosperity Program in Armenia. Launched in 2013, its objective is to empower rural communities and SMEs in the regions through the development of local clusters in various sectors, such as cheese and dried fruit production.
- A training support programme covering a variety of topics. In 2013, for instance, topics included tax legislation, financial education for micro and small enterprises, accountancy for start-ups, and women's entrepreneurship.
- Business networking activities, including matchmaking events (to establish partnerships between Armenian and EU-based SMEs) organised by the Enterprise Europe Network, which SME DNC joined in 2008.
- Information services, such as business guides and reference books distributed by SME DNC's local branches. Topics covered include licensing, innovation, intellectual property rights, standardisation, accounting, etc.

Source: SME DNC website, http://smednc.am/.

Access to business-related information is growing

In most EaP countries, efforts have been made to increase SMEs' access to business-related information. For instance, Georgia has published a comprehensive guide on how to start a business on the Ministry of Economy webpage. Moldova has launched a web portal that provides information on financing opportunities for firms (e.g. grants, concessional loans, leasing, etc.). Despite this, Moldova's ODIMM web portal on BDS for SMEs has not been kept up to date since its launch in 2012, which illustrates the importance of ensuring sustained implementation of new initiatives. Azerbaijan's Ministry of Economy and Industry has launched several information websites, although these initiatives require a more co-ordinated approach (e.g. a single web portal with links to the different resources).

Table 5.1. **Scores for sub-dimension 5a.1: SME support services provided by the government**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	4.40	3.20	4.20	3.80	4.20	3.00
Implementation	4.06	4.43	3.39	3.82	3.16	2.61
M&E	3.40	4.20	1.80	3.40	4.20	1.00
Weighted average	***4.05***	***3.96***	***3.36***	***3.73***	***3.73***	***2.43***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

EaP governments initiatives to stimulate private BDS development remain limited

Government support services are often provided free of charge in EaP countries, and are heavily reliant on state budget or donor support. Although these services bring value to SMEs, they might also distort market competition and inhibit the development of private BDS markets by potentially discouraging entrepreneurs from paying for services.

This might partially explain why private business support services are not widely used in EaP countries. According to the latest Business Environment and Enterprise Performance Survey (BEEPS V), in all countries but Belarus, less than 10% of surveyed SMEs reported having hired an external consultant in the past three years (EBRD, 2014). An additional potential reason for the low use of consulting services could be the lack of awareness of BDS benefits, as more than 70% of SMEs indicated that they had no need of external help (EBRD, 2014). Another reason could be a lack of financial resources, mentioned as the second biggest obstacle to the use of BDS.

This suggests that to stimulate the use of private BDS, governments should adopt a strategic approach to awareness raising and encouraging SMEs to seek external support. A few initiatives already exist in the region. For instance, Moldova's ODIMM is currently developing a comprehensive list of BDS providers that will be available on their website. Financial incentives are less frequent. In Georgia, a co-financing mechanism implemented by Enterprise Georgia in the framework of the Produce in Georgia programme covers part of the costs of participating SMEs that contract private consultants.

Donor programmes have tried to fill the financing gap. A good example is EBRD's Small Business Support programme, which operates in all EaP countries. The programme provides co-financing for SMEs to retain local and international consultants, as well as capacity building for consultants in EBRD's countries of operation. While the number of participating SMEs is limited (e.g. 94 in Ukraine in 2014), the programme has strong demonstration effects and has acquired a solid track record as well as in-depth knowledge of domestic BDS markets. Recognising this, the Georgian government entered into a Memorandum of Understanding with EBRD to allow beneficiaries of its Produce in Georgia programme to benefit from technical assistance from EBRD's Small Business Support programme.

Nevertheless, private BDS markets remain widely underdeveloped in EaP countries. In most countries, the market is populated by large consulting companies that work mostly with larger, more profitable clients and who demand less diverse services than SMEs. As a result, business services for SMEs are often limited to public support schemes and donor-funded programmes.

Table 5.2. **Scores for sub-dimension 5a.2: Government initiatives aiming at stimulation of private business support services development**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	2.67	1.67	2.33	4.33	4.00	1.00
Implementation	4.71	2.71	3.57	3.57	2.86	1.57
M&E	3.80	1.00	1.00	2.60	1.40	1.00
Weighted average	***3.81***	***2.00***	***2.62***	***3.64***	***2.97***	***1.26***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

The way forward

Going forward, to achieve a more systematic approach to the provision of BDS, the following priorities should be considered across EaP countries:

- **Enhance the existing policy frameworks and ensure a match between BDS supply and demand.** The first step in designing support measures tailored to SMEs' demands and needs should be to identify market failures (by using surveys and evaluations of existing services). Support measures outlined in the relevant policy frameworks should also take account of the various segments (e.g. start-ups, growth-oriented medium-sized firms, exporters) of the SME population and sector-specific needs. Public agencies should therefore be selective and only provide the services as a short-term measure where market failures have been identified. Free services should be balanced against the significant risk of crowding-out private providers. Finally, while donor support should be leveraged to implement relevant programmes, their design should ensure they can be sustained when donor support ends (e.g. by requesting beneficiary fees and increasing government funding).
- **Monitor and evaluate the effectiveness of support schemes and mechanisms regularly.** The introduction of comprehensive monitoring and evaluation mechanisms is required to ensure that the quality and content of services provided meet SMEs' demands and expectations, as well as to evaluate the efficiency of existing support schemes. Incubators are a good case in point: while they are quite popular across the region, their effectiveness cannot be evaluated without performance data. Quality control should be emphasised and, where appropriate, capacity-building programmes for BDS providers should be considered.
- **Enhance the availability of information on existing BDS (public and private) and basic information about starting and conducting business.** Policies should bridge the information gap amongst SMEs on the value and potential benefits of

BDS. Dedicated communication and outreach campaigns should be developed both physically (e.g. through business information centres, regional authorities etc.) and online (e.g. websites, databases of BDS providers). A dedicated website with relevant information on starting and conducting a business could be a first step.

- **Encourage the development of a sustainable market of private BDS providers.** EaP countries need to introduce mechanisms to promote the development of private BDS markets. Governments should try to move away from being direct providers of BDS (e.g. through SME agencies, state-funded incubators, subsidised training etc.) to becoming regulators and promoters of private services. Direct provision may still be justified to correct market failures or on a temporary basis to stimulate supply and demand of business services beyond the period of initial public assistance. Private BDS markets can be promoted through information campaigns (including business-to-business web portals) and financial incentives (e.g. voucher schemes, matching grants). These initiatives should take into account the willingness and capacity of entrepreneurs to pay for services, while avoiding distorting market dynamics.

Table 5.3. **Dimension 5a: Challenges and policy instruments**

Challenges	Policy instruments
Lack of co-ordinated and systematic approach to the provision of business support services	Make business support services one of key priorities of SME strategy or equivalent
	Supplement the strategy with an action plan and measurable targets on the provision and stimulation of BDS (e.g. number of beneficiaries, outcomes etc.)
	Introduce comprehensive monitoring frameworks and independent evaluation of support programmes
	Develop quality standards (e.g. quality certification systems) and control systems
Information gaps	Provide SMEs with business-related information (e.g. starting and conducting business, laws and regulation, internationalisation opportunities etc.) on a dedicated web portal
	Organise awareness-raising and information campaigns, particularly focusing on regions
Poor match between supply and demand of BDS services	Systematically conduct feedback surveys and interviews with programme beneficiaries
	Conduct market analysis (e.g. company surveys) to identify support needs
	Tailor the provision of BDS to different segments of SMEs (e.g. start-ups, high growth, exporters etc.)
Underdeveloped market of private BDS contractors	Inform SMEs about the existing private BDS providers through a dedicated website and/or information sessions
	Introduce targeted financial incentives (e.g. co-financing mechanisms, vouchers, matching grants) to encourage use of BDS providers

Dimension 5B: Public procurement

Introduction

Public procurement is an area where SMEs face particular difficulties: rules are often complex and procedures lengthy, and the efforts needed for participating in a tendering procedure seem too great in view of the uncertain outcome. While this is a matter of concern for all companies, SMEs are particularly affected. They often lack the resources and know-how to deal with burdensome administrative requirements and cannot afford spending money and time on a potentially fruitless exercise. As a result, SMEs often shy away from bidding in a call for tenders. Given the large share of public procurement in overall public expenditure, this means that they are missing important opportunities for boosting their growth. Increasing the participation rate of SMEs in public procurement will in turn increase competition and lower prices for public purchasers. SMEs are also often particularly innovative and may offer solutions larger companies cannot provide.

Even where SMEs are prepared to tender, they are often prevented from doing so by unfavourable conditions. In many cases, the size of the contract is simply too large for a small company to implement, even though SMEs can offer good value for money. In other cases, SMEs are excluded by overly rigorous qualification or financial requirements given the nature and size of the purchases in question. Finally, even when SMEs manage to win a contract and implement it successfully, late payment – a widespread problem in the public sector – can be particularly harmful.

These obstacles are, however, not insuperable. A few relatively simple legislative changes can greatly improve the situation for SMEs if they are supported by an SME-friendly mind-set. For example, in many cases goods, services or works do not need to be procured through very large contracts; instead a number of smaller contracts will suffice. Lawmakers can legislate that the default situation should be to divide contracts into smaller lots. This puts the burden of proof on the contracting authorities to make a good case for deviating from that rule. Likewise, it would be reasonable and proportionate in most cases to limit the financial ability of tenderers to what is strictly necessary and to allow tenderers to submit joint bids. It would also significantly reduce the administrative burden if supporting documents were not required during the tendering procedure. SMEs can benefit from electronic procurement, as this makes information more readily available at a lower cost and also facilitates the submission of bids. A first, albeit insufficient, step to avoid late payments to contractors is to adopt a law setting strict deadlines and penalties for late payments by the public sector. At the same time, a culture of prompt payment can only be established if countries can ensure that these laws are actually enforced and effective remedies are available that discourage the occurrence of late payments.

Assessment framework

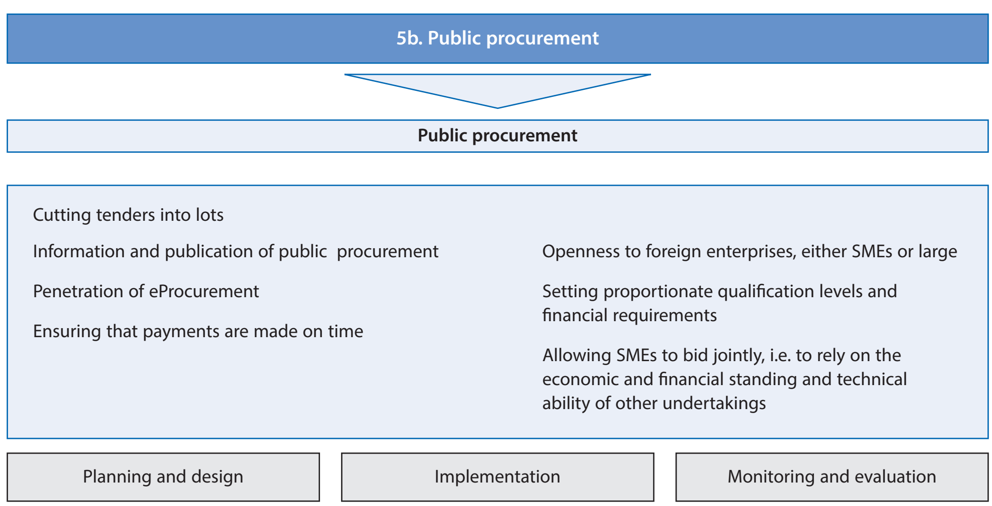
Dimension 5b analyses the policies and tools in place in EaP countries to allow SMEs better access to public procurement markets, including:

- the extent to which public authorities use tools to take account of the small size of firms bidding in tenders and to provide them with equal opportunities, such as allowing tenders to be cut into lots, allowing SMEs to bid jointly, and setting proportionate qualification levels and financial requirements

- whether information on public procurement is centralised and free of charge for all participants, and whether there is training and a helpdesk available to help interested firms
- the existence and implementation of electronic procurement, starting with the provision of information on procurement online right through to the electronic submission of tenders
- whether legislation is in place that imposes strict deadlines for payments by public authorities and penalties for non-compliance
- whether public procurement is open to foreign enterprises, both SMEs and large enterprises, to ensure a fair level of competition.

To assess these policies, the dimension focuses on three thematic blocks covering policy design, implementation and monitoring and evaluation (Figure 5.3).

Figure 5.3. **Assessment framework for Dimension 5b**

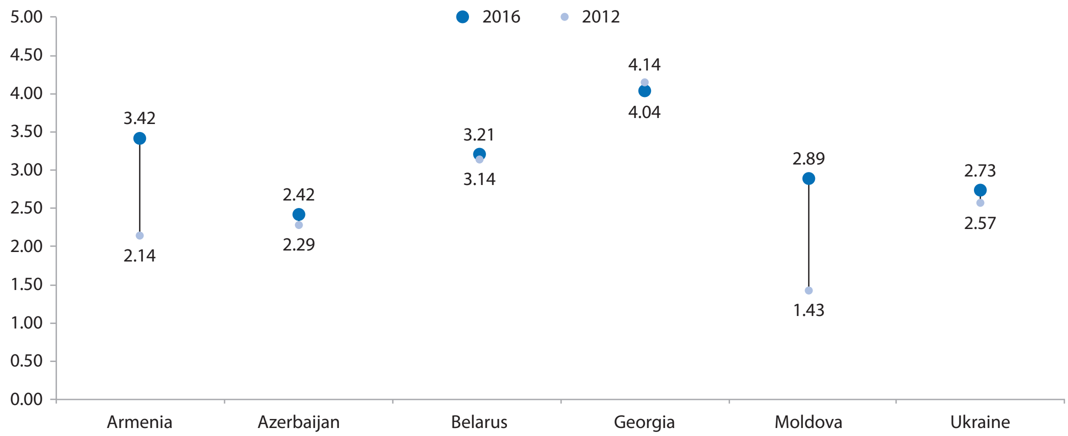


Analysis

Overall, this dimension has seen modest progress since the 2012 assessment; only two countries (Armenia and Moldova) have been able to significantly improve their performance (Figure 5.4). All EaP countries have legislation that allows for cutting large contracts into lots; this seems to happen in practice, although it is unclear to what extent. None of the EaP countries obliges contracting authorities to cut all tenders above a certain value into lots. Information on public procurement opportunities is generally openly available and centralised (but see Box 5.3), but is not always in electronic format or free of charge. Contracting authorities allow companies to bid jointly in Azerbaijan, Armenia, Georgia and Moldova, but this is not yet on the cards in Belarus and Ukraine.

One of the main developments has been the greater use of electronic tools in public procurement. E-procurement has fully replaced the former paper-based system in Georgia (Box 5.4), and all other countries have made legislative changes to prepare for the further development of electronic procurement systems, albeit to varying degrees.

Figure 5.4. **Weighted scores for Dimension 5b compared to 2012**



Several countries have opened up their public procurement markets further, increasing business opportunities for SMEs across the region and beyond. Georgia, Moldova and Ukraine have concluded Association Agreements (including DCFTAs) with the EU, which will grant market access to companies from these countries to the EU Member States (and vice versa) following a process of legislative approximation and institutional reform. Moldova and Ukraine have made good progress towards accession to the World Trade Organisation's Government Procurement Agreement (GPA) and both countries are expected to become members during 2016. Armenia has been a party to the GPA since 2011.

There has been a certain increase in training activities for procurement specialists in contracting authorities, notably in Armenia, and for SMEs. This will help to further professionalise public procurement and build the required expertise.

Armenia and Moldova have made the biggest leap forward (Figure 5.4). Armenia has significantly improved transparency and competition in public tendering by considerably

Box 5.3. **What are SMEs' views on public procurement in EaP countries?**

The six company surveys carried out in the EaP countries as part of this SBA assessment revealed that the majority of companies in three EaP countries (Armenia, Belarus and Ukraine) feel that information on public procurement opportunities is not readily available. Companies rated the availability of information highest in Georgia (62%) and lowest in Ukraine (28%).

In Armenia and Moldova, more than half of surveyed enterprises (55% and 56% respectively) would consider or have considered taking part in a public tender, while a slight majority responded negatively to this question in Belarus (57%), Georgia (53%) and Ukraine (53%).

In five countries (Armenia, Belarus, Georgia, Moldova and Ukraine), the requirement for financial guarantees ranks amongst the top three factors preventing an enterprise from taking part in a public tender. This is followed by the high administrative burden (Belarus, Georgia, Moldova and Ukraine) and difficulties in finding partners abroad (Armenia and Moldova). Difficulties in obtaining information on public tenders was mentioned as the top preventing factor (Armenia), as well as the high qualification levels and required certifications (Belarus), the costs of preparing a proposal (Georgia) and corruption (Ukraine).

Source: 2015 OECD company surveys in the six EaP countries, see Box A.3 in Annex A.

reducing the use of non-competitive simplified procurement procedures and increasing the share of open tenders. Moldova has opened its public procurement market further to international participation by concluding an Association Agreement with the EU in June 2014 and completing negotiations on GPA membership in 2015. Both agreements reflect international standards and best practice and have triggered a number of reforms in the Moldovan public procurement system.

Box 5.4. **Efficiency and transparency in Georgia's e-procurement system**

In Georgia, all procurement information is now openly available in electronic form. This has helped raise the number of tenders significantly, limit corruption risks and cut participation fees by four.

Bidders are able to submit complaints electronically and they are reviewed within ten working days by the Dispute Resolution Board. The procedure for submitting a complaint is simple, and is published on the official procurement website, which allows for public scrutiny of the process. The transparent and efficient nature of Georgia's system has been recognised by the United Nations, which awarded it the UN Public Service Award (UNPSA) in 2012 in the category "Preventing and Combating Corruption". The reduced administrative burden and costs and the increase in transparency brought by e-procurement are particularly beneficial for SMEs. Other EaP countries could follow the Georgian example.

However, the e-procurement system has still some shortcomings which should be improved. Notably, price is the only award criteria, which does not allow for ensuring best value for money. Any e-procurement system in line with international (WTO Government Procurement Agreement) or European (EU Public Procurement Directives) rules will have to take this into account and develop technical solutions allowing for the use of non-price related award criteria to select the most economically advantageous tender. The "most economically advantageous tender" (MEAT) principle implies that contracting authorities may apply criteria in addition to – or other than – price, such as quality, delivery time, and after-sales services, in order to identify the tender that offers best value for money.

Source: Official website of UN Public Administration Programme, www.unpan.org/unpsa, www.worldbank.org/en/news/feature/2015/02/18/georgia-an-e-procurement-success; official website of State Procurement Agency of Georgia, https://tenders.procurement.gov.ge/login.php?lang=en.

There are still a number of challenges to overcome (Tables 5.4 and 5.5). Armenia, Azerbaijan, Belarus and Moldova still need to establish an impartial review body that is independent from the parties to the procurement procedures and functionally independent from the government (especially the institution making public procurement policy). Late payments are a problem across all EaP countries – only Armenia has adopted legislation regulating late payments to contractors. The lowest price remains by far the main or even the only (in the case of Georgia) criterion used for the award of contracts, which poses problems for those SMEs which are particularly competitive on quality. The use of proportionate qualification levels and financing requirements for SMEs is not legally ensured in most countries.

Table 5.4. **Scores for Dimension 5b: Public procurement**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.95	2.14	2.43	2.90	1.86	1.86
Implementation	4.08	3.27	3.60	4.50	3.94	3.00
M&E	1.00	1.00	3.67	5.00	2.33	3.67
Weighted average	***3.42***	***2.42***	***3.21***	***4.04***	***2.89***	***2.73***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

The way forward

Going forward, countries in the EaP region are encouraged to:

- **Align their legislation with EU rules and international best practice.** They should in particular allow for joint bidding and limit the minimum annual turnover requirement for economic operators to be eligible to twice the contract value, except for duly justified cases.
- **Encourage the division of contracts into lots wherever possible.** The division of contracts should become the rule. Supporting documents should only be required from the winning tender, while self-declarations provided through electronic tools during the procedure should be sufficient.
- **Establish an impartial and independent review body** where it does not exist.
- **Increase the use of non-price criteria for the contract award** to encourage good quality solutions.
- **Tackle the problem of late payments to contractors** by adopting and enforcing provisions containing strict deadlines and penalties in case of late payments.

The actions outlined in Table 5.5 would greatly benefit the SME community, making it easier for smaller companies, which are often excluded, to participate in public procurement. Reduced bureaucracy, easier access to public tenders, more quality-oriented public purchasers and impartial oversight will be particularly helpful for SMEs.

Table 5.5. **Dimension 5b: Challenges and policy instruments**

Challenges	Policy instruments
Disproportionate financial requirements	Limit the minimum annual turnover required for participation to twice the contract value except in duly justified cases. Allow joint bidding.
Large size of contracts	Make the division of contracts into lots the rule. Contracting authorities wishing to maintain a large contract should be obliged to state the reasons ("apply or explain" principle).
High administrative burden	Legislate that supporting documents should only be required from the winning tender, and that self-declarations during the procedure are sufficient. Develop e-procurement further.
Late payments to contractors	Adopt and enforce strict deadlines for public payment and penalties in case of late payments.

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Chapter 6

Access to finance for SMEs (Dimension 6) in Eastern partner countries

Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions (Small Business Act Principle 6)

Access to finance remains a key challenge for SMEs in the Eastern partner (EaP) region. It is cited by companies in most countries in the Business Environment and Enterprise Performance Survey (BEEPS V) as among the top three most severe obstacles to doing business. This chapter focuses on government policies to encourage SME lending and assesses the availability of finance instruments, in line with Principle 6 of the Small Business Act for Europe. Bank lending remains the main source of finance for SMEs across the region, although the global financial and economic crisis has seen lending generally tighten. Alternative sources of financing, such as leasing, factoring and venture capital, remain limited, while micro-financing is the most common non-bank option in many countries. Some progress has been made to strengthen the legislative and regulatory framework for SME lending. Availability, coverage and accessibility of credit information have generally improved, however challenges remain in enforcing creditors' rights. Generally, financial literacy remains low and initiatives to raise skills in financial management are limited. Across the region, governments could strengthen their activities to encourage bank lending to SMEs and improve their legal and regulatory frameworks to realise the potential offered by the currently underdeveloped non-banking financial sector.

Introduction

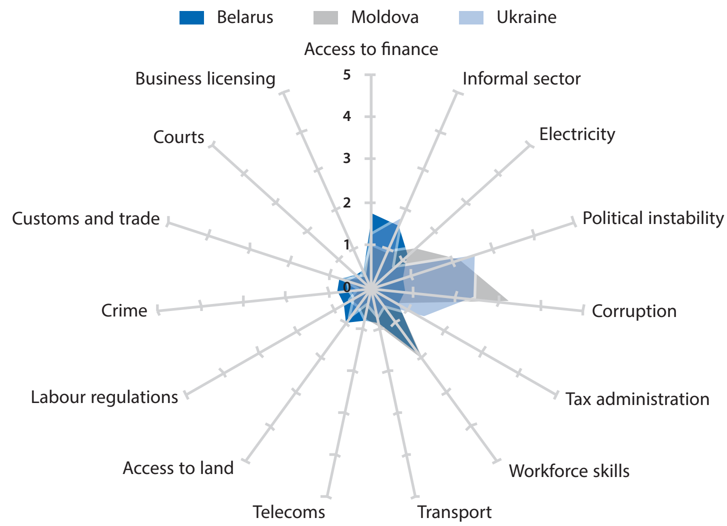
External financing is an important resource for allowing companies to run their business, modernise their equipment or expand their operations. Overall, these investments help enterprises to improve their competitiveness and to grow. However, SMEs in particular tend to be more credit constrained, often due to their higher risk profile. In the Eastern partner (EaP) countries especially, SME access to financing is a major problem, and cited as a key obstacle to doing business (EBRD, 2014). For many enterprises, high interest rates and collateral requirements make accessing a bank loan prohibitive. These inaccessible loan terms often reflect perceived risks by lenders about the SMEs' ability to repay. In some countries this problem is exacerbated by an insufficiently developed legal framework for secured creditors, making the enforcement of collateral difficult in case of default, and therefore further increasing the cost of lending.

Governments can play an important role by creating a legal environment that reduces uncertainty and by establishing schemes to support SME access to finance. A well-functioning cadastre as well as a system to register security interests over movable assets facilitates taking collateral, while a legal framework that allows creditors to enforce this collateral in an efficient way helps to stimulate bank lending. In addition to establishing an adequate legal and regulatory framework for secured transactions, government policies can help mitigate lending risks through various channels. For example, credit guarantees can help increase banks' risk appetite and alleviate collateral constraints for SMEs. Information asymmetries between creditor and borrower can be decreased by establishing comprehensive and reliable credit information systems. In addition, helping SMEs build their business planning and financial management skills makes them more attractive clients for financial service providers. As well as bank financing, governments can also facilitate the development of alternative financing industries – such as micro-finance, leasing and factoring – by creating adequate legal frameworks and supervisory mechanisms, and by helping to raise awareness of the range of financing options available to SMEs.

For support schemes to be effective and sustainable, they need to be carefully designed. Rather than distorting the market, they should support the private sector in the provision of financial services. Otherwise, they risk crowding out the private sector and making businesses dependent on continued state support for accessing finance. This puts most of the burden on the public budget instead of leveraging private funding sources. In addition, any support programme should be monitored and evaluated to make sure that it reaches those parts of the business population that are in need of support. Such evaluations are necessary to trigger a calibration of target groups, instruments or delivery processes when needed.

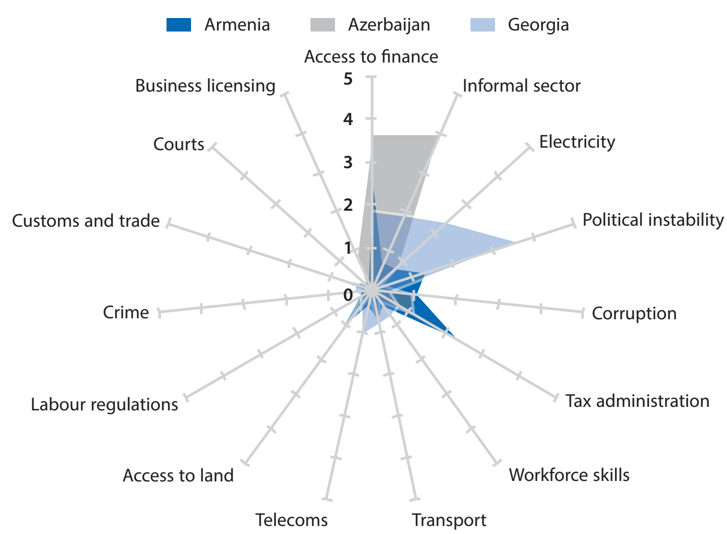
Despite improvements across almost the entire region, access to finance remains one of the key challenges for businesses operating in the EaP countries (Figures 6.1 and 6.2). It is perceived as the most or second most important obstacle to doing business by companies in Armenia, Azerbaijan and Belarus.

Figure 6.1. **Perceived obstacles to businesses in Belarus, Moldova and Ukraine (BEEPS V)**



Source: EBRD (2014), Business Environment and Enterprise Performance Survey, BEEPS V (2011-2014), dataset available at http://ebrd-beeps.com accessed July 2015.

Figure 6.2. **Perceived obstacles to businesses in Armenia, Azerbaijan and Georgia (BEEPS V)**



Source: EBRD (2014), *Business Environment and Enterprise Performance Survey, BEEPS V (2011-2014)*, European Bank for Reconstruction and Development, dataset available at http://ebrd-beeps.com, accessed July 2015.

Assessment framework

Given the pivotal role of legal and regulatory frameworks in facilitating access to finance for SMEs, the assessment framework for Dimension 6 focuses first and foremost on these aspects (Sub-dimension 6.1 in Figure 6.1). Sub-dimensions 6.2, 6.3 and 6.4 assess the regulation and availability of various forms of financing for SMEs. Finally, Sub-dimension 6.5 measures governments' efforts to evaluate and promote financial literacy among businesses and the wider population.

However, it should be noted that access to finance, as illustrated by BEEPS V, is also influenced by the complex interaction of various others areas, such as the general macroeconomic environment, the health of the banking sector, and levels of competition among banks. These cannot all be captured by the assessment framework for Dimension 6, which focuses on a specific set of themes and indicators that are deemed to be particularly important for SMEs. As a result, the scores may not always reflect all the difficulties faced by SMEs and larger corporates alike when seeking finance.

Since 2012, the assessment framework for Dimension 6 has changed slightly:

- bank financing has been added as a sub-dimension, as it represents the most common form of financing for SMEs and is an important source of external funding
- venture capital financing is now assessed as a separate sub-dimension
- factoring and savings and loan associations (SLAs) have been added as external financing sources
- the weighting has been adapted to reflect the addition of new sub-dimensions and themes, but continues to reflect the importance of the legal framework in supporting lending activities.

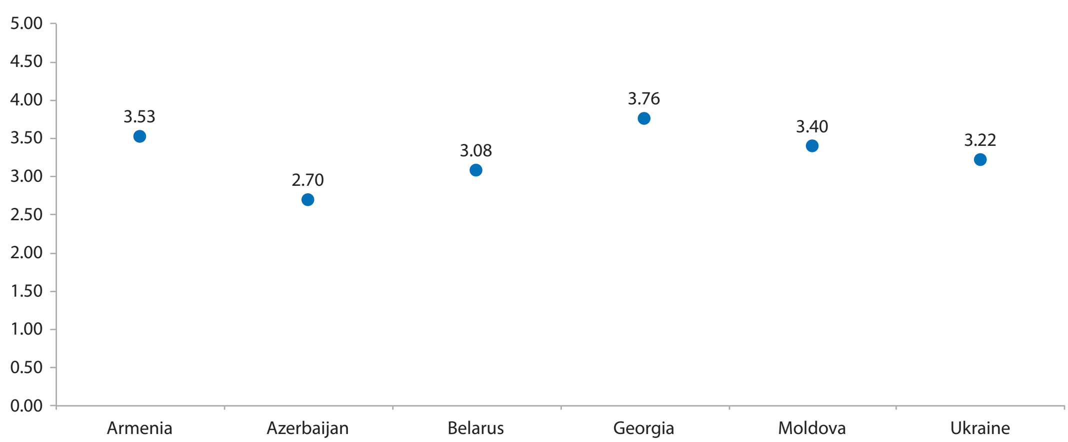
Figure 6.3. **Assessment framework for Dimension 6**

6. Access to finance for SMEs		
6.1 Legal and regulatory framework	• Creditor rights • Register • Credit information bureau	• Banking regulations • Stock market
6.2 Bank financing	• Lending practices • Credit guarantee scheme	
6.3 Non-bank financing	• Microfinance • SLAs	• Leasing • Factoring
6.4 Venture capital	• Legal framework	• Implementation • Monitoring and evaluation
6.5 Financial literacy	• Planning, design and implementation	• Monitoring and evaluation

Analysis

Even though the methodological changes described above mean that the 2012 scores are not directly comparable with the 2016 scores, improvements in SME access to finance can be observed across all countries to varying extents (Figure 6.4). While many countries already had a functioning secured transactions framework in place in 2012, some have introduced further improvements, for example by improving credit information systems (e.g. Armenia, Ukraine) or strengthening the legal framework for taking collateral (e.g. Georgia). However, the effective enforcement of securities could be further improved in many countries by significantly shortening the process time and by appointing specially trained judges to reduce incoherence in court decisions. In addition, movable assets are still rarely used as collateral, with banks showing a strong preference for immovable assets. The acceptance of movables as collateral could be supported by creating unified and easily accessible online registers for security interests over such assets; these are still largely lacking.

Figure 6.4. **Weighted scores for Dimension 6**



Note: Due to changes in the methodology, 2012 and 2016 scores are not directly comparable.

While domestic credit to the private sector as a share of GDP has increased in Armenia, Azerbaijan, Georgia and Moldova (Table 6.2), there is room for improving access to bank financing. Expensive interest rates and high collateral requirements pose a problem for SMEs in particular. Most countries try to counter such issues with support programmes, some of which have been expanded since 2012 (e.g. Moldova), or newly introduced (e.g. Azerbaijan and Georgia).

Non-bank financing options, offering an alternative to bank credit, are not very well developed in most countries. Leasing and factoring services are particularly underdeveloped, and further constrained by the lack of a specific legal framework. Most countries offer training in financial literacy, but co-ordination of providers could be improved in certain cases (e.g. Moldova) and a focus on business needs and skills introduced in others (e.g. Belarus). While most countries have conducted some form of financial literacy assessment of the population, training programmes are not generally assessed or evaluated.

Improvements to the legal and regulatory framework are uneven across countries

Given the macroeconomic challenges faced by the EaP region, business environments and public policies that facilitate SME access to finance are as important as ever. Increased numbers of non-performing loans, which tend to be higher for SMEs than larger businesses, point to a deterioration in banks' balance sheets and further undermine banks' willingness and capacity to lend, with a disproportionate impact on SMEs (Table 6.1). A legal and regulatory framework that enables the collection and distribution of credit information on borrowers and ensures the ability of banks to take security and enforce it effectively can play an important role in increasing banks' appetite to lend. For example, comprehensive, well-functioning credit information reporting systems, supportive legal provisions for secured transactions and functioning registries for security interests can play an important role in decreasing lending risks. Creditor rights, banking regulations, as well as registration and information systems are all important ingredients of a legal and regulatory framework that stimulates, rather than impedes, lending to SMEs.

Overall, there has been some progress in improving parts of the legal and regulatory framework across the region. Credit information systems have been extended, even though in some countries coverage remains relatively low (e.g. Azerbaijan and Moldova). There have also been improvements in the registration of collateral and related pledges, even though online availability remains a challenge, in particular for movable assets.

The legal framework for creditor rights has generally improved but enforcement remains an issue

Secured transaction frameworks that give creditors the right to enforce claims against their debtors make it easier for creditors to collect debts, increase the probability of repayments and reduce the cost of debt. This is likely to encourage bank lending to SMEs. Compared to 2012, the legal framework for secured transactions has improved in some countries, even though positive developments are most noticeable in those countries with already relatively robust frameworks. Armenia, Georgia and Moldova have laws in place to ensure collateral recovery in case of default, and these laws have been tested and improved since 2012. Insolvency procedures generally do not envisage limitations on automatic stay in case of re-organisation, which inhibits the seizing of collateral in such cases. Legal frameworks on secured transactions require further strengthening to fully ensure the necessary rights for secured creditors, as well as their enforcement, which can still be lengthy and costly. Azerbaijan has been working towards a secured transactions legal framework for many years, but the reform is not yet complete.

Land cadastres are coming on line

An official register or cadastre of the quantity, value and ownership of land and real estate is important for using land as collateral. A fully functioning cadastre should allow easy access, preferably online, to a country's land and real estate information (value, tenure, ownership). Armenia, Georgia and Moldova have taken important steps to improve usability, with fully functioning, online cadastres in place. Azerbaijan is in the process of digitising its cadastre, and information on property and land covering the whole country is scheduled to be available online by the end of 2015. With international donor support some progress has been made in improving geographical coverage and online availability of cadastres in Belarus and Ukraine, but neither is fully comprehensive at this point.

Registries facilitating the use of movable assets are being developed but online availability lags behind

Registries for security interests over moveable assets can facilitate the use of assets other than real estate as collateral. When centralised and unified, these registries also serve to control the use of the same collateral for multiple loan applications. Centralised and unified systems for registering pledges over movable assets are in place in both Georgia and Moldova, even though online availability of services could be further improved, in particular in Moldova. In Armenia, efforts have been made to establish a unified, online system and corresponding legislation is expected to enter into force in October 2015. In Azerbaijan and Belarus some progress has been made in creating functional registries, but significant efforts are still needed to complete these processes in a way that will enable the use of movable collateral effectively and thus ease access to finance for SMEs.

Credit information coverage is increasing

Public registries or private credit information bureaus provide information on the credit status of borrowers. The former are usually managed by the central bank, mainly for supervisory purposes, while the latter are often established by financial institutions. In order to facilitate access to finance, the information provided by such entities should be complete and reliable, as well as widely and easily accessible. Across the region, coverage of private credit information bureaus has increased since the 2012 assessment, particularly in Armenia, Georgia and Ukraine. Armenia and Georgia remain the only two countries in the region with both public and private credit information bureaus in place. Going forward, it will be important to ensure accuracy and protection of collected data; this can be achieved by further strengthening the legal and regulatory framework.

Banking regulations are aligning with international standards, although unevenly

The consistent implementation of banking regulations across all credit institutions is an important safeguard against instability in the banking system which could lead to dried up liquidity, thus constraining access to finance further. In this context, it is important to note that central banks in the region recognise the importance of complying with Basel Core Principles. While most countries in the region have implemented some recommendations from Basel II and are either preparing or in the process of implementing certain Basel III standards, they have done so to differing extents and with varying levels of success. Foreign currency exposures, for example, remain an important source of risk across the region.

Capital market regulation and activity remain underdeveloped

Capital markets across the region are underdeveloped. In all countries, stock markets exist but are in many cases virtually non-functional due to extremely low levels of market capitalisation and turnover. While Georgia had a relatively vibrant stock exchange pre-2008, attracting foreign and institutional investors, geo-political and economic crises have since dried up activity. Nevertheless, its development potential remains among the highest in the region. Given the low level of development of both stock and bond markets, the development of separate stock market segments or bond pricing benchmarks for SMEs still seems very distant.

Table 6.1. **Scores for sub-dimension 6.1: Legal and regulatory framework**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Creditor rights	4.15	2.95	2.91	4.64	4.52	3.85
Register	4.50	2.83	3.00	4.90	4.60	3.49
Credit information bureau	4.54	4.05	4.53	4.42	3.78	4.31
Banking regulations	3.50	2.00	3.50	4.00	2.00	3.50
Stock market	3.01	2.89	2.97	3.06	2.53	3.00
Weighted average	***4.08***	***3.05***	***3.41***	***4.34***	***3.73***	***3.70***

Source: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Bank financing levels remain relatively low

Bank lending is the main source of external funding for SMEs in the EaP countries, as for many companies across the world. Even so, bank lending in the region remains low with domestic credit to the private sector accounting for between 24% of GDP in Belarus and 60% in Ukraine (Tables 6.2 and 6.3). This share has increased since the last SBA assessment, but a majority of small businesses – between 66% and 80% – still relies on internally generated cash to finance investments (EBRD, 2014). Such a high share is problematic as it may mean that firms needing loans cannot access external financing, either because they are being rejected, or because they are discouraged by prohibitive loan terms. According to BEEPS V results, between 35% and 76% of those companies saying they needed a loan report credit constraints, with a large majority being discouraged from even applying (EBRD, 2014; Figures 6.5 and 6.6).

Table 6.2. **Banking sector indicators**

	Private sector credit, as % of GDP		Credit constrained firms, as % of firms needing a loan		Non-performing loans, as % of total gross loans	
	2011	2014	2008	2012	2011	2014
Armenia	35.4	52.3	34.7	38.1	3.4	7.0
Azerbaijan	17.3	30.7	78.3	75.5	6.0	12.7
Belarus	39.2	24.5	33.7	41.3	4.2	4.4
Georgia	32.7	45.2	36.2	35.0	4.5	3.6
Moldova	35.9	37.2	41.2	52.5	10.7	12.3
Ukraine	71.1	60.6	50.5	75.7	14.7	19.0

Source: World Bank (2015), *World Development Indicators 2015*; EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset available at http://ebrd-beeps.com (accessed July 2015).

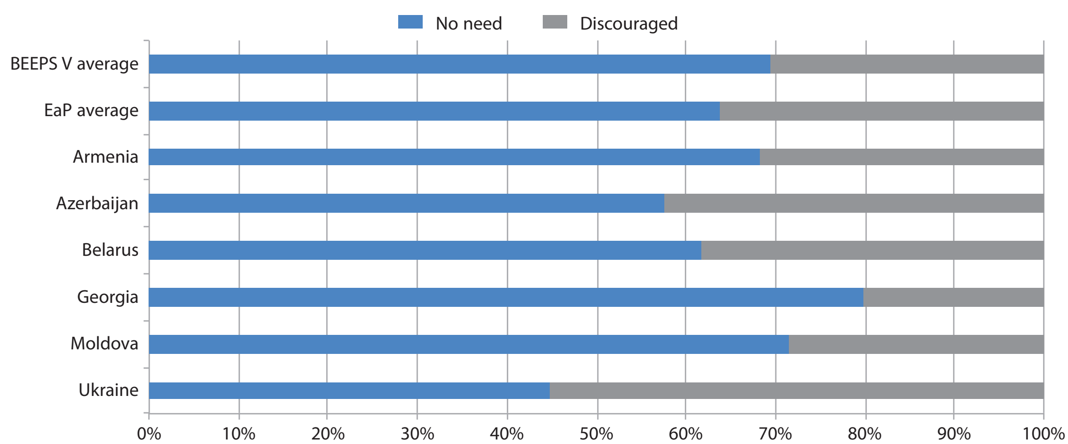
Table 6.3. **Scores for sub-dimension 6.2: Bank financing**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Banking statistics	2.82	2.12	3.53	4.04	2.70	2.32
Credit guarantee schemes	2.56	1.00	1.00	2.11	2.63	1.67
Weighted average	***2.71***	***1.67***	***2.52***	***3.27***	***2.67***	***2.06***

Source: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

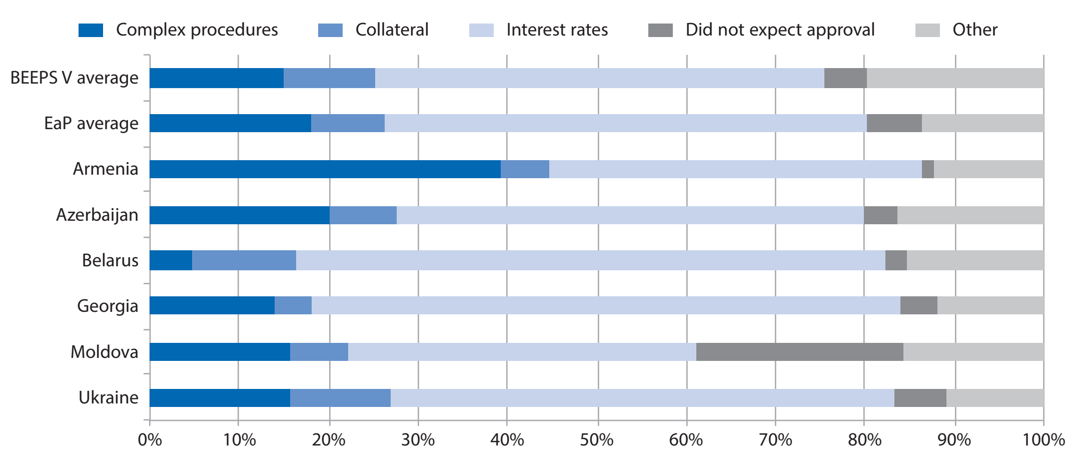
Across the region, high interest rates and collateral requirements that significantly surpass the loan value represent a significant obstacle for SMEs in accessing finance (Figure 6.5). Well-designed support schemes can help alleviate these constraints, but should involve private sector participation where possible. They should also be as closely aligned with commercial principles as possible in order to limit market distortions. Following best practice examples can help set up these schemes, but in light of countries' differing challenges, it is crucial to monitor and evaluate the success of these schemes in order to ensure that they help those companies that are truly constrained. Even though some form of support exists in all countries, independent monitoring and evaluation is either non-existent, or not done in a systematic way, failing to feed back into policy design.

Figure 6.5. **Share of discouraged firms in all firms not applying for a loan**



Source: EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset available at http://ebrd-beeps.com (accessed July 2015).

Figure 6.6. **Reasons discouraged firms do not apply for a loan**



Source: EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset available at http://ebrd-beeps.com (accessed July 2015).

Credit guarantee schemes exist but governance and monitoring could be improved

Credit guarantee schemes can help SMEs overcome credit constraints. They can integrate small businesses into the formal lending market by reducing bank's lending risk, and in some cases they can alleviate capital requirement constraints. Credit guarantees as part of SME support programmes exist in almost all countries except for Azerbaijan, where the main channel of support is interest rate subsidies provided by the National Fund for Entrepreneurship Support. The credit guarantee schemes in the region tend to work in close collaboration with local banks, but private sector participation in their governance and efficiency in the provision of services could be improved in many cases. Armenia has a credit guarantee scheme run by a business support agency (the SME DNC), as does Moldova (run by ODIMM), which also has a dedicated private guarantee scheme run by banks (GarantInvest). In Belarus and Georgia general support programmes have been in place since 2012 providing credit guarantees alongside interest rate subsidies. Georgia's scheme, Produce in Georgia, is closely linked with private sector provision of services and support is time bound. Conversely, the programme in Belarus, provided through the Belarusian Fund of State Support of Entrepreneurs (BFSSE), relies heavily on state funding. While in Ukraine credit guarantees have been available for some time for specific purposes (e.g. import-export, energy efficiency), the establishment of a general credit guarantee scheme with private sector participation is currently under consideration.

One good practice example comes from Estonia, where the government has set up KredEx, a self-sustainable financing institution offering loan guarantees to business (Box 6.1). A key factor in KredEx's success, and one which applies more widely to any type of policy for SME access to finance, has been the consistent monitoring and evaluation of efforts to ensure adequate impact and outreach.

Box 6.1. **KredEx: a credit guarantee scheme in Estonia**

In 2001, the government of Estonia set up KredEx, a self-sustainable financing institution offering loans, loan guarantees and related financial products to help businesses access the finance they need to invest and grow. In 2014 alone, KredEx provided guarantees amounting to EUR 68 million, reflecting a year-on-year increase of 30%, thus helping 393 additional companies to access finance (KredEx, 2014)

KredEx provides guarantees for up to 75% of financing products offered by partner banks and leasing companies, with a contract fee of 1% of the guaranteed amount and minimum guarantee fees of 0.4%-1.7%, depending on the financial product. A key success factor for KredEx has been good co-operation with its partner banks, currently over a dozen, through efforts and initiatives to maintain positive relations with credit officers, such as regular personal meetings, seminars and an open information policy. Counterparties at KredEx are perceived by their partners as being competent and co-operative. The institution is governed by a council and a board with some private sector participation.

KredEx has taken measures to lower loan transaction costs for small businesses through efficient decision-making processes, thus speeding up loan procedures. This has had a particularly positive impact on micro-sized enterprises and start-ups, which benefited from 71.3% of KredEx guarantees in 2013. From the beginning, KredEx devoted significant funds to marketing, primarily through regional information events, in order to increase public awareness of its products. The result was significant take-up (EC, 2006). Providing guarantees for a broad range of financing purposes is also likely to have contributed to the popularity of its services.

KredEx monitors both its efforts in maintaining effective relationships with its partners and its impact on clients through surveys (EC, 2006). Such monitoring is extremely valuable for evaluating performance and adjusting policies and programmes as necessary.

Source: KredEx (2014), *Annual Report*; EC (2006), "Guarantees and mutual guarantees", *Best report,* No. 3.

Non-bank financing offers largely untapped potential

With relatively high collateral requirements and interest rates, many SMEs are unable to meet banks' lending requirements and therefore cannot obtain the financing they need to invest and grow their businesses. Non-bank sources of financing can play an important role in complementing bank financing and offering alternatives to SMEs. Leasing, for example, can help SMEs modernise equipment while enabling them to overcome collateral constraints that they face with banks. Micro-finance institutions, too, can play an important role in offering financial products and services outside of traditional bank financing, tailored to the needs to SMEs. Moreover, factoring services can provide SMEs with working capital financing without imposing additional liabilities on borrowers' balance sheets. However, such alternatives to bank financing require comprehensive legal frameworks and generally remain underdeveloped across the region (Table 6.4).

Table 6.4. **Scores for sub-dimension 6.3: Non-bank financing**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Microfinance	3.33	4.67	3.67	4.67	4.33	3.00
SLAs	3.00	4.33	1.00	5.00	5.00	3.67
Leasing	2.50	2.00	3.42	2.83	2.42	3.50
Factoring	2.33	2.33	3.67	2.33	2.33	4.00
Weighted average	***2.79***	***3.33***	***2.94***	***3.71***	***3.52***	***3.54***

Source: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Micro-finance institutions are a key source of non-bank financing, but often rely on donor support

Micro-finance institutions offer the main alternative to bank financing in the region; in most EaP countries the number of micro-finance institutions has increased since the last SBA assessment, particularly in Azerbaijan and Moldova. Despite their wide presence, however, micro-finance institutions in Armenia, Georgia and Ukraine lack capital and continue to rely mainly on international donor support. Following a recent decree in Belarus, micro-finance activities there must now be registered with the National Bank of the Republic of Belarus, which has temporarily limited their availability, even though it should be noted that the primary source of funding for SMEs is banks. Going forward, it will be important to strengthen the regulatory framework for micro-finance more generally across the region, to expand the range of products tailored to the needs of SMEs.

Leasing would be better supported by sound legislation

A leasing sector that is both profitable and sustainable requires a fully functioning legal framework and adequate regulation. Clearly defined rights of lessors and lessees under bankruptcy, for example, are particularly important. In most countries, it is more common for companies to lease vehicles than equipment. The small market size with only limited opportunities to re-sell or re-use seized assets can curb the development potential of such services. Compared to its regional peers, the Ukrainian leasing sector is well-developed, supported by the size of its market. However, since 2014 activities have been hit by severe economic challenges. In Armenia, a specific law was drafted at the time of the last SBA assessment to establish a clear legal framework for leasing activities. However, it has not been adopted. In Belarus, increased legal obligations on disclosures have improved transparency and quality of leasing since 2012. In Azerbaijan, Georgia and Moldova, leasing activities are gradually being developed but are not enough to providinge real alternatives for SMEs.

Factoring is an area of high potential

SME uptake of factoring services remains low across the region, offering significant development opportunities. Even though factoring services are on offer in Armenia, Azerbaijan, Belarus and Ukraine, as indicated by the high score in the assessment (Table 6.4), there is much room for stimulating their greater use. Factoring is also available in Moldova and Georgia; however, uptake among SMEs is lower than in other EaP countries and not supported by a specific legal framework. Limited use across the region is partly due to the lack of clear definitions and specific legal provisions, the absence of which increase the legal uncertainty surrounding the provision of factoring services.

Venture capital initiatives are underway

Given the high levels of risk associated with untested business models and an absence of sufficient credit histories, bank financing is often not an option for innovative start-ups and fast-growing businesses, despite their high potential for growth. These companies stand to gain from a well-functioning venture capital ecosystem. Yet venture capital activities, like private equity in general, tend to be relatively sparse across the region. This can be explained by the lack of specific legal provisions, limited investment and exit opportunities, and low public support for venture capital. However, several governments have started to translate their growing awareness of venture capital into action and overall venture capital activity in the region has grown since the last SBA assessment. Many activities are focused on the IT sector, such as Granatus Ventures, a venture fund launched in Armenia in 2012; and Azerbaijan's State Fund for IT Development. Going forward, it will be important to evaluate the success of these activities to better understand potential obstacles to investment. At the same time, stronger legal frameworks are required to create an enabling environment for venture capital activities.

Table 6.5. **Scores for sub-dimension 6.4: Venture capital**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Legal framework	3.11	1.33	2.78	2.33	1.33	1.45
Design and implementation	2.20	1.53	2.29	1.54	1.86	1.49
M&E	1.00	1.00	1.00	1.00	1.00	1.00
Weighted average	***2.28***	***1.36***	***2.20***	***1.71***	***1.50***	***1.38***

Source: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Financial literacy efforts need an increased focus on business skills

Financial literacy is recognised as a key priority by most EaP countries. Measures have been taken to provide the skills required to set up and run an SME, including online information portals and dedicated training programmes (Table 6.6). However, across the region, the primary drawback of such initiatives is the widespread lack of central co-ordination, oversight and evaluation of these efforts. Increased attention to these fields would make the various government financial literacy efforts more transparent and visible to entrepreneurs, significantly increasing their appeal and effectiveness.

Table 6.6. **Scores for sub-dimension 6.5: Financial literacy**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Design and implementation	2.71	2.40	2.33	1.00	4.05	3.86
M&E	3.67	3.67	3.67	1.00	3.67	1.00
Weighted average	***2.90***	***2.65***	***2.60***	***1.00***	***3.97***	***3.29***

Source: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

The way forward

Bank lending, and in particular high interest rates and collateral requirements, remains an issue across the region. This is despite broad improvements in legal frameworks and more selective development in the areas of banking and non-banking finance as well as financial literacy. Governments should consider focusing their efforts on the following:

- **Facilitate the development of a healthy banking sector**. This encompasses the development of sustainable funding bases for banks in both foreign and local currency. Ensuring adequate levels of competition would help encourage banks to offer more competitive rates and reach out to new segments.
- In the short to medium term, **promote policies that make funding more accessible for SMEs**. Such policies, however, should be designed with a view to minimising market distortions in order not to undermine the sustainability of the banking sector. Thus, non-targeted and heavily subsidised interest rates should be avoided. Instead, government-funded credit guarantee schemes can provide viable alternatives and have a proven track record in successfully promoting access to more and better credit for SMEs.
- **Ensure that support programmes are being monitored and evaluated** in order to create a feedback loop for better policy making. Currently, such mechanisms are mostly lacking across the region.
- **Improve enforcement of creditor rights.** While legal frameworks for secured transactions have continuously improved across most of the region, enforcement remains a challenge. This is often due to lengthy procedures and high uncertainty regarding outcomes, which increases cost and reduces recovery rates. Shortening the processing time for claims and appointing specially trained judges can go a long way towards increasing efficiency.
- **Step up efforts to create unified, accurate and easily accessible online registers for security interests over movable assets**. This should increase banks' acceptance of a broader range of assets and thus help SMEs with limited collateral options to access finance.
- **Develop non-bank financing instruments as viable alternatives to bank financing**. Ensuring an efficient repossession process in the event of default is of particular importance for leasing activities. For factoring, of the various types of contracts and services available globally, reverse factoring models have proven effective in helping SMEs access finance by using the credit history and standing of larger, more established corporates. It appears, however, that in the EaP countries a number of legal and regulatory impediments to factoring remain. The adequate treatment of recourse factoring in case of insolvency of the assignor, and clear and unambiguous rules for assigning future receivables to facilitate long-term factoring relationships, are two ways in which governments can facilitate factoring services for SMEs.

Table 6.7. **Dimension 6: Challenges and policy instruments**

Challenges	Policy instruments
High interest rates and collateral requirements	Consider establishing a credit guarantee scheme with private sector involvement Ensure effective implementation by introducing rigorous evaluation mechanisms for credit guarantee schemes or other types of government support
Low levels of acceptance of movable assets as collateral	Introduce legal provisions to allow for the use of a broad range of movable assets as collateral Establish a unified and comprehensive register for pledges over movable assets Increase accessibility of the registers by making them available online Ensure reliability of information with regular and timely updates
Poorly developed array of non-banking financial instruments	Introduce specific legal provisions governing leasing and factoring contracts For leasing, ensure efficient repossession process in cases of default For factoring, increase efficiency and decrease legal uncertainty, e.g. by ensuring adequate treatment of recourse factoring in case of insolvency of the assignor, or establishing clear and unambiguous rules for assigning future receivables to facilitate long-term factoring relationships

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Chapter 7

Standards and technical regulations (Dimension 7) in Eastern partner countries

Help SMEs to benefit more from the opportunities offered by the single market (Small Business Act Principle 7)

Technical barriers to trade can severely distort trade by preventing market access, protecting domestic producers and discriminating between domestic and foreign producers. Technical barriers to trade thus represent one of the most important obstacles to the liberalisation of trade between the EU and EaP countries. Dimension 7 analyses government efforts to eliminate technical barriers to trade in the area of industrial products.

All EaP countries have undertaken an approximation process with international and European rules in the area of technical regulations and standards. Georgia, Moldova and Ukraine have made strongest progress in adopting EU standards, with a consequent improvement of scores, having signed an Association Agreement including a Deep and Comprehensive Free Trade Area with the EU in June 2014. These countries should continue upgrading their technical regulations in line with their strategies in this area and their commitments under the relevant agreements. Key priorities for the rest of the region include strengthening the overall strategic framework, including monitoring and evaluation, and continuing to enhance their quality infrastructure.

Introduction

Technical regulations set out essential requirements for products before they are placed on the market. These requirements usually serve legitimate public policy objectives – e.g. protection of health and safety, or the environment. Voluntary standards contain detailed technical solutions for meeting the essential requirements. At the same time, these technical standards and regulations can have an important influence on trade, especially if they vary from country to country, or are costly and burdensome. Bringing the legislation of EaP countries in line with the international and European framework for technical regulations and standards offers substantial trade benefits (e.g. simpler conformity assessment procedures, shorter time to market and lower total costs of trading). This is especially important for SMEs, who will find it difficult to comply with different sets of rules in order to place their products on the EU market.

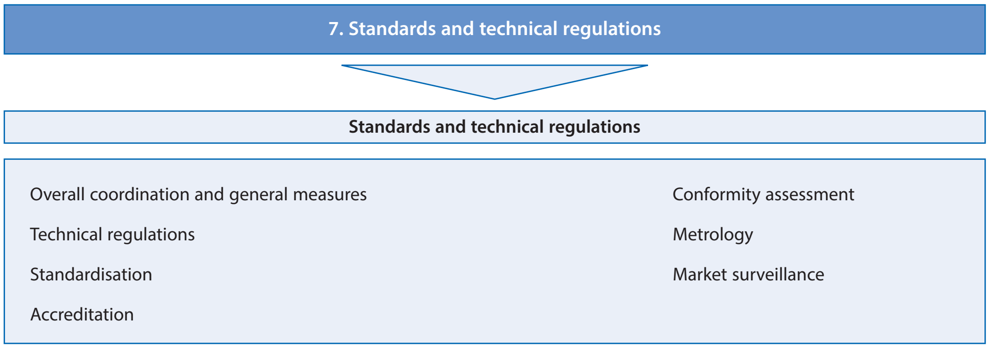
This chapter explores the steps being taken by EaP countries to improve their framework for technical regulations and standards. This includes efforts to enhance the overall quality infrastructure for product regulations (accreditation, standardisation, conformity assessment, legal metrology and market surveillance) and their alignment with those of the EU and other international best practice. Of particular importance is the need for special measures aimed at enhancing SMEs' participation in exports, such as ensuring that information is easy to find and understandable. Of equal importance is the need for adequate administrative capacity to correctly and efficiently implement the legislation and ensure that only safe and compliant products reach final consumers. Finally, regular monitoring and evaluation of technical regulations and standards policies and legislation will ensure they are adjusted to the changing needs of businesses and consumers.

Assessment framework

Dimension 7 analyses the policies and legislation in EaP countries in the field of technical regulations and standards to allow SMEs to gain better access to the EU Single Market. The dimension is divided into 7 sub-dimensions, which assess (Figure 7.1):

- **Overall co-ordination and general measures**: the scope of general policies and tools for facilitating SME access to the EU Single Market, including a strategy or action plan for adopting technical regulations and the provision (e.g. on a designated website) of information tailored to the needs of SMEs on product requirements for exports to the EU.
- **Technical regulations**: the level of alignment with EU technical regulations, as well as the capacity of institutions for efficient implementation, plus their transparency, monitoring and evaluation.
- **Standardisation**: presence of an independent standardisation body with active participation by SMEs.
- **Accreditation**: of laboratories and certification/notified bodies.
- **Conformity assessment**: risk-based inspection systems, testing, and certification of products, personnel, and quality management.
- **Metrology**: including the calibration of measurement systems and testing equipment.
- **Market surveillance**: the degree to which measures and supervision practices are compatible with those of the EU.

Figure 7.1. **Assessment framework for Dimension 7**



These represent the "building blocks" of a comprehensive system of technical regulations. Each of the sub-dimensions also assesses the existence of regular monitoring and evaluation of the measures. The aim should be to determine to what extent the legislation achieves the public policy objectives, to allow for adjustments to the changing needs of industry, while at the same time providing a high level of protection for legitimate public interest.

Analysis

All the EaP countries have begun an approximation process with international and European rules in the area of technical regulations and standards. However, the EaP region is quite heterogeneous; Azerbaijan and Belarus are still acceding to the World Trade Organisation (WTO), while in 2014 Georgia, Moldova and Ukraine signed an Association Agreement, including a Deep and Comprehensive Free Trade Area (AA/DCFTA), with the EU. These agreements oblige signatories to align their horizontal infrastructure and sectoral legislation with that of the EU, thus giving these countries an additional impetus. Belarus and Armenia are part of the Eurasian Economic Union (EEU), which has its own technical regulations. Nevertheless, both countries are making efforts to align with the EU and international rules. Armenia upgraded its quality infrastructure and aligned some sectors with EU rules while it was negotiating an Association Agreement with the EU; however the negotiations were subsequently abandoned in favour of joining the EEU.

Figure 7.2. **Weighted scores for Dimension 7 compared to 2012**

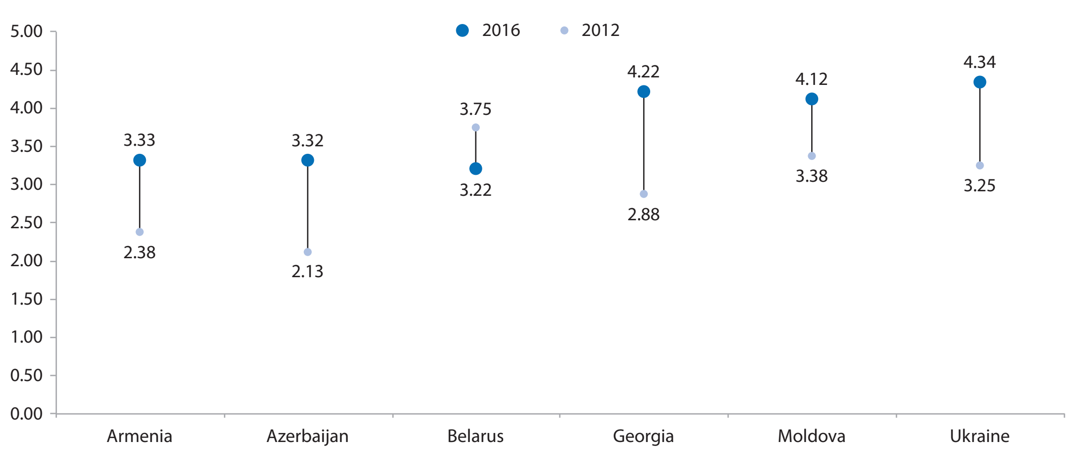


Table 7.1. **Scores for Dimension 7: Standards and technical regulations**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Overall co-ordination and general measures	3.67	2.11	1.00	4.33	3.00	3.89
Technical regulations	4.73	1.67	3.40	4.20	4.47	4.80
Standardisation	3.57	3.52	3.14	4.43	4.43	4.29
Accreditation	2.97	3.56	3.88	3.96	4.20	4.20
Conformity assessment	2.67	3.83	3.75	4.50	4.67	4.67
Metrology	2.33	4.56	4.33	4.33	3.44	4.33
Market surveillance	3.33	4.00	3.00	3.78	4.67	4.22
Weighted average	***3.33***	***3.32***	***3.22***	***4.22***	***4.12***	***4.34***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Progress on overall co-ordination and general measures is variable

While Armenia, Georgia, Moldova and Ukraine have adopted or are in the process of adopting some form of overall strategy or action plan for legislation in the field of technical regulations, this is not the case for Azerbaijan and Belarus. Furthermore, all EaP countries provide SMEs with only limited information on product requirements for complying with EU requirements.

Technical regulations are being upgraded across the board

The assessment shows that those EaP countries with an AA/DCFTA (Georgia, Moldova and Ukraine – see Box 7.1), and Armenia, have to a large extent aligned their technical regulations with those of the EU in priority sectors (e.g. low voltage products, machinery, pressure equipment etc.). Belarus and Azerbaijan are transforming their technical regulations into modern rules following international best practice. All countries provide online information on the latest technical regulations, although it is not targeted at SMEs. However, not all the countries have equally recognised the importance of adequate administrative capacity (i.e. enough qualified staff) to implement product legislation efficiently, and monitoring and evaluation is a specific problem for Azerbaijan and Belarus.

Standardisation is progressing slowly

Standards are shaped through a consensus among enterprises, public authorities, consumers and trade unions obtained through a consultation process organised by independent, recognised European standardisation bodies at the national and European level. All EaP countries have established standardisation bodies which are affiliate members of European[1] and international standards organisations.[2] The EaP standardisation bodies are being transformed to comply with EU requirements (e.g. transparency, openness, impartiality, consensus, efficiency and relevance). The level of adoption of European standards in national standards varies from country to country, with Ukraine, Moldova and Georgia making most progress. However, the process of adoption is rather slow and could be accelerated. Similarly, all countries except Azerbaijan and Belarus have measures in place for enhancing SME participation in the standardisation process.

Box 7.1. **Ukraine's standards and technical regulations reforms**

The Association Agreement including a DCFTA between Ukraine and the EU was signed in June 2014. The Agreement requires Ukraine to align its systems governing the manufacturing and circulation of industrial products with those of the EU. This will mean developing and adopting horizontal legislation and technical regulations that are harmonised with the EU legislation; adopting EU harmonised standards; and establishing institutional quality infrastructure in accordance with European practice.

In preparing for the Association Agreement, Ukraine had already undertaken key changes to its legal framework in order to align its horizontal legislation with that of the EU, including adopting laws on:

- technical regulations and conformity assessment, which eliminated duplication and inconsistencies in the current legal framework and created the legal basis for the adoption of technical regulations based on the relevant EU directives
- standardisation, to simplify and optimise procedures for the development and harmonisation of standards
- metrology and metrological activity, providing the foundation for creating an effective and transparent metrology system to test products for compliance with basic safety requirements.
- general product safety for non-food products, market surveillance and liability for defective products.

In addition to adopting horizontal legislation, Ukraine has also made progress in developing and adopting 27 technical regulations listed in the section of the Association Agreement on technical barriers to trade. However, while most of these technical regulations have been formally adopted in Ukraine, and some of them are already in force, actual compliance with the respective EU Directives is still rather low. The authorities recognise this problem, and a revision process is ongoing.

Furthermore, Ukraine has abolished mandatory certification in a number of product categories recognised as low risk, and created an infrastructure of 98 conformity assessment bodies to verify compliance of products with technical regulations and issue certificates (in the case of voluntary certification).

Source: Interview with Ukraine Ministry of Economic Development and Trade

Progress in accreditation frameworks is uneven

Accreditation supports conformity assessment bodies in both voluntary and mandatory areas. All EaP countries have an established accreditation body; however only those in Belarus, Georgia, Moldova and Ukraine are affiliate members of the European Co-operation for Accreditation (EA). The EA develops, harmonises and builds consistency in accreditation with countries outside the EU Single Market in order to reduce barriers to trade and to contribute to protecting health and safety. The EA embraces and supports the development of accreditation bodies in these countries and their understanding of EA practices. EA Full Members participate in EA Multilateral Agreements (EA MLAs) to recognise and accept equivalence of the accreditation systems operated by signing members (and also the reliability of the conformity assessment results). A bilateral agreement is an agreement between an EA Associate Member and the EA and has the same purpose as the EA MLA. However, only Ukraine has signed a bilateral agreement with the EA.

Conformity assessment information needs to be better targeted at SMEs

The purpose of a conformity assessment is to determine that products conform to the provisions of the relevant legislation, in particular with respect to health and safety. Most EaP countries have legislation on conformity assessment, as well as established conformity assessment bodies. However, they lack SME targeted information on necessary conformity assessment procedures. Also, monitoring and evaluation of legislation could be further developed.

Metrology systems are well advanced

Harmonising legal metrology procedures ensures that the certification of measuring devices is compatible globally. This then facilitates trade in measuring devices and the products relying on them.

All EaP countries, except Armenia whose legislation is currently being developed, have adopted metrology legislation in line with international and European principles. Their metrology institutions are members of the relevant international metrology organisations and they are strengthening their administrative capacity (e.g. training of staff and hiring new staff where necessary). According to the assessment, the field of metrology appears to be rather well developed.

Market surveillance is present but needs to be more consistently implemented

Market surveillance is essential for protecting consumers from the risks of non-compliant products, and for protecting responsible businesses from unfair competition through deceitful economic operators who ignore the rules or cut corners. Moldova has a well-developed system of market surveillance. Georgia and Ukraine have adopted legislation, but need to do more to implement it efficiently and build institutional and administrative capacity. Armenia, Azerbaijan and Belarus also have legislation on market surveillance in place, but now need strategies and/or action plans to ensure coherent and consistent implementation.

The way forward

The assessment reveals substantive progress in the area of technical barriers to trade. Continued efforts are needed, however, especially to:

- **Strengthen institutional and administrative capacities** to implement the new quality infrastructure framework. Specific product legislation would benefit SMEs by providing them with a predictable legal environment and streamlined procedures for placing their products on the market.
- **Accelerate the transposition of international and European standards**.
- **Develop more SME-tailored information** on the regulatory changes and requirements in the areas of technical barriers to trade, conformity assessment procedures, and the opportunities of the EU single market.
- **Implement regular monitoring and evaluation** to ensure that the development of quality infrastructure takes into consideration the specific needs of SMEs. Evaluations should therefore include private sector consultations.

Table 7.2. **Dimension 7: Challenges and policy instruments**

Challenges	Policy instruments
Insufficient institutional and administrative capacity	Introduce quality assurance measures at institutional level Conduct systematic training needs analysis Provide policy framework support to training needs analysis and quality assurance
Slow process of adoption of international and European standards	Enhance the work of technical committees Strengthen the participation of industry in standards development process
Information not tailored to SMEs	Hold workshops Prepare leaflets and brochures for dissemination through local commercial chambers or SME associations Create SME-tailored information on product requirements and conformity assessment procedures and post on a single website/portal
Lack of monitoring and evaluation	Prepare progress reports on implementation of legal framework for technical requirements for products Impose obligation to consult private stakeholders in evaluations

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Notes

1. The European Committee for Standardization (CEN), European Committee for Electrotechnical Standardization (CENELEC) and European Telecomunications Standards Institute (ETSI).

2. Such as the International Organization for Standardization (ISO), and the International Electrotechnical Commission (IEC).

Chapter 8

Enterprise skills and innovation (Dimensions 8a and 8b) in Eastern partner countries

Promote the upgrading of skills in SMEs and all forms of innovation (Small Business Act Principle 8)

Skills and innovation are crucial drivers of firm productivity and SME growth in today's knowledge-driven economy. Principle 8 of the Small Business Act provides the framework for analysing and evaluating innovation and enterprise skills policies in two areas. The first, building enterprise skills, has seen moderate progress since the 2012 assessment. National training needs analysis has been introduced and training to SMEs has been expanded. EaP countries now need to focus on sharpening SME training and support policies and institutions, including data collection, monitoring and evaluation, and quality assurance.

The second dimension is innovation policy; this is one of the lowest scoring SBA dimensions across the EaP region. Policy tools remain underdeveloped in all EaP countries despite some improvements since 2012. Three EaP countries have introduced or are currently working on comprehensive innovation strategies and more resources have been devoted to innovation infrastructure and financial support schemes. Yet governments in the EaP region still have two fundamental challenges: *(a)* promoting a broader concept of innovation that goes beyond technological innovation and research and development; and *(b)* becoming "innovator matchmakers" by building and promoting partnerships among SMEs, research institutions and other knowledge providers to create innovation that strengthens enterprises' market positions.

Dimension 8a: Enterprise skills

Introduction

Dimension 8a assesses the development of human capital in small and medium-sized enterprises – a policy area which has gradually risen to the top of the European Union's agenda. In the EU, 99% of businesses (or a total of 21.6 million enterprises) are SMEs, and employ 88.8 million people (or two out of every three employees in the EU). Together they generated EUR 3 666 trillion in value added in the non-financial business sector in 2013 (EC, 2014). The high job creation and competitiveness potential of small and medium-sized enterprises is at the centre of EU reforms and there is an increasing understanding that high-quality entrepreneurial human capital must be a primary objective of strategic investment by governments. Thus, three pillars of the EU 2020 Entrepreneurship Action Plan are the development of entrepreneurial education and training, creation of the right business environment and role models, and reaching out to specific groups (EC, 2013).

Evidence confirms that government policies need to proactively address these challenges: lack of availability of skilled staff and managers for SMEs are among the top three challenges for SMEs in the EU (EC, 2014). Lack of core business skills and broad, "key" competences translates into a high rate of SME attrition and slow growth, with all the accompanying negative impacts on social and economic indicators.

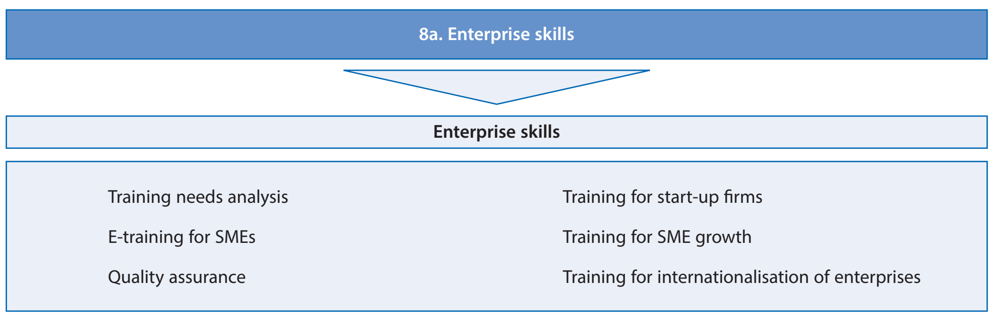
The 2012 SBA assessment revealed that the human capital challenges for SMEs in the Eastern partner (EaP) region are similar to those in the EU (OECD, 2012). Application of the principles of Small Business Act for Europe in the context of the EaP region provide a good basis for benchmarking, exchange of expertise and practice between the EU and its neighbourhood. In 2015, high-quality SME skills remain just as important for all EaP countries. As we saw in the previous chapter, the Association Agreements and Deep and Comprehensive Free Trade Area (DCFTAs) with the EU have encouraged Georgia, Moldova and Ukraine to strengthen their institutional conditions for supporting trade promotion. The new impetus for closer economic co-operation and better aligned policies and legislation requires a greater level of skills and competences among SMEs. Governments need to pay special attention to skills strategies that benefit entrepreneurs.

The EU28 governments have recently agreed to strive for a Digital Single Market, "to make the EU's single market fit for the digital age – tearing down regulatory walls and moving from 28 national markets to a single one" (EC, 2015a). The EU expects the Digital Single Market measures to contribute an additional EUR 415 billion to the economy annually and create 3.8 million jobs, with an estimated 4% annual growth in the demand for digitally skilled employees (EC, 2015a). This brings e-services and tools to the forefront of national and regional social and economic development strategies and will require adequate institutional and technological infrastructure, as well as e-training services and the development of e-platforms.

Assessment framework

The assessment framework for Dimension 8a consists of six indicators. It is structured around the same pillars as in the 2012 assessment (OECD, 2012), though some changes have been introduced, as noted below. It allows for the comparison of individual countries' results between 2012 and 2015, as well as an analysis of trends in the EaP region and benchmarking across all EU partner regions involved so far in SME policy assessments in line with the SBA.

Figure 8.1. **Assessment framework for Dimension 8a**



While the majority of Dimension 8a indicators were part of both 2012 and 2016 assessments, two major changes should be noted when looking at the individual progress of each EaP country (see also Annex A for further information on the changes):

a. Four of the indicators (training needs analysis, quality assurance, training for start-up firms, and training for SME growth) have been improved following consultations with experts and stakeholders in the partner countries; this change may affect the comparability of scores across levels of the assessment grid.

b. Two new indicators have been introduced, replacing the indicator on access to training: *(i)* e-training for SMEs; and *(ii)* training for the internationalisation of enterprises. These reflect developments in the EU and region's SME policy agenda. The scores of these indicators will provide a baseline for future assessments.

Dimension 8a indicators look at the following aspects of SME training policy and practice:

- The **training needs analysis** indicator assesses the availability of a strategic agreement between the key stakeholders – government, public, private providers, sectoral associations, employment support structures – and other partners on the systematic analysis of SMEs' skills needs. It prompts the use of training needs analysis in order to improve the relevance of training, fill gaps in provision and avoid overlaps in training supply. Ideally, this effort should be part of a country's broader sector analysis and skill needs anticipation work, and should support the more effective use of public and private funds. Training needs analysis contributes to the training policy framework, better targeting of services, training quality improvement, as well as accountability and transparency in the use of public budget. It also contributes to availability of data and greatly depends on it.

- The **e-training for SMEs** indicator has a triple purpose:
  a. It prompts the addition of a "digital dimension" to entrepreneurship competence. E-training helps users to successfully operate in modern learning environments (Loughran, 2014). It also supports peer learning, networking and collaboration.
  b. It prompts greater training quality through a diversity of new tools for active online learning and innovative training methods and modern content of training programmes.
  c. It prompts improved access to and outreach of training programmes through flexible, individualised training delivery approaches that overcome distance and lack of training resources for full-scale face-to-face training.
- The **quality assurance** indicator reflects the state of quality culture in a country's training sector and looks at "interfaces" between various parts of the business training market. The quality assurance framework for SME training is a result of existing, broader agreements on education and training quality in a country. It links SME training to existing arrangements for assuring the quality of education and training provision, as well as other factors, including the adoption of a national qualifications framework, competence frameworks, national and sectoral skills partnerships, certification, accreditation and licensing norms and regulations, etc. It provides a set of commonly agreed rules or standards for training quality control, quality improvement and quality assessment (Gribben, 2013). Quality assurance measures cover both internal and external dimensions at both system and institution level.
- The **training for start-up firms**, **training for SME growth** and **training for internationalisation of enterprises** indicators underscore the importance of distinguishing between SMEs at pre-start-up, start-up and more advanced stages of their development. This distinction should be reflected in approaches to planning, design, provision, monitoring and evaluation of training and support services, and should be supported by available and relevant data.

The overall focus of Dimension 8a is on government's policies and their ability to mobilise public resources for maintaining highly effective and efficient SME training and support systems as part of the country's entrepreneurship enabling environment. Critical elements of such support systems are:

- Strong government leadership in setting up co-operation frameworks and structured partnerships with key stakeholders, including public and private training providers, as well as SMEs themselves.
- Open and transparent data collection for anticipating SME skills needs and for monitoring and evaluating policy implementation. Data collected should be relevant to the policy objectives and sufficient for assessing the impact of policy measures.

All elements of the Dimension 8a assessment framework are inter-linked and reflect the complexity of the SME policy reform objectives. Effective use of data is at the core of the indicators on training needs analysis and training for start-up firms. Both training needs analysis and quality assurance require structured cross-stakeholder co-operation and a holistic approach by the main stakeholders, including public and private training providers. They are also key aspects of effective human capital policy, which addresses:

- wider national skills and competences strategies
- national and sectoral approaches to anticipating skills needs, and skill gaps analysis

- implementation of national qualifications frameworks and improvement of national qualifications systems
- internal and external quality assurance measures, as well as quality improvement strategies in formal education and non-formal learning.

The three indicators on training for start-ups, training for growth and training for internationalisation support the conceptual approach of targeted support measures that are fine-tuned to the specific needs of different categories of enterprises (Lasku, & Gribben, 2013). These three indicators track whether training design is based on training needs analysis and whether it applies quality assurance measures. The e-training indicator has a cross-cutting character, since it looks at the format of training delivery, applicable at any stage of SME development. It has, however, a special value vis-à-vis growth and internationalisation training as it reinforces the digital edge of SMEs' trade promotion and internationalisation.

Analysis

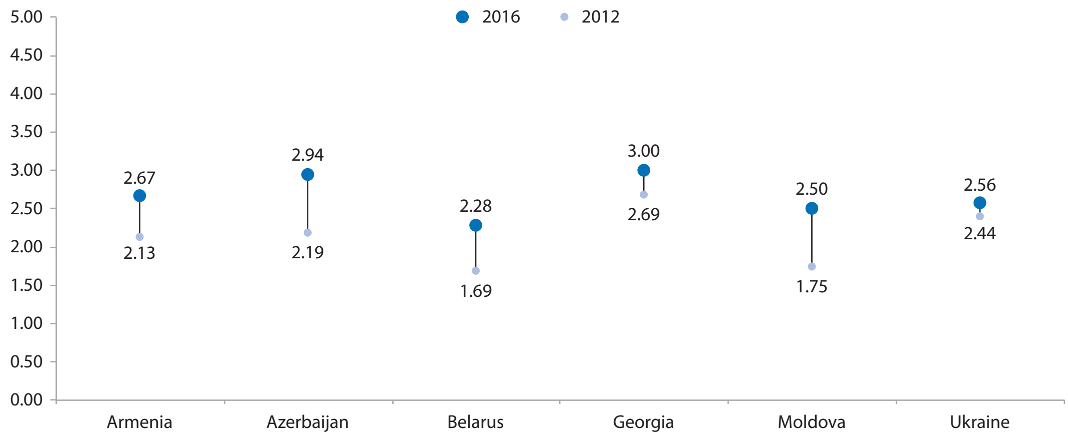
There has been a noticeable increase in engagement by the key national stakeholders in the SBA assessment on human capital dimensions in all EaP countries. All countries have been involved in follow-up actions between the two assessments and helped to develop the indicator framework after the 2012 assessment. The main recommendations of the 2012 SBA assessment were: to improve awareness of human capital policy issues, strengthen policy partnerships, improve oversight by policy makers for developments at the institutional level, engage practitioners in policy discussions, identify policy leaders and advocates, and launch the development of new strategies and actions for building SMEs' human capital (OECD, 2012). In 2012, most of the scores for Dimension 8a were clustered around levels 2-2.5 (below the break-even point of level 3), with some countries being at level 1.

The latest findings demonstrate overall progress across the region and clustering of country scores around the break-even point (Figure 8.2), with some "spikes" of outstanding achievements or "breakthrough" on some parts of the agenda. In spite of the fact that countries have started to develop – or already adopted – new SME strategies in recent years, overall progress across the region was relatively more modest than in Dimension 1 (entrepreneurial learning and women's entrepreneurship).

The SBA analysis shows that in those countries where SME support has an "institutional home" – dedicated SME support agencies and institutional structures – SME training programmes are better off and demonstrate more consolidated progress across this dimension. These specialised SME support organisations have been instrumental in advancing national reforms and supporting government's system-building efforts. For example, in Armenia, Azerbaijan, Georgia and Moldova, these specialised organisations implement a variety of training and support programmes for SMEs.

While access to training by all population groups and categories of SMEs remains an issue, more important is fine-tuning support to the needs of each target group and reaching out (e.g. through e-training or training needs intelligence). All areas of training support require a new approach to upgrade the quality and relevance of training provision, and resources matched to the future impact of government policies. Governments should also invest in the collection of data for policy making, monitoring and evaluation, and modern training methods and modalities.

Figure 8.2. **Weighted scores for Dimension 8a compared to 2012**



Training needs analysis is still rather ad hoc

The 2012 assessment concluded that none of the countries in the EaP region had a well-established national training needs analysis framework. Analysis of enterprises' training needs involved ad hoc surveys of training providers, employer organisations, etc. Currently, all countries are holding discussions on the importance of reliable data for assuring the quality of training programmes. However, training needs analysis remains mostly confined to ad hoc measures and tools.

Azerbaijan and Georgia are making the greatest strides in setting up a national training needs analysis framework. Both countries have done much to build SME skills' needs assessment frameworks and create institutional structures which have a role in analysing SMEs' skills needs and gaps. In Azerbaijan training needs analysis is gradually becoming an important function of policy partnership and an element of vision building on future education and training. Azerbaijan is testing a sector skills' council model and supports systematic skills intelligence development. The central role belongs to the Baku Business Training Centre (BBTC) and its seven regional offices. Training needs analysis is becoming standard practice at sectoral level and is linked to the key competence approach underpinning the large-scale reform of the education system.

Georgia is doing well in connecting its SME support, training, education and innovation policies, underpinned by the strong human capital focus of the forthcoming SME strategy and the new institutions for SME support. Skills intelligence is the responsibility of the recently established Enterprise Georgia, which oversees both pre-start-up and start-up training, and helps enterprises to grow and become globally competitive. Georgia's approach to establishing systematic training needs analysis for SMEs is linked to the forthcoming SME strategy and is involving intense expert consultations on the systematic improvement of the quality and development of the analysis methodology.

Systematic data collection on the training needs of SMEs also occurs in Armenia and Moldova, using standardised data collection instruments. Training needs analysis is run by the government through specialised SME support agencies – SME DNC in Armenia and ODIMM in Moldova – as well as by individual training providers and projects. The training needs of SMEs are regularly assessed; however, data quality and the framework of analysis need to be addressed. Statistical data for training needs analysis and for the evaluation of quality of training provision should be collected in a disaggregated format

(Bekh, 2013) to reflect the sex, sector and other characteristics of trainees, so as to allow for analysis by target groups (women, youth, start-ups, growth, etc.).

Quality assurance is improving slowly

Quality assurance remains a challenge in most of the countries, and overall progress has been slow in the region. However, the assessment notes that Georgia and Ukraine have made progress through co-ordinated efforts by governments, social partners and training providers covering various aspects of this complex policy area. The increased co-operation of these countries with the EU and European quality assurance approaches is adding further impetus. Quality assurance measures in these countries include both system-building actions (standards and procedures, assessment methodology, accreditation of providers, and involvement of national and sectoral employer organisations in decisions on future skill needs and competence development targets, etc.), and measures for improving the quality of training provision and quality assurance approaches within individual institutions (quality of inputs into training programmes, learning process, management culture of the training provider, self-assessment practices, client satisfaction assessments, etc.).

Ukraine has gradually been increasing its quality assurance of education and training, based on excellent institutional co-operation between the government and employer organisations, its efforts to adopt strong measures for the quality assurance of training programmes, and its building of skills intelligence. It has been piloting sectoral and regional skills needs analysis, anticipating future skills demands, developing transparent competence assessments in formal education, and gathering intelligence on the core sectors of the economy with trade potential. The EU association agreement has been driving Ukraine's national SME development policies. Major reforms are underway to strengthen the quality of human resources and gradually develop the effectiveness of public institutions.

Georgia has made progress across the board – strengthening the quality assurance arrangements in formal education, collecting evidence on the quality of training programmes for SMEs, supporting analysis in the sectors most concerned with the increased trade and Georgia-EU economic co-operation, adopting a national qualifications framework and increasing the role of Enterprise Georgia in training quality.

E-training for SMEs is progressing too slowly

In spite of the Web-2.0 and social media revolution, as well as the exponential global development of massive open online courses, e-training for SMEs in the region has been developing slowly. It does not yet feature among the top national priorities of any of the EaP countries. Various e-training activities are available, however, for SMEs in the EaP countries, including some individual courses in electronic format and training programmes with e-modules. Numerous information resources for self-development and distance learning are also available on the websites of training providers and SME support organisations.

Of the six countries, Azerbaijan has made the most visible progress in introducing e-training for SMEs. The BBTC has a well-developed online training facility giving access to SMEs from all regions of Azerbaijan to training in business planning, start-up and e-trade. Implementation of e-training is subject to monitoring, including analysis of participants by geographical region, sex, etc. E-commerce development and support to distance training are part of the BBTC's mission. Azerbaijan has been focusing on the systematic creation of a conducive SME support environment.

Start-up training needs more investment

Pre-start-up and start-up training is well developed in all countries; however, its effectiveness and its coverage of the SME population are not yet monitored at the system level in the Eastern partner region. For this reason, during the collection of evidence for the SBA assessment, most countries – as in the 2012 assessment – were not able to provide statistical data or analysis on the share of newly registered SMEs who attended the training, or on the impact of pre-start-up training programmes on the creation of new enterprises. These gaps prevent policy makers and SME support organisations from evaluating the quality and effectiveness of public investment in SME training and support in general, and pre-start-up and start-up training in particular. They also signal a lack of attention by policy makers to the importance of targeted investment in service provision to different categories of SMEs. This limits the options for improving the quality and relevance of training services to the training needs of potential entrepreneurs and newly established enterprises.

Armenia has been successful in targeting pre-start-up and start-up SME training and support, combined with collecting skills intelligence and a special focus on individual target groups, including women and youth. It leads the region in its availability of start-up training statistics, which have improved since the first SBA assessment. Official data on start-up training programmes supported by the state budget allowed the government to confirm that during the reporting period at least 40% of new start-ups had attended the training courses. Azerbaijan and Georgia have business training registers on pre-start-up and start-up training, and dedicated budget funds for start-up training. Access to finance is one of the topics of these programmes. The Georgian Innovation and Technical Agency has recently launched the "Start-up challenge for technology start-ups", a system of mini-grants for young innovative businesses and start-up support initiatives by the Tbilisi municipality.

Belarus focused on reorganising its support structures for entrepreneurship and human capital promotion after the first SBA assessment, engaging in concept development and planning, as well as systematically monitoring SME support programmes. Today, entrepreneurship and innovation are at the top of the country's national priorities, and Belarus is able to capitalise on its steady government engagement in training provision, along with a highly educated and innovative population, to create innovative programmes and initiatives for promoting pre-start-up and start-up training.

Training for growth and internationalisation of SMEs is a dynamic area

Training and support for SME growth and international trade are the most dynamic areas of Dimension 8a. All countries are in the process of strengthening their programmes and institutional facilities for supporting enterprises with high growth and international trade potential. This is being driven by national development strategies, as well as regional and international trade dynamics.

The final scores on both indicators cluster around level 3 – the break-even point (Table 8.1). This indicates that most countries have reached agreement on a policy framework for enterprise growth training, have made available public funds for these programmes, and have integrated trade promotion and internationalisation skills development into their national SME support strategies. As in other areas of policy assessment, there has been more systematic progress in the countries which have established dedicated institutions for SME support: Armenia, Azerbaijan, Belarus and Georgia.

Overall training offers are well developed in all six countries, with excellent examples by public and private providers (see Box 8.1 for a Belarus example). The Azerbaijan Export and Investment Promotion Foundation, a public-private initiative, and GITA in Georgia are systematically working to increase the growth potential of SMEs. The Government of Moldova invests in trade promotion and SME internationalisation potential as one of its national priorities. Moldova has also moved fast to include human capital support measures in its SME development strategy, giving major attention to skills development. In recent years, the Government of Moldova has concentrated its efforts on the systematic promotion of entrepreneurship and placing its SME support goals into the context of international trade, economic growth and integration with EU policies. In Armenia, internationalisation training and support is offered through the SME DNC, the Chamber of Commerce and the Armenian Development Agency. Ukraine has a well-developed trade-support infrastructure consisting of both public and private providers and is currently re-engineering public infrastructure to fit the new trade opportunities available through the DCFTA.

Box 8.1. **Young business people in Belarus are driving the internationalisation of SMEs**

In recent years, entrepreneurship development has been re-energised in Belarus as part of the country's transformation of its state-owned, centrally planned economy to make it more agile, competitive and SME-friendly. Export promotion is one of the key objectives at both national and local levels, reinforced by Belarus' strategic geo-political position in Europe. In Minsk, a Youth Business Incubator (KUP Youth Social Service) has become actively engaged in a broader national policy development process, proposing new initiatives which expand its mandate. The result is a new type of youth entrepreneurship community, motivated by constant learning and generating new business development ideas together. In 2014, the Youth Business Incubator launched a trade-promotion "serial" initiative "Export=Success". This combines innovative ideas' fairs, "free networking zones", training sessions on business internationalisation, master-classes, seminars and workshops organised and led by youth, and is open to all categories of entrepreneurs. While this trade promotion initiative mainly targets enterprises with growth potential, it also opens its doors to future entrepreneurs, students and all interested partners. "Export=Success" is a joint initiative by the Minsk city administration, Youth Business Incubator and partners, including the Ministry of Sport and Youth, Ministry of Education, business support agents and a large group of youth SMEs which contribute to both the concept and implementation of all activities under the project, and who themselves benefit from the new trade development opportunities.

Source: Youth Business Incubator, website www.mcc.by/o-nas/novosti/2015/otchet-eksport-uspex-brazovatelnyij-turizm.html.

The overall conclusion from the assessment is that countries are doing better on the general provision of SME training and support than on monitoring and evaluation, targeting their interventions, or ensuring quality assurance measures for small and medium-sized enterprises (Table 8.1).

Table 8.1. **Scores for Dimension 8a: Enterprise skills**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Training needs analysis	2.5	3	2	3	2.5	2
E-training for SMEs	2	3	2	2	2.5	2.5
Quality assurance	2	2	1.5	3.5	1.5	3.5
Training for start-up firms	4	3.5	3	3.5	2	2.5
Training for enterprise growth	2.5	3	2	3	3	2.5
Training for internationalisation of SMEs	3	3	3	3	3	3
Weighted average	**2.7**	**2.9**	**2.3**	**3.0**	**2.5**	**2.6**

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

The way forward

Governments across the EaP region need to focus on sharpening their SME training and support policies and institutions through the following actions:

- **Base policy decisions on evidence:** this will require the systematic collection of quality data.
- **Develop policy frameworks and partnerships which include a clear vision of the impact on SMEs' human capital**, and with built-in provisions for ensuring access to services and the cost-effective use of resources. These frameworks need to cover analysis of SMEs' training needs and quality assurance measures.
- **Monitor the needs of all key SME target groups and tailor resources to ensure the best fit.** Availability of statistical data should be improved as a matter of highest priority, with an overall focus on "measuring what matters": analysing client satisfaction, and linking training and support programmes for different categories of SMEs to their business performance and to national economic indicators.
- **Ensure that training quality improvement is part of the SME skills' development culture.**
- **Put innovation and proactive, strategic thinking at the core of the design and delivery of SME support measures.** The efficient use of new technologies is critical for the knowledge economy and requires a variety of e-training tools and a well-developed infrastructure to support entrepreneur skills, professional networking, communication and e-trade.

Table 8.2. **Dimension 8a: Challenges and policy instruments**

Challenges	Policy instruments
Low relevance and quality of SME training	Implement systematic training needs analysis
	Create policy frameworks for training needs analysis and quality assurance
	Agree quality assurance measures at national and institutional level
	Establish national policy partnerships involving training providers, business support organisations, sectoral associations and SMEs for systematic training needs analysis and quality assurance co-operation

Table 8.2. **Dimension 8a: Challenges and policy instruments** *(continued)*

Challenges	Policy instruments
Poorly targeted SME training programmes not meeting the needs of different categories of SMEs	Provide pre-start-up training and support to wide groups of potential entrepreneurs
	Provide start-up training for all newly registered enterprises (including on access to finance)
	Give dedicated support to growth enterprises in strategic sectors of the economy
	Offer internationalisation training and support programmes to SMEs with trade potential in the key sectors of economy
	Adopt systematic data collection and analysis of the implementation of training programmes as a basis for further improvements
Insufficient access to quality information and learning resources and undeveloped e-training infrastructure and content	Develop e-training courses
	Actively use digital communication and social media instruments to expand access and increase quality of training provision for all categories of SMEs

Dimension 8b: Innovation policy for SMEs

Introduction

Innovation is a key driver of knowledge-based economic growth. The concept of innovation is multifaceted, going beyond the conventional notion of technological innovation to incorporate a broad range of knowledge-driven activities that lead to increased productivity and ultimately to growth. Innovation entails the development and deployment of new or significantly improved products, processes, marketing or organisational methods (OECD and Eurostat, 2005).

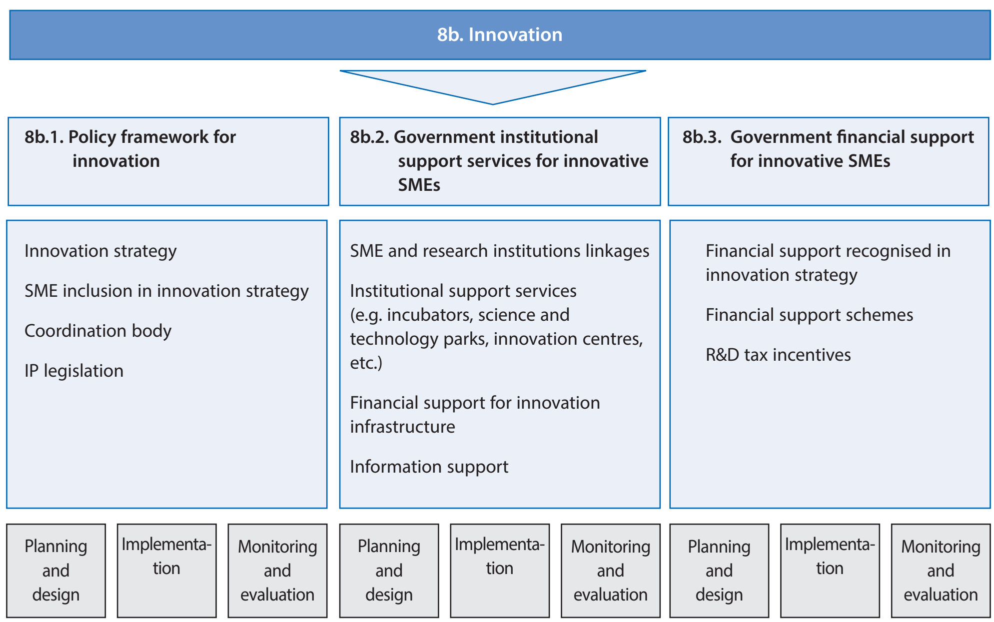
SMEs play a vital role in the creation and adoption of innovation and help upgrade the economy overall by displacing firms with lower productivity. However, due to their limited size and capacity, SMEs often face difficulties in developing and sustaining innovative activities over a long time. Only a few SMEs have a strategic agenda based on an ambition of innovation-led growth. Evidence suggests that SMEs tend to introduce fewer new products and technologies than large, more established firms, but that they are fast and flexible in developing and commercialising higher quality and breakthrough innovations (Van Praag and Versloots, 2007; OECD, 2010). Many SMEs with innovative and competitive products face challenges financing the scaling-up of their operations and growing their business. These can often only be overcome through co-operation with large enterprises (with greater purchasing power and easier access to diverse markets) or investors. As clients and suppliers to large enterprises, SMEs also contribute to the innovation activities of these larger entities.

Government support to innovation often takes the form of public investment in science and R&D, but without taking into account the needs of enterprises and entrepreneurs. This overlooks the important issue of the diffusion and exploitation of knowledge and technologies and excludes non-technological innovations. Knowledge spillovers from other firms and from universities are important for the development of innovative enterprises (Audretsch, 2004). Public policy can enhance these through measures that promote co-operation amongst firms and between firms and universities. Trade fairs, conferences, improved broadband access and clustering can all be considered by governments to encourage co-operation among innovation stakeholders (Verheul et al., 2002).

Assessment framework

The assessment framework for Dimension 8b has been restructured since the 2012 assessment and now looks at three sub-dimensions: *(a)* the strength of the innovation policy framework (particularly regarding SME innovation); *(b)* the institutional support measures for innovative SMEs; and *(c)* financial support for innovative SMEs. Each sub-dimension is in turn structured in three thematic blocks covering the entire policy cycle, from planning and design to implementation and monitoring and evaluation.

Figure 8.3. **Assessment framework for Dimension 8b**



Policy framework for innovation

The first sub-dimension assesses the level of development of the innovation policy framework and its main building blocks, including the existence of a comprehensive innovation strategy (national and/or regional), a co-ordinating body in charge of innovation policy development, and legislation on intellectual property rights.

The innovation strategy can be a standalone document or can be included in other relevant policy documents (e.g. entrepreneurship policy, industrial policy, education and science strategy, etc.). It should cover core policy objectives (e.g. fostering innovation activities, commercialisation, technology transfer, etc.), ideally with a focus on SMEs. Policy frameworks should recognise that innovation can be both technological and non-technological and identify policy interventions to strengthen non-technological innovation as a complement to more conventional support for science and technology. This implies a greater focus on innovation support to increase SMEs' capacity to absorb knowledge from outside the firm.

A strategic approach to policy formulation and co-ordination should be undertaken to develop and co-ordinate programmes to foster public-private partnerships, financial support schemes and institutional support services. Policy co-ordination through a multi-stakeholder body avoids duplicating effort, minimises structural inefficiencies and harmonises policy actions.

Government institutional support services for innovative SMEs

The second sub-dimension assesses the existence and implementation of institutional support measures for innovative SMEs, including innovation infrastructure such as incubators, science and technology parks, technology transfer offices, innovation centres and others.

When introducing institutional support, policy makers need to distinguish between highly innovative high-growth firms (e.g. R&D-based breakthrough innovators) and SMEs that introduce incremental innovations in their products or every-day operations (e.g. upgrading internal processes). Both types of innovation need to be encouraged through tailored support measures. In both cases, knowledge exchange and transfer need to be stimulated. Collaboration with other stakeholders in the innovation ecosystem can help SMEs to overcome some common barriers (e.g. lack of a skilled workforce and technological competences, limited funding, etc.). In this regard, the government can play a "matchmaking" role, promoting and facilitating linkages between SMEs and research institutions or universities. Policy approaches to establishing these linkages include developing a cluster policy, creating science parks and technology transfer offices, and ensuring a legal framework for licenses and patents conducive to the commercialisation of innovation.

Government financial support services for innovative SMEs

The third sub-dimension analyses the financial incentives and services provided by the government to encourage SMEs to innovate. SMEs' limited financial resources are a significant barrier to innovation. Policy interventions are needed to help SMEs access the required financing, tailored to the type of innovation (e.g. technological product, internal process innovation) and stages of innovative activities (e.g. idea development, engineering, commercialisation phases). Box 8.2 provides a good practice from Germany. Policy interventions can take the form of grants, loans, loan guarantees, mezzanine finance, seed capital, venture capital, business angel finance and investor readiness programmes.

Box 8.2. **EXIST Transfer of Research programme in Germany**

EXIST is an initiative of Germany's Federal Ministry of Economy and Technology, and aims to improve the entrepreneurial environment in research institutions and to increase the number of technology and knowledge-based companies. This initiative includes a Transfer of Research Programme that provides financial support for transferring knowledge and technology from research and academic institutions to high-tech start-ups for further product development. Other goals of the programme include encouraging researchers interested in becoming entrepreneurs and helping aspiring start-ups to prepare economically feasible business plans and obtain external funding.

The programme focuses mainly on technological areas involving relatively long development phases, such as energy, environmental, biological and optical technologies; materials technology, micro-systems technology, and medical technology; and some areas of information and communication technologies.

Box 8.2. **EXIST Transfer of Research programme in Germany** *(continued)*

The EXIST Transfer of Research programme has two phases of funding for a total period of up to 18 months. For highly innovative projects, this period can be extended by a further 18 months during Phase I.

- Funding Phase I: Project funding in preparation of the start-up ("Pre-Seed"): funding is provided to research teams at German universities and research institutions that are involved in transferring the results of scientific research into technical products and processes. These teams are required to prepare a business plan for commercialising innovation and the planned business start-up. In this phase, financial support covers staff costs, plus an additional amount of up to EUR 250 000 for equipment, intellectual property rights, and other investments.
- Funding Phase II: Project funding at the start of the business ("Seed"): funding is provided for further development work, for the measures needed to begin business activities in the newly formed technology undertaking and for the creation of the conditions needed to obtain external corporate financing. This phase involves a grant of up to EUR 180 000, although a 25% counterpart contribution of total project costs is required.

Project management staff monitor start-up projects that are funded by EXIST Transfer of Research through three detailed interactions at each stage of programme implementation, including start-up, strategy and financing advice. Interaction at the start-up phase helps allocate the tasks and responsibilities and define the timeline milestones. During the second phase of monitoring, the business plan and financial concept of the project are evaluated. The third phase evaluates the quality of the financing plan and the presentation of the business.

Source: Federal Ministry for Economic Affairs and Energy (2015), EXIST Transfer of Research, website, www.exist.de/EN/programme/EXIST-Transfer-of-Research/content.html, accessed 25 September 2015; Federal Ministry for Economic Affairs and Energy (2014), *Directive on the Funding of Research-intensive Business Start-ups (EXIST Transfer of Research) in Conjunction with the Programme "University-Based Business Start-Ups"*, Federal Ministry for Economic Affairs and Energy, www.exist.de/SharedDocs/Downloads/EN/Programme/Transfer%20of%20Research/EFT-Richtlinie-en.pdf.

Analysis

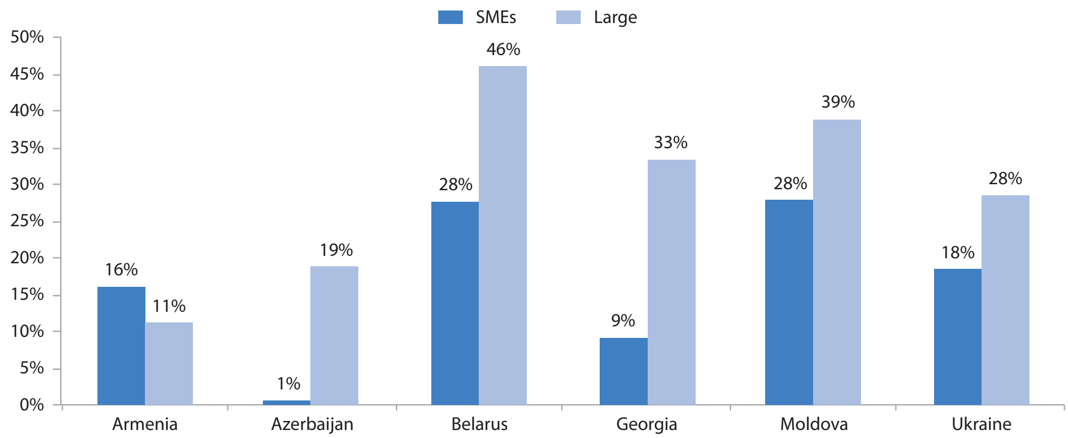
Although the EaP countries inherited strong technical and scientific education systems and research institutions from the Soviet Union, the level of innovation activities by SMEs varies widely from country to country. In the European Union, an estimated 28.7% of SMEs innovate in-house (i.e. introduce new or significantly improved products or production processes) (EC, 2015b). In the EaP, only SMEs in Belarus and Moldova come close to this figure, at 28% (Figure 8.4). The share of innovative firms is higher among large companies in all countries except Armenia.

Compared to the 2012 assessment, EaP governments are paying increasing attention to developing innovation frameworks and infrastructure in general and to the role of SMEs, albeit to a lesser extent (Figure 8.5). These improvements reflect a growing recognition by EaP countries of the need to move to innovation-driven and knowledge-based economies.

Innovation policy frameworks already exist in Belarus and, since 2013, in Moldova. Innovation policies are also being developed in Armenia and Georgia, with the latter country having recently established a dedicated innovation agency and policy co-ordination body. In

Figure 8.4. **Innovation activity in SMEs versus large firms, 2010-12**

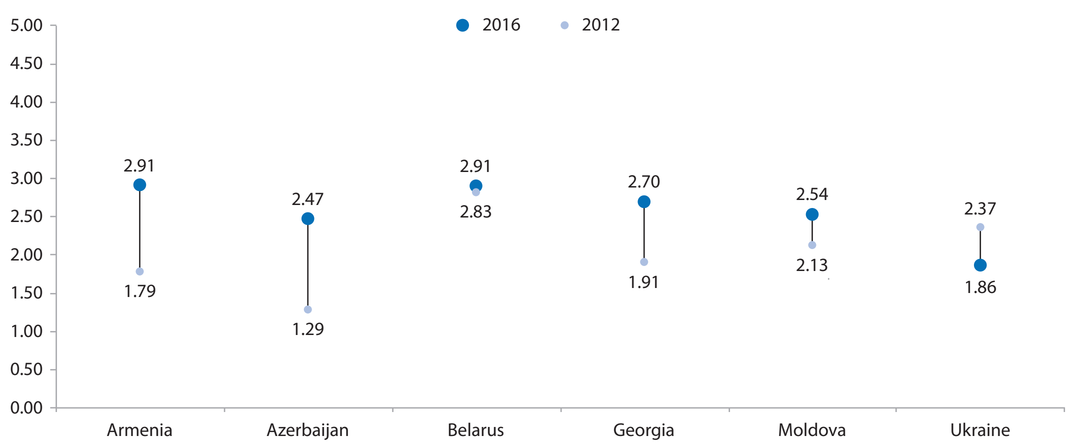
% of firms introducing new or significantly improved products or services



Note: The definition of small, medium and large firms is taken from the BEEPS categories (see Policy Framework, Methodology and Assessment Process chapter).

Source: OECD calculations based on EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset, European Bank for Reconstruction and Development, available at http://ebrd-beeps.com, accessed July 2015.

Figure 8.5. **Weighted scores for Dimension 8b compared to 2012**



these two countries, such positive developments alongside other measures (e.g. co-financing mechanisms, and infrastructure enhancement) have resulted in a significant increase in scores since the 2012 assessment (Figure 8.5). More resources are increasingly being devoted to innovation infrastructure (e.g. technological parks, incubators) and innovation-focused financial support schemes. This is true for all countries except Ukraine, where lack of funding and implementation have seen a deterioration in the overall score. New innovation infrastructure and financial support (e.g. a new financial facility, techno parks and industrial parks) explain Azerbaijan's significant progress since 2012.

Overall, however, innovation policy tools remain underdeveloped in all EaP countries. Dimension 8b is one of the SBA dimensions with the lowest overall scores across the EaP region. Governments should tackle the following outstanding challenges:

- **An overly narrow interpretation of innovation**. Innovation policy frameworks in EaP countries focus mainly on the development of an information and communication technologies (ICT) sector and on publicly-funded research and development activities in universities and research institutes. Much less attention is paid to non-technological innovation, modern organisation principles and management methods, the uptake of ICT and other enabling technologies to raise efficiency, and the commercialisation phase of the innovation process.
- **Limited financial and infrastructural support**. Azerbaijan and Ukraine still lack strategic innovation policy frameworks, while the number and scope of support systems continue to be very limited in all EaP countries. Innovation-focused financial support for enterprises (e.g. vouchers, grants) is at a nascent stage in almost all EaP countries, while innovation infrastructure has actually weakened in some countries (e.g. Belarus, Ukraine).
- **Weak mechanisms for knowledge-sharing and technology transfer**. Top-down government interventions, non-transparent funding decisions, and a legacy of public R&D institutes that continue to operate in isolation from the private sector all constrain innovation. Weak linkages between SMEs and research institutions result in limited technology transfer and commercialisation of innovation.

EaP countries need to strengthen their innovation policy frameworks and scale up policy co-ordination

Moldova and Belarus lead the other EaP countries in formulating comprehensive innovation policy frameworks (Table 8.3). In Belarus, a well-structured policy framework for innovation is outlined in the "State Programme of Innovation Development 2011-2015", including concrete measures and timelines for implementation. The "Innovation Strategy of the Republic of Moldova for 2013-2020" and the "Research and Development Strategy of the Republic of Moldova until 2020" both provide clear policy directions for innovation promotion in the country.

Armenia and Georgia are currently developing new innovation strategies. Georgia's "National Innovation Strategy 2020" is being developed under the leadership of a new co-ordination body, the Research and Innovation Council. In contrast, in Azerbaijan and Ukraine, innovation policies remain scattered across different policy documents and lack a co-ordinated approach.

Policy co-ordination is not systematic in most EaP countries but some steps have been taken by governments to introduce a whole-of-government approach to innovation policy making. Georgia, for instance, has established the Georgia Innovation and Technology Agency (GITA) for implementing innovation policy, innovation infrastructure development, commercialisation of innovation, and financial and non-financial assistance to innovative companies. Innovation policy co-ordination bodies comprising representatives of the innovation ecosystem exist in Georgia (the Research and Innovation Council), Armenia (the Scientific-Technical Council) and Belarus (a dedicated commission of the Council of Ministers), although it is difficult to evaluate their effectiveness. In Ukraine, responsibilities for implementation and co-ordination of innovation policy were transferred to the Ministry of Education and Science in October 2014. No single co-ordination body exists in Azerbaijan; instead a number of government agencies and structures implement or support the implementation of state innovation initiatives.

Formal frameworks for innovation clusters are relatively underdeveloped in the EaP countries, present only in Moldova and Belarus. However, legal frameworks for industrial and technology parks exist or are being developed in some EaP countries (e.g. Azerbaijan, Ukraine).

Table 8.3. **Scores for sub-dimension 8.1: Policy framework for innovation**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.51	1.51	3.49	2.89	3.46	2.37
Implementation	3.33	2.83	2.33	3.67	2.17	1.00
M&E	1.00	1.00	1.00	1.00	1.00	1.00
Weighted average	**2.93**	**2.01**	**2.47**	**2.86**	**2.39**	**1.48**

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

More can be done to support non-technological innovation

Since the 2012 assessment, most EaP countries have scaled up their innovation infrastructure (Table 8.4). However, it is still largely focused on ICT sector support (e.g. technological parks, ICT incubators) while non-technological innovation remains underdeveloped.

New innovation infrastructure has been developed in Armenia, Azerbaijan and Belarus. A technology park was opened in Armenia in 2014 and builds on an extensive support infrastructure for the ICT sector. In Azerbaijan, the State Fund for Development of Information Technologies (ICT Fund) was established in 2012 to support ICT projects. Four industrial parks and two ICT technology parks are currently under construction. In Belarus, a hi-tech park has been created to promote the development of the ICT sector.

Georgia's GITA has plans to scale up innovation infrastructure. These include the construction of the country's first technology park and the piloting of two fabrication labs and three university-based innovation labs targeting start-ups in the ICT sector. This would be a first step towards the development of a nation-wide innovation network. In contrast, lack of funding in Ukraine has been a significant constraint and, as of 2014, only about one-third of incubators for innovative start-ups and technology parks were operational.

Co-operation among the actors in the innovation ecosystem remains limited. One legacy of the Soviet era is that research and development systems continue to be centralised in the hands of public research institutions, and little emphasis is put on facilitating technology transfer, commercialising innovation and responding to enterprise needs. However, EaP governments are progressively acknowledging the importance of these aspects. For instance, the Moldova government and the Academy of Sciences of Moldova have entered into a co-operation agreement to stimulate innovative SMEs through technological parks, clusters and incubators, and to develop technology transfer projects. In Azerbaijan, the government has announced plans to introduce a technology transfer platform.

Table 8.4. **Scores for sub-dimension 8.2: Government institutional support services for innovative SMEs**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	3.67	2.17	3.83	3.33	4.67	4.33
Implementation	1.83	2.17	4.60	1.87	1.60	2.87
M&E	3.67	3.67	1.00	1.00	2.33	2.33
Weighted average	**2.84**	**2.47**	**3.61**	**2.21**	**2.82**	**3.27**

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Targeted financial incentives are needed to help SMEs innovate

Limited access to finance remains a significant constraint for SME innovation in EaP countries. It is therefore not surprising that the number of companies investing in research and development remains very low. According to BEEPS V data, the share of SMEs reporting having invested in R&D between 2010 and 2012, either in-house or through contracts, represents about 7-8% of all SMEs in Belarus and Moldova, 5% in Armenia and Ukraine, and 3% in Georgia (EBRD, 2014). No SME surveyed in Azerbaijan reported having made any such investment. OECD company surveys conducted in all six EaP countries as part of this SBA assessment find the lack of financial resources to be the main factor explaining this pattern.

Governments are taking the initial steps to develop financial incentives for innovative behaviour amongst SMEs. For instance, in Armenia, new sources of financing for innovative enterprises have emerged in recent years. The Enterprise Incubator Foundation has been providing matching grants to innovative enterprises while the country's first venture capital fund was established in 2013. Azerbaijan's ICT Fund provides various types of financial support (e.g. concessional loans, equity and venture capital, grants, etc.). In Belarus, financial assistance products (e.g. grants, loans and voucher schemes) are available for each stage of the innovation process (Box 8.3). In Georgia, GITA is starting to support individual innovators. Moldova offers innovation vouchers. Some EaP governments also provide tax incentives to innovative enterprises (e.g. Belarus), although not just to SMEs.

While public funding for SME innovation is very limited, Moldova and Ukraine have joined the EU's main research and innovation funding programme, Horizon 2020. This offers countries the opportunity to create synergies between national and European

Box 8.3. **Financial support for innovation in Belarus**

The Belarusian Innovation Fund is a key provider of direct financial incentives and support to innovative companies in the country. It is a public non-profit organisation that specialises in investments in innovation industries with a particular focus on the scientific and technological sector. Its main activities include financial support for innovative projects, analysis of the results of science and technology programmes, and the selection of innovative projects. The fund provides finance for innovative companies at each stage of the process:

- grants for the pre-production stage
- innovation vouchers of up to USD 25 000 at the design stage
- vouchers and grants of up to USD 100 000 (with a minimum 10% counterpart contribution by the enterprise) for products at the engineering and design stages
- subsidised lending by the Belarusian Innovation Fund or the Belarusian Fund of State Support of Entrepreneurs (BFSSE) at the production stage.

Innovation vouchers and grants are awarded following a competitive selection process. It appears that the main beneficiaries of these programmes are still large companies and state-owned enterprises, however. The most recently available data indicate that only 6.5% of total funding disbursed was provided to SMEs.

Source: State Committee on Science and Technology of the Republic of Belarus (2014), *The Status and Prospects of Development of Science in the Republic of Belarus at the End of 2013*; Presidential Decree No. 229 of 20 May 2013, "On some measures to promote the implementation of innovative projects".

programmes, for example by introducing support schemes building on the orientation of European programmes. Research bodies and enterprises in Moldova and Ukraine may further benefit from engaging in European collaborative projects as equal partners. The most ambitious entrepreneurs should be motivated to develop their innovative business ideas and compete for the European grants. They could then act as role models for others.

Finally, the findings of the SBA assessment suggest that in many EaP countries access by the private sector to research and development funding is limited. For instance, legal obstacles in Georgia prevent GITA from awarding grant funding to enterprises. In Ukraine, the state budget does provide funding for research and development, although the focus is clearly on academia and research organisations, with limited emphasis on the commercialisation of innovations.

Table 8.5. **Scores for sub-dimension 8.3: Government financial support services for innovative SMEs**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	2.69	3.69	4.56	2.75	2.69	2.19
Implementation	2.20	4.40	3.80	2.60	2.60	1.40
M&E	5.00	3.00	1.00	3.00	3.00	1.00
Weighted average	**2.93**	**3.87**	**3.51**	**2.73**	**2.71**	**1.60**

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

The way forward

In EaP countries, innovation by SMEs remains a largely underdeveloped area that requires targeted policy interventions in the form of institutional, infrastructure and financial support. The following priorities should be considered by all EaP countries:

- **Strengthen the institutional framework for innovation policy and establish a co-ordinated approach to its implementation.** Those countries whose innovation strategy is absent or outdated (e.g. Azerbaijan and Ukraine) should consider developing innovation frameworks that resolve policy fragmentation. Countries with innovation strategies in place need to develop concrete action plans to ensure they are implemented effectively, and should also introduce strong monitoring and evaluation mechanisms. The policy framework should adopt a broad approach to innovation (including in particular non-technological innovation) and address shortcomings across the region (i.e. weak systems for transferring knowledge and technology to SMEs; weak networks among SMEs, large enterprises, researchers and international partners; low level of commercialisation of innovations; and weak innovation support services). Creating specific policy co-ordination structures involving representatives of the entire innovation ecosystem would also improve policy consistency and effectiveness in countries which lack such structures.
- **Scale up institutional support to innovative SMEs, particularly in non-technological fields of innovation.** Innovation infrastructure in the EaP region has considerable scope for further development and expansion, particularly to cover SMEs operating outside the ICT sector. A specific focus on SME needs is also desirable as most innovation support schemes in the region are general in scope, with state-owned enterprises as the major beneficiaries.

- **Establish linkages and promote partnerships between research institutions and the private sector.** Governments should progressively adopt the role of "innovation matchmaker" to build and promote partnerships between research institutions and SMEs to ensure innovation is driven by market demand**.** All EaP countries need to promote technology transfer as well as the commercialisation of innovation. The first step could be to develop a network of innovation and knowledge centres that regularly interact and co-operate with SMEs.
- **Expand the number and size of financial incentives for SMEs to innovate and invest in R&D.** The EaP countries need to adopt a more strategic, proactive and market-oriented approach to the development of financial support measures, including targeted financing mechanisms (e.g. grants, loans) for each SME segment (e.g. pre-seed, start-ups, high-growth SMEs, etc.). Other forms of targeted support should be also considered (e.g. tax credits for R&D activities).

Table 8.6. **Dimension 8b: Challenges and policy instruments**

Challenges	Policy instruments
Weak links among new entrepreneurs, SMEs, large and international enterprises, academia and support infrastructures	Introduce cluster policy frameworks Develop institutional support measures
Institutional support is mostly limited to ICT sector	Tailor institutional support to different segments of innovative SMEs (e.g. high-growth technological innovators, operational processes innovators)
Low level of growth-oriented, knowledge-based, innovative entrepreneurship	Provide support to the development of business plans and "investment readiness", for example through business plan competitions, high quality incubation and business accelerators Link SMEs with private investors and customers through brokerage activities
Lack of financial support and incentives for SMEs to innovate	Provide SMEs with direct financial support (e.g. business innovation grants, seed capital, credit guarantees) Introduce initiatives to support cross-border co-operation to create links between SMEs and foreign direct investment ventures
Shortage of innovation skills and competencies	Raise awareness among enterprises on managing innovation projects from the idea to the generation of profits on the market Encourage the introduction of "innovation management courses" in engineering and business schools

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Chapter 9

SMEs in a green economy (Dimension 9) in Eastern partner countries

Enable SMEs to turn environmental challenges into opportunities (Small Business Act Principle 9)

The green transformation of SMEs is a significant business opportunity, a source of innovation and competitive advantage, and a driver of green growth. The first step in achieving this is a strategic and comprehensive policy framework that recognises the role and needs of SMEs. The framework should incorporate regulatory and financial incentives to encourage SMEs to benefit from green growth opportunities.

Dimension 9 analyses Eastern partner countries' efforts to green SMEs. Compared to the 2012 assessment, recognition of the benefits of SME greening has been growing but remains uneven across the region. Inclusion of greening initiatives in SME support policies is in its infancy in countries with SME strategies (e.g. Moldova) and non-existent in others. Countries with established SME agencies (Armenia, Georgia and Moldova) have begun to design initiatives to promote resource efficiency and a green growth model among SMEs. Information and financial support for SMEs to invest in energy efficiency measures and renewable energy have also been growing. Despite these developments, governments remain largely passive in promoting environmental sustainability. They need to become more proactive in "greening" the SME policy framework and encouraging entrepreneurs to seize the benefits.

Introduction

The transition of SMEs to sustainable practices, in both manufacturing and services, is key to green growth. "Green transformation" offers a significant business opportunity for SMEs and could be a source of innovation, competitive advantage and new business generation. However, SMEs often suffer from limited capacity – lack of resources, time and expertise – to absorb environmental requirements and to comply with them. In addition, SMEs are often not aware of the potential benefits of addressing their environmental footprint. For SMEs to fully participate in the transition towards sustainable economic patterns and to seize the opportunities they present, it is essential that the main barriers to green growth and eco-innovation are identified and addressed through policy interventions.

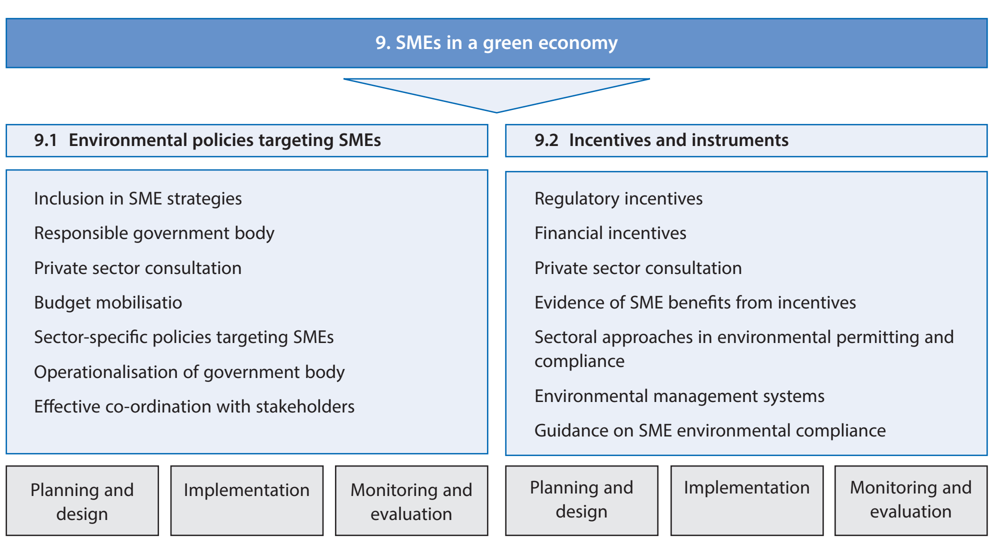
Beyond environmental regulations and standards, the role of government in facilitating the creation of environmentally responsible firms is essential. To encourage SMEs to move to products and processes with a lower environmental impact, governments need to provide regulatory and financial incentives to influence practices by SMEs. These can include tax credits, subsidised consultancy services, capacity building programmes and others. A policy framework which combines eco-efficient businesses and eco-innovation will enable SMEs to adapt their businesses to environmental challenges and seize the economic opportunities on offer through green business practices. This chapter explores progress across the EaP towards these policy goals.

Assessment framework

Dimension 9 assesses governments' approaches to fostering green growth (Figure 9.1). The 2016 SME Policy Index has increased the breadth and depth of the indicators used in this dimension. The dimension is now organised into two sub-dimensions, each of them analysing performance across the entire policy cycle (planning and design, implementation, and monitoring and evaluation). 2012 scores have been recalculated based on the updated methodology (see Annex A).

The first sub-dimension evaluates the degree of greening of the current policy framework in the field of SME development, industry and innovation. It examines whether strategic

Figure 9.1. **Assessment framework for Dimension 9**



enterprise and innovation policy documents cover eco-efficiency and eco-innovation, and assesses the extent to which these concepts are embedded in national policy frameworks.

The second sub-dimension looks at the provision of institutional and financial incentives for SME greening. It evaluates the availability of environment-related information, expertise and funding targeted at SMEs. It also measures governments' efforts to promote environmental management systems and standards and compliance with environmental regulations.

Analysis

Compared to the 2012 assessment, recognition of the benefits of SME greening has been growing, but remains uneven across the region (Figure 9.3). Countries in the region have historically given little consideration to the greening of small businesses, and lack the legal, policy and institutional means to enhance the environmental performance of SMEs. Activities to promote compliance with environmental regulations are underdeveloped, other than a few examples of incentives for enterprises to adopt a certified environmental management system (e.g. in Belarus). More recently, however, governments across the region have been realising the importance of SME support policies in the context of greening the economy. Ministries of economy in both Moldova and Armenia are planning to introduce environmental considerations into their strategic documents on SME support activities, but have not yet started to develop specific policy measures.

The environmental regulatory system in the region is still heavily dominated by single-medium permitting – issuing separate permits for impacts on each environmental media (air emissions, wastewater discharges and waste disposal). These apply to every enterprise likely to have an impact on the environment. Such general environmental regulations are not sector-specific and do not distinguish between facilities with different levels of impact. This creates a heavy administrative burden for both SMEs and regulators. However, the situation is beginning to change. Several countries have taken the first steps to diversify their environmental permitting and compliance monitoring regimes according to the level of environmental risk, lessening the regulatory burden on SMEs. For example, Armenia and Azerbaijan have developed draft laws that introduce requirements for enterprises based on their environmental impact, sector and type of economic activity. In addition, Armenia is implementing a risk-based system of compliance monitoring whereby the frequency of inspections is based on the assessed level of the enterprise's environmental risk. Moldova's "Small and Medium Enterprise Sector Development Strategy for 2012-2020" also envisages adjusting the regulatory framework to match SME needs.

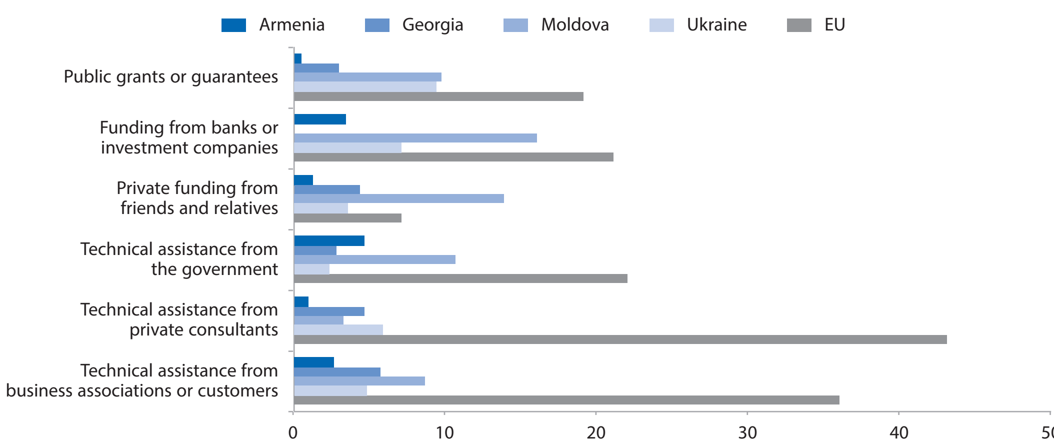
Environment ministries and their associate institutions provide regulatory information to the regulated community. Specialised environmental information centres, usually associated with environment ministries, use telephone advice, workshops, and guidelines to help businesses understand environmental requirements. However, these information services rarely reach smaller businesses. Some information-based instruments have been put in place to recognise green business practices. For example, the Georgian Green Business Award was announced by the Ministry of Environment and Natural Resources Protection in October 2013. The award is made in the green company, green product and green building categories and seeks to motivate entrepreneurs for environmental protection and social responsibility actions.

Government environmental support for SMEs in the region is still very uneven. Governments are mostly passive in promoting environmental sustainability and best practices

– their involvement is generally limited to hosting international donor-funded projects. Ministries of economy in several countries implement information and training programmes for small businesses, but they are rarely institutionalised. Business support organisations – SME DNC in Armenia, ODIMM in Moldova, Enterprise Georgia – are just beginning to design activities to promote resource efficiency and other green practices among SMEs.

SMEs' access to finance for energy efficiency and renewable energy investments has improved in recent years. For example, several private banks in Armenia offer green or renewable energy loans. In 2013, Moldova's ProCredit Bank launched an EcoLoan programme for business clients, becoming one of the country's first banks to provide green loans to small and micro-enterprises for investments in energy efficiency (which requires energy savings of at least 20%), renewable energy, and other green practices (organic agriculture, water and soil protection, etc.). Despite this, according to SME surveys of Armenia and Moldova (OECD, 2015a; 2015b), only 12% and 23.5% of the companies that undertake resource efficiency measures in the respective countries receive some technical or financial support (Figure 9.2). The larger the enterprise, the more likely it is to receive some support, and support almost never reaches micro-businesses. This lack of government support is in stark contrast with the extent of public support activities in the EU (EC, 2013). Most private financing mechanisms are generally limited to credit lines provided by international finance institutions. International donor-funded initiatives to promote green SME development play a substantial role in improving access to finance and know-how for SMEs in the region. While they are not sustainable in the long term, they do help to build social and environmental responsibility in private banks.

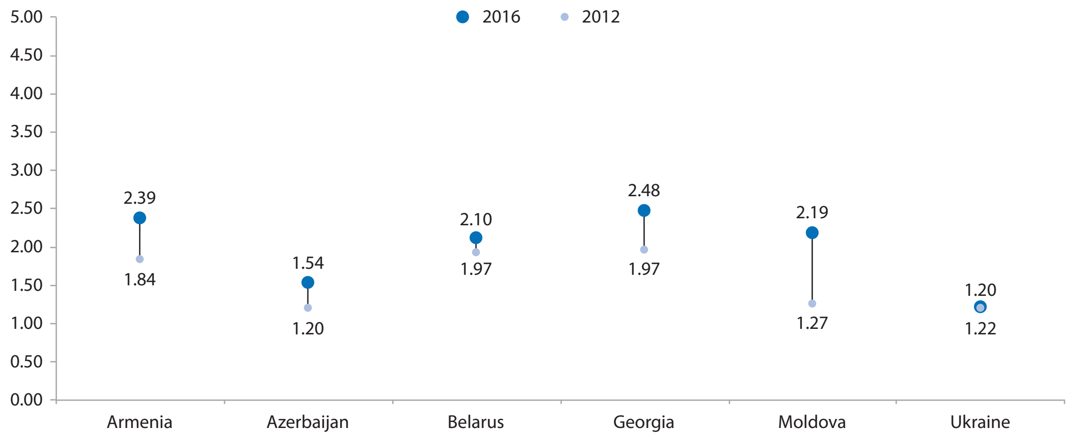
Figure 9.2. **Share of SMEs receiving support for resource efficiency**



Source: EC (2013), "SMEs, resource efficiency and green markets", *Flash Eurobarometer* 381; OECD (2015a), *Promoting Better Environmental Performance of Small and Medium-sized Enterprises in Armenia*; OECD (2015b), *Promoting Better Environmental Performance of Small and Medium-sized Enterprises in Moldova.*

The principal institutional challenges to address include the lack of capacity in environmental authorities to develop and implement sector-specific policies, the neglect of environmental compliance promotion activities, the weakness of the "green" component of SME support policies and institutions, and the shortage of resources (besides the limited donor funding) for the support of green business practices.

Figure 9.3. **Weighted scores for the Dimension 9 compared to 2012**



Environmental policies for SMEs need specific targets

Most countries have environmental policies for SMEs included in government strategies (commonly referred to as "green economy strategies"). They are accompanied by action plans in Armenia and Moldova. Such strategies generally promote resource-efficient and cleaner production as well as eco-innovation and green products, but nowhere do they set measurable targets and timeframes for their achievement. The strategies are usually designed by ministries of economy in association with SME agencies where they exist (in Armenia, Georgia and Moldova), but not always in consultation with trade associations or other business groups. Their implementation almost fully relies on donor funding, with only a small contribution of budgetary resources. There are some performance monitoring provisions contained in green economy strategies but so far they have not been put into practice.

Table 9.1. **Scores for sub-dimension 9.1: Environmental policies targeting SMEs**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	4.60	2.20	1.00	4.20	5.00	2.20
Implementation	3.00	1.00	2.50	3.00	3.67	1.00
M&E	3.67	3.67	1.00	3.67	1.00	1.00
Weighted average	***3.69***	***1.95***	***1.68***	***3.55***	***3.60***	***1.42***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Incentives and instruments are largely lacking

There are very few cases of regulatory incentives for green practices (Table 9.2). Financial incentives in Armenia, Georgia and Moldova are in the early stages of development and are limited to certain tax privileges and access to finance at below-market interest rates. There is a big gap in providing SMEs with sector-specific guidance on environmental compliance and green business practices. Enterprise Ireland's approach to promoting green practices could be a model for EaP countries to follow (Box 9.1).

Table 9.2. **Scores for sub-dimension 9.2: Incentives and instruments**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	1.00	1.00	3.00	1.00	1.00	1.00
Implementation	2.14	1.57	2.52	2.71	1.57	1.19
M&E	1.00	1.00	1.00	1.00	1.00	1.00
Weighted average	***1.51***	***1.26***	***2.39***	***1.77***	***1.26***	***1.09***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Box 9.1. **Enterprise Ireland's Green Offer for SMEs**

Enterprise Ireland is the government organisation responsible for promoting Irish enterprises in world markets, with a particular emphasis on SMEs. In addition to efforts to enhance environmental awareness and improve performance in Irish industry through its environmental information portal (Envirocentre.ie), Enterprise Ireland's Green Offer aims to increase the adoption of green business principles by its clients. The Green Offer comprises three programmes:

a. The Green Start programme helps SMEs, at no cost to them, to establish a simple environmental management system by conducting a site audit and providing advice on regulatory compliance issues, green market positioning, preparation of an environmental policy, etc.

b. Green Plus is meant to build on Green Start and to assist companies to develop products and services to a level where they comply with specific green procurement requirements. This may involve the implementation of an accredited environmental management system, improvements in products or processes or applying for eco-labels.

c. Green Transform is designed to further improve the competitiveness and market access of those companies who have maximised their energy efficiency or reduced their carbon footprint.

Source: Official website of Enterprise Ireland, www.envirocentre.ie.

The way forward

While the recognition of the benefits of SME greening is growing, there is still more to be done. Inclusion of greening initiatives in SME support policies is in its infancy, and still non-existent in some countries. Governments continue to play a rather passive role in promoting environmental sustainability. There is a need for government to take a more proactive approach to greening the policy framework for SMEs and to encourage entrepreneurs to benefit from these frameworks (OECD, 2015c):

- **Simplify environmental regulatory requirements for those SMEs that are of low environmental risk.** This simplification generally involves replacing bespoke environmental permitting with standardised requirements (e.g. general binding rules) for specific activities with low environmental risk that are practised by a large number of operators and employ similar technologies.

- **Strengthen efforts to promote compliance and encourage green business practices.** While in the long term web-based guidance is likely to become the primary source of support for SMEs, in the short and medium term online tools need to be complemented by other, more traditional instruments such as paper and electronic mailings, brochures and workshops.
- **Communicate the benefits to business of improved environmental performance.** Environmental outreach to SMEs should communicate the benefits of greening business in terms of greater efficiency and competitiveness. Sector-specific communication channels are likely to be the most appropriate, reflecting the different business models and activities of different sectors. Government bodies, including ministries of economy and environment, should work in partnership with trade associations and business support organisations to develop and disseminate environmental guidance; this would add to its credibility.
- **Tailor environmental management systems, both in terms of their content and delivery, to the particularities of SMEs.** Focus on simple, accessible improvements in management practices. Relatively simple environmental management systems and little paperwork, as well as sectoral green label schemes, are more likely to be attractive to small businesses than formal ISO 14001 certification, which is relatively complex and costly. Sector-specific green certification (of business practices) and eco-label schemes (for products) also contribute to an increased demand for green business practices.
- **Encourage SMEs to invest in green technologies by using tax privileges (accelerated amortisation, reduced property or corporate taxes) and favourable loan policies.** Free technical assistance to SMEs helps to increase their awareness and secure their initial engagement in green practices. However, given the limited availability of public funding for promoting compliance and green business practices, a gradual transition toward a fee-based system for technical assistance would improve its long-term sustainability.

Table 9.3. **Dimension 9: Challenges and policy instruments**

Challenges	Policy instruments
Complex regulatory requirements for SMEs and few regulatory incentives for going beyond compliance and adopting green practices	General binding rules (instead of customised permits) for low-risk facilities
	Regulatory incentives for environmental management system (EMS) certification (including simplified EMS schemes): reduced inspection frequency, monetary penalties, etc.
	Sectoral approach to compliance assurance (sector-specific strategies, inspection campaigns, partnerships with trade associations)
Lack of advice and guidance on green business practices for SMEs	"Regulatory watch" service
	Web-based guidance on compliance and good practices
	Direct capacity building (audits, etc.)
Lack of recognition of green practices by SMEs and demand for green products and services	Simplified environmental management systems
	Sector-specific green certifications
	Eco-labels
	Environmental recognition awards
	Green public procurement
Lack of finance for green investments by SMEs	Tax privileges (accelerated amortisation, reduced property or corporate taxes)
	Soft loans
	Subsidies (grants) for consultancy services

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Chapter 10

Internationalisation of SMEs (Dimension 10) in Eastern partner countries

Encourage and support SMEs to benefit from the growth of markets (Small Business Act Principle 10)

The relatively small size of most Eastern partner (EaP) countries' domestic markets and the recent trade agreements underscore the importance of SME internationalisation for the region. Exposure to foreign competition and integration into global value chains can increase firm productivity through better management practices, higher employment, innovation, knowledge transfer and stronger business networks. Dimension 10 assesses government support (both financial and non-financial) for SMEs to access international markets and become integrated into global value chains.

Despite some positive developments since 2012, SME export promotion efforts are still nascent and support remains weak. While most EaP countries now have dedicated export promotion agencies, their services remain largely limited to trade fairs and training. Key priorities going forward include scaling up those services, adding more sophisticated products (such as support regarding quality requirements in the EU and other export markets), building capacity in existing export promotion agencies, as well as further developing trade finance options. There are currently no targeted government programmes to help SMEs integrate into global value chains.

Introduction

The increasing pressure for globalisation combined with the constraints of domestic markets means that internationalising SMEs' activities is becoming crucial. By accessing international markets, SMEs can grow and achieve economies of scale which are not possible when operating in the domestic market alone (OECD, 2009). Greater competition from foreign firms can also enhance quality, innovation and productivity. Similarly, integration into global value chains (GVCs) plays a major role in raising growth and productivity at the macro level (OECD, 2013a). A value chain is the full range of activities in which firms engage to bring a product to the market, from conception to final use. Such activities range from design, production, marketing, logistics and distribution to support to the final customer, and can be carried out by a single firm or several firms (OECD, 2013a). Global trade and production increasingly take place within global value chains, with about 60% of global trade consisting of trade in intermediate goods and services that are incorporated at various stages in the production process (UNCTAD, 2013).

The fragmentation of production and increased use of outsourcing by multinational enterprises has created opportunities for SMEs as global suppliers of components or services. SMEs can exploit their flexibility and speed to fill niches for the supply of novel products and services (OECD, 2013a). Those SMEs that can act as suppliers for multinational enterprises gain access to global markets at lower costs, and can benefit from the transfer of technology, innovation, managerial expertise and skills (OECD, 2008; OECD, WTO and World Bank Group, 2014). GVC integration also allows SMEs to internationalise and grow by helping them to secure a position as specialised suppliers, while also providing them with opportunities for outsourcing and greater competitiveness by rationalising production (OECD, WTO and World Bank Group, 2014).

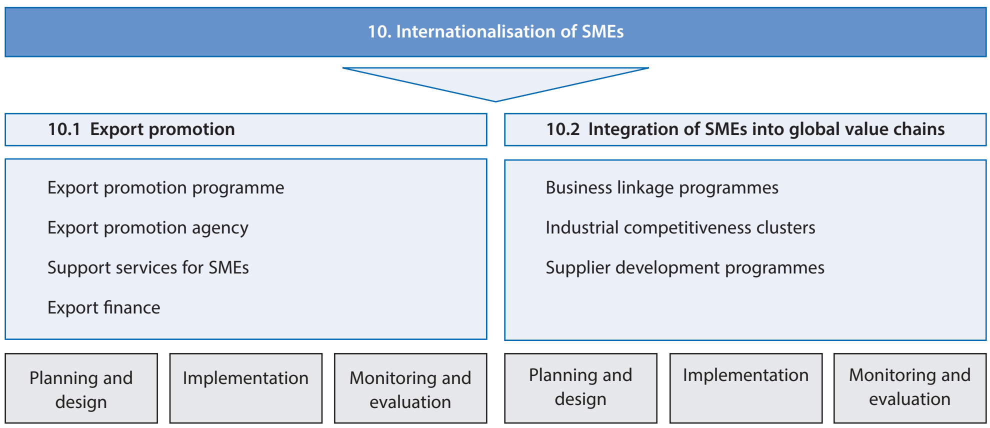
Despite these advantages, only a small proportion of SMEs is engaged in some form of internationalisation. In the EU, only one in four SMEs exports directly, and 60% of small enterprises have "very low" or "low" export intensity (EC, 2014). Similarly, the proportion of SMEs exporting either directly or indirectly in the EaP region is also low (see Box 10.1 further below) (EBRD, 2014). SMEs face a number of information, administrative, technical and financial barriers to entering external markets, further exacerbated by their limited resources, weaker management skills and lack of access to business support tools. According to the OECD company surveys conducted in the EaP countries as part of this SBA assessment (see Box A.3, Annex A), shortage of working capital to finance exports, limited information to analyse foreign markets, difficulties obtaining reliable foreign representation and excessive transportation costs are among the top challenges facing SMEs in internationalising.

SMEs can also face a number of challenges in integrating into GVCs, including the need to upgrade technology and innovation capacity, the lack of adequate finance and human capital, and inability to meet international standards and certification requirements (UNCTAD, 2010). These challenges call for policy makers in emerging economies to develop targeted programmes and incentives for SMEs and other players (including multinational enterprises) to deepen collaboration (such as those implemented in the Czech Republic, Box 10.3 at the end of the chapter). This chapter explores the policy measures being undertaken in the EaP countries to achieve this.

Assessment framework

The assessment framework for Dimension 10 has been expanded since the 2012 assessment to focus more closely on GVCs, the role of export promotion agencies, and the implementation, monitoring and evaluation of existing policies. The framework is now composed of two sub-dimensions, analysing government measures for *(a)* export promotion; and *(b)* integrating SMEs into global value chains (Figure 10.1).

Figure 10.1. **Assessment framework for Dimension 10**



Export promotion

The first sub-dimension assesses the government's export promotion efforts. The main objective of these efforts is to address the most important barriers for SME internationalisation identified in firm-level surveys, including: *(a)* financial barriers (especially a shortage of working capital); *(b)* limited information to locate and analyse potential export markets; *(c)* inability to contact potential overseas customers; and *(d)* lack of managerial time, skills and knowledge (OECD, 2009).

A major element is the existence of a comprehensive export promotion programme covering both financial and non-financial support for exporting SMEs:

- On the non-financial front, export promotion programmes include services such as trade policy information, commercial intelligence on potential export markets and business contacts, networking platforms, country representation at major trade fairs, training and consulting for marketing and product development, and border trade zones or cross-border co-operation networks (EC, 2008; OECD, 2012). These services are typically provided or co-ordinated by an export promotion agency or similar body, or by other stakeholders, including chambers of commerce, business support organisations or different forms of business networks (EC, 2013). Some business support programmes have been launched at the EU level, including the Enterprise Europe Network (the world's largest support network for SMEs with international ambitions, working with over 600 partner organisations in more than 60 countries). At the national level, export promotion programmes are often implemented with a regional or sector focus (OECD, 2009).
- Regarding financial assistance, governments can enhance SMEs' access to targeted financial products, such as export credit and export insurance. Lack of financing is also considered by EU SMEs as one of the three most important barriers for doing business outside of the Single Market (EC, 2011). As a result, export finance tools play a critical role in allowing SMEs to tap into external markets.

Integration of SMEs into global value chains

A second sub-dimension – integration of SMEs into GVCs – has been added to the 2016 framework. This sub-dimension assesses the extent to which governments are undertaking measures to promote SME integration into GVCs, on both the demand side (e.g. tax credits to foreign-invested firms that provide tangible benefits to domestic suppliers, FDI-SME linkage programmes, etc.) and supply side (e.g. skills development, supplier networks etc.).

Analysis

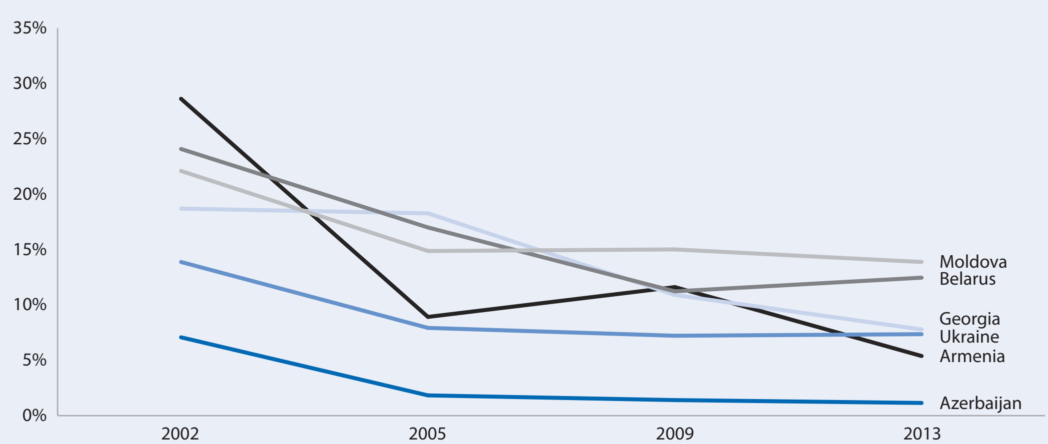
SME internationalisation remains weak in the EaP region, with manufacturing SMEs exporting only 8% of their sales directly or indirectly on average (Box 10.1) (EBRD, 2014). Export promotion efforts are still nascent and support remains uneven. The difficulties facing SMEs in achieving the necessary economies of scale to produce for international markets and build relevant networks, the relatively small size of the domestic markets (except Belarus and Ukraine) and the opportunities presented by recent trade agreements (including the Deep and Comprehensive Free Trade Areas – DCFTAs – with the EU) all underscore the importance of stepping up existing support.

Box 10.1. **Exports by SMEs are declining in EaP countries**

According to four BEEPS survey rounds – 2002, 2005, 2009 and 2013 – the percentage of exporting SMEs and the average proportion of total sales exported by SMEs active in the manufacturing sector has declined over the past decade (EBRD, 2014). This decline has been particularly intense in Armenia and Azerbaijan, where between 2002 and 2013 the percentage of total sales exported fell from 28.7% to 5.4% in Armenia and from 7.1% to 1.2% in Azerbaijan (Figure 10.3). The percentage of exporting enterprises also halved in Armenia, Georgia, Moldova and Ukraine, and fell by 80% in Azerbaijan between 2002 and 2013 (Figure 10.4).

Figure 10.3. **SME exports in the EaP region are declining, 2002-13**

% of total manufacturing sales exported directly or indirectly



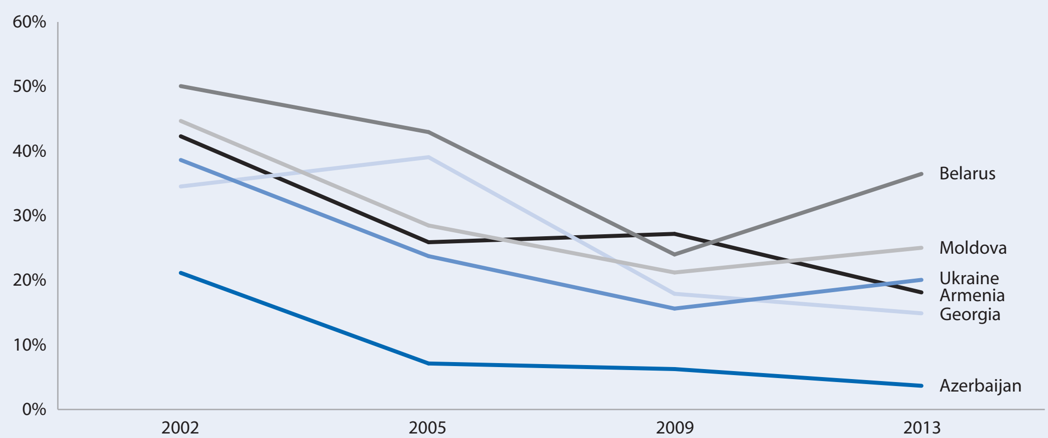
The percentage of sales exported by SMEs and percentage of exporting SMEs is highest in Belarus (12.5% and 36.5%) and Moldova (13.8% and 25.0%). Belarus leads in exports by large enterprises (84.4% exporters, 42.4% of sales exported), indicating higher levels of internationalisation among Belarusian enterprises as a whole. Azerbaijan has the lowest share of sales exported by SMEs and of exporting SMEs (1.2% and 3.7%), as well as the lowest percentage of exports by large enterprises in the EaP region (9.2%), partly due to the importance of hydrocarbon products in the export basket.

Box 10.1. **Exports by SMEs are declining in EaP countries** *(continued)*

With the exception of Belarus, the relative importance of exports in total sales has declined for both SMEs and large enterprises in EaP countries since 2002. However, the impact varies across the region. In Georgia, Moldova and Ukraine, the importance of exports for large enterprises has fallen by an equal or greater degree as SMEs (e.g. from 54.1% in 2002 to 16.7% in 2013 in Georgia), whereas in Armenia and Azerbaijan, the drop in the level of internationalisation has been more significant for SMEs. In the case of Belarus, exports by large enterprises have increased from 40.7% of total sales in 2002 to 42.4% in 2013, while the relative weight of exports by SMEs has halved (from 24.1% of total sales in 2002 to 12.5 in 2013).

Figure 10.4. **Share of export-oriented SMEs is declining in the EaP region, 2002-13**

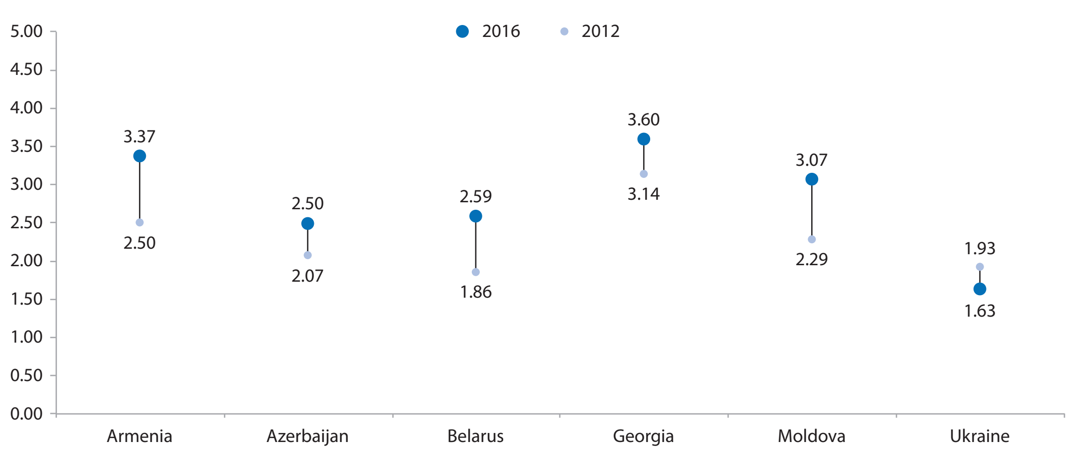
% of total manufacturing SMEs exporting directly or indirectly (at least 1% of sales)



Source: EBRD (2014), *Business Environment and Enterprise Performance Survey*, BEEPS V (2011-2014), dataset, available at http://ebrd-beeps.com/, accessed July 2015.

Since 2012, EaP countries have generally made progress in providing support measures for SME internationalisation: Dimension 10 scores have increased across the region, with the exception of Ukraine (Figure 10.2). Nevertheless, average scores remain low (below 3), leaving ample room for improvement. All of the EaP countries have some export promotion

Figure 10.2. **Weighted scores for Dimension 10 compared to 2012**



tools in place. Export strategies exist in Armenia, Belarus, Moldova and Ukraine, and are being developed in Azerbaijan and Georgia. Export promotion activities usually include the organisation of promotional events (e.g. business forums) and supporting participation of SMEs in international trade fairs, training and export consultancy. They are carried out by independent export promotion agencies in Armenia, Azerbaijan, Georgia and Moldova. An export insurance agency has been operational in Armenia since early 2015, and an export credit agency is currently being developed in Georgia. DCFTA-related support activities are also being carried out in Georgia, Moldova and Ukraine.

Despite this progress, SME internationalisation still lags behind in a number of areas:

- Export promotion activities tend to be restricted to trade fairs and training; they lack more sophisticated support (e.g. market intelligence – market reports on target markets and databases of potential foreign partners – and quality standards).
- Support measures to integrate SMEs into GVCs are virtually non-existent in most countries; where they do exist, they are highly dependent on donor programmes (e.g. in Moldova).
- Initiatives for upgrading the capacity of exporting SMEs to meet new trade opportunities are still limited in scope. This is particularly important for Georgia, Moldova and Ukraine, where exporting and non-exporting firms alike will need to upgrade their quality standards within the context of the DCFTAs.
- The institutional aspects of export promotion activities lack clear strategies to identify priority destinations, strengthen policy co-ordination and build the capacity of the national export promotion agencies.
- Trade finance products for SMEs are lacking in the majority of EaP countries, yet one of the key obstacles for SMEs to export is lack of working capital.
- Regulatory hurdles, such as the large number of documents and long length of time involved in exporting, are also hindering SME internationalisation, although some improvements have been made to simplify export procedures in some EaP countries (e.g. Moldova).

Export promotion initiatives are still nascent and underdeveloped

All EaP countries have export promotion strategies in place or in development. Armenia's "Export-led Industrial Development Strategy" (2011) and accompanying action plans outline a variety of support measures, including sector-specific promotion activities. Azerbaijan is in the process of developing a new export promotion programme, with a particular focus on increasing the capacities of AZPROMO, its export promotion agency. In Belarus, export promotion activities are implemented under the "National Programme for Export Development (2011-2015)", although the programme was not complemented by a detailed action plan. A new programme for 2016-20 is currently being developed. In the case of Georgia, SME internationalisation is one of the strategic directions of the new draft SME strategy and action plan, including measures for export promotion, export finance and integrating SMEs into GVCs. Moldova has had an export promotion and investment attraction strategy since 2006. A new "Export Promotion and Investment Attraction Strategy for 2016-2020" is currently being prepared with the primary objective of seizing the opportunities created by the DCFTA with the EU. Ukraine adopted the "Concept of Creation of State Export Support System" in 2013, although implementation has been very limited due to the unavailability of funding.

Most countries in the region have established export promotion agencies that are delivering basic support services to exporting SMEs. Armenia has recently reorganised its export promotion efforts, merging several government agencies to create a single export promotion agency, the Armenian Development Fund. In Azerbaijan, AZPROMO delivers export training and promotional events, and funds participation in international trade fairs. The government is planning to expand the capacity of AZPROMO to undertake matchmaking and policy advocacy activities, as well as developing more sophisticated support services. Georgia's export promotion activities have been transferred to the newly established Enterprise Georgia, which provides export training, certified courses for export managers, and support for participation in trade fairs. Enterprise Georgia has also been active in providing technical and financial assistance for DCFTA compliance. The Moldovan Investment and Export Promotion Organization (MIEPO) is responsible for organising business-to-business meetings, export forums and economic missions to other countries, as well as providing various coaching and consultancy programmes. MIEPO is currently being restructured in order to expand its capacity and increase the breadth and depth of support provided to exporting companies. There are currently no export promotion agencies established in Ukraine or Belarus, with basic support activities being carried out by the Ministry of Economic Development and Trade and the Chamber of Commerce, respectively.

While basic export promotion activities, such as training, coaching and trade fair participation, are carried out across the region, export finance is generally less developed, although there are some encouraging signs of a growing awareness of the importance of encouraging financial institutions to meet the needs of exporting SMEs. The Export Insurance Agency of Armenia has been operational since January 2015, offering insurance products against risk of non-payment by overseas buyers and exchange rates (Box 10.2). However, its range of finance tools could be expanded. An export credit agency is also being developed in Georgia, in co-operation with SACE, the Italian export credit agency. Development of export finance tools is also envisaged in the "Concept of Development of Export Support State System of Ukraine", but no progress has yet been made to implement it. Further help is at hand for Georgia, Moldova and Ukraine, in the shape of the DCFTA Facility for SMEs, set up to ease the process of aligning their various export activities with the requirements of the DCFTA (Box 10.4).

Table 10.1. **Scores for sub-dimension 10.1: Export promotion**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	4.33	2.78	2.33	5.00	3.67	1.89
Implementation	4.11	3.11	3.40	4.33	3.61	2.07
M&E	3.00	2.50	2.00	2.00	3.00	1.00
Weighted average	***3.97***	***2.87***	***2.75***	***4.10***	***3.51***	***1.79***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Box 10.2. **Armenia's Export Insurance Agency**

The Export Insurance Agency of Armenia (EIA) was founded in October 2013 within the framework of Armenia's export-oriented industrial policy, and has been operational since January 2015. The agency is fully state-owned, with shares divided equally between the Ministry of Economy, Ministry of Finance, Ministry of Foreign Affairs, Ministry of Agriculture and Ministry of Energy and Natural Resources.

Box 10.2. **Armenia's Export Insurance Agency** *(continued)*

The agency provides insurance against financial losses incurred as a result of non-payment for supplied goods by the foreign buyer or its bank, reducing export risk for businesses. Two types of risks are covered:

- Commercial risks directly related to the foreign buyer, such as the general inability of the foreign buyer to fulfill his payment obligations (insolvency/bankruptcy) or refusal of the payment without any legal reason.
- Political risks leading to a payment default by the foreign buyer as a result of events in the foreign buyer's country, such as administrative decisions or legislative measures, restrictions in conversion of payments as well as other events such as war, revolution, civil disorder and natural catastrophes.

Furthermore, the EIA has agreements with two Armenian banks allowing the insured firms to obtain short-term working capital financing up to the amount of the insurance coverage, for the same credit period and currency mentioned in the insurance policy. Banks are also able to provide financing in the form of export factoring in exchange for the cession of the rights on the receivable from the export contract. As of July 2015, the agency was in the process of establishing similar agreements with other domestic commercial banks.

An awareness campaign has also been launched to inform businesses of the main features and benefits of export insurance. The agency has been carrying out face-to-face meetings with businesses and business organisations, such as the Union of Manufacturers and Businessmen (Employers) and Armenia's Exporters' Union, as well as field visits to Armenia's regions.

As of August 2015, ten companies are receiving export insurance, eight of which are SMEs. Of the approximately EUR 1.45 million credit limit approved by the agency, roughly EUR 320 000 are financed by banks. There are plans to develop the activities of the agency further in conjunction with commercial banks, for example by offering subsidised interest rates to those receiving insurance. The EIA is also in the process of developing a financial literacy programme to increase capacity in commercial banks.

Source: Official website of Export Insurance Agency of Armenia, www.eia.am/en/home.html; interview with EIA.

Tools for integrating SMEs into global value chains are not yet developed

There are currently no targeted government programmes to enable SME integration into GVCs in the EaP region (Table 10.2). Activities in this area are limited to networking and promotional events organised by export promotion agencies, but they lack specific matchmaking schemes or targeted capacity upgrading initiatives. In Moldova, two donor programmes are currently being implemented in the agri-business sector to facilitate SME-FDI linkages, providing loans with subsidised interest rates, along with capacity building. The draft Georgia SME strategy and action plan also envisage a pilot programme on FDI-SME linkages to be established in the third quarter of 2016.

Table 10.2. **Scores for sub-dimension 10.2: Integration of SMEs into global value chains**

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Planning & design	1.00	1.00	3.75	2.67	1.00	1.00
Implementation	1.00	1.00	1.00	1.00	1.67	1.00
M&E	1.00	1.00	1.00	1.00	1.00	1.00
Weighted average	***1.00***	***1.00***	***1.96***	***1.58***	***1.30***	***1.00***

Note: See the chapter on "Policy Framework and Assessment Process" for further information on the methodology.

Box 10.3. **Creating SME-multinational enterprise linkages in the Czech Republic**

The Industrial Zone Initiative in the Czech Republic highlights how a property-led approach to economic development can attract flagship investors, promote SMEs linkages and bring economic benefits to a wide range of regional economies including less favoured regions. The programme is administered by the Ministry of Industry and Trade of the Czech Republic and is designed to provide support which will stimulate and support the construction and regeneration of industrial sites and related infrastructure by municipalities, associations of municipalities, regions, development companies, and significant investors.

Following two pilot programmes in 1998, industrial zones were rolled out on a national basis between 1999 and 2006. In 2006 the initiative was expanded to include strategic industrial zones (SIZs), which aim to attract strategic investors in advanced industrial technologies, construction and development of technology centres and centres of business support services, and science and research.

One of the key problems initially was the fact that incoming foreign companies retained their original input supply chain rather than sourcing intermediate products locally. For example, Panasonic originally bought only 5% of its inputs on the Czech market. To address this, the Supplier Development Programme was launched in 2000. Its main aim was to enable a group of Czech SMEs (with a maximum of 25% foreign capital) to supply large, foreign-owned companies in the electro-technical and electronics sector. Out of 200 Czech companies, 45 were chosen on the basis of predetermined assessment criteria. Eleven multinational companies looking for local supplies participated in this programme.

The programme had several phases: *(a)* identification of the business weaknesses and strengths of SMEs, based on the European Quality Model assessment and other methodologies; *(b)* development of a six-month action plan based on the company evaluations; *(c)* election of relevant companies; and *(d)* linking selected SMEs with multinational corporations (MNCs).

By the end of the programme (July 2002), the majority of selected companies had become suppliers of MNC affiliates in the Czech Republic and had experienced a substantial increase (on average 10%) in earnings between 2000 and 2001. The share of local input in the sector had risen by 21% in 2004, according to KPMG estimates.

Following the success of this pilot programme, the EU provided additional financing to expand the programme to other sectors considered strategic by CzechInvest. The programme's second phase was launched in January 2003 and lasted until October 2004; 50 firms were involved from the following selected sectors: production of components for automotive and aircraft industries, equipment, biotechnology and pharmaceuticals/health care. As of 2015, there are 103 fully prepared industrial zones, which are on average 70% occupied with over 600 investors.

Source: Official website of Investment and Business Development Agency, www.czechinvest.org/en/industrial-zones-cr; OECD (2013a), *Interconnected Economies: Benefiting from Global Value Chains*; OECD (2006), *Progress in Policy Reforms to Improve the Investment Climate in South East Europe: Investment Reform Index 2006*.

Box 10.4. **The European Union's DCFTA facility for SMEs**

The DCFTA Facility for SMEs was established in May 2015 for the three countries (Georgia, Moldova and Ukraine) which have signed an Association Agreement including a Deep and Comprehensive Free Trade Area (DCFTA) with the EU. Its objectives are to:

- help SMEs to seize the new trade opportunities with the EU and within the region which have been opened up thanks to the DCFTA
- improve SME access to finance for the necessary investments to comply with the DCFTA provisions
- allow SMEs to take advantage of the increased inflow of foreign direct investment triggered by the DCFTA
- enable SMEs to comply with new sanitary, phytosanitary, technical and quality standards, as well as with environmental protection measures, thereby benefiting local customers and boosting exports to the EU and beyond.

The DCFTA Facility for SMEs will receive approximately EUR 200 million of grants from the EU budget, which are expected to unlock at least EUR 2 billion of new investments by SMEs in the three countries, largely coming from new loans provided through European financial institutions supported by the facility. Such investments will transform business fundamentals. The local banking sector, business services to SMEs, trade and quality infrastructure, and the overall business climate will benefit substantially from the facility, creating a virtuous cycle of growth and contributing to significant job creation.

Source: EC (2015), *The DCFTA Facilities for SMEs*, available at http://europa.eu/rapid/press-release_MEMO-15-5013_en.htm.

The way forward

In order to boost SME internationalisation in the region, EaP countries may want to take the following steps:

- **Develop and strengthen their export promotion strategic and institutional frameworks to step up export promotion services**. In particular, export promotion activities need to move beyond promotional events, co-financing of trade fair participation and training into more sophisticated products (e.g. market intelligence, support for upgrading quality standards). In the case of Georgia, Moldova and Ukraine, these should include support measures to ensure SMEs benefit from DCFTA opportunities and financial support for some of the necessary adaptation costs. Providing a wider range of support services will require significant capacity building in existing agencies, and the establishment of specialised export promotion agencies in Ukraine and Belarus. Monitoring and evaluation of existing initiatives is important to better tailor them to the needs of exporting SMEs and improve their effectiveness. In addition, partnerships should be developed with business support organisations, chambers of commerce and bilateral and multilateral programmes aimed at creating cross-border business networks (including the Enterprise Europe Network).
- **Introduce trade finance tools and products for exporting SMEs**, delivered by an independent, specialised government agency in partnership with financial institutions. These tools should be diverse to cater for the various challenges SMEs

encounter when exporting. They could include export working capital provided directly to exporters; export credit guarantees provided through commercial banks; export credit insurance against commercial and political risk; and export factoring combining financing, insurance and collection. Financial support programmes should be deployed only in response to actual market failures and should be developed and implemented in partnership with financial institutions. These tools can also be coupled with technical assistance aimed at reducing export risks for SMEs. In Armenia and Georgia, where trade finance has or is in the process of being established, it will be important to ensure that it is properly monitored and evaluated.

- **Reduce the regulatory and administrative export barriers**, such as the number of documents and the time involved. Customs processes should be reviewed and simplified, particularly in countries where these are reported to be a particular hurdle for SMEs (e.g. Azerbaijan, Belarus and Ukraine).
- **Establish initiatives to promote global value chain integration among SMEs**. These could include programmes to promote business linkages (e.g. matchmaking, FDI-SME linkage and supplier development programmes), industrial competitive clusters and supplier upgrading schemes (e.g. skills development, training on compliance and international quality standards).

Table 10.3. **Dimension 10: Challenges and policy instruments**

Challenges	Policy instruments
Lack of finance for SME internationalisation	Establish an export finance agency or alternative structure in co-operation with financial institutions and the private sector (e.g. chambers of commerce) to provide a range of financial services to export-oriented SMEs, including: • working capital funds for exporters • export credit guarantees in co-operation with commercial banks • export credit insurance covering non-payment risk • foreign buyer financing in the form of direct loans to or guarantees for importers at fixed interest • export factoring. Facilitate financing for subcontracting SMEs to improve their production processes and introduce innovation
Lack of information on SME market opportunities for exporting and subcontracting to multinationals	Identify priority export countries Develop market intelligence (e.g. market reports on target markets and database of potential foreign partners) Establish an Internet portal with all relevant information on exporting procedures Leverage embassy networks to provide information and business contacts in foreign markets Support enterprises in attending international trade fairs and organise trade missions abroad, including ad-hoc advice during trade fairs (for instance IPR-related) Provide access to individualised consulting services for SMEs and introduce business coaching programmes (e.g. coaching of SMEs by multinational partners)
Few opportunities for collective action and business linkages	Create business networks to promote internationalisation amongst SMEs Join the Enterprise Europe Network and similar cross-border co-operation programmes Establish sectoral, regional and/or technology clusters linking multinationals with domestic sub-contractors Promote business linkages through matchmaking programmes integrated with FDI promotion activities
Lack of SME capacity for internationalisation	Introduce skills development programmes providing SMEs with training and capacity building on topics of interest (e.g. DCFTA opportunities) Facilitate SME compliance with product and process standards by providing or facilitating information and training

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Part II

Small Business Act assessment: Eastern partner country profiles

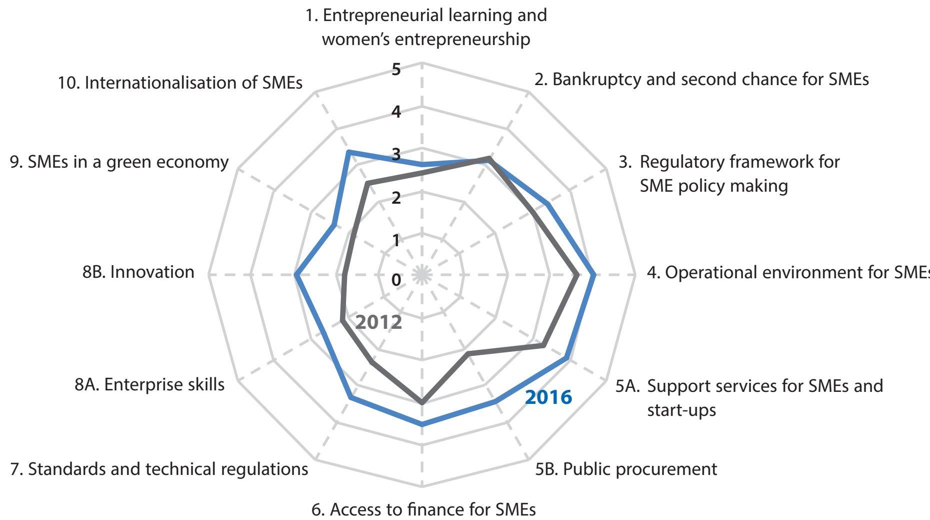
Chapter 11

Armenia: Small Business Act country profile

With its small internal market vulnerable to external shocks, and its challenging geographical location, economic competitiveness and export-led growth constitute key policy priorities for Armenia. Building on a strong entrepreneurial culture, a good performance in the implementation of business environment reforms and a well-developed business support infrastructure, the policy framework for SME development in Armenia has been considerably improved since 2012. Noteworthy reforms include a comprehensive guillotine process to streamline business legislation, an expansion of e-government services and the introduction of a one-stop-shop for business registration, the development of financial support measures for innovation, and the creation of an export promotion entity and an export insurance agency.

A few crucial reforms are currently in the pipeline. In particular, the government should finalise the preparation of a medium-term SME strategy to improve policy co-ordination and develop a stronger monitoring and evaluation framework. Reforms are also required to improve the insolvency and collateral frameworks to facilitate access to finance, as well as to strengthen the public procurement framework to stimulate SME participation and bring it into line with international best practices. Longer-term challenges include improving the scope and quality of SME statistics collection; streamlining tax administration; and expanding current support for innovation, export development and SME greening.

Figure 11.1. **SBA scores for Armenia**



Key findings

SME development is key to strengthening economic competitiveness in Armenia, a small land-locked country highly dependent on exports and remittances. Building on a strong entrepreneurial culture, on a solid track record in the design and implementation of business environment reforms, and on a well-developed business support infrastructure co-ordinated by one of the region's most dynamic SME agencies, the Armenian government has continued to improve its SME policy framework since 2012. Armenia's regulatory simplification process and regulatory impact analysis framework continue to strengthen the business environment for SMEs. Efforts to simplify procedures, including the establishment of a one-stop-shop for business registration and a sizeable expansion of e-government services, have also reduced SMEs' entry barriers and operational costs, although there is still room for improvement in certain areas (e.g. tax administration). Business support services provided by the SME Development National Centre (SME DNC), including a small credit guarantee scheme, have expanded with significant donor support and government resources. Entrepreneurial learning has received fresh impetus with a new financial education programme. Moreover, strategic focus on support to women entrepreneurs through SME DNC has increased women's access to training and finance. Likewise, support for SME innovation has improved through new financial and infrastructure initiatives. Data from the Business Environment and Enterprise Performance Survey (BEEPS) suggest that Armenian businesses are amongst the most innovative in the Eastern partner (EaP) region (EBRD, 2014). A property registry is now fully available online and legislation was adopted in 2014 to establish a registry for moveable assets to be used as collateral.

These recent efforts have translated into sizeable improvements in Armenia's 2016 SME Policy Index scores for Dimensions 3 and 4 (on the regulatory and operational environment for SMEs) (Figure 11.1). Work on bringing technical barriers to trade into line with international standards has also been reflected in Dimension 7 scores, while innovation initiatives have considerably improved performance against Dimension 8b, although a comprehensive strategy has not yet been adopted. Capacity-building efforts and increased use of open tenders are reflected in an improved score for Dimension 5b. On the other hand, there has been limited progress in improving the insolvency framework, so the score for Dimension 2 remains almost unchanged. SME greening remains weak, although Armenia compares favourably with other countries in the region.

Going forward, continued emphasis on horizontal reforms should be combined with a stronger strategic framework to ensure co-ordination across the many targeted initiatives developed by the Armenian authorities in recent years. The 2016 SBA assessment considers the following to be priorities for Armenia in improving its SME policy framework:

- Policy making in the area of SME development is currently based on yearly action plans developed by the Ministry of Economy and implemented by SME DNC. A longer-term strategy is currently being drafted and would provide a clearer roadmap for government reforms and initiatives. It would also act as a platform to improve institutional co-ordination beyond these two key actors and strengthen public-private dialogue, which has decayed somewhat in recent years. The new strategy should also improve monitoring and evaluation systems, which require a significant effort to enhance the scope and quality of SME statistics (including collection of sex-disaggregated statistics).
- Additional efforts in export promotion will be required so as to seize the opportunities on offer from increased trade with the major economic blocks (including the EU) as well as from Armenia's recent accession to the Eurasia Economic Union (EEU). The consolidation of existing initiatives within a single agency (the Armenian Development Fund) and the adoption of an Export-led Industrial Development Strategy are positive developments. More needs to be done, however, to improve the internationalisation of Armenian SMEs, which is well below regional averages according to BEEPS data (EBRD, 2014). Upgrading business skills through greater use of private business development service providers (in addition to SME DNC's services) will also help to strengthen SME competitiveness. Integrating entrepreneurship key competence in the national curriculum and teacher training will help to ensure a lifelong entrepreneurial learning approach to human capital development. Women's entrepreneurship support policy and actions will require further consolidation, with a key emphasis on policy partnerships.
- Access to finance continues to be a challenge for SMEs, with high collateral requirements posing a significant problem. Legal reforms since 2012 have helped to strengthen the regulatory framework underpinning SME access to finance, but to address existing constraints for SME growth it would be important to establish an online registry for security interests over movables, and to promote non-banking finance (e.g. through a strengthened framework for leasing).

Table 11.1. **Armenia: Challenges and opportunities**

Strengths	Weaknesses
• Significant progress in improving business environment (2nd best EaP performer in World Bank *Doing Business 2015*); improved e-government and company registration (one-stop-shops, e-portal) • Export-orientation, SME development are policy priorities, solid sector strategies • Good track-record on legislative simplification and implementation of regulatory impact analysis • Wide range of SME-targeted business and financial support through SME DNC (including credit guarantees) • Good results in innovation by SMEs (cf. BEEPS); well-developed policy framework, including financial incentives • Support measures rely on M&E systems; transparency on beneficiaries of financial support • High entrepreneurial activity, business acumen in the country	• Lack of comprehensive multi-year SME strategy, policy led instead by annual programmes • Tax administration is a significant burden for firms (top obstacle to doing business according to BEEPS V) • Customs and trade regulations continue to be a constrain for exports (cf. WB *Doing Business*, BEEPS) • Weak statistics collection – use of inconsistent SME definition for data collection hampers comparability • Public-private consultations remain ad-hoc • Increasing difficulties in access to finance – required collateral has increased substantially (60% in 2009 to over 200% in 2013), bank financing decreased from 21.7% to 9.5% – well below the regional average (BEEPS V) • High unemployment (~17%), potential skills mismatches

Table 11.1. **Challenges and opportunities** *(continued)*

Opportunities	Threats
• Strong human capital (e.g. science) • Growing exports (above pre-crisis levels); could be further boosted by EEU membership and expanded trade with EU • Some evidence of structural transformation: increasing share of manufacturing and services in GDP, employment shifts; dynamic IT sector • Several donor projects on business/SME development • Great potential in Armenian diaspora (6 million people) • Incipient development of non-banking sources of finance (e.g. first Armenian venture capital fund established in 2013) • Relatively high levels of FDI can be leveraged by SME linkage programmes • Participation in EU programmes (COSME, including the Enterprise Europe Network; potentially Horizon 2020)	• Small internal market; difficult geographic position, infrastructure gaps are an obstacle for export development • Significant exposure to regional dynamics (e.g. Russia represents a quarter of exports) and dependence on remittances (18-20% of GDP) • Export basket remains unsophisticated, quality upgrading (also through innovation) required for export growth • Dependence on often piecemeal donor support programmes, without longer-term strategies • Large informal sector (estimated 52% of employment in 2009) • Initiatives need to streamline regional development beyond Yerevan • Level of competition in certain key markets is low

Overview

Economic snapshot

Armenia experienced strong economic growth prior to the 2008-09 crisis, with an annual average GDP growth of 13.4% between 2002 and 2007, driven by capital inflows and remittances (Table 11.2). Growth has occurred particularly within the infrastructure sector, with USD 3.2 billion of foreign direct investment (FDI) in the telecommunications, energy and transportation sectors between 2002 and 2012, representing 58% of Armenia's FDI over this period (UNCTAD, 2013). However, following a deep recession in 2009, post-crisis growth has been moderate due to falling investment activity, particularly in the construction sector, whose share in GDP reduced from 27% in 2008 to 9.3% in 2014.

The Armenian economy has strong links to the Russian market, which represents one quarter of Armenian exports – the second largest destination after the EU – and is the source of about 90% of remittances. Meanwhile, the economy continues to be highly dollarised, which further increases vulnerability to external shocks. As a result, the country was strongly affected by the recession in Russia, causing economic growth to slow to 3.5% in 2014 (EBRD, 2015). The dollar value of remittances, which represent 18-20% of Armenian GDP, halved with the depreciation of the rouble, causing a contraction in household spending and growth. After a 17% devaluation against the dollar in 2014, which prompted a swift intervention by the Central Bank to tighten monetary policy, Armenia's currency has stabilised in the course of 2015. Inflation increased considerably from 3% in 2014 to above 5% in early 2015. The impact of regional spillover effects is expected to continue and the Armenian economy is projected to experience negative real GDP growth in 2015, before a gradual recovery begins in 2016 (IMF, 2015).

While pre-crisis growth was driven by the construction industry, the agriculture, services and mining sectors have been gaining prominence in recent years. Agriculture remains the largest sector of the economy (19% of GDP), though processed manufacturing is increasing its share of GDP (10% in 2014, compared to 8.3% in 2008). Given the small size of the country and its geopolitical constraints to trade, increasing and diversifying exports have become a government priority. Between 2010 and 2014, exports of goods grew at an annual average rate of 11%, surpassing pre-crisis levels to reach EUR 1.4 billion in 2014. Nonetheless, the current account balance remains negative (8% of GDP in 2013). After a sharp fall driven by the world economic crisis, FDI net inflows are still on the decline, limiting opportunities for economic growth. Net FDI inflow stood at USD 240 million in 2013 (much below the USD 935 million in 2008). Armenia's external balance could benefit from its recent accession to the EEU, potentially leading to increased food exports and reduced energy prices, although trade openness will also increase pressures on economic competitiveness.

Although it has begun declining in recent years, Armenia's unemployment rate remains high (estimated at 17% in 2013-14) (EV Consulting, 2014). There is some evidence of skills gaps in key economic sectors, and negative migration flows intensified after the 2008-09 crisis. Likewise, a large informal sector, which represented 11.2% of total gross value added and 52.1% of employment in 2009 (World Bank, 2013), is detrimental to fiscal revenues and economic competitiveness.

Table 11.2. **Armenia: Main macroeconomic indicators, 2010-14**

Indicator	Unit of measurement	2010	2011	2012	2013	2014[a]	2015[b]
GDP growth	Percent, year-on-year	2.2	4.7	7.1	3.5	3.4	-1.0
Inflation	Percent, average	7.3	7.7	2.5	5.8	3.1	6.4
Government balance	Percent of GDP	-5.0	-2.9	-1.6	-1.7	-2.1	-4.5
Current account balance	Percent of GDP	-14.2	-11.1	-11.1	-8.0	-7.9	n.a
Exports of goods and services	Percent of GDP	20.8	23.8	24.6	27.0	31.3	n.a
Imports of goods and services	Percent of GDP	45.3	47.4	49.3	48.0	51.2	n.a
Net FDI	Percent of GDP	5.6	4.3	4.7	4.9	n.a	n.a
External debt	Percent of GDP	66.4	71.5	74.9	81.5	n.a	n.a
Gross reserves	Percent of GDP	20.1	19.1	18.1	21.6	n.a	n.a
Credit to private sector	Percent of GDP	28.4	35.3	42.5	44.9	n.a	n.a
Unemployment[c]	Percent of total active population	19.0	19.0	19.0	18.5	18.0	17.9
Nominal GDP	USD billion	9.3	10.1	10.0	10.4	10.3	9.3

Notes: **a.** 2014 figures on GDP growth and nominal GDP are IMF projections; **b.** IMF projections; **c.** IMF estimates for 2012-14.

Source: EBRD (2014), *Transition Report 2014*; IMF (2015), *World Economic Outlook*; World Bank (2015), *World Development Indicators 2015*

Business environment trends

Armenia has made substantial progress in developing its business environment, and currently ranks 45th globally on the World Bank *Doing Business* report (second best of all EaP countries; World Bank, 2014), 4th in the Starting a Business indicator and 7th in the Registering Property indicator (World Bank, 2014). At 85th out of 144 countries in the Global Competitiveness Index 2014-15 (up from 92nd in 2011-12) (World Economic Forum, 2014), Armenia's economic competitiveness is hampered by its relatively limited financial sector development, relatively poor social services and weak innovation.

Since the 2012 SBA assessment, the government has undertaken a number of reforms to improve the business environment, including the extension of e-government services, simplification of licencing, and easing of company registration by reducing the number of procedures and establishing a one-stop-shop. Inspections have also been subject to considerable streamlining under a new law to improve transparency and adopt a risk-based approach. Ongoing reform efforts focus on promoting access to finance by addressing regulatory bottlenecks and improving the legal regimes for insolvency and use of collateral.

Armenia has also introduced a risk-based control system in tax administration to ease the administrative burden for businesses. This is reflected in a reduced frequency of inspection by tax officials (2.1 vs. 1.3 times per year) between 2009 and 2013 according to BEEPS surveys (EBRD, 2014). However, 23.6% of Armenian enterprises continued to cite tax administration as one of the three main obstacles to doing business in Armenia (the other two being high tax rates and political instability). About three-quarters of firms received visits or inspections from tax officials in 2013, almost 18 percentage points above the regional average for Eastern Europe and Central Asia. Customs and trade regulations also continue to be burdensome, with exports taking 8.6 days (nearly twice the regional average) and imports 17.6 days (more than three times regional average) to clear through customs (EBRD, 2014). Given Armenia's landlocked geographic location and small internal market, inefficient trade regulations are an important barrier to economic growth. A new Customs Code was enacted in May 2014 to streamline existing procedures and a single customs window is under development to address these constraints. Likewise, low levels of competition and high concentration in key sectors of the economy (including telecommunications and infrastructure, as well as certain imports) constrain competitiveness and SME development.

The "2014-2025 Armenian Development Strategy" emphasises export-led growth based on agriculture, IT, tourism, and industrial processing. Economic competitiveness and private sector development reforms (in particular to reduce administrative barriers and streamline tax administration) are among the key priorities. Despite several years of negotiations with the European Union (EU) on an Association Agreement (AA), including a Deep and Comprehensive Free Trade Area (DCFTA), Armenia decided to join the EEU in 2013 instead. EEU membership entered into force on 2 January 2015, and is likely to have a significant impact on the development of the business environment, including trade policies. Talks have recommenced for a new Framework Agreement with the EU, however, which could help bring regulatory standards in line with EU benchmarks.

SMEs in Armenia

Armenia has a single SME definition, which was updated in 2011 to conform to the EU definition in terms of employment criteria. The definition uses balance sheet, employment and turnover criteria (Table 11.3).

Table 11.3. **Definition of micro, small and medium enterprises in Armenia**

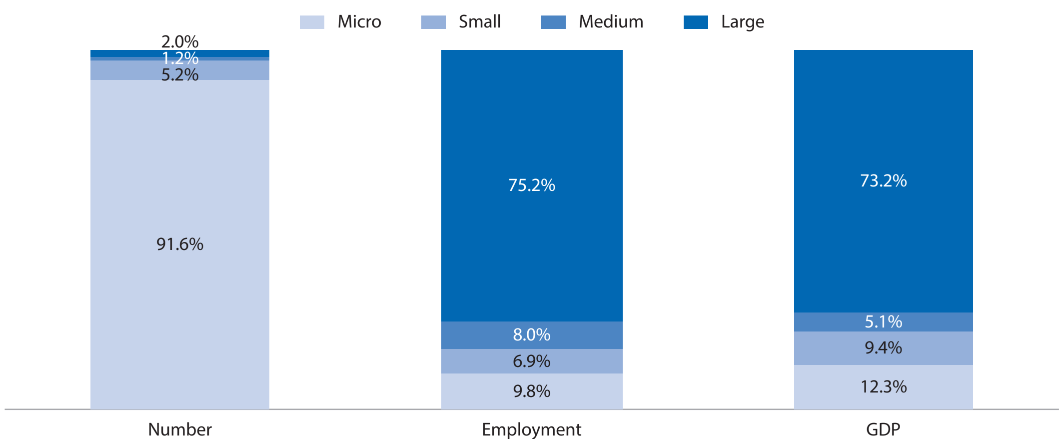
	Employment	Annual turnover	Balance sheet
Micro	< 10 Employees	≤ AMD 100 million (EUR 187 000)	≤ AMD 100 million (EUR 187 000)
Small	< 50 Employees	≤ AMD 500 million (EUR 936 000)	≤ AMD 500 million (EUR 936 000)
Medium	< 250 Employees	≤ AMD 1 500 million (EUR 2 808 000)	≤ AMD 1 000 million (EUR 1 187 000)

*Note: E*xchange rates as of June 2015.

Source: Amendments to the Law on State Support of Small and Medium Entrepreneurship (2011).

As of 2012 (the last year for which estimates are available), SMEs constituted 98% of all registered and functioning legal entities (Figure 11.2). There were about 75 400 SMEs in total. Between 2010 and 2012, the number of SMEs increased by around 25%. The contribution of SMEs to GDP has doubled since 2002, and currently stands at 27%. No estimates exist for SME value added. Micro-enterprises dominate SMEs, making up 92% of all registered enterprises. These are followed by small firms (around 5%). Nearly 60% of SMEs are engaged in retail and wholesale trade, with only 8% engaged in processed manufacturing (40% of them in food sector) and 5% in the transport sector. Just over half of all SMEs (53%) operate in the capital city Yerevan (where the density of SMEs is 38 firms per 1 000 inhabitants). The rest are spread across the regions (at the much lower density of 18 SMEs per 1 000 inhabitants).

Figure 11.2. **Business demography indicators in Armenia, 2012**



Note: Data includes both small enterprises and individual entrepreneurs; latest available figures are for 2012.

Source: SME DNC.

In 2012, around 290 000 people were employed by SMEs (making up 24.7% of total employment) This is a 12% increase over 2010, contrasting with a slight decrease in employment overall in Armenia. Micro-enterprises make the highest contribution to total employment among SMEs and 40% of SME employment is located in the regions. SMEs play a significant employment role, especially in sectors such as construction (accounting for 86% of jobs), accommodation and food services (88%), leisure (80%), trade (66%) and processed manufacturing (64%). The trade and processed manufacturing sectors represent around 29% and 13%, respectively, of total SME employment.

SBA assessment results

This section outlines the main results for Armenia from the 2016 SBA assessment of EaP countries. It also highlights the changes that have occurred since the previous assessment in 2012 (OECD, 2012). The assessed policy dimensions are grouped under five key thematic pillars, reflected in the section headings below.

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

Armenia continues to take a proactive approach to SME policy, with an extensive range of support measures delivered by SME DNC. A new phase of the legislative guillotine process was launched in 2012, and regulatory impact assessment continues to be implemented while taking SME aspects into consideration. Substantial reforms have also been made to the operational environment with the simplification of company registration procedures and expansion of e-government services. On the other hand, the insolvency framework still presents shortcomings when compared to best international practices.

Institutional framework

In Armenia, the Ministry of Economy is responsible for developing SME policy, in line with the Law on State Support and the "Concept for SME Development Policy and Strategy", both adopted in 2000. The law defines various forms of support, including a favourable legislative framework, financial support, infrastructure, information provision and consulting, export support, assistance for innovation, an enabling tax policy, human resource development, assistance for participation in public procurement processes, and simplification of accounting and statistics systems and procedures. A three-year Medium-Term Expenditure Framework is prepared regularly, along with annual state programmes for Small and Medium Entrepreneurship State Support, providing a detailed list of activities and timelines. In 2014, the annual programme was funded with about EUR 330 000 from the state budget.

The SME DNC is the independent agency responsible for implementing the annual SME development programme. The agency's governance board is chaired by the Ministry of Economy, with representation from other ministries and the private sector. Regular consultations are also held with the other stakeholders (e.g. ministries, NGOs, etc.) to ensure co-ordination of activities. SME DNC provides targeted support, including a credit guarantee scheme created in 2005 as a EUR 3.6 million revolving fund.

There is no overarching, medium-term SME strategy in place. SME development is addressed in Armenia's main economic development document, the "Armenian Development Strategy 2014-2025", which sets a target of increasing SMEs' contribution to up to 60% of GDP by 2025. In the absence of a new document, the 2000 "Concept for SME Entrepreneurship Development Policy and Strategy" is formally still under implementation. A draft strategy organised around the ten principles of the Small Business Act for Europe was prepared in December 2014 with donor support; in June 2015 it was being discussed by key government stakeholders. The government aims to adopt a final version of the strategy by the last quarter of 2015. This would be a positive development as it would help the Ministry of Economy and SME DNC to define and prioritise interventions and improve monitoring and evaluation over a longer timeline, while improving co-ordination with other stakeholders (including SMEs themselves).

Armenia collects both structural and demographic statistics on businesses, including birth, death and survival rates by size and sector. An annual report is published by SME DNC analysing the major trends in the development of the SME sector. However, despite the introduction in 2011 of a new SME definition which is consistent with EU employment criteria (Table 11.3), the use of the old SME definition persists for national statistics collection. This creates a mismatch between the data that is available and the policy-making data requirements. In addition, some statistical data are limited (e.g. on SME export activities) and the methodologies used could be improved. Indeed, the main data produced by SME DNC are based mainly on a secondary analysis carried out on limited information produced by other government agencies (e.g. social security and tax authorities). Finally, there are very limited data and information available on the shadow economy (despite significant evidence suggesting that it is of considerable size). The government could develop surveys and other tools to understand this sector better, and as the first step in developing targeted policies to encourage business formalisation.

Legislative simplification and regulatory impact analysis

Since 2008, the Armenian government has developed and implemented "Annual Action Plans on Improvement of the Business Environment", determining the legislative areas and laws to be prepared, modified, reformed or repealed in the coming period. In 2012, Armenia also launched a large-scale "guillotine" programme to eliminate obsolete business related legislation and ease regulations, with financial assistance and technical support from international donors. The process aims to review 3 000 rules and regulations in 30 sectors, engaging 17 ministries and 10 regulatory bodies. A Reform Council – comprising the Prime Minister, Chief Advisor to the President, Minister of Economy, Minister of Finance and Minister of Justice – was established as the decision-making body. A dedicated unit (the National Centre for Legislative Regulation) was set up to conduct the legislative guillotine process. By April 2015, 20 sectors of the economy had already been reviewed, 5 were in progress and another 5 were planned to be reviewed by mid-2015. Actual elimination of legislation is awaiting final decision by the government and the National Assembly.

Legislation on regulatory impact analysis (RIA) was adopted in 2008 and has been in practice since 2011. The RIA consists of an assessment of the potential impact of draft legislation on business using cost-benefit analysis, and includes impacts on SMEs. Consultations with stakeholders are also held, including representatives from industry and SMEs.

While these initiatives have had a tangible impact on the administrative burden for SMEs, businesses continue to identify heavy regulation as a constraint, particularly tax administration. A company survey of 150 Armenian SMEs conducted by the OECD in 2015 as part of this SBA assessment revealed that over 50% of SMEs consider the "complexity of administrative procedures" to be a problem when doing business.

Public-private consultations

Armenia has a solid legislative framework for public-private consultations and several active platforms for dialogue, although their effectiveness could be further improved. The Business Support Council, chaired by the Prime Minister, was established in 2000 as the main platform for public-private dialogue. However, while meetings are required to be organised monthly, a more sporadic pattern is observed in practice and the impact of private sector feedback appears to be limited.

Similarly, in 2011, the Small and Medium-Sized Enterprise Development Council was established by the Prime Minister to create effective public-private consultations and generate tangible results in identifying and discussing SME sector-specific issues. Although meetings are supposed to be held quarterly, the actual pattern appears to be less frequent and somewhat irregular. In the framework of the "Export-led Industrial Strategy", the Industrial Board and sectoral councils have also been established as public-private dialogue platforms.

An important element of public-private consultations is public hearings to discuss draft legal acts, which currently take place mainly via electronic means. Again, while all the formal components are in place, their enforcement and impact could be considerably improved. For instance, the government is not required to take comments into consideration in the final amendment of the act.

Overall, the representation and contribution of SMEs is mostly limited to formal inclusion in a limited number of councils and boards. The effectiveness of the dialogue platforms and SME engagement largely depend on the existence of an inclusive and dynamic sectoral association. Currently only a few sectors, such as IT and pharmaceuticals, possess such effective organisations.

Interaction with government services (e-government)

Since the 2012 assessment, considerable progress has been made in the development of e-services. To increase the use rate of e-services, the government approved a concept paper – "Formation of E-society in the Republic of Armenia (2010-12)" – which led to the development of a range of online government services. Functional e-services currently include online filing of tax returns and social security contributions, e-pension, e-procurement systems, e-cadastre, e-registration, filing of intellectual property applications, e-visa, and e-payments. In addition, the electronic version of the cadastre is now fully operational. A bilingual online portal (www.egov.am) provides links to the e-government service websites.

E-signature is in use and has been integrated with a range of other e-government services since the adoption of legislation in 2004. In 2009, several government ministries and public institutions adopted a specialised workflow management system that enables the centralised storage of electronic documents. This has contributed to more effective communication between public institutions. Nevertheless, a fully integrated and single platform for data sharing among the various public institutions does not exist.

For the purposes of streamlining online reporting of enterprise statistics, the Ministry of Economy and the Enterprise Incubator Foundation have developed ICT Stat, an online registry of ICT companies. This platform serves as a pilot for other industries, although no progress has yet been made to scale it up.

Despite this progress, limited awareness and use of electronic tools by SMEs remain a problem in Armenia. The Armenia OECD company survey conducted in 2015 revealed that approximately half of participating SMEs did not consult government websites for any purpose.

Company registration

Armenia has made significant improvements to the cost and efficiency of its company registration process. Today it ranks 4th on the "Starting a Business" dimension of the World Bank *Doing Business* report (World Bank, 2014). The business entry one-stop-shop was established in 2012, bringing together in a single location the services for business name reservation, company registration and tax registration. Consequently, the number of days required for issuing a company registration certificate has been reduced from five in 2012 to two. The reforms have also transferred the burden of notification away from the firm, by enhancing communication between the company register and government agencies that interact with the enterprises. The overall registration process currently takes three days and two administrative steps (compared to three and eight, respectively, in 2012). All procedures can be carried out online.

However, the capital city and several urban areas are the main beneficiaries of the implemented reforms. In Armenia's regions, the lack of one-stop-shops and the limited availability and use of the Internet still represent obstacles for company registration.

Bankruptcy procedures and second chance

Armenia ranks 69th out of 189 economies in the “Resolving Insolvency” dimension of the World Bank *Doing Business* report 2015. It has the second best performance among EaP countries for bankruptcy time (1.9 years) and costs incurred through bankruptcy proceedings (11% of the estate’s value). However, the recovery rate for creditors is almost half the OECD average (37.2% and 71.9% respectively) (World Bank, 2014).

Bankruptcy procedures are governed by the Law on Bankruptcy of 2006, as amended in 2007. Separate legal frameworks exist for banks and other financial entities, while state-owned enterprises are subject to the general regime. The law reflects only medium compliance with international standards according to a European Bank for Reconstruction and Development assessment (EBRD, 2009), being let down by deficiencies in the provision of material information to creditors and the absence of a requirement for an independent analysis of the reorganisation plan.

With no major amendments since the 2012 assessment, the existing legal framework still presents a number of weaknesses. Reorganisation is underemphasised in general, with preference being given to credit-driven methods of resolving corporate distress. The majority of bankruptcy cases thus terminate in liquidation, even though there are reorganisation provisions in the law. Lack of mechanisms to encourage post-petition financing is a particular problem in this respect. In addition, the provisions in the Armenian law for the avoidance of pre-bankruptcy transactions are brief and incomplete. In particular, the definition of “reviewable transaction” needs to be clarified to give guidance to both courts and insolvency practitioners. Creditors’ rights and creditor participation remain limited, and the law does not have provisions to ensure that material information is supplied to creditors throughout the insolvency process. In addition, the law does not require an independent analysis of the reorganisation plan. The 2006 law also does not provide a sound platform to manage cross-border insolvency cases. More generally, there are no effective early-warning systems in place to identify financially distressed companies.

The government is currently considering a revision of the insolvency legislation to address these shortcomings through amendments in the course of 2015. In addition, further efforts to increase court insolvency specialisation, as well as an improvement in the number and qualifications of bankruptcy administrators, would considerably support the effectiveness of the insolvency framework in its day-to-day implementation.

In terms of second chance treatment, there are no discriminatory provisions that would limit access by re-starters to business support mechanisms or from taking part in public procurement tenders. However, the Law on Bankruptcy does prohibit a bankrupt natural person from starting or partnering in a business for five years (World Bank, 2013), which prevents an immediate fresh start. Armenia currently has no targeted programmes to promote a second chance for failed entrepreneurs. The 2015 OECD company survey found that 77% of SMEs find it difficult or very difficult to resume business after failure; acquiring finance was mentioned as the most significant hurdle.

Facilitating SME access to finance (Dimension 6)

SME access to finance is dominated by bank lending and some targeted support schemes for young enterprises and agricultural producers. Alternative sources of finance are not fully developed yet and could benefit from a stronger legal framework, in particular leasing activities, which can be an important alternative to bank financing for SMEs.

Legal and regulatory framework

Important developments have taken place to the cadastre and registry of security over movables. The cadastre is now fully available online, an important step to improve its usability. In 2014, a new Law on Secure Rights Records of Mobile Assets was adopted and is due to enter into force in October 2015. This law stipulates the creation of a unified online database for movable assets. If implemented, this would help create an effective system for the use of movable collateral. Both public and private credit registries exist and coverage currently stands at 23.5% and 65.8% of the overall population, respectively.

Certain Basel recommendations have been implemented and the Central Bank of Armenia regularly reviews its regulations to comply with Basel requirements. Changes include stricter terms of capital requirements since Basel II, and the discouragement of foreign currency lending to unhedged borrowers. The latter is achieved by applying higher risk ratings and provisioning requirements on foreign exchange lending than on loans in local currency.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

Bank intermediation has slightly increased, with the private sector credit-to-GDP ratio standing at around 38.7% in 2013 compared to 30.6% in 2011. Lending to SMEs seems to have increased more rapidly, with an estimated 35.7% of domestic credit going to SMEs, compared with around 25% at the time of the last SBA assessment. However, access to finance remains the most important obstacle to doing business according to results from BEEPS V (EBRD, 2014). Given substandard quality in financial reporting by many enterprises, banks rely heavily on collateral which poses a significant problem to SMEs.

There are public programmes in place to facilitate SME access to bank financing. These mainly focus on young firms and agricultural producers. One of the most important is implemented under the auspices of the SME DNC. The programme supports SMEs and start-ups with credit guarantees and interest rate caps. The number of SMEs supported is relatively moderate (19) while the number of start-ups is quite significant (224 in 2014). The programmes have remained largely unchanged since 2012, apart from the maximum guarantee amount for start-ups having been increased from AMD 3 million to AMD 5 million (approximately EUR 5 600 and 9 400, respectively).

A law on leasing activities has recently been drafted to establish a clear legal framework; however, it has not been adopted. There are legal provisions in place for factoring and factoring services are offered by 8 out of the country’s 21 banks. However, uptake is not very high.

Private equity more generally is not very well developed as a market and scarce investment opportunities combined with limited exit opportunities have constrained international investor appetite. Once completed, the pension reform could allow a local institutional investor base to contribute to the development of the market. However, there is public support for start-ups provided through the SME DNC. In 2013, Armenia’s first venture fund, Granatus Ventures, was launched to invest in start-ups with an IT focus. No institutionalised business angel network exists, but there are investors, in particular among the Armenian diaspora abroad.

Financial literacy

In 2012, the Central Bank of Armenia initiated a general financial literacy assessment leading to a “National Strategy on Financial Literacy Action Plan”, approved by the national government in 2014. Information on SME financing options is provided through financial literacy training organised by the SME DNC, and is also available on the Central Bank's dedicated online portal. The former was used by 521 entrepreneurs in 2013. While these programmes have been regularly monitored, their success in helping SMEs has not been evaluated.

The inclusion of financial literacy as part of the education system is planned, but has not yet been implemented. The government's action plan includes the introduction of financial education to the secondary school curriculum, as well as training courses for teachers in 2015.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Entrepreneurial human capital is a strategically important area of development for the Armenian economy, one which could trigger national growth and competitiveness. The SBA assessment report of 2012 emphasised the promotion of entrepreneurial learning, women's entrepreneurship and SME skills' development programmes as the main priorities for government support and national policy partnership. Since the last assessment, Armenia has made impressive progress in several policy areas of Dimension 1 (supporting entrepreneurship and human capital development), including: implementing government measures for financial education in upper secondary schools; developing university-business co-operation; putting in place policy measures to promote entrepreneurial efforts by women; and supporting SME start-up training. In all these areas, the government has successfully put together its own institutional support systems and resources, and engaged international development assistance in order to achieve faster, more sustainable progress towards these policy targets.

Lifelong entrepreneurial learning

The Ministry of Education and Science is a major player in the implementation of lifelong entrepreneurial learning programmes in Armenia. It has previously developed and approved a "Lifelong Learning Concept" for Armenia, introduced the mandatory subject of social science, and co-operated in the Junior Achievement of Armenia programme. Over the last assessment period the government has moved swiftly to implement elements of key entrepreneurship competence in formal education. "The National Strategy on Financial Literacy Action Plan (2014-2019)" has been adopted and is expected to cover all levels of pre-university education. The subject of applied economy is offered in secondary schools as an optional introductory course, covering free market relations and the basics of economics, while a course on entrepreneurial and civil learning for young people is also taught. Given the need for substantial investment in a review of general educational standards, curricula and teacher training, the government has engaged a World Bank loan to support an Education Improvement Programme (2015-19).

During the last SBA assessment period Armenia established structured policy partnership arrangements for the design and implementation of financial education programmes within the formal school system. This was an important step forward, and involved the establishment of a Government Committee with representatives from the ministries of finance, education and science, economy, Central Bank and other major players.

All these efforts are giving Armenia regional prominence for its promotion of financial literacy in formal education. This assessment recommends now that Armenia focuses its future policy efforts on the systemic introduction of the entrepreneurship key competence across all levels of formal education and in non-formal learning. These should cover the key competence as a whole, including risk-taking, opportunity-seeking and creativity. Embedding key entrepreneurship competence support measures into the Education Development State Programme for 2016-25 should be strongly considered as the next step. Furthermore, an evolving policy dialogue on lifelong entrepreneurial learning in Armenia should bring together experts, practitioners and policy makers to agree how to co-ordinate efforts and how to feed good practice into policy. It is critical to ensure engagement by major stakeholders in the development of sustainable policy partnerships for lifelong entrepreneurial learning, with specific focus on the development of entrepreneurship key competence. The gradual development of key competences through years of education and non-formal learning should prepare learners for the changing demands of the modern knowledge society.

Vocational education and training and higher education both need to strengthen their efforts to unlock the entrepreneurial potential of their graduates through career guidance, providing all learners with entrepreneurial experience opportunities and tracking former graduates. An entrepreneurial culture in universities should play a major role in economic growth and innovation at both regional and national levels. Entrepreneurial learning should be brought into the centre of discussions of the Armenian higher education network. A major step forward has been the active collaboration between universities and enterprises. Nevertheless, embedding entrepreneurship within the "fabric" of Armenia's higher education system still requires more concerted efforts, such as introducing entrepreneurial learning in non-business faculties and adopting a "cross-campus" approach to higher education. Moreover, systematic exchange of good practice would allow universities to engage in peer learning and develop an entrepreneurial mind set among students, teachers and managers of higher education. The outcome would be to turn universities into the hubs of Armenia's national entrepreneurship "ecosystem".

Women's entrepreneurship

While the first SBA report recognised the government's commitment to promote gender equity in the broad sense, it identified no direct support for women's entrepreneurship as an economic issue. In 2013, the government adopted the "Women's Entrepreneurship Strategy in Armenia". This is closely linked to the SME State Support Annual Programs, which since 2013 have included a special section devoted to women's entrepreneurship. The government has also obtained support from the Asian Development Bank and other partners for implementing women's entrepreneurship. A whole range of support measures have been provided: start-up support to women entrepreneurs, mentorship, coaching, access to finance, business advisory services, etc. Policy partnership with the main stakeholders has been developing fast and benefits from regular consultations, including national policy discussions and public awareness campaigns in the regions. The International Conference of Women Entrepreneurs ("Vision of new developments") in June 2015 is a recent example. Government commitment to women's entrepreneurship is also demonstrated by the substantial shares of state co-financing in donor-supported programmes. Armenia made progress on good practice exchange for women's entrepreneurship through strong efforts by specialised networks led by the "Women Entrepreneurs Network in Armenia" (Armenian Young Women's Association, AWAY). Noticeable efforts have also been invested in "engendering" national SME statistics to allow monitoring and evaluation of women's entrepreneurship policy; however, the availability and quality of sex-disaggregated statistical data remains a major challenge. Armenia does assess women entrepreneurs' business development services needs – this experience could be shared with the peer countries of the Eastern partner region as it serves as a solid basis for ensuring quality and relevant service provision by SME DNC.

SME skills

SME DNC and its broader network ensure that the Armenian Government is able to offer a whole range of services to various categories and groups of SMEs, including special target groups (pre-start-up, start-up, growth and internationalisation training, services specifically targeting women, youth, etc.). However, policy evaluation arrangements should be strengthened further and need to focus on the impact of government support and effectiveness of institutional support structures.

SMEs' training needs are regularly assessed by the SME DNC, Business Support Centre (BSC), State Employment Service Agency (SESA) and individual training providers, using standardised data collection instruments. However, there is no agreement on the training needs analysis framework. Once adopted, this framework would allow for gap analysis, programme review and improvement of the training on offer. Agreement is also needed on SME training quality assurance and quality improvement measures, with a view to establishing specific arrangements among public and private training providers. This should build on the strength of existing institutions, including the National Centre for Quality Assurance of Tertiary Education, and the Centre for Education Projects, and be linked to the National Qualifications Framework for the development and accreditation of providers. More attention should be devoted to entrepreneurs' digital competence, including the quality and availability of learning opportunities via e-training and other web-enabled services. Current progress in implementing e-services for SMEs and the launch of the e-portal should provide a good basis for expanding the e-training offer.

The current assessment has also identified a significant step forward in targeted provision of SME training to the needs of different categories of SMEs in Armenia. Following the recommendations of the 2012 SBA assessment report, the quality of monitoring of start-ups and growth training has further improved. However, official statistical data still cover only publicly supported training provision. The current statistical data allow the government to estimate that at least 40% of newly registered start-ups participated in training during the reporting period. Ongoing start-up programmes include training on access to finance. Training in internationalisation is offered through the SME DNC, Chamber of Commerce and Armenian Development Agency (which is now expected to be dissolved and absorbed into the Armenian Development Fund), and is supported by the provisions of the draft SME development strategy and an allocation under the state budget. Training in SME growth and internationalisation is an integral part of SME policies, given the increasing need for export-led SME growth.

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Armenia continues to have a number of well-developed targeted support programmes, providing technical and financial assistance to enterprises. Innovation support has also been expanded with the founding of Armenia's first venture fund in 2013, although the development of a comprehensive innovation strategy is still in progress. The increased share of open tenders and greater emphasis on capacity building are positive developments in public procurement, although no independent review body exists. Finally, Armenia has introduced a series of government and donor-funded support measures for SME greening, although efforts remain fragmented and inconsistent.

Business information and services

SME DNC continues to be the main institution providing business, technical and financial services to SMEs in Armenia. It operates through an annual state action plan composed of a comprehensive list of planned initiatives matched with a budget and timeframe. Its services include: start-up support, guidance on promotion and branding of products and services, export assistance, provision of business information, consulting and training, and financial support. From 2012, the SME DNC introduced local economic development as a new strategic direction. SME DNC has wide geographical coverage through its 10 regional offices. In 2014, it provided support to 6 200 SMEs, 95% of which were based in the regions.

The agency implements several of its support programmes in collaboration with international donors. The Start-up Business Support programme is run in partnership with the United Nations Development Programme (UNDP) and provides full-cycle support to local SMEs, including a two-month training course, consultations on developing business ideas, drafting feasible business plans, and support for implementation and financing. SME DNC also leads the consortium for the United States Agency for International Development's (USAID) five-year Partnership for Rural Prosperity Program in Armenia. Launched in 2013, its objective is to empower rural communities and SMEs in the regions. Under the framework of this programme, several regional value chains have been targeted to develop local clusters, such as cheese and dried fruit production. SME DNC has also been a member of the Enterprise Europe Network since 2008.

Other development agencies and support institutions that provide information and advisory services include the Armenian Development Agency (now the Armenian Development Fund), the Industrial Development Fund, National Competitiveness Foundation of Armenia, the Union of Manufacturers and Businessmen of Armenia, the Chamber of Commerce of Armenia and several private sector associations.

Start-up support is further complemented by the Enterprise Incubator Foundation, one of the largest business development and incubation agencies in the region (see next section). It provides a range of advisory and business services along with incubation facilities, and targets start-ups and enterprises in the ICT sphere in particular.

While public provision of business support infrastructure is quite extensive in Armenia, the government could adopt targeted measures, such as dissemination campaigns, to further encourage the use of private business support services by SMEs. At present, private business support services are not widely used in Armenia, with only 7% of enterprises reporting having hired an external consultant in the past three years (EBRD, 2014). A possible reason appears to be lack of awareness of the benefits of these consulting services, as 86% of SMEs surveyed by the OECD indicated that they had no need for external consulting. The main areas of interest identified by surveyed enterprises include marketing (46%) and export activities (26%).

Public procurement

Procurement legislation in Armenia allows for tenders to be divided into lots; this happens in the case of 50-75% of tenders. There is a law regulating late payment to contractors, imposing penalties for late delivery. This is also regulated for individual contracts. Information on public procurement opportunities is openly available, centralised at the national level and free of charge. Secondary legislation prescribes the lowest price as the only criterion for the award of contracts under framework agreements, negotiated procedures and simplified procedures. For certain low-value procurements, tenderers do not need to fulfil any criteria regarding financial standing or qualification levels.

Armenia has made some progress against this dimension by increasing training activities for procurement specialists. The use of non-competitive simplified procurement procedures has been reduced and the share of open tenders rose to 22% in 2014.

Some challenges remain. The percentage of tenders awarded after a negotiated procedure without publication is still very high (48%) and should be further reduced. Armenia has yet to establish an impartial and independent review body which is detached from the body responsible for public procurement policy. The number of contracts awarded on the basis of the most economically advantageous tender award criterion should be increased as the vast majority of tenders are still awarded on the basis of lowest price only.

Innovation policy

Armenia performs relatively well in the innovation dimension of the BEEPS V, with 15.8% of companies reporting having undertaken product innovation and 11.9% having undertaken marketing innovation in the past three years (EBRD, 2014). The "Concept Jump-start Strategy for Designing Innovation Economy" adopted in 2011 outlines the Armenian government's vision for increasing the competitiveness of the national economy via innovation and sector specialisation. However, innovation strategy and initiatives are still fragmented among different policy documents. The Law on State Support to SMEs (2000) and "SME Support Annual Programs" (since 2001) refer to innovation policy for SMEs but have not been very effective in implementing concrete support measures. As of May 2015, the Ministry of Economy was in the process of developing a comprehensive innovation strategy, which would introduce clear priorities as well as co-ordination and monitoring systems as steps towards a national innovation system for the country.

Significant concrete steps are being taken in the meantime. In 2012, the Scientific-Technical Council was set up as an inter-governmental body for innovation policy co-ordination. The council includes senior executives from the relevant line ministries and from industry. In practice, its functions are limited to designing and implementing large-scale innovation projects involving various public bodies, such as the Ministry of Economy and the State Committee of Sciences (under the Ministry of Education and Science). Nevertheless, the council does not have a mandate to fully co-ordinate innovation policy in Armenia. In practice, this is the role of the Ministry of Economy (through a newly-created department on technological development and innovation) and the State Committee of Sciences.

A number of state and donor-funded initiatives and centres are providing financial support for innovative firms in particular. Among its many services for business incubation, the Enterprise Incubator Foundation provides matching grants to enterprises for innovative ventures (in partnership with the Ministry of Economy of Armenia and in the framework of a World Bank project). Armenia's first venture fund "Granatus Ventures Fund I", established in 2013, provides idea grants and innovation matching grants. The fund targets seed stage, start-up and spin-off investments in the USD 50 000-1 million range. In the education sector, the Competitive Innovation Fund has been established to co-finance innovative projects involving universities and their partners, funded by the State Committee of Sciences. SME DNC Armenia also provides financial support for innovative start-ups under its credit guarantee scheme.

The government is also expanding innovation infrastructure with the establishment of Gyumri Technopark in 2014, providing technology support and incubation services. Another technopark is currently in its planning phase. The Microsoft Innovation Centre provides local IT communities with skills development programmes. A regional mobile applications laboratory and enterprise incubator (mLab ECA) has also been established in Yerevan.

Overall, however, the support mechanisms for innovative activities are dispersed among various platforms, and their scope and scale are limited. Access to support for non-technological innovation is also limited. Moreover, there is little interaction between industry and academia with the latter also being absent from the government policy making, including the Scientific-Technical Council. Going forward, the new strategy should emphasise technology transfer and links between SMEs and research institutions.

Green economy

Most SMEs in Armenia are either not subject to environmental regulation or do not know that they are. According to an OECD survey (2014) of over 400 Armenian SMEs, 56.7% the surveyed SMEs declared themselves to not be subject to any environmental requirements, and 22.6% said that they must comply only with general (sometimes referred to as “duty of care”) obligations, such as proper disposal of non-toxic waste. Indeed, the database of regulated entities maintained by the Ministry of Nature Protection includes only 4 000 businesses that receive environmental permits and submit self-monitoring reports. This covers only a very small fraction of the country’s SMEs (less than 5%). Most other businesses are not known to the country’s environmental authorities.

Armenia has taken a first step in the diversification of environmental regulatory regimes: the recent Law on Environmental Impact Assessment and Expertise, adopted in July 2014, classifies regulated entities into three categories (A, B and C) with different assessment procedures for each category. At present, however, a small share of SMEs is over-regulated through a complex permitting regime, while the vast majority are unregulated.

There is a lack of proactive dissemination of environmental regulatory information to SMEs on the part of the Armenian government. The principal sources of such information are the website and the telephone hotline of the Ministry of Nature Protection, but very few SMEs use them. The ministry’s Information-Analytical Centre develops and disseminates educational manuals, newsletters, digests and other information materials, but they are mainly disseminated to businesses at occasional training events.

Several trade associations are trying to promote environmental compliance among their member companies through publications, workshops, seminars, and recognition awards. However, these are usually short-term initiatives which do not bring lasting results. In addition, there is no strong collaboration between business associations and the environmental authorities on this issue.

Less than 2% of the surveyed SMEs have a certified ISO 14001 environmental management system: As of 2012, Armenia’s National Institute of Standards had issued ISO 14001 certificates to only 10 SMEs. A few consulting companies provide services to enterprises to implement an environmental management system according to the ISO 14001 standard, and the National Institute of Standards organises environmental management system training courses. However, these services are expensive and not targeted at SMEs.

While the “2012-2015 SME State Support Strategy” did not address environmental aspects of SME activities, in 2015 for the first time the Ministry of Economy included in its annual SME Support Programme a new objective to “support the application of resource efficiency and cleaner production principles by SMEs”. The Republican Union of Employers of Armenia has been organising annual Green Economy Conferences since 2012 in co-operation with the Ministry of Nature Protection, UNDP and the International Labour Organization. However, there are still no concrete government initiatives and/or programmes to encourage SMEs to adopt green technologies and management practices.

In order to fill this gap, a number of international donor-funded programmes have been promoting environmentally-friendly production practices across the SME community. These initiatives rely primarily on audits and training of volunteer companies. However, these fragmented efforts have not institutionalised specific instruments to promote green practices and have not had any tangible impact on the environmental performance of Armenia's business community.

According to the SME survey, 88% of the companies that undertake resource efficiency measures receive no technical or financial support. Less than 5% receive technical assistance from government authorities: this figure is 9-10% for small and medium-sized businesses, but micro-enterprises do not benefit from government support at all.

Supporting SME internationalisation (Dimensions 10 and 7)

Despite a policy focus on export-led growth, SME internationalisation in Armenia remains limited. The new Armenian Development Fund will take the lead on export promotion activities previously carried out by various institutions. Going forward, the fund will need to expand the breadth and depth of export support, including existing trade finance instruments. In addition, since the previous assessment Armenia has reformed its quality infrastructure system in line with EU legislation; despite its accession to the EEU, harmonisation might continue in areas which do not contradict EEU rules.

Export promotion and integration into global value chains

Given the small size of the domestic market, international trade is critical to enterprise growth and competitiveness. Despite the country's potential for export development in certain sectors (e.g. agribusiness), export levels remain low. For instance, only 6.9% of small and 7.8% of medium-sized enterprises export (at least 1% of sales) directly or indirectly (compared to the regional average of 15% and 25.6% respectively) (EBRD, 2014). Twenty-four percent of Armenian companies cite lack of working capital and 23% lack of information and market intelligence as the greatest barriers to internationalisation. In addition, limited export knowledge and promotional efforts, scarce trade finance, inadequate export infrastructure and export facilitation continue to be obstacles for exporting SMEs (OECD, 2015).

Customs and trade regulations are among the top obstacles facing firms in Armenia. It takes 8.6 days for goods to clear customs (twice the ECA average) (EBRD, 2014). Armenia is ranked 110th in the "Trading Across Borders" dimension of the World Bank's *Doing Business 2015* report due to the number of documents required (5) and the length of the export process (16 days) (World Bank, 2014).

Armenia's Export-led Industrial Development Strategy was adopted in 2011, and sectoral strategies and action plans have been developed for a number of sectors. The strategy has adopted both general and industry customised support toolsets in the following dimensions: quality assurance, enhanced access to raw materials, human capital development, affordable financing for exports and investments, FDI attraction and sector promotion. The action plans – implemented by the Armenian Development Agency (ADA) and the Industrial Development Fund (IDF), among other organisations – include provision of information, guidance and assistance on exporting procedures; training in promoting Armenian products in export markets; and co-financing the costs of participation at international trade fairs. The National Competitiveness Foundation of Armenia (NCFA) also carried out export support services for the tourism sector. In 2014, NCFA, ADA and

IDF were merged to create a single export promotion agency to implement the Export-led Industrial Development Strategy, the Armenian Development Fund.

Export finance in Armenia is a recent phenomenon. A key development has been the creation, in 2014, of the Export Insurance Agency of Armenia. In operation since January 2015, this new entity is offering trade insurance for Armenian exporters, with a specific focus on SMEs in wine production, agribusiness and mining. Products on offer include insurance against commercial risks arising from non-payment by overseas buyers as well as against exchange rate fluctuations. The agency is also expected to provide consulting advice on quality standards to access export markets. Over the medium term, the agency's capital could be opened to the private sector and its range of export finance products expanded (OECD, 2015).

SME DNC Armenia has become a partner of the Enterprise Europe Network through its Business Co-operation Centre, providing information on EU markets and helping local companies to benefit from the matchmaking services of the network. In 2014, 154 Armenian SMEs benefited from this initiative.

Attracting multinationals to Armenia is one of the key aims of the "Export-led Industrial Development Strategy". However, only a few support mechanisms have been established (e.g. free economic zones) and little progress has been made in enhancing business linkages. A special case is the IT sector, where a promotion front-desk for Armenian enterprises has been opened in Silicon Valley, which serves the purpose of helping local IT enterprises to enter the US market and establish linkages.

Standards and technical regulation

The process of negotiating an Association Agreement with the EU, including a DCFTA, saw Armenia make significant reforms to its quality infrastructure system. As Armenia instead decided to join the EEU and abandoned the signing of the Association Agreement and the DCFTA with the EU in September 2013, Armenia is required to comply with the EEU common framework for technical regulations. However, it may continue to harmonise processes with the EU in areas that do not contradict the EEU technical regulations.

In 2010, the government adopted the "Reform of the Quality Infrastructure Strategy of the Republic of Armenia", which aimed at developing and upgrading the existing system to meet international and European standards. The strategy targeted gradual compliance with European requirements for full integration of the Armenian quality infrastructure into the European system, addressing key barriers to trade. In 2012 four fundamental laws were adopted on technical regulation, standardisation, accreditation and uniformity of measurements and legislation to implement these laws has been prepared. Regulations have also been adopted to reform the standardisation and accreditation bodies to bring them in line with EU practices. These reforms have strengthened the independence of the National Institute of Standards, National Accreditation Body, National Institute of Metrology, and the Market Surveillance Inspectorate. In three sectors – toys, cigarettes and tobacco products, and low voltage electric equipment – technical regulations that comply with EU directives have been adopted and are expected to enter into force. Armenia has developed a new law on market surveillance and safety of non-food products, which was being assessed by the National Assembly in June 2015.

The way forward

The 2016 SBA assessment considers the following to be priorities for Armenia in improving its SME policy framework:

- **Finalise the preparation of a medium-term SME strategy**. This would provide the Ministry of Economy and SME DNC with a clearly prioritised roadmap for SME development reforms and initiatives, backed by adequate monitoring and evaluation systems. A new strategy would help to improve policy co-ordination beyond these two key actors and revive public-private consultations, in particular by involving the SME community in the policy process. In addition to targeted support measures and reforms, the new strategy should include an effort to **improve SME statistics collection** in Armenia as a prerequisite for evidence-based policy making. Regulatory simplification efforts should also be continued, with a special emphasis on tax and customs administration.
- **Address gaps in the provision of financial infrastructure** through the establishment of an online registry for securities over movables. This would also help improve access to finance, which is one of the main constraints for SME growth in Armenia. Adopting regulation for leasing activities would diversify sources of funding for SMEs beyond the banking sector.
- **Promote lifelong entrepreneurial learning.** Policy partnership should look beyond financial education, applying the key competence approach more comprehensively and linking it to the national qualifications system. Integrating entrepreneurial learning outcomes into the national curricula, offering experiential entrepreneurial learning, and teacher training are all important elements of the support system. The concepts of "entrepreneurial schools", "colleges" and "universities" need further promotion. The government should encourage and support the development of e-training programmes for SMEs. It also needs to engage the main stakeholders in **establishing a national quality assurance framework of SME training, in particular by introducing accreditation of providers**.
- **Strengthen existing capacity and develop a comprehensive export promotion programme.** The government should build on the recent creation of the Armenia Development Fund to fulfil the promise of export-oriented growth and improve the current levels of SME internationalisation. Adequate attention should be paid to the development of trade finance in Armenia following the creation of the Export Insurance Agency, as well as to the continuous improvement of quality standards. Despite its EEU membership, Armenia may want to continue streamlining its quality support infrastructure with EU standards as much as possible in order to improve access to the EU market.

Table 11.4 presents a potential policy roadmap to guide SME development policy over the short, medium and long term, based on the findings of the SBA assessment.

Table 11.4. **Armenia: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• **Adopt a comprehensive longer-term SME strategy**	S
• **Improve statistics collection (availability, methodologies, alignment with new definition)**	S/M/L
• Review and streamline tax legislation and administration from an SME perspective and introduce improvements; develop targeted programmes for economic formalisation	M/L
• Streamline customs regulations to improve efficiency and transparency while implementing the 2014 Customs Code	M/L
• Improve public private consultations (e.g. increasing frequency of SME Council meetings)	S/M
• Finalise the electronic integration of government data system	S/M
• Review insolvency legislation to address weaknesses, promote second chance, including by removing discrimination against good-faith failed entrepreneurs	S/M
2. Facilitating SME access to finance	
• **Strengthen creditor rights – including through a reform of the insolvency legislation**	S/M
• **Establish online registry for security over movables (following 2014 law)**	S
• Adopt a specific legal framework for leasing	M
3. Promoting skills and entrepreneurship development	
• Fully integrate entrepreneurship key competence into the national curricula and teacher training, across all levels of education	S/M/L
• Embed lifelong entrepreneurial learning into the Education Development State Programme, SME Strategy and other government documents. Introduce a graduate tracking system to monitor the impact of entrepreneurial education in vocational educational training	M/L
• Improve systematic data collection on entrepreneurial learning (formal and non-formal learning) and women's entrepreneurship (disaggregated by gender and sectors), and ensure the quality of data by type of SME training (pre-start-up, start-up, growth and internationalisation)	S/L
• Systematically promote and support the exchange of good practice on entrepreneurial learning and women's entrepreneurship	S/M
4. Enhancing SME competitiveness	
• **Introduce specific measures to promote the private business development service market** (e.g. **generalisation of voucher initiatives, awareness campaigns, online list of providers)**	M/L
• Strengthen public procurement legislation to introduce an independent review body, improve publication requirements, encourage most economically advantageous tender (MEAT) criterion in bid awarding; promote SME participation	S/M
• Develop a policy framework and specific support measures for SME greening (e.g. through the new SME strategy)	S/M/L
• Adopt a new innovation strategy to improve co-ordination and encourage technology transfer	S
5. Supporting SME internationalisation	
• **Develop and implement targeted support measures for exporting SMEs, including an enabling environment for trade finance (expanding existing export credit schemes), build the capacity of ADF**	S/M/L
• Increase compliance of national technical regulations and standards with international and EU standards; support SMEs to comply with standards	S/M
• Further develop FDI-SME linkage programmes (e.g. tax incentives, knowledge transfer)	M/L

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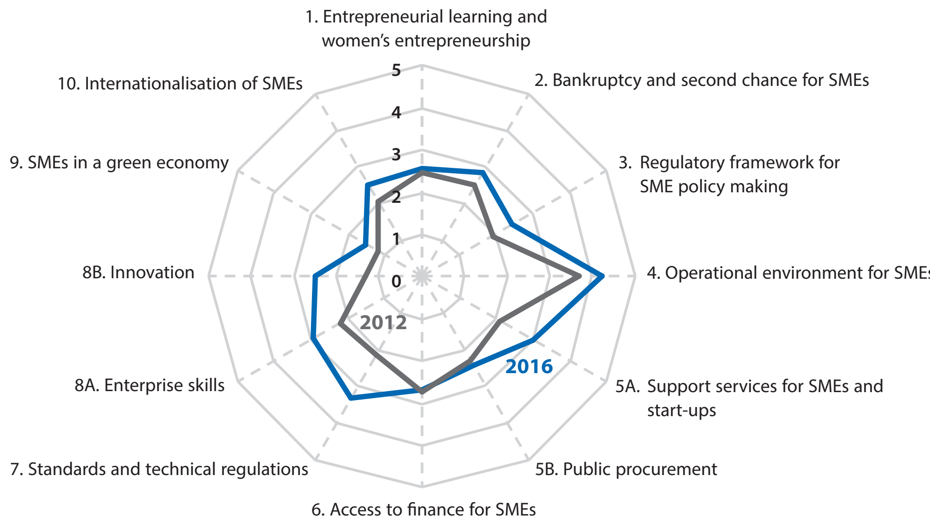
Chapter 12

Azerbaijan: Small Business Act country profile

Azerbaijan has been proactive in reforming its business environment, including the introduction of one-stop-shop company registration and a best practice e-government portal. Financial and institutional support measures for innovation and SME capacity building have been launched since 2012, although a strategic framework for these measures is still lacking. The government is also in the process of drafting legislation to address remaining challenges in bankruptcy procedures, business licencing, access to finance and regulatory impact assessment.

Given the importance of SME development for the country's diversification agenda, Azerbaijan would benefit from a more structured and strategic approach to SME policy, including the development of an SME strategy, co-ordination structure and implementation body. Access to finance remains a significant challenge for SME growth, and key financial infrastructure is still needed to encourage access to bank loans and alternative sources of finance, including capital markets. Finally, existing support measures for SMEs could be strengthened through structured monitoring and evaluation. Support measures could also be expanded; for example, export finance tools would be a useful addition.

Figure 12.1. **SBA scores for Azerbaijan**



Key findings

Azerbaijan has paid increasing attention to SME development since the 2012 assessment. The country's heavy reliance on oil exports and resulting exposure to exogenous shocks has pushed economic diversification to the top of the government agenda, galvanising reforms in a number of areas. In particular, government initiatives have further improved the business-enabling environment, and the country has become a top performer in some dimensions of the World Bank's *Doing Business* report (e.g. starting a business, registering property). E-government services have also expanded significantly with the creation of a best-practice government portal. In addition, the SME innovation framework has been enhanced through both infrastructure (e.g. industrial parks, technology parks and business incubators) and financial support (through the creation of a dedicated fund for the information and communications technology – ICT – sector). Furthermore, an intense legislative agenda has been pursued, and draft legislation has been prepared in several other areas, including the establishment of a private credit bureau and a collateral registry, the improvement of the bankruptcy framework, the streamlining of requirements for business licences and permits, and the introduction of regulatory impact assessment. The government also introduced an updated SME definition in June 2015, recognising medium-sized enterprises for the first time, and adding turnover criteria alongside employment criteria.

Azerbaijan's success in implementing business environment reforms is visible in its strong performance on Dimension 4 of the 2016 SME Policy Index, where it receives one of the highest scores in the EaP region. Progress in the development of support tools for SME competitiveness, including in the areas of innovation and internationalisation, is reflected in its higher scores in Dimensions 5a, 8b and 10, although there is room for further improvement. The same applies to the human capital dimensions (Dimensions 1 and 8a), including women's entrepreneurship, which have also seen notable improvements. Continued difficulties in accessing finance explain the limited progress in Dimension 6. SME greening initiatives should be encouraged to improve performance in Dimension 9.

To fully leverage the potential of SMEs for economic diversification, the Azerbaijani government could consider a number of additional improvements to its SME policy framework:

- The government currently lacks a comprehensive strategy to guide SME policy, as well as an effective co-ordination mechanism. Although SME policy is under the domain of the Department of Entrepreneurial Development Policy of the Ministry of Economy and Industry, several different agencies are responsible for developing and implementing policy measures. They work without a formal co-ordination mechanism or an independent structure in charge of policy implementation. A new strategy could also be used as an opportunity to address private sector involvement in a structured manner as well as to promote regular monitoring and evaluation of the several initiatives introduced in recent years.
- Access to finance remains a key obstacle for SME growth in Azerbaijan. According to the Business Environment and Enterprise Performance Survey (BEEPS V – a firm-level survey conducted among 390 enterprises in Azerbaijan in 2013), only 14.6% of surveyed firms had a loan or a line of credit, down from 19.9% in 2009 (EBRD, 2014). This was the lowest share among the 30 countries included in the survey. In addition, only 4.7% of companies reported financing their working capital through banks, while 92.8% financed it through internal funds. This was the highest in the region (EBRD, 2014). While some progress has been made to strengthen the legal framework, some gaps remain: legislation has yet to be finalised and/or implemented governing the establishment of a private credit bureau, movable collateral registry and secured transactions.
- Support measures for innovation and internationalisation have been introduced, but without clear strategies or co-ordination mechanisms. Government policy on innovation should broaden out its currently narrow focus on the ICT sector. Support for internationalisation is also limited to some export promotion, and could be expanded further to include export finance and measures to allow SMEs to benefit from global value chains. The government could also promote a private market for business development services, and could improve transparency and efficiency in the procurement framework, while actively promoting SME participation.

Table 12.1. **Azerbaijan: Challenges and opportunities**

Strengths	Weaknesses
• Stable macroeconomic environment (e.g. current account surpluses), strong recovery from the global crisis • Expanding non-oil economy (6.9% growth in 2014) • Significant progress in global competitiveness benchmarks (38th in Global Competitiveness Index after constant progress) • Extensive e-government infrastructure, strong track record in business environment reforms (one-stop-shops, e-government); favourable environment for business registration and ongoing reforms in other areas (credit bureau, collateral registry, RIA) • Comparatively good infrastructure and service provision (cf. BEEPS data on electricity, water) • Low unemployment, relatively flexible labour regulations • Increased attention to targeted support in business support infrastructure, innovation (ICT fund) • New SME definition introduced in June 2015 with segmentation by size	• SME policy fragmentation among several state programmes without formal co-ordination and lack of a comprehensive strategy • Public-private consultations lack a structured institutional set-up beyond informal co-operation; limited SME involvement • Limited access to bank finance (high collateral, low levels of access, cf. BEEPS); other sources underdeveloped (banking sector holds 95% of total assets); growth in credit mostly to households, consumer credit • Absence of M&E for government support tools • Corruption perceptions are still cited as obstacle for business (cf. BEEPS, Global Competitiveness Index) • Low levels of SME internationalisation despite relatively low customs barriers (new legislation in 2014 and 2015) and AZPROMO's existing activities

Table 12.1. **Challenges and opportunities** *(continued)*

Opportunities	Threats
• Economic diversification, competitiveness recognised an urgent priorities in Azerbaijan 2020 vision	• Dependence on natural resources results in economic volatility (e.g. Feb 2015 devaluation; oil output expected to decline from 2017)
• Major infrastructure projects will help galvanise new growth opportunities	• Exposure to regional dynamics, particularly in the non-oil sectors (e.g. exports to Russia)
• New export programme in development, with a focus on boosting exports of non-oil products	• Lack of independent implementation agencies in key areas such as innovation and entrepreneurship
• Expanding banking sector; strong capital position of commercial banks; new laws being prepared on private credit bureaus and registry of moveable assets	• Non-oil exports hindered by delays in approximating national standards and technical regulations, limited international quality certification (12.8% vs. 22.6% ECA average – cf. BEEPS)
• WTO membership prospects likely to boost trade	• Existing initiatives in innovation lacking strategy, focused largely on ICT
• Untapped potential in non-oil sectors, e.g. agriculture (5.3% of GDP but 38% of jobs) and manufacturing	
• FDI in oil & non-oil sectors with potential for SME linkages	
• Innovative approaches to SME training design and delivery	

Overview

Economic snapshot

Azerbaijan has been able to maintain high levels of growth since 2001, seeing GDP per capita increase from USD 660 to about USD 7 350 today (World Bank, 2015). The country has recovered strongly from the economic crisis, with a 5.8% GDP growth rate in 2013 (Table 12.2). However, the economy is highly dependent on hydrocarbon exports, which represent 39% of GDP and 92.2% of exports, creating vulnerability to fluctuations in oil production and prices. The steep drop in oil prices which took place in 2014, together with a contraction in Azerbaijani oil output early that year, brought about an economic slowdown, with GDP growth falling to 2.8%. Growth is expected to slow still further – to 1.5% in 2015 according to estimates by the European Bank for Reconstruction and Development (EBRD, 2015). The economic downturn was further compounded by the sharp depreciation of the currencies of some key trading partners, including Russia. The current account surplus consequently narrowed from 21.8% of GDP in 2012 to 15.3% in 2014, and Azerbaijan's real effective exchange rate appreciated by 16.9% in 2014, reducing the competitiveness of its non-oil sectors. Lower commodity export receipts also exercised pressure on the local currency and after selling 27% of its currency reserves to maintain a stable currency, the Central Bank devaluated the manat by 34% in February 2015 to reduce fiscal pressures and restore competitiveness.

The non-oil industry sector has been expanding in recent years, achieving 6.9% growth in 2014 (IMF, 2015). The government has successfully leveraged oil revenues to reduce the poverty rate from 50% in 2001 to 5.3% in 2013. The Azerbaijani economy also benefits from a low level of unemployment (6% in 2014 according to IMF estimates) due to relatively flexible labour regulations (IMF, 2014). Recently, the government has invested in a number of major infrastructure projects to strengthen the non-oil sector and support economic diversification. These include the Trans-Anatolian (TANAP) and Trans-Adriatic (TAP) pipelines, which are targeted for completion in 2018 and 2020 respectively. Growth of the non-oil economy could be further boosted by accession to the World Trade Organization, for which negotiations are ongoing.

The major non-oil tradable sectors in 2013 included foodstuffs and livestock (2.7% of total exports), industrial products (1.1%), vegetable oils and fats (0.8%), and chemical products (0.7%). The biggest international trade partner for Azerbaijan is the European Union (EU); however, Russia and Turkey remain the key partners for non-oil exports (44.6% and 7.5% respectively on average between 2007 and 2011) (IMF, 2014).

Table 12.2. **Azerbaijan: Main macroeconomic indicators, 2010-15**

Indicator	Unit of measurement	2010	2011	2012	2013	2014[a]	2015[a]
GDP growth	Percent, y-o-y	5.0	0.1	2.2	5.8	2.8	0.6
Inflation	Percent, average	5.7	7.9	1.0	2.4	1.4	7.9
Government balance	Percent of GDP	14.0	11.6	3.8	1.4	0.4	-5.7
Current account balance	Percent of GDP	28.4	26.0	21.8	16.6	13.6	n.a
Exports of goods and services	Percent of GDP	54.3	56.4	53.7	48.7	43.3	n.a
Imports of goods and services	Percent of GDP	20.7	24.1	25.6	26.9	26.2	n.a
Net FDI	Percent of GDP	0.6	1.4	1.1	1.5	n.a	n.a
External debt	Percent of GDP	21.3	20.4	17.0	n.a	n.a	n.a
Gross reserves	Percent of GDP	12.1	15.9	16.4	19.6	n.a	n.a
Credit to private sector	Percent of GDP	7.9	17.6	20.1	25.5	n.a	n.a
Unemployment[b]	Percent of total active population	6.0	6.0	6.0	6.0	6.0	6.0
Nominal GDP	USD billion	52.9	64.8	68.7	73.5	74.1	62.2

Notes: **a.** IMF projections; **b.** IMF estimate; latest actual data from 2009.

Source: EBRD (2014), *Transition Report 2014*; IMF (2015), *World Economic Outlook*; World Bank (2015), *World Development Indicators 2015*

Business environment trends

Azerbaijan has made significant progress against global competitiveness benchmarks. It currently ranks 38th in the World Economic Forum's Global Competitiveness Index, up from 57th in 2010 (World Economic Forum, 2014). The country has implemented reforms in key areas of the World Bank's *Doing Business* report, such as "Starting a Business" (12th) and "Registering Property" (10th), although it still ranks only 80th overall due to low performance in other areas (World Bank, 2014). The government has also developed an extensive e-government infrastructure, and envisages a further review and simplification of business regulations under the Presidential Decree on Additional Measures for the Development of Entrepreneurship of 3 March 2014. Recent reforms include the adoption of the Law on Protection of Interests of Entrepreneurs and Regulation of Inspections in 2013, which prompted the creation of an online inspection registry to make this area more transparent. The amount of time Azerbaijani business managers spend in dealing with business regulation is one of the lowest in the region, at just 0.2%, compared to an average of 11% across the Europe and Central Asia countries (EBRD, 2014).

However, despite improvements to the business environment, doing business in Azerbaijan continues to be challenging, particularly outside the oil sector. The main obstacles mentioned by respondents to the BEEPS V are practices of the informal sector (30.7%) and access to finance (30.2%), followed at considerable distance by tax rates and licenses and permits (EBRD, 2014). In addition, international benchmark studies suggest that there is room for improvement in perceptions of corruption. For example, in 2013 the country ranked in the 19th percentile in the World Bank's Worldwide Governance Indicator for "Control of

Corruption," compared with a regional average for Eastern Europe and Central Asia of 63. In response to these concerns, the government has launched the "National Action Plans on Promotion of Open Government and Fight Against Corruption (2012-2015)" to increase transparency and accountability in public institutions, and strengthened its anti-corruption legislation. However, reforms remain limited and lack a strategic approach (OECD, 2013).

Economic diversification is one of the top priorities for the government in light of the country's exposure to shocks in oil prices and output. The "Azerbaijan 2020 Vision" was released in 2012 and focuses on developing competitiveness and export growth in the non-oil sector. SME development could be a key platform to achieve the 2020 Vision target of increasing non-oil sector export turnover to USD 1 000 (approximately EUR 890) per person by 2020. In addition to business environment reforms, the government has focused on infrastructure development, including the establishment of industrial parks and estates and techno parks. The government has also been working with the United States Agency for International Development (USAID) since 2011 to develop a competition code in line with international good practices, although the adoption process currently appears to be stalled.

SMEs in Azerbaijan

Azerbaijan has two separate SME definitions, one that was included in the general legislation in June 2015, and the other used only for tax purposes (Table 12.3). The Tax Code does not define small and medium enterprises per se, but distinguishes between individual entrepreneurs and legal entities. Individual entrepreneurs are defined as physical persons who are engaged in business activities. The majority of small enterprises are registered as individual entrepreneurs (94.5% in 2013). The turnover threshold used in the tax legislation for individual entrepreneurs is currently aligned with that of small enterprises in the general legislation, following the June 2015 amendment.

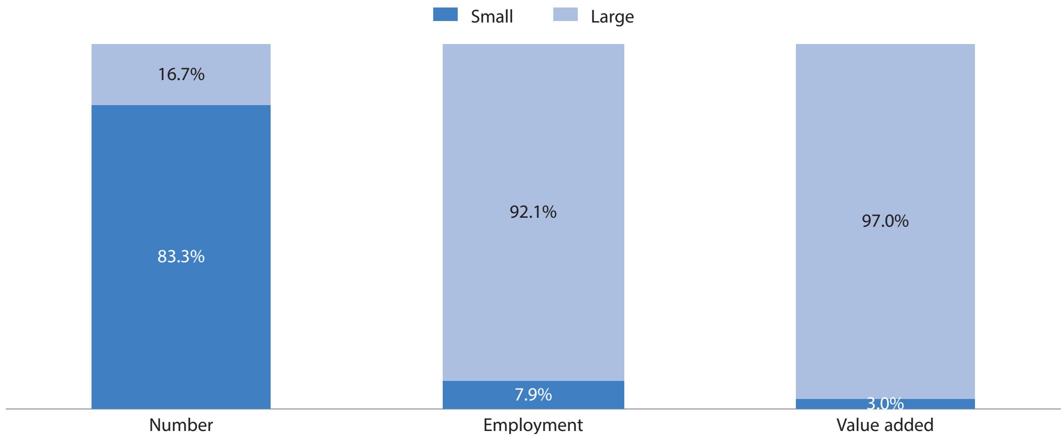
Table 12.3. **Definitions of small and medium enterprises in Azerbaijan**

	Employment		Turnover	
	Definition 1	Definition 2 (for tax purposes only)	Definition 1	Definition 2 (for tax purposes only)
Small	< 25 employees	Self-employed (no hired labour)	< AZN 120 000 (EUR 101 500)	< AZN 120 000 (EUR 101 500)
Medium	< 125 employees		< AZN 1 250 000 (EUR 1 057 500)	

Source: Decision of the Cabinet of Ministers No. 215 of 5 June 2015, Tax Code of Azerbaijan; exchange rates as of June 2015.

While small enterprises accounted for 83% of all companies in 2013, their contribution to value added was only 3% (although this is better than in 2010, when it was just 1.7%) (Figure 12.2). Their contribution to total employment has also increased, from 5.9% in 2010 to 7.9% in 2013. The majority of small enterprises operate in the trading and vehicle repair sectors (32.7% in 2013) (Figure 12.3). The other sectors with a significant presence of small enterprises are construction (23.4% in 2013) and transportation and storage (11.3%). Nearly 36% of all active small enterprises are registered in the capital, with 18.4% in the Aran region and 12.6% in the Ganja-Gazakh region.

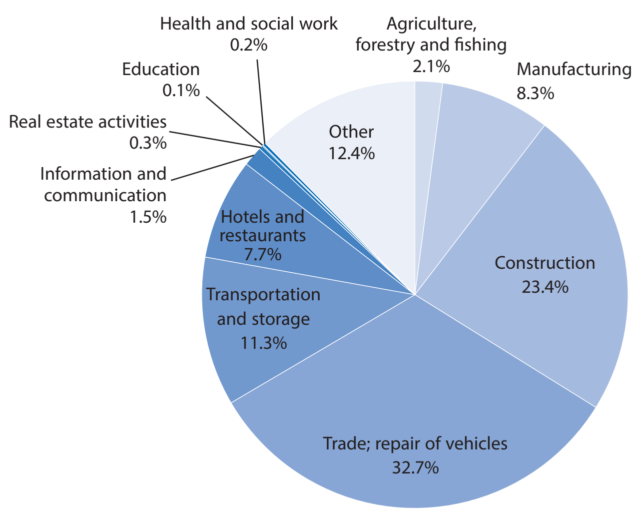
Figure 12.2. **Business demography indicators in Azerbaijan, 2013**



Note: Based on active enterprises using SME definition prior to June 2015; data include both small enterprises and individual entrepreneurs.

Source: Azerbaijan State Statistical Committee.

Figure 12.3. **Sectoral distribution of SMEs in Azerbaijan, 2013**



Source: Azerbaijan State Statistical Committee.

SBA assessment results

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

Azerbaijan has taken a number of steps to strengthen the institutional, regulatory and operational environment for SMEs, particularly by easing company registration and developing e-government services. The institutional support for SMEs has also been improved with the establishment of the Department of Entrepreneurial Development Policy under the Ministry of Economy and Industry. However, a comprehensive SME strategy has yet to be adopted to address policy fragmentation, improve inter-agency co-ordination, and enhance public-private dialogue. An inadequate insolvency legal framework and a cumbersome licensing and permit regime are other outstanding challenges.

Institutional framework

The Department of Entrepreneurial Development Policy in the Ministry of Economy and Industry is responsible for both the development and implementation of SME policy in Azerbaijan. In addition, there are several agencies under the Ministry of Economy and Industry – the National Fund for Entrepreneurship Support, the Baku Business Training Centre and AZPROMO – which also have activities to support SMEs. While these agencies submit periodic reports to the ministry, there is no formal co-ordination platform for other government agencies and departments involved in SME policy (e.g. the ministries of education and justice). A joint co-ordination platform (e.g. a working group or committee) could therefore improve the effectiveness of SME policy making.

The Azerbaijani government does not currently have an SME strategy or programme in place, and the previous programme ended in 2005. The "Azerbaijan 2020 Vision", which lays out the country's medium-term strategic framework, highlights the role of entrepreneurship and SMEs in economic development. Entrepreneurial development and related aspects are included in a number of state programmes, such as the Programme on Social-Economic Development of the Regions (2014-18), the Poverty Reduction Programme (2008-15), the Food Security Programme (2008-15) and the Azerbaijan 2020 Development Concept. The development of a comprehensive strategy would be highly desirable to avoid policy fragmentation and improve co-ordination amongst government and non-government actors.

As outlined above, Azerbaijan currently has two definitions for SMEs, one specified in legislation and applicable to nearly all policy areas, and another used exclusively for taxation. The new definition recognises medium-sized enterprises and increases both internal and external consistency by using turnover criteria that are aligned with the existing tax regulations, and employment criteria aligned with the EU SME definition (Table 12.3). However, micro-enterprises are still not defined, and an overlap exists between the two SME definitions due to the use of different employment criteria.

These shortcomings affect the quality of statistics on SMEs. As the data do not differentiate micro-enterprises it is difficult for policy makers to design policies (e.g. start-ups and subsistence-oriented small businesses) adapted to this segment of the SME universe. Azerbaijan collects both structural and demographic business statistics by size class, including on birth, death and survival rate of enterprises. The State Statistical Committee also publishes an annual yearbook on "Small Entrepreneurship in Azerbaijan", reporting major trends.

The informal economy remains a challenge for the authorities, with "practices of the informal sector" identified as the biggest obstacle to doing business by 30.7% of the 390 respondents to the BEEPS V (EBRD, 2014). However, as in many other EaP countries, there is no comprehensive approach to addressing this phenomenon beyond general business climate reforms. Neither are there targeted measures in state programmes explicitly aimed at stimulating the transition to the formal sector.

Legislative simplification and regulatory impact analysis

A presidential decree was issued in March 2014 on "Additional Measures for the Development of Entrepreneurship". This targets the review and simplification of business regulations in areas relevant to the World Bank's *Doing Business* report (i.e. registration of business, construction permits, electricity connection for businesses, property registration, corporate governance, export-import procedures and bankruptcy legislation).

Azerbaijan has also developed two "National Action Plans on Promotion of Open Government and Fight Against Corruption (2012-2015)" to increase transparency and accountability in public institutions and public participation in policy making. These include a separate section on improving the business environment. Despite this progress, there is no formal framework for legislative review or guillotine.

Currently, there is no legal requirement to conduct regulatory impact analyses (RIA) in Azerbaijan. According to the Law on Legislative Acts, economic analysis and expert consultations can be conducted before adopting legislation; however, this is rarely done in practice. The Ministry of Justice has developed draft legislation for the introduction of RIA as part of the national action plans on open government and corruption. Its final adoption is still pending.

Public-private consultations

Azerbaijan adopted the Law on Public Participation in 2014. This provides a legal basis for public councils, hearings and consultations, written consultations via the Internet, as well as public consultations on draft legislation organised by parliament. The degree of implementation of this law in practice is unclear. Draft business legislation is also placed on the licenses and permits website (www.icazeler.gov.az; see below) for feedback, although the feedback is not visible to the public. As of June 2015, 159 draft legal acts from 20 state agencies had been posted online. The parliament also posts draft laws and other legislative acts online and provides opportunity for feedback.

Specifically regarding business legislation, the Ministry of Economy and Industry, Ministry of Taxes and other public institutions conduct periodic meetings with entrepreneurs, both in Baku and the regions. "Open door" days and citizen forums are organised, enabling walk-in consultations. Despite these efforts, there is no systematic information and no centralised website on all ongoing and past public private consultations or their outcomes. Public-private consultations (PPCs) are still conducted on an ad-hoc basis and lack a formal framework. There is also no detailed information about PPCs conducted with the participation of SMEs.

The National Confederation of Entrepreneurs, the main organisation representing business interests in the country, has 14 thematic commissions. One of these is on small and medium entrepreneurs and young businessmen, while another looks at co-operation with legislative bodies. The confederation works closely with public institutions, including the Ministry of Economy and Industry under a co-operation memorandum signed in 2010. It organises public hearings, discussions and roundtables with the participation of business community on a range of business-related topics, including the legislative process. However, small businesses have little influence in practice and their participation in PPCs remains limited. The Entrepreneurs Council under the President of the Republic of Azerbaijan, created in 2002, is no longer active.

Interaction with government services (e-government)

Azerbaijan has made significant progress in the development of electronic government and e-services since the 2012 assessment. It now offers an example of best practice for the region and beyond. The Data Processing Centre in the Ministry of Communications and High Technology is in charge of the e-government and e-signature projects. An e-government portal was created in 2012 and currently offers 463 e-services (although not all of them are fully active), including filing of tax reports and social security returns, company registration, and business licencing. Forty-one state agencies offer e-services. Currently 45% of company registrations are carried out online.

Enterprise statistics can also be filed online using a streamlined single-form reporting process for both individual entrepreneurs and firms. Over 96% of legal entities and 50% of individual entrepreneurs submit their reports online, according to the State Statistics Committee. The databases of 46 public institutions, such as the Ministry of Internal Affairs, State Committee for Property Issues and Social Protection Foundation, are integrated into the web portal for shared access. On the other hand, the business database of the Ministry of Taxes is not always used by other public institutions for the provision of e-services (Transparency Azerbaijan, 2014) although the Ministry of Taxes submits the information to the Ministry of Justice, the Customs Committee and the Statistics Committee.

A smart-card based electronic signature was introduced in 2011 by the Ministry of Communications and High Technologies. Close to 30 000 e-signatures had been issued by the end of January 2015. Most of them were issued to public institutions, around 5 000 to legal entities and 7 000 to physical persons (including individual entrepreneurs). In 2014, the fees for obtaining an electronic signature were lowered to increase access. Along with this, a SIM-card based electronic signature (ASAN-imza) was introduced by the Ministry of Taxes in 2013, allowing mobile access to the tax online platform, as well as to a range of other services on the e-government portal. The service is used mainly by businesses, with 145 000 ASAN-imza certificates issued by March 2015. The government is currently in the process of piloting the digitalisation of the real estate cadastre, which is due to be ready for public access by the end of 2015. This will further strengthen on an already efficient property registration system. According to the World Bank's *Doing Business 2015* report, registering property in Azerbaijan requires just three procedures, takes 8.5 days and costs 0.4% of the property value, well below regional averages (World Bank, 2014). Transferring property was made easier in 2014 with the introduction of an online procedure for obtaining the non-encumbrance certificate. Application for the initial registration (for new property) or re-registration of property (as a result of sale, gift, inheritance etc.) is accepted both online and through ASAN Service.

Company registration

Azerbaijan has improved its company registration procedures significantly, ranking it 12th overall on the "Starting a Business" indicator of the World Bank *Doing Business 2015* report (World Bank, 2014). Registration of companies takes three days and is free of charge for individual entrepreneurs. A business can be set up in five days in total, at a cost of just 3.1% of national income per capita. In November 2014, amendments to the legal framework for registration were adopted to streamline procedures and eliminate the requirement for a corporate seal.

Registration for an electronic signature (ASAN-imza) and taxpayer's ID number can be done at the same office and a tax ID is issued immediately (with the tax ID card issued within two business days). The only document required for registration is the state ID card. Registration of both individual entrepreneurs and companies can be done either in tax offices or the State Agency for Public Services and Social Innovation's one-stop shop for public services (ASAN Service Centres). Registration information is sent automatically by the tax authorities to the State Social Protection Fund, eliminating the need for separate registration. In addition, entrepreneurs might need to obtain permits and licenses if required for their specific sphere of business. All information on business permits and licenses issued by various public institutions is published on a single government website (www.icazeler.gov.az). However, the licensing permitting system is still cumbersome and subject to considerable discretion (World Bank, 2013). A draft law to establish a general framework for licencing and permitting procedures has been prepared and is under consideration.

Bankruptcy procedures and second chance

Azerbaijan ranks 94th in the "Resolving Insolvency" dimension of *Doing Business 2015*. This low ranking is due to its weak legal framework, especially for reorganisation and creditor participation, and a low recovery rate (39.3% compared to an OECD average of 71.9%) (World Bank, 2014).

Insolvency continues to be governed by the 1997 Insolvency and Bankruptcy Law, the 2001 Civil Code and the 1999 Civil Procedure Code. The Civil Procedure Code was reformed in November 2013 to introduce maximum times for discharge from bankruptcy, and an additional amendment adopted in February 2015 reduces the timeline for the completion of insolvency procedures. These new amendments have reduced the length of a typical insolvency process from 18 to 12 months.

In spite of the 2013 reform, the bankruptcy framework continues to contain a number of weaknesses. According to a 2009 analysis conducted by EBRD, the Insolvency and Bankruptcy Law represents "low compliance" with international standards, and is deficient in most areas, with the exception of the treatment of creditors (EBRD, 2009). Major issues relate to the reorganisation procedures (which are virtually non-existent as the law is generally focused on liquidation), as well as the functions of the insolvency administrators, as the law does not require their registration or licensing. Moreover, there are no provisions for professional work standards, ethical rules, or discipline for insolvency administrators. The law fails to provide for an automatic moratorium on legal proceedings against the debtor once the bankruptcy procedure has been initiated. While the law offers the option of out-of-court settlement in "exceptional cases," it is unclear if this option is ever used in practice. Further, Azerbaijani law defines insolvency as the inability of a debtor to pay its debts, which means that a viable business with cash-flow problems could be declared insolvent (World Bank, 2013). This problem is further exacerbated by the lack of incentives for post-petition financing. As a result, it is not surprising that the majority of bankruptcy cases result in the business being sold off piecemeal. Finally, there is no separate online open bankruptcy or insolvency registry in Azerbaijan.

More generally, it is unclear whether the existing insolvency legal framework is being widely used in practice. Bankruptcy cases are rarely heard in Azerbaijani courts and in the majority of the cases the debtor reaches an amicable agreement with the creditor.

There are also no state-sponsored mechanisms that would promote a second chance for businesses that want a fresh start. Two-thirds of the 390 respondents to the 2015 OECD company survey found it very or somewhat difficult to resume business after failure, and 42% of respondents cited acquiring finance as the most significant difficulty (see Box A.3, Annex A).

Facilitating SME access to finance (Dimension 6)

Overall, Azerbaijan has made some progress in facilitating SME access to finance since the 2012 SBA assessment. Major developments include the launch of the Start-up Project and the National Fund for Entrepreneurship Support. However, their impact has yet to be evaluated. Key remaining challenges are that entrepreneurs generally do not consider banks to be an effective mechanism for financing their businesses, especially because of high interest rates.

Legal and regulatory framework

As noted above, insolvencies continue to be cumbersome. In 2014 the government took a step in the right direction by establishing a working group to develop a comprehensive legal framework for secured transactions, including a registration system for movable assets. While the cadastre of land and property is fully functional in Azerbaijan, it has yet to be digitised. The process is underway, however, as part of the World Bank Real Estate Project. Cadastre information covering the whole country is expected to be available by late 2015. Key recommendations made by the SBA in 2012 were to improve the capacity, coverage and effectiveness of the credit information system and to introduce a private credit information bureau (OECD, 2012). However, these recommendations have not been implemented. Despite the submission of a first draft law on the establishment of a private credit registry, the government has not finalised this law. As a result the public credit bureau continues to be the only source of credit information in the country. It will thus be important to complete ongoing work on the legal frameworks not only for a private credit bureau, but also for a movable collateral registry.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

Access to finance continues to be a major obstacle for SME growth in Azerbaijan. With only 15% of BEEPS V firms using bank credit to finance their businesses in 2014, Azerbaijan lags behind other Eastern partner countries (where the average share of firms using bank credit is 31%). According to the *2014 MSME Access to Finance Demand Survey in Azerbaijan*, the use of loans among SMEs remains low regardless of sector and size (World Bank, 2015). Conversely, 93% of BEEPS V firms reportedly rely on internal funds for working capital, which is the highest ratio in the Eastern partner region. The government's main financial support mechanism for SMEs is through subsidised financing, e.g. through its National Fund for Entrepreneurship Support, the State Fund for Development of Information Technologies, as well as the State Service on Management of Agricultural Projects and Credits, Azerbaijan Investment Company (which provides equity to greenfield and brownfield projects in Azerbaijan) and the Mortgage Fund. For instance, the National Fund provided AZN 295 million (approximately EUR 255 million) in subsidised lending to 5 560 enterprises in 2014. Going forward, an evaluation of existing mechanisms will be important to determine their impact on closing the SME financing gap.

In terms of non-bank financing, Azerbaijan's micro-finance institutions continue to be an important source for SMEs, and their reach is growing. In 2013 micro-finance institutions were estimated to have financed approximately 400 000 SMEs; by the end of 2015, this figure is expected to grow by 50%. However, use of other financing instruments such as leasing and factoring appears to be limited. The World Bank estimates uptake of leasing and factoring to be 4% and 2% of SMEs, respectively (World Bank, 2015).

Venture capital activity in Azerbaijan has grown since the last SBA assessment. The State Fund for Development of IT, established in 2012, provides investments to innovative SMEs and start-ups. In 2014, the Start-up Project was launched to provide entrepreneurs with training to realise their business ideas and make links to potential investors.

Financial literacy

Low levels of financial literacy are a key demand-side obstacle to SMEs' ability to access finance. According to the *2014 MSME Access to Finance Demand Survey in Azerbaijan*, over one-third of Azerbaijan's SMEs do not maintain financial records or conduct future cash flow planning (World Bank, 2015). To address this, the Central Bank has dedicated the month of November of every year to raising financial awareness. It conducted a new financial literacy survey in 2013-14, though its conclusions have yet to be presented. Financial literacy is not an integral part of the school curriculum.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Lifelong entrepreneurial learning

The 2016 assessment points to better awareness and understanding of entrepreneurship as a key competence. However, the implications for curriculum reform and the teaching and learning process remain to be addressed. This will require a stronger "internal partnership" (Gribben, 2013) within the formal education system, i.e. a more joined up entrepreneurship curriculum framework from primary right up through secondary, vocational and tertiary education. Linkages between education and the enterprise world are generally good; moving entrepreneurial learning forward should ensure that business plays an integral role across the entrepreneurial learning spectrum. More specifically, thought should be given to how businesses can help schools ensure that young people acquire entrepreneurial experience. This should be set against the youth entrepreneurship provisions of the "Azerbaijan 2020 Vision".

A specific sub-group could be set up to define entrepreneurial learning outcomes for all levels of education. These could be piloted, evaluated and ultimately integrated into the national curriculum. This group could borrow the model of working groups already established by the Ministry of Education to support the "Strategy for Education Development". The implications for teaching will need to be integrated into the planning process. While the education authorities will ultimately be responsible for all developments, the interest and support of the Ministry of Economy and Industry in entrepreneurial learning developments is strong, providing an important leverage for putting entrepreneurial learning on the national development agenda.

While there are good examples of entrepreneurship promotion in non-formal learning, these need to be more visible and available for education and training institutions to learn from, including schools, colleges and universities within the formal education system. The vocational education and training (VET) system in particular stands to benefit from experience of certain VET organisations providing self-employment and start-up support. Schools careers guidance services will also need to upgrade their provision to include entrepreneurship as a career option (Loughran, 2014). The information and support provided should dovetail with wider SME advisory services.

Higher education has a critical role to play in building a competitive and innovative economy. Strategic steps should be taken to ensure that all university graduates have access to entrepreneurial learning. While there are excellent examples of university-based incubators, a system-based approach is necessary to ensure that entrepreneurial learning is available across all faculties, at all universities. This requires dialogue among the higher education community, key ministries, businesses and other stakeholders (e.g. student and teacher associations).

Women's entrepreneurship

Women's entrepreneurship receives considerable policy coverage, spanning regional development, employment and economic development. The Ministry of Economy and Industry, in co-operation with the employers' organisation (ASK), co-ordinates planning and good practice developments.

The official data on women's businesses gathered by the national statistics office is particularly important. Broken down by sector of activity, this baseline data provides an excellent opportunity for evidence-based policy analysis (the lion's share of women entrepreneurs operate in agriculture, trade and services). Such analysis can help ensure that women are engaged in the country's wider competitiveness drive. While the national statistics office may not necessarily elaborate on the data, key ministries (e.g. those responsible for the economy, employment, innovation and regional development) and other interest groups (e.g. employers' associations or development organisations) could add to this data. This would create a more robust source of policy intelligence to support women's entrepreneurship, including training, mentoring services and access to finance.

There are very good examples of targeted training support for women entrepreneurs and prospective entrepreneurs by the regional training centres, such as on developing a business plan, financial literacy, quality management and accessing micro-finance. This training effort could be reinforced through a more systematic focus and annual review of developments, including data and emerging good practice. This could be linked back into the policy arena, to ensure that both data and good practice shape and improve women's entrepreneurship policy. In this regard, ASK's Women's Commission could assume a more policy advocacy role. A further incentive to engage more women entrepreneurs in the economy would be a dedicated women entrepreneurs ambassadors' group that could eventually link into a wider European network (Bekh, 2013).

SME skills

Azerbaijan has a clearly identifiable range of organisations supporting SME training. These include the Baku Business Training Centre (BBTC) and its seven regional offices, the National Fund for Entrepreneurship support, the Export and Investment Promotion Foundation and ASK. SME surveys administered through BBTC's regional network help identify training needs, while financial support from the Ministry of Economy and Industry aids in the design and delivery of training.

While start-up training is well developed, data capturing the training provision by the various training organisations (e.g. public employment services, BBTC, NGO service providers) still need to be reconciled to give a more comprehensive picture of start-up training support. Meanwhile, the National Fund for Entrepreneurship supports training for enterprises with growth potential. Better data on training for growing SMEs, and particularly SMEs with export potential, will help the policy effort to build a more competitive and diversified economy (Lasku & Gribben, 2013).

BBTC has a well-developed online training facility. This allows SMEs across the seven administrative regions to access online training in areas such as business planning, start-up and e-trade. A good monitoring system allows policy makers and the BBTC network to track training developments, including e-training activity by region and gender participation (approximately 25% of those using the online training services are women).

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Since the 2012 assessment, Azerbaijan has improved its support services for SME competitiveness with the introduction of a pilot incubator project and regular training organised by BBTC. There has also been progress in strengthening the institutional support for innovation, and three technology parks have been established along with new funding sources for the ICT sector. Reforms to public procurement have been slow, with little progress in the development of e-procurement and other areas. Finally, greening policy has been developed further with the adoption of the risk-based diversification of environmental regulation, although SME-targeted policies are still lacking.

Business information and services

Azerbaijan lacks a strategic, targeted approach to support services for SME development. It also lacks a specific action plan for business support services, although such services are provided free-of-charge by the Ministry of Economy and Industry through the BBTC. Established in 2007, BBTC is fully funded through the state budget and has offices in seven regions. These organise training courses on a wide range of topics, such as starting a business, developing business plans and investment projects, logistics, green agriculture, insurance in agriculture, export markets, marketing and management. Distance learning is also available. In the second half of 2014, 144 training courses for entrepreneurs were held.

In 2014, the BBTC launched a pilot business incubator for start-ups, which is expected be rolled out to a number of rural regions, plus the industrial and technology parks. Also in 2014, the Azerbaijan Economic University established a business incubator to develop entrepreneurial skills among students.

Progress has also been made in the provision of business information to entrepreneurs with the launch of several new websites by the Ministry of Economy and Industry. For instance, the new www.biznesinfo.az website provides general information on business related topics, while the first e-trade business portal in the country (www.b2b.az) connects businesses by distributing information on products and services to potential buyers and providing free market access. The website of the Ministry of Economy and Industry has a section on entrepreneurship providing information about support programmes, starting a business, subsidised loans, and business opportunities (http://economy.gov.az).

Despite the growing number of websites created to help businesses, resources are somewhat fragmented and could be consolidated into a single e-portal. More can also be done to increase awareness of the value and potential benefits of business development services. According to the BEEPS V, only 3.5% of surveyed enterprises in Azerbaijan had hired an external consultant during the previous three years (EBRD, 2014). More generally, targeted initiatives (e.g. voucher schemes, matching grants) could help grow the private market for the provision of business support services.

Other actors are active in providing business support infrastructure. These include donors, such as the German development co-operation agency GIZ, which facilitates business study tours; and the EBRD's Small Business Support Programme, which has helped over 700 enterprises since 2003. NGOs are also active. The Entrepreneurship Development Foundation (EDF) has developed an information resource allowing entrepreneurs to access information on current legislation; state support programmes; international experience; business statistics; development indices; surveys; e-books and brochures.

However, despite the progress in provision of support services to businesses, 79% of SMEs surveyed by the OECD in 2015 were not aware of any services provided by the government to support small businesses.

Public procurement

Azerbaijan has made modest progress in upgrading its public procurement framework since the previous assessment. New amendments to the legislation create the necessary regulatory conditions for the full introduction of an electronic procurement system. The Public Procurement Agency runs a helpdesk for SMEs and provides regular training in Baku and the provinces, although these do not focus specifically on SMEs.

While the possibility of cutting tenders into lots is not stated in the legislation, it is common practice in the majority of procurement procedures. Contracting authorities may allow companies to submit joint bids. It could not be verified whether there is a law governing late payments to contractors or legal provisions to ensure proportionate qualification levels and financial requirements for SMEs. There are no provisions governing late payments to contractors, and discounts for local material and workforce, if applied in practice, do not allow best value for money, which could lead to increased public spending and reduced competition.

Azerbaijan needs to establish an independent review body that is detached from the regulatory body for public procurement to avoid potential conflicts of interest. Electronic procurement should be further developed in line with the reformed legislation – currently full tender documentation can only be obtained in person from the contracting body and for a fee.

Innovation policy

Innovation by SMEs remains very low in Azerbaijan, with none of the companies surveyed by BEEPS V reporting any R&D expenditure in the previous three years. Product and process innovation is similarly limited; with only 2.1% firms surveyed having introduced a new product and 2.8% a new process in the previous three years (EBRD, 2014).

There is no comprehensive national innovation policy in place in Azerbaijan. Instead, innovation policies are scattered across a number of state programmes and policy documents, such as the “Azerbaijan 2020 Vision”, the “National Industrial Strategy 2015-2020”, the “National ICT Strategy of the Republic of Azerbaijan 2014-2020” and the “National Education Development Strategy 2013-2020”. A number of government agencies and structures are implementing or supporting the implementation of state innovation initiatives, including the Ministry of Economy and Industry, the Ministry of Communications and High Technology, and the National Academy of Sciences. However, no formal co-ordination arrangements have been established and, in practice, the various initiatives do not appear to be co-ordinated. The development of an innovation strategy could resolve policy fragmentation, improve monitoring and evaluation of existing initiatives, and improve inter-agency co-ordination. An innovation law is being drafted at present but policy guidance and concrete action plans are likely to be needed to ensure effective implementation.

Despite the absence of an overall strategy, Azerbaijan has introduced a number of initiatives to boost innovative entrepreneurship, although most of them are focused on the ICT sector and appear to target enterprises in general, not just SMEs. In 2012 the Ministry of Communication and High Technologies of the Republic of Azerbaijan established the State Fund for Development of Information Technologies (the ICT Fund), with activities financed entirely from the state budget. The fund has a supervisory board with representatives from four ministries and three NGOs (the private sector as such is not represented). It supports innovative ICT projects in several ways:

It distributes concessional loans through authorised banks with a maximum 5% interest rate. Loans can be small (from AZN 10 000 to 50 000 for up to three years), medium (from AZN 50 000 to 500 000 for up to five years) or large (from AZN 500 000 to 5 000 000 for up to ten years).

It provides equity and venture capital for the development of new projects, technologies, software and equipment, as well as for commercialising innovations.

It awards grants – mainly to SMEs – for the development of software products, innovative infrastructure projects, and development of e-services. The maximum duration of the grant project is 36 months. In the two first selection processes (up to January 2015), the ICT Fund awarded only small grants ranging from AZN 10 000 to AZN 12 000 to 30 companies in each round, although the maximum potential size of a grant is AZN 300 000.

Azerbaijan has also made significant progress in developing physical infrastructure for innovative companies. Two ICT technology parks are currently under construction in the Pirallahi Islands and in Mingechevir. Once finalised (between 2016 and 2018), they will provide tax benefits to hosting companies, including start-up projects that are receiving grants from the ICT Fund. While construction continues, the Pirallahi techno-park's incubator is already working in Baku. It groups 35 projects selected for ICT Fund support from 120 applicants. They also receive technical support from private IT companies. The first university-based technology park was established in 2013 at Qafqaz University. Its aim is to produce advanced technological products through scientific research in non-oil sectors. It also aims to increase collaboration between universities and the private sector. More generally, under the newly-approved "National Industrial Strategy 2015-2020", the Ministry of Education is expected to create innovation centres in the country's universities in 2016-17, with the support of the private sector. Significant efforts have also been directed to developing industrial parks. Regulations were adopted in 2014 and the Ministry of Economy and Industry is currently building four industrial parks and one industrial estate focusing on chemicals manufacturing industries, aluminium and metal transformation, light industry, ship construction, and non-oil industry and processing. When operational, these parks are expected to provide concessional loans and training and consultancy support to the participating SMEs.

Despite the above progress, innovation initiatives would benefit from a broader focus on innovation across industries and sectors (as opposed to ICT exclusively) as well as more emphasis on technology transfer, commercialisation of innovations, and closer innovation networks, including research institutes, which remain almost non-existent at present. In this connection, the Azerbaijan National Academy of Sciences, which plays a leading role in the co-ordination of R&D activities in the country and receives most of its funds from the state, has recently announced plans to create a National Innovative Centre by transforming its Scientific Innovation Centre into a technology transfer platform.

Green economy

Environmental policies in Azerbaijan remain focused on the large industrial sector, while the SME dimension is neglected. The "National Industrial Strategy 2015-2020" pays particular attention to the observance of high environmental standards during the establishment of new enterprises and the use of energy-saving technologies. However, it does not target SMEs.

The Ministry of Ecology and Natural Resources is starting to implement risk-based diversification of environmental regulation: the draft Law on Environmental Impact Assessment allows for the differentiation of environmental impact assessment (EIA) and permitting requirements for enterprises according to their environmental impact, sector and type of economic activity. However, no further reforms are envisaged in this area.

There is a policy to encourage the establishment of eco-industrial parks in order to attract entrepreneurs and investors interested in green business, especially the recycling industry. This involves various exemptions from corporate, land, real estate and value added taxes. Balakhani, the first eco-industrial park, was established in 2011 and currently hosts three companies, but has not been replicated elsewhere.

Limited financing for green investments is available. In 2014, the EBRD lent USD 5 million to Demirbank to finance energy efficiency projects in Azerbaijan. The facility will be used for on-lending to qualifying corporate and individual customers for industrial and residential energy efficiency projects and equipment.

Supporting SME internationalisation (Dimensions 10 and 7)

Azerbaijan is in the process of developing a new export promotion programme as part of the government's broader economic diversification efforts. SMEs could also benefit from the introduction of support measures to insert themselves into global value chains, as well as the development of export finance. Although Azerbaijan has made progress in aligning its legislation with international best practices, reforms to its conformity assessment and market surveillance are necessary to upgrade existing systems.

Export promotion and integration into global value chains

International trade in Azerbaijan is dominated by large, often state-owned, enterprises with only 2.1% of small and 1% of medium sized enterprises exporting directly or indirectly (EBRD, 2014). This share of exporting companies is the smallest of all the Europe and Central Asia countries covered by BEEPS. Shortage of working capital is a key problem; 68.2% of Azerbaijani companies use their own or family resources to finance exports. This is the highest figure among Eastern partner countries participating in a 2014 survey conducted by East Invest (2014). Only 20.5% of respondents use commercial banks.

The World Bank's *Doing Business 2015* report ranks the country at 166th place for ease of trading across borders due to the large number of documents required (9) and length of export process (27 days, compared with an ECA average of 23.6) (World Bank, 2014). However, a Resolution of the Cabinet of Ministers and a Presidential Decree, adopted in July 2014 and July 2015 respectively, are expected to reduce the number of documents required to clear customs and promote the use of e-customs services.

AZPROMO is the leading agency in charge of promoting international trade opportunities among local businesses, including SMEs. It is a joint public-private initiative established in 2003 by the Ministry of Economy and Industry with operational autonomy and reporting directly to the Minister. Its annual budget is about EUR 1 million and all its services are offered free of charge.

AZPROMO's core activities include export training, product and producer catalogues, promotional events (e.g. business forums, B2B meetings) and funding company participation in international trade fairs. In 2013, AZPROMO and GIZ jointly prepared and published a detailed export manual (*Instruction Book for Exporters*) covering specific issues related to exporting to the EU. In December 2014, AZPROMO also established the Exporters Club, in which SMEs make up 25-30% of members. The major function of the club is to support manufacturers in exporting Azerbaijani products to foreign markets and establish a platform for communication between non-oil exporters. However, none of the SMEs surveyed by the OECD in 2015 were aware of government programmes to encourage companies to export to or partner with international companies.

Currently, AZPROMO, the Ministry of Economy and Industry and GIZ are developing a new export promotion programme targeting all industries and enterprises operating in Azerbaijan. SMEs are one of the focus areas. The new programme is expected to pay particular attention to building the capacity of AZPROMO itself. The aim is to improve its effectiveness and to scale up and develop more sophisticated export promotion services, such as market intelligence, match-making and linkages, policy advocacy and co-operation with other international trade and investment promotion agencies.

Despite progress in export promotion measures, there is a notable absence of financial support mechanisms for exporting SMEs in Azerbaijan. While exporters benefit from some reductions in customs duties and other fees, export finance is underdeveloped. In January 2014, the President of Azerbaijan announced plans to develop a system of incentives and benefits for exporting companies, although the details of the support measures remain to be seen.

Finally, there are currently no specific government programmes to support SME integration into global value chains in Azerbaijan or to promote linkages between FDI and local enterprises.

Standards and technical regulation

The State Committee for Standardization, Metrology and Patents of the Republic of Azerbaijan (SCSMP) is responsible for implementing state policy in the sphere of technical regulations, standardisation, metrology, conformity assessment, accreditation, quality management and protection of industrial property.

At the moment Azerbaijan's major policy goal is to modernise its standardisation system by transforming existing mandatory standards into technical regulations and voluntary standards, as well as to harmonise Azerbaijani standards with international standards. In 2013, the Standards Institute was restructured into a Standardisation and Certification Institute. It has a broader remit now, including managing a standards database and national technical committees. Draft legislation is currently being developed on standardisation that is in line with EU principles and WTO regulations.

The new law on accreditation was adopted in 2014. However there are still gaps in the law; amendments to this primary legislation are foreseen in order to bring it in line with EU *acquis*. To address these gaps a new EU twinning service to support accreditation is currently being prepared.

With regard to legal metrology, the law on uniformity of measurements was enacted in 2013 and is deemed to be in line with EU requirements. A new law on accreditation was adopted in 2014 and is also in line with the EU *acquis*.

Draft legislation on technical regulations is being developed with the support of the EU Twinning project, and sectoral legislation in priority sectors is in the draft stage.

With regards to conformity assessment, there is still a state monopoly on the recognised conformity assessment bodies, and the current legal framework related to market surveillance does not appear to fully comply with the EU *acquis*.

The way forward

The 2016 SBA assessment suggests the following as priorities for Azerbaijan to continue improving its SME policy framework:

- **Improve the institutional framework for SME policy making by adopting a strategy or similar policy document** which identifies priorities and concrete actions over the medium and long term. This document could outline the creation of a dedicated SME agency in charge of implementing the policies formulated by the Department of Entrepreneurial Development Policy. It could also introduce structured frameworks for co-ordination amongst all ministries and agencies active in SME policy, as well as for dialogue with the private sector.
- **Prioritise the adoption of the series of draft key laws and regulations which address existing shortcomings**. These include a clear set of rules and guidelines on RIA, and the streamlining of licenses and permits.
- **Reform the legal framework for both bank and non-bank sources of finance** to address bottlenecks in SME access to finance. Completing key pieces of legislation (e.g. on facilitating the establishment of a private credit bureau, the movable collateral registry and legal reforms regarding secured transactions) would fill the gaps in the country's financial infrastructure. Innovative approaches could encourage banks to lend to SMEs, including the establishment of a credit guarantee scheme and improvements to current support schemes. Finally, emphasis could be placed on capital market development as an alternative to bank finance.
- Reinforce the Working Groups of the Strategy for Education Development to include entrepreneurial learning. A dedicated group could be formed focusing on **developing entrepreneurship as a key competence** at all levels of formal education, piloting and evaluating it before mainstreaming it into the curricula. Training and mentoring for high-potential women entrepreneurs should be increased. Enterprise skills can also be developed through a more joined-up SME training intelligence framework to support policy development, monitoring and evaluation.
- **Increase SME competitiveness by strengthening the monitoring and evaluation of existing initiatives on innovation, capacity building and export promotion**. A more strategic approach is needed to ensure that innovation support measures being introduced by the government are coherent and effective. The narrow focus on the ICT sector should be broadened to take in the full framework for innovation, including developing institutional linkages between academia and the private sector. The government could also strengthen general support to SMEs by promoting a private market for business advisory services. One approach could be to co-finance SMEs using these services. Developing trade finance and promoting quality upgrading in the non-oil sector could support the government's export diversification efforts. Further reforms are also needed to the public procurement framework; the establishment of an independent review body detached from the regulatory body for public procurement is a priority to avoid conflicts of interest.

Table 12.4 outlines a potential policy roadmap to guide SME development policy over the short, medium and long term, based on the findings of the SBA assessment.

Table 12.4. **Azerbaijan: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• **Consider the adoption of a comprehensive SME strategy/programme, potentially including a SME implementation agency**	M/L
• **Finish ongoing work to develop a RIA framework; as well as improved frameworks for licenses and permits**	S
• Revitalise Entrepreneurs Council or introduce formalised PPC platform	S/M
• Improve statistics collection; develop targeted programmes for economic formalisation	S/M/L
• Introduce M&E systems in existing support programmes to evaluate impact on SMEs, improve access to information for potential applicants	M
• Reform the insolvency legal framework to improve access for creditors, introduce incentives for post-petition financing	S/M
2. Facilitating SME access to finance	
• **Complete ongoing work on the draft legal frameworks for a private credit bureau, movable collateral registry and secured transactions; consider regulation on leasing**	S/M
• Continue capital market development under current state programme, including potential stock exchange platform for SMEs	M
• Consider innovative approaches to supplement collateral requirements; evaluate direct support by National Fund for Entrepreneurship Support	M/L
3. Promoting skills and entrepreneurship development	
• Upgrade entrepreneurial learning developments within the Strategy for Education Development to include *(a)* a dedicated working group on entrepreneurship key competence development across all levels of formal education; and *(b)* a developed monitoring and evaluation framework (formal and non-formal entrepreneurial learning)	S/M
• Establish a national dialogue between government, business and the higher education community and student representative organisations (e.g. national symposium) to determine issues and options for more strategic development of entrepreneurship in higher education	S
• Build on already good institutional developments supporting women's entrepreneurship in particular through more developed data and intelligence focusing on high-potential women's entrepreneurship	S/M
• Establish focus groups comprising managers/owners of growing businesses in key sectors to determine training support requirements for onward sharing with public and private sector training providers	S/M
4. Enhancing SME competitiveness	
• Improve support to grow a business development support market (e.g. consultant database, voucher programmes); introduce single web interface for SME support	S/M
• **Develop a comprehensive innovation strategy that encourages ICT uptake in all sectors of the economy relying on locally developed ICT skills and offer targeted SME support measures (for example ICT innovation vouchers)**	S/M/L
• Promote SME participation in public procurement by establishing an independent review body and publishing all procurement information electronically	M/L
• Provide regulatory and financial incentives for SME "greening"	M/L
5. Supporting SME internationalisation	
• **Develop and implement targeted support measures for exporting SMEs, including an enabling environment for trade finance (export credit schemes)**	S/M/L
• Increase compliance of national technical regulations and standards with international and EU standards; support SMEs to comply with standards	S/M/L
• Develop targeted programmes to foster FDI-SME linkages (e.g. matchmaking schemes, knowledge transfer)	M/L

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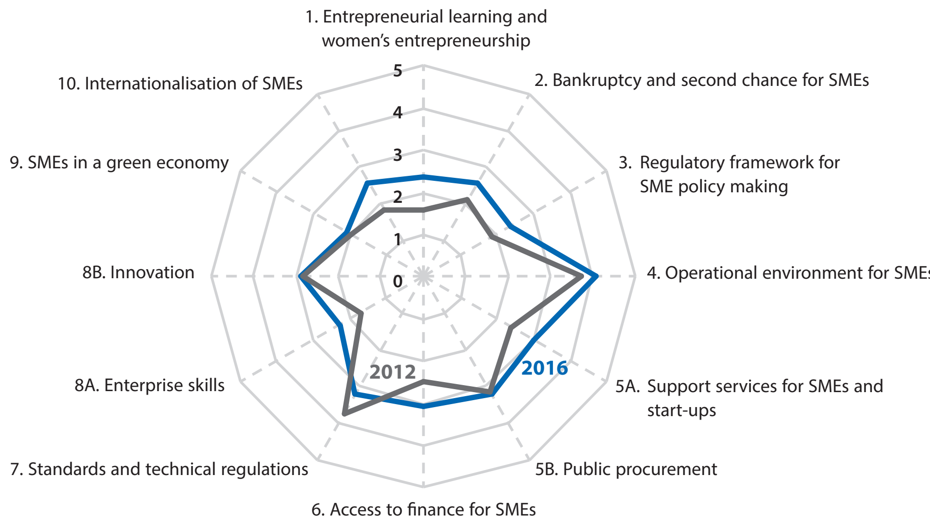
Chapter 13

Belarus: Small Business Act country profile

While state-owned enterprises continue to be the backbone of the Belarusian economy, the government has paid greater attention to SME development in recent years. Slow but steady progress has been made since 2012 to simplify regulatory procedures, and legislative reforms have been implemented in key areas, such as insolvency, business registration and public procurement. Surveys suggest that Belarusian SMEs have significant levels of internationalisation and innovation activity compared to other EaP countries.

SME growth in Belarus will largely depend on broader liberalisation measures aimed at creating a level playing field for all economic actors regardless of their size or ownership structure. The development of a medium-term strategic framework and a dedicated SME agency would considerably improve the effectiveness of policy making and implementation. Largely reliant on state financial assistance to date, SME support measures should be broadened and adequately monitored. The development of a private market for business support services would help reduce the reliance on direct state support. Likewise, legal and regulatory reforms are still needed to strengthen creditors' rights, promote access to finance and reduce the regulatory burden on SMEs.

Figure 13.1. **SBA scores for Belarus**



Key findings

State-owned enterprises (SOEs) continue to play a prominent role in Belarus. Since 2010, however, the government has increasingly acknowledged the importance of developing the private sector, and in particular SMEs, as an engine of sustainable growth and competitiveness. Some liberalisation measures have been adopted (in particular the removal of price controls). Since the last SBA assessment, progress has been uneven, with only limited changes made to the institutional framework. However, significant developments have taken place in the operational environment for SMEs. These include the introduction of online business registration and other electronic services and the introduction of a new insolvency law in 2012. The coverage of the public credit registry has been significantly expanded and the government has introduced various financial support schemes for SMEs in an attempt to increase access to finance and encourage innovation. This includes a new scheme offered by the Development Bank of the Republic of Belarus, which is expected to improve take up and effectiveness compared to the programmes currently offered by the Belarusian Fund of State Support of Entrepreneurs (BFSSE). Despite these developments, the contribution of SMEs to employment and output remains below the country's potential and below EaP regional averages.

Recent efforts have translated into sizeable improvements in the 2016 SME Policy Index scores for Dimensions 2 and 4 (on the operational environment for SMEs, including insolvency). Progress has also been made in the human capital dimensions (Dimension 1 and 8a), mostly due to consistent government efforts to move entrepreneurial learning up the policy agenda and implement concrete skills development programmes. Progress has been more modest in establishing an institutional framework (Dimension 3) and developing targeted support measures for innovation and export promotion (Dimensions 8b and 10). Relatively limited progress in upgrading quality support infrastructure to meet EU standards explains the deterioration in the score for Dimension 7. Access to finance remains a significant impediment to SME growth, reflected in a small improvement in the score for Dimension 6.

The pace of reform in Belarus is slow compared with other EaP countries. SME development should be considered a part of broader efforts to promote private sector development, liberalise the economy and improve economic competitiveness. In this context, the creation of a level playing field for all businesses, regardless of their size and ownership structure, will be key for Belarus to achieve sustained economic growth in the medium to long term. Addressing the main constraints to SME development in the country should be part and parcel of this agenda:

- In the absence of a medium-term framework identifying priorities, targets and monitoring mechanisms, the current approach to SME support lacks strategic focus. A new SME development strategy should fill this gap. The strategy should be accompanied by institutional reform to separate policy design from implementation. This could be achieved through the creation of a dedicated SME agency under the overall guidance of the Ministry of Economy. This agency could diversify the existing menu of support services, which are largely focused on government-directed lending schemes, and adopt a more proactive and market-oriented approach to developing business support infrastructure. Monitoring and evaluation of existing schemes should also be prioritised to enhance their effectiveness and efficiency.
- Despite the government's efforts, access to finance remains a major obstacle for SME competitiveness and growth. An inadequate framework for creditors' rights, high collateral requirements and limited sources of finance beyond large state-owned banks are some of the challenges for SMEs. A revision of the insolvency legal framework, the operationalisation of a collateral registry covering moveable assets, the promotion of SME-specific financial products, and the promotion of competition in the banking sector should all be prioritised.
- A more concerted effort is needed in entrepreneurial learning and women's entrepreneurship support. A structured co-operation framework between the education and business sectors could lead to the integration of entrepreneurship key competence into curricula and teacher training across all levels of formal education. Women's entrepreneurship support and policy partnership require high quality, sex-disaggregated statistical data, strategic policy partnership and systematic support to good practice exchange.

Table 13.1. **Belarus: Challenges and opportunities**

Strengths	Weaknesses
• Policy commitment to private sector development and SME development (e.g. "National Strategy 2030"; "Programme of Social and Economic Development 2011-2015") • Significant track record in legal and regulatory reform (e.g. business registration); strong World Bank Doing Business performer in registering property and enforcing contracts • Growing digitalisation of governmental services • Incipient public provision of business infrastructure • Comprehensive institutional framework for innovation ("National Programme 2011-2015", vouchers and grants, tax incentives, clusters) • Relatively high levels of internationalisation (export-orientation, including by SMEs, cf. BEEPS V) • Some incentives for adopting greening practices	• Generally underdeveloped private sector, high state controls (e.g. pricing, SOE dominance in many markets) • SME definition could be improved (e.g. no turnover threshold) • Reforms often lacking implementation, limited monitoring and evaluation • Room for reducing regulatory burden (e.g. for exports) • Public-private dialogue could be further strengthened and formalised; no structured RIA is undertaken • Access to finance largely reliant on state-owned banks; limited non-bank alternatives • Insolvency framework needs improvement (e.g. creditors' rights, unequal treatment of companies)

Table 13.1. **Challenges and opportunities** *(continued)*

Opportunities	Threats
• Reform of state-owned enterprises could create level playing field and offer opportunities for SMEs • SME development strategy under preparation as a roadmap for reforms • Competitive and qualified labour force (literacy rate is close to 100%); low unemployment although labour market has limited dynamism • High innovation potential among entrepreneurs; new scheme for the provision of government funding to the innovative projects; new cluster policy • Strategic geographic position between EU and Russia • Highly open to trade compared to other EaP countries (e.g. trade represented over 135% of GDP in 2009-12)	• Slow pace of reform compared to regional peers • Macroeconomic risks (e.g. current account); exposure to regional instability • Declining competitiveness, lack of export diversification (over 50% to Russia) • Limited FDI (necessary to enhance competitiveness, exports); limited international quality certifications • Potential skills mismatch (inadequate workforce skills identified as the biggest obstacle faced by Belarusian firms in BEEPS V) • Practices of the informal sector mentioned as a barrier to business (cf. BEEPS V) • Underdeveloped services sector (e.g. business consulting)

Overview

Economic snapshot

With the second largest economy of all the Eastern partner (EaP) countries, Belarus continues to pursue a state-led development model. State-owned enterprises (SOEs) account for over 50% of output and 65% of employment and are the dominant players in key industries (e.g. machinery, chemicals, etc.). In contrast with other post-Soviet economies, Belarus has not implemented a privatisation programme and structural reform has proceeded at a slow pace. The economic model continues to be based on full employment primarily in the state-controlled sector, which constrains the reallocation of capital and labour to more productive sectors while distorting the price system and misallocating resources (EBRD, 2015). On the other hand, the economy is very open to trade (which represents about 140% of GDP), although exports are concentrated, with the Russian Federation accounting for roughly half (IMF, 2015a). Structural rigidities and the frequent recurrence of expansionary policies to boost internal demand (in particular real wage and credit increases), followed by periods of adjustment, are the main causes of slow growth and large external imbalances (EBRD, 2015). The Belarusian economy thus remains highly vulnerable to external shocks, having experienced three major exchange rate crises since 2008 (IMF, 2015a).

Since 2012, Belarus has experienced a period of sluggish growth (1.7% in 2012, 1% in 2013 and 1.6% in 2014, compared to 7.7% in 2010 and 5.5% in 2011; Table 13.2). This reflects the weak external environment and the country's limited export competitiveness. The small output expansion in 2014 was primarily driven by a recovery in potash exports. As a result of mounting imbalances, a significant currency devaluation (of 30% against the dollar) took place in December 2014, fuelling inflation levels to about 18%. Merchandise exports contracted by almost 30% in early 2015 due to economic slowdown in Russia and Ukraine. The exchange rate has stabilised in 2015 and currency and price controls have been removed. However, the impact on the real economy is significant, and, as of May 2015, negative growth of -2.5% is forecast for the entire year due to falling exports and a weaker domestic demand (EBRD, 2015). The current account deficit is expected to remain around 7% of GDP, while devaluation is forecast to push inflation to 22% (IMF, 2015a). A tightened monetary policy and the currency devaluation have also increased pressures on the banking sector, which presents high levels of dollarisation and state ownership.

In May 2014, Belarus joined the Eurasian Economic Union (EEU) along with Russia, Kazakhstan, Armenia and the Kyrgyz Republic. Belarus' participation in this union is expected to provide the country with further access to Russian oil and gas at prices below world market levels. The harmonisation of technical regulations and elimination of barriers for participation in public procurement should also boost trade within the EEU.

Table 13.2. **Belarus: Main macroeconomic indicators, 2010-15**

Indicator	Unit of measurement	2010	2011	2012	2013	2014 [a]	2015 [b]
GDP growth	Percent, y-o-y	7.7	5.5	1.7	1.0	1.6	-2.3
Inflation	Percent, average	7.7	53.2	59.2	18.3	18.1	22.1
Government balance	Percent of GDP	-4.3	-2.9	0.5	-0.8	-3.3	n.a.
Current account balance	Percent of GDP	-15	-8.5	-2.9	-10.4	n.a.	n.a.
Exports of goods and services	Percent of GDP	53.2	81.1	81.3	60.3	57.2	n.a.
Imports of goods and services	Percent of GDP	66.9	82.2	76.7	63.5	57.9	n.a.
Net FDI	Percent of GDP	2.4	6.5	2.1	2.9	2.6	n.a.
External debt	Percent of GDP	52.1	57.7	54.2	54.1	n.a.	n.a.
Gross reserves	Percent of GDP	6.3	10.2	9.2	7	n.a.	n.a.
Credit to private sector	Percent of GDP	44.1	38.6	21.5	22.6	n.a.	n.a.
Unemployment	Percent of total labour force	0.8	0.7	0.6	0.5	0.5	0.5
Nominal GDP	USD billion	55.2	59.7	63.6	71.7	76.1	60.5

Notes: **a.** GDP growth and nominal GDP figures are IMF projections, government balance and net FDI are EBRD projections; **b.** 2015 figures are IMF projections.

Source: EBRD (2014a), *Transition Report 2014*; IMF (2015b), *World Economic Outlook*; World Bank (2015), *World Development Indicators 2015*.

Business environment trends

The prominent role of SOEs in Belarus and the preferential regime they enjoy in terms of financial resources, lower energy prices and regulatory obligations is a constraint for the development of a vibrant private sector. Private sector contribution to GDP remains below 30%, compared to between 60% and 75% in other EaP countries. The services sector is particularly underdeveloped (World Bank, 2012).

In recent years, the government has taken important steps to promote private sector development. At the end of 2010, the President of the Republic adopted Directive No. 4 on Development of Entrepreneurship and Stimulation of Business Activity in Belarus. While some measures listed in Directive No. 4 remain unimplemented, 184 legal acts have been adopted covering a wide range of areas: simplification of company registration and tax administration, e-registration of companies, significant reduction in licensing requirements, introduction of SME quotas in public procurement, facilitation of public-private dialogue, etc. Price controls have also been reduced in recent years. A new Directive on Additional Measures for Development of Entrepreneurship and Stimulation of Business Activity in Belarus was published for public consultation in March 2015.

Belarus scores relatively well overall (57th out of 177 countries) in the 2015 World Bank *Doing Business* report (World Bank, 2014). This is an improvement over its position at 69th place in 2012. The country has significantly improved its ranking in the paying taxes indicator (from 156th in 2012 to 60th position in 2015). This is thanks to the introduction of an electronic system for filing and paying the obligatory insurance for work accidents, as well as the simplification of corporate tax and VAT filing. Belarus also improved its insolvency framework in 2012 and has continued to expand e-government services for business. In September 2013, the government approved a dedicated action plan to improve the business environment and its ranking on the World Bank *Doing Business* report.

A new Investment Law was adopted at the beginning of 2014 by the Belarusian Parliament. This aims to stimulate investment activity in the country through clear rules and mechanisms for protecting investors' rights. Likewise, a new law on public-private partnerships is planned for adoption in 2015. These initiatives are expected to increase FDI flows, which remain very low compared with other countries in the region. While a broad privatisation programme is not envisaged, the government intends to reform the SOE sector by changing incentives, rationalising state support and subsidies and improving management and corporate governance standards. Financial sector development is constrained by significant government-directed lending schemes to priority sectors. While specific financing programmes exist for SMEs (most recently through the Development Bank of the Republic of Belarus), there is some evidence that they disproportionally favour SOEs (World Bank, 2012).

Despite this progress, private businesses in Belarus (including SMEs) continue to face significant obstacles. According to the Business Environment and Enterprise Performance Survey (BEEPS V), the most significant constraints are tax rates (mentioned by 22.8% of respondents), an inadequately educated workforce (20%), access to finance (18.7%) and practices of the informal sector (12.1%) (EBRD, 2014b).

SMEs in Belarus

The latest definition of the SME sector in Belarus dates from 2009, which includes a new category for micro-enterprises (Table 13.3). This definition contains significant weaknesses, as it relies exclusively on the number of employees. It is not used consistently across the legislation either (e.g. tax advantages are based on turnover figures).

Table 13.3. **Definition of micro, small and medium enterprises in Belarus**

	Micro	Small	Medium
Average number of employees	< 15 employees	< 100 employees	< 250 employees

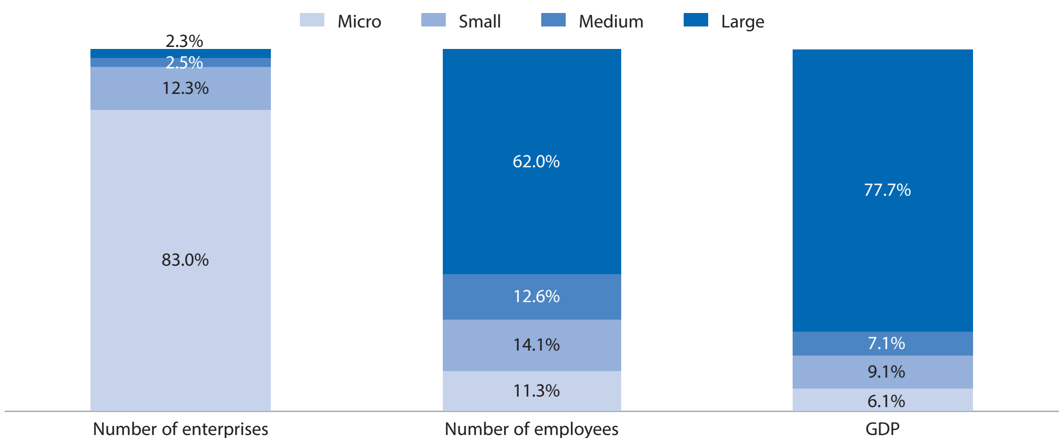
Source: Law of the Republic of Belarus of 1 July 2010, No. 148-31, On State Support for Small and Medium Entrepreneurship.

The SME sector in Belarus remains underdeveloped. In 2013, the share of SMEs in the total business population was 97.7%. While the total number of SMEs increased between 2010 and 2013 (from 77 000 to 94 000), their share in the overall business population remained broadly constant. In 2013, micro-enterprises represented 83% of all business units; small enterprises, 12%; and medium enterprises, 3% (Figure 13.2). The number of micro-enterprises has increased – from 62 600 in 2010 to 79 800 in 2013. Meanwhile, the number of medium-sized enterprises has fallen – from 2 800 in 2010 to 2 400 in 2013. This suggests that Belarusian SMEs are facing significant obstacles to growth.

The number of people employed in the SME sector has slightly decreased – from 1 132 600 in 2010 to 1 109 100 in 2013. SMEs' contribution to employment experienced an increase of 0.25 of a percentage point between 2010 and 2013. In 2013, the share of SMEs in GDP amounted to 22.3%, a 2.5 percentage point increase over 2010. However, most of this is due to the growing importance of micro and small enterprises, while the contribution of medium enterprises has actually declined slightly.

Most SMEs operate in rather low productivity sectors. The sectors with a large share of SMEs (versus large companies) are retail (99.4%), transportation and communication (99.2%) and construction (97.5%). Both the manufacturing and construction sectors have a relatively large proportion of small enterprises (24% and 23% respectively), while medium-sized enterprises play a comparatively larger role in the agriculture and mining sectors (17.1% and 14.9% respectively). In 2013, most SMEs were in the trade and retail sectors (39% of all SMEs), followed by manufacturing (14%), real estate and business services (13%) and transport and communication (12%) (Figure 13.3).

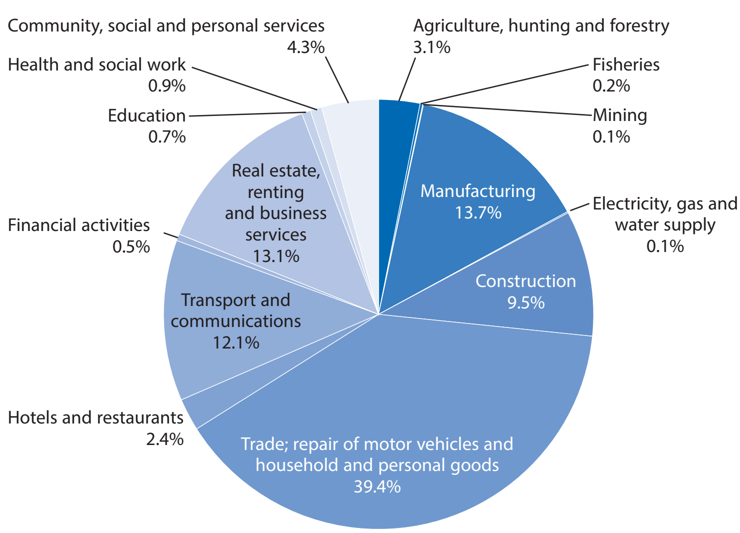
Figure 13.2. **Business demography indicators in Belarus, 2013**



Note: Figures for total number of enterprises and employment include enterprises where the state has a stake of 25% or more. Those enterprises represent 0.62% of the total number of micro-enterprises, 9.32% of small enterprises and 45.83% of medium enterprises. Their employment accounts for 1.3% of employees of micro-enterprises, 14.37% of small enterprises and 44.3% of medium enterprises.

Source: Belstat.

Figure 13.3. **Sectoral distribution of SMEs in Belarus, 2013**



Source: Belstat.

SBA assessment results

This section outlines the main results for Belarus from the 2016 SBA assessment of EaP countries. It also highlights the changes that have taken place since the previous assessment in 2012 (OECD, 2012). The assessed policy dimensions are grouped under five key thematic pillars, reflected in the section headings below.

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

The institutional framework for SME policy continues to be governed by a Presidential Directive adopted in 2010, as well as three-year state programmes for SME support. The Ministry of Economy is currently considering a new medium-term strategic framework to improve SME policy making and expand support beyond the current focus on financial assistance. It is also contemplating changes to the current SME definition and the creation of a dedicated SME agency. Despite the adoption of a new law on economic insolvency, Belarusian insolvency legislation contains significant gaps compared with international best practices (in particular regarding the protection of secured creditors).

Institutional framework

The institutional framework for SME development in Belarus is currently being reformed. At present, the legal basis for government action in this area is provided by the Law on Support for Small and Medium Enterprises (adopted in 2010) and the Edict of the President No. 255 on Specific Measures of State Support for Small Entrepreneurship (adopted in 2009). The former requires the Council of Ministers to develop three-year programmes for SME support. The programme for 2013-15 is in place, mostly funded from regional (*oblast*) budgets. The 2016-18 three-year programme will be adopted at the end of 2015. Measures for SME support are embedded in the draft "National Strategy for Sustainable Development of the Republic of Belarus until 2030" (NSSD), the country's main development strategy. This document includes a chapter on SMEs and sets a target to increase their contribution to GDP to 47% by 2030.

The 2010 Directive of the President on Development of Entrepreneurship and Stimulation of Business Activity in Belarus (Directive No. 4) is the main policy document defining priorities and actions for promoting private sector and SME development in Belarus. It contains a series of objectives, including promoting fair competition regardless of enterprises' ownership category; eliminating administrative barriers and streamlining tax administration; fostering entrepreneurship; improving access to finance for SMEs; and promoting public-private dialogue. The directive has led to the adoption of 193 legal acts (as of July 2015) covering several areas (e.g. simplification of company registration, introduction and development of e-registration, significant reduction in licensing requirements, introduction of SME quotas in public procurement). However, some of the measures listed in Directive No. 4 have not been adopted and/or fully implemented in practice. In March 2015, a draft new Directive on Additional Measures for Development of Entrepreneurship and Stimulation of Business Activity was published for public consultation. As of June 2015, the draft directive was still being finalised, along with an action plan.

Despite these areas of progress, the policy framework for SME development in Belarus presents a number of outstanding challenges:

- Belarus lacks a single SME development strategy. In 2012, business associations tried to develop a strategy but the document was not adopted by the government. Some of the measures proposed have been incorporated in state programmes, however. The Ministry of Economy is in the process of drafting a medium-term SME development strategy with support from the International Finance Corporation (IFC). The introduction of a strategic framework would be a positive development for improving policy consistency and expanding the range of support measures for SMEs.
- There have been no changes to the institutional set up since 2012. The Department of Entrepreneurship within the Ministry of Economy of the Republic of Belarus is in charge of the design, overall co-ordination and implementation of SME support measures under the three-year programmes. Numerous government bodies and local authorities, including the BFSSE, also implement government support measures. The effectiveness of BFSSE in fulfilling its mandate has been questioned by an independent report, which notes its very limited impact on the Belarusian economy (German Economic Team Belarus, 2014). For example, in 2013 only 47 projects were supported with a total financing envelope of just BYR 12.7 billion (approximately EUR 900 000); and loan guarantees have not been used due to insufficient funding. Since August 2014, financial support to SMEs has been channelled through the Development Bank of the Republic of Belarus, which questions the role of BFSSE. To address these shortcomings, the government is currently contemplating separating SME policy design from implementation, with the latter to be assigned to a new entity or SME agency. This new body would monitor the effectiveness of SME-focused programmes, assess demand and supply of business support services and provide information services to SMEs. Crucially, this structure would be responsible for developing non-financial forms of SME support, which are currently underdeveloped in Belarus, to complement financial support provided through the Development Bank.
- The SME sector lacks robust monitoring and evaluation mechanisms. Although the existing SME development policy documents contain some measurable indicators (e.g. share of SMEs in GDP, employment, etc.), no progress reports are published on the implementation of existing action plans and state programmes.
- The fact that the Belarus SME definition is limited to employee numbers creates significant problems for statistical reporting as well as the design of targeted support measures. Under this definition, companies with a high annual turnover but a small headcount, as well as subsidiaries of large companies (some of them with significant state participation), are considered to be SMEs. Moreover, this definition is used mostly for state support and statistics collection and is not used in other areas (e.g. tax legislation). The government is currently considering revising the definition to include a turnover criterion.

Legislative simplification and regulatory impact analysis

The National Centre of Legislation and Legal Research of the Republic of Belarus is the national body responsible for regulatory policy and monitoring of regulatory quality. Following the adoption of the “Concept for Legislation Improvement in the Republic of Belarus” in 2002, measures were implemented to streamline the Belarusian legislation and eliminate obsolete laws across all branches of the legislation. Though most of the measures were implemented by 2012, the National Centre continues to review the legislation and make proposals for simplifying redundant laws. However, this review process falls short of a guillotine process and does not specifically target business regulation from an SME perspective.

There is a methodology in place, developed by the central government, for evaluating draft laws against such criteria as their social, financial and environmental impact as well as their impact on state and local budgets. As per existing legislation, draft legal acts must be accompanied by an adequate justification and a financial and economic assessment. These analyses are treated as internal documents, but are sometimes published on government websites. The existing methodology is not compulsory, however, and does not constitute a comprehensive regulatory impact assessment (RIA). Furthermore, it does not take into consideration the impact of proposed acts on businesses in general and SMEs in particular. Post-implementation reviews are also not mandated by law.

Public-private consultations

The Resolution of the Council of Ministers No. 247 on Public-Private Consultations (PPCs) of Legal Acts (2012) requires the views of the private sector to be sought on laws and regulations that may have a "significant effect" on business. Public-private consultations on new legislation can take place in the form of advisory council meetings, online consultations or through the distribution of draft legislation to experts and stakeholders. The PPC framework contains important limitations, however. For example, it is up to the authorities to decide whether a legal act has a significant impact on business. Furthermore, there is no minimum timeframe for consultations. In practice, PPCs are used on an ad-hoc basis, and important business regulations are being adopted without any participation by the private sector (e.g. on a VAT tax refund in February 2015).

Despite these limitations, Directive No. 4 has invigorated the use of advisory councils by listing their creation within state and local public authorities as a priority. According to the model statute for these platforms, adopted in 2012, at least one-third of their members must be business representatives, including SMEs and SME associations. Council meetings must be organised at least on a quarterly basis. Business representatives may contribute to the agenda, call for exceptional meetings and formally comment on draft SME-related legislation. However, participation in the councils is subject to approval by the head of the relevant governmental body, there is no formal requirement to consider the comments collected during the PPCs and private sector representatives are not entitled to submit their own draft legal acts.

Since 2011, 32 new advisory councils have been created, with the total number reaching 64 in January 2015. During that period, 522 PPC meetings took place, including 152 meetings during 2014 alone. However, there is no systematic monitoring and evaluation of PPCs and it is too early to assess their impact. In its report on the use of advisory councils, the Department of Entrepreneurship admits that "the analysis of activities of the Advisory Councils does not reveal really positive measures or "landmark" decisions which could have a positive impact on solving critical issues of SME interest" (Ministry of Economy, 2014).

Interaction with government services (e-government)

Belarusian SMEs benefit from a wide range of e-government services. These include online completion of tax returns; VAT, pension and social security contributions; and custom declarations. In 2014, Belarus streamlined its tax administration by introducing an electronic system for filing and paying contributions for the obligatory insurance for work accidents and by simplifying the filing requirements for corporate income tax and VAT.

In recent years the list of cadastre e-services has expanded. It now includes access to the cadastre data, the administrative-territorial or territorial units register, the land value register, etc. However, the National Cadastre Agency does not allow for online registration of real estate property or land plots. In addition, access to almost all registries (e.g. the Unified State Register of Legal Entities and Entrepreneurs, Real Estate Register) requires a fee.

Considerable progress has also been achieved in the online reporting of enterprise statistics. This was not available in 2012. The State Statistics Committee is developing an electronic form to establish a centralised statistical reporting system. The list of statistical reports that can be submitted online includes 95 different reports. However, this list does not yet include all forms of enterprise statistics.

Presidential Decree No. 157 requires 63 government agencies and 33 departments to connect to the electronic document flow system by 1 January 2015. However, in practice this process has experienced some delays for technical reasons. In 2014, the Republican Certification Centre was established to allow enterprises to use a single electronic signature for interaction with all governmental entities. This is a significant improvement: before 2012 enterprises had to use different and non-interchangeable electronic keys to sign documents for different state authorities. E-signatures are now used in about half of all government transactions.

There are no surveys on the use, satisfaction with and effectiveness of e-government services. According to the 2015 OECD company survey of 220 SMEs in Belarus, 49% of respondents considered the information provided on government websites to be too basic (see Box A.3. Annex A).

Company registration

Presidential Decree No.1 of January 2009 on State Registration and Liquidation of Economic Activities introduced the silence-is-consent principle and established one-stop-shops for company registration. These are responsible for collecting all documents needed to start a business in a single day. Significant progress has been achieved since 2012 in streamlining online company registration. Amendments to Decree No. 1 have made it possible to obtain an approval of a company's name online through the website of the State Register. In addition, the Ministry of Justice Resolution No. 197 of September 2014 has made online company registration available throughout the country. Previously it was only possible for enterprises based in Minsk. Another amendment to Decree No. 1, still in draft stage as of May 2015, intends to further improve business registration processes, including by streamlining the procedures involved in opening a temporary bank account.

It takes on average 9 days and 5 procedures to start a business in Belarus, including 1 day for issuing the company registration certificate (World Bank, 2014). These figures are close to the OECD averages (9.2 days and 4.8 procedures), but still lag behind those of other EaP countries. While registration is fast, in accordance with Decree No. 1, an additional four days are needed for the State Register to notify the tax authorities, state statistical authorities, Social Security Fund and Belarusian Republican Insurance Enterprise. In 2013, Belarus made starting a business easier by lowering registration fees (to about EUR 31) and eliminating the requirement for an initial capital deposit at a bank before registration.

Bankruptcy procedures and second chance

Belarus' bankruptcy legal framework has evolved since the last SBA assessment. A new law on economic insolvency was adopted in June 2012 and came into force in January 2013. The new law introduces stricter conditions for starting bankruptcy proceedings and extends the term of the moratorium on legal actions against companies undergoing insolvency procedures. It also changes the appointment process for insolvency administrators, encourages the sale of assets in insolvency procedures and regulates the liability of shareholders and directors of the insolvent company. Despite these developments, the Belarusian insolvency legislation still contains significant gaps compared with international standards:

- In practice, the insolvency legislation is not applied equally to all firms. Special insolvency rules are applied to state and strategic enterprises, municipal enterprises, banks, insurance companies, and other financial institutions, as well as farming households. The exclusion of SOEs from the general framework means that, in practice, it is extremely difficult for creditors to initiate insolvency procedures against them. As of 1 January 2015, the total number of cases on economic insolvency of SOEs recorded by the Supreme Court of Belarus amounted to 42 (only 2% of all bankruptcy cases).
- The maximum time for full discharge from bankruptcy is not clearly defined. The Belarusian insolvency legislation sets out maximum durations for the different steps in a typical insolvency procedure (i.e. protective period, rehabilitation and liquidation). However, at the request of a public authority, and with the agreement of the Council of Ministers, insolvency procedures may be extended beyond those maximum timeframes. As a result, the timeline for bankruptcy procedures can vary from one year to up to seven or eight years.
- The protection of secured creditors under the Belarusian insolvency law is still very weak. While there are general provisions for secured transactions in the Civil Code and Presidential Decrees, no specific legal framework exists. As with the general insolvency legislation, social payments take the first priority in order of debt settlement in liquidation procedures while secured creditors are ranked fourth out of five in the order of preference. This shortcoming should be addressed to encourage access to finance for SMEs.

Another development in the insolvency framework has been the creation in 2013 of an official insolvency register. In accordance with the Ministry of Economy Resolution No. 391, official information on companies undergoing bankruptcy procedures is publicly available on the webpage of the Unified State Register of Bankruptcy (www.bankrot.gov.by).

There is some evidence of increased implementation of the insolvency legal framework. In 2014, the total number of cases of economic insolvency (bankruptcy) amounted to 2 035, an increase of 479 cases over 2013. However, the effectiveness and efficiency of the insolvency framework still lags behind other countries in the region. According to the 2015 World Bank *Doing Business* report, the average time for insolvency procedures in Belarus is 3 years (compared to 2.3 years in the Eastern Europe and Central Asia region) and the cost is 22% of the value of the estate (compared to a regional average of 13.3%; World Bank, 2014).

Belarus has no special policy measures to promote a second chance for failed entrepreneurs. While legislation on public procurement and state support does not contain any discriminatory provisions, failed entrepreneurs can only register a new enterprise one year after the date of exclusion of a bankrupt firm from the Unified State Register of Legal Entities and Entrepreneurs. According to the OECD company survey conducted during the present SBA assessment, more than two-thirds of Belarusian SMEs find it "very difficult" or "somewhat difficult" to restart a business after failure.

Facilitating SME access to finance (Dimension 6)

Little progress has been made to improve SME access to finance in Belarus in recent years. Access to finance remains a key impediment to SME growth, particularly local currency financing and longer-term financing more generally. The government has prioritised the development of the sector in recent years and has launched a number of support schemes. However, these remain heavily exposed to state control and lack transparency, causing SMEs to continue to rely on bank lending as their main source of funding. Lending to the private sector has fallen dramatically: from over 60% in 2011 to 24% in 2014 (turning temporarily negative in 2012), and the share of SME lending in total credit stood at 23% in 2013.

Legal and regulatory framework

The legal and regulatory framework in the financial sector is underdeveloped in a number of key areas and SMEs are exposed to costly and time-consuming requirements. In the absence of dedicated laws to guarantee a prioritised pay-out for secured creditors, protection of the rights of creditors is weak. A real estate cadastre exists, but accessing information is costly and the registry is not centrally managed. There is no registry of movable assets and the development of pledge laws remains limited. With international donor support, some progress has been made in creating a functional registry for securities over movable assets, but significant efforts are still needed to create a modern and unified system that would ease access to finance, especially for SMEs. A presidential decree drafted in early 2014 addressing regulations of pledges of movable assets is a promising sign, but tangible results are yet to be seen.

Information on the credit history of individuals and firms is provided by financial institutions and is accessible through a public credit information registry. Coverage has increased significantly since the last assessment, from 34% of the country's adult population in 2011 to 64% in 2015, but access remains costly for the public.

The National Bank of the Republic of Belarus closely monitors banking activities in line with Basel III guidelines, and is planning to introduce requirements accordingly. These should help with bank discipline in an environment dominated by state-owned banks and where a significant share of transactions is still carried out on non-commercial terms. Capital market legislation exists, although regulatory hurdles make active trading on the stock exchange cumbersome and capitalisation rates and turnover continue to be relatively low.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

The banking system remains dominated by Belarusian and Russian state-owned banks, with little competition from privately-owned financial institutions. Bank financing continues to be the prevailing source of funding for SMEs in Belarus, but banks generally do not offer specific SME products or lending practices tailored to the needs of small businesses. In addition, interest rates tend to be relatively high, especially in local currency.

The development of the SME sector has become more of a priority in recent years and the government provides a number of financial support mechanisms for SMEs, such as interest rate subsidies and caps, through the Development Bank and the government-led "Programme on State Support for Small and Medium Enterprises in the Republic of Belarus for 2013-2015". In addition, state support programmes are accompanied by a public credit guarantee scheme. The scope of these programmes has significantly expanded in recent years. However, they subject SMEs to extensive governmental control and contribute further to market distortions linked to a heavy reliance on publicly funded rather than commercially based financing mechanisms.

Alternative, non-bank, sources of SME finance could benefit from further development. Micro-finance is mainly provided by banks thanks to support by the EBRD and other international organisations. Since early 2015, dedicated micro-finance institutions must be registered with the National Bank of the Republic of Belarus; to date, only consumer co-operatives that lend exclusively to individuals have registered. Leasing continues to grow (2.9% of GDP in 2012) and activities have become more transparent owing to increased legal disclosure obligations. However, access to leasing and availability of leasing products to SMEs could be broadened further.

The legal framework for venture capital remains underdeveloped. While existing laws have been adapted to allow for venture capital operations and the government provides certain fiscal incentives for venture capital funds, current legislation continues to place restrictions on institutional investors to invest in such funds.

Financial literacy

Some progress has been made in promoting financial literacy. The government has introduced an action plan to improve financial literacy among the wider population. This plan was jointly adopted by the government and various financial institutions in 2013 and envisages a number of training courses and awareness-raising activities. However, these activities are not targeted at the business community specifically.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Lifelong entrepreneurial learning

The first SBA assessment (2012) urged the government of Belarus to strengthen national efforts for lifelong entrepreneurial learning and to ensure effective, structured policy partnerships. Among its main recommendations were: defining common goals, defining the roles of partners, and designing institutional measures for promoting key entrepreneurship competence throughout formal and non-formal education.

The current assessment notes substantial developments in the leadership role of the Ministry of Economy in raising policy awareness and moving entrepreneurial learning in Belarus up the national policy agenda. Following Presidential Directive No. 4, and in line with the 2012 SBA recommendations, the Belarusian Government has conducted a policy analysis to identify the corrective measures needed to improve the SBA country's performance in key international rankings. The Institute of Economy has been asked by the government to make recommendations to the "Programme of Modernisation of Socio-economic Relations and the Forecast of Socio-economic Development (2015-2017)". These include: *(a)* the development of the national lifelong entrepreneurial learning concept; *(b)* implementation of entrepreneurship support programmes and courses in general secondary, vocational education and training (VET) and teacher training; *(c)* special programmes for the unemployed; *(d)* business education programmes; and *(e)* a proposal to establish a centre under the Ministry of Economy focusing on entrepreneurial learning at the national and regional levels.

Entrepreneurship is now also featured in the policy provisions for the "National Programme of Social and Economic Development (2016-2020)" and in the "Main Directions of Social and Economic Development (2016-2025)". It is also considered a priority in the preparation of the draft SME development strategy.

During the assessment period, regular discussions on entrepreneurial learning were held involving the ministries of economy and education, academic institutions, business support organisations, the Republican Confederation of Employers, local authorities, NGOs and other partners. Social partners and education institutions organised roundtable discussions and workshops on entrepreneurship development and business education.

Belarusian stakeholders have achieved a major success in establishing a structured partnership for one of the three main pillars of key entrepreneurship competence – financial literacy. Joint Decree No. 1009/5 (2012) issued by the government and the National Bank created an inter-government Co-ordination Council on Financial Literacy. The National Bank and Ministry of Education have approved a joint action plan for promoting financial literacy covering all population groups and levels of education, as well as informal learning. Furthermore, the Ministry of Education envisages measures for entrepreneurship development in its "Programme of Continuous Upbringing of Children and Young Learners (2011-2015)".

The "Programme on State Support for Small and Medium Enterprises (2013-2015)" contains a range of specific measures for entrepreneurship promotion in higher education. In 2014 the Ministry of Education collected a comprehensive stock of examples of excellent practices in entrepreneurship development across the whole national network of Belarusian higher education institutions. The data and analysis strongly supported this current SBA assessment on policy and practice of entrepreneurial learning in Belarus. The new data also informed the preparation of the International Conference on Higher Education, organised in early 2015 by Belarus State University and the Republican Institute of Higher Education, with support from the World Bank and the ETF. The conference had a special focus on entrepreneurial learning and provided a platform for developing the draft concept of an Entrepreneurial University in Belarus, which would apply a "cross-campus" and key competence approach to entrepreneurship promotion.

In 2015 several important developments took place on the national entrepreneurship agenda: Belarus has formally joined the Bologna process; has completed the pilot phase of the Sector Skills Councils project in co-operation with ETF; and has developed measures for adopting a national qualifications system (NQF).

Furthermore, there is a growing focus on entrepreneurship competence development in vocational education and training. The Ministry of Education and the Republican Institute of Vocational Education conducted a monitoring study of entrepreneurship development in VET in 2013. They have also organised a national seminar to review the results of the monitoring, and provide guidelines and recommendations for strengthening the capacity of VET institutions in the promotion of entrepreneurial learning. EU assistance is planned to address the skills mismatch and improve VET quality; the competence-based approach will be one of the main pillars.

Belarus has also made visible progress in the practical implementation of entrepreneurial learning. Entrepreneurship competence development programmes are currently available at all levels of pre-university and higher education (mostly as optional subjects). Examples include the Basics of Entrepreneurship for grades 10 and 11, and the Basics of Economic Knowledge for grades 5 to 11. There are numerous cases of VET-business and university-business co-operation. Excellent practices have been identified in informal learning too (for example, the Business Hive run by the Minsk Youth Social Service, the "Ladder of Success" project, and the School of the Young Entrepreneur at the Belarus State University). There are some partnership alliances providing practical entrepreneurial experience for secondary, VET and higher education students but they are rather ad hoc.

Women's entrepreneurship

Belarus' progress in developing women's entrepreneurship has been limited. While the "Programme on State Support for Small and Medium Enterprises (2013-2015)" lists several support areas for women entrepreneurs, there is no dedicated state budget beyond measures for the unemployed and initiatives at the local level. Gender equity has traditionally been among the top state priorities; however, lack of awareness of the economic contribution of women entrepreneurs to national growth combined with a lack of data have had an impact on policy making. There are gaps in SME statistics, particularly in sex-disaggregated data. Women's entrepreneurship is not monitored at the national level.

Individual policy initiatives and support measures are however having positive outcomes both for individual women and for raising people's awareness by making women's entrepreneurship policy issues more visible to the broader public. Some recent initiatives include the 4th Women's Entrepreneurship Forum in October 2014, the award competition "Successful Business Woman in Belarus", the Start-up by Women Initiative, etc. Overall, however, Belarus lacks steering policy instruments that address the needs and challenges for women entrepreneurs. The lack of a dedicated institutional structure or working group overseeing women's entrepreneurship policy at the national level means that policy dialogue is rather ad hoc. This lack of concerted action and targeted support leaves women entrepreneurs with limited possibilities for effective business development.

SME skills

Numerous instruments (both standardised and ad hoc) are used by various institutions for collecting data on SME training needs; however, no training needs analysis framework has been agreed among the main stakeholders in Belarus. Various SME training activities for start-up, growth and internationalisation of enterprises are available, including some e-training courses. The number and diversity of e-resources at the national, local or sectoral level have grown over the assessment period. These include a new platform (Pathway to business: from idea to implementation), distance courses for start-up training, the SUCSID-Tempus programme, etc.). The promotion of and support for enterprise skills development are gradually being given greater priority in a large number of public and private activities, many of which target specific groups of entrepreneurs: e.g. young people through the Business Start 2014 initiative and Export=Success scheme run by the Youth Social Service of Minsk city in 2014-15. However, SME services are rather underdeveloped, and require an "institutional home" – a specialised institution fully dedicated to implementing government policies and support measures for developing SMEs and entrepreneurship. This need is being addressed in the course of discussions on the new SME support strategy, but this is work in progress and is currently supported by the international development partners.

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Modest progress has been achieved since 2012 in developing and expanding targeted support interventions to strengthening the competitiveness of Belarusian SMEs. Business support infrastructure continues to be limited to a network of support organisations funded by government subsidies. A strong institutional framework and various innovation support schemes are in place but it is unclear to what extent SMEs benefit from them. Recent progress in public procurement includes a new law and a web portal, although an independent review body is not yet in place. Finally, despite the introduction of general support measures for the green economy, there is a need to promote environmental compliance and green business practices among SMEs.

Business information and services

The legal framework for the provision of SME support services is outlined in the Law of the Republic of Belarus on SME Support adopted in July 2011. The three-year state and regional programmes for SME support incorporate among their key activities the roll-out of SME infrastructure, organisation of forums and meetings with SMEs, the provision of financial and informational support for start-ups, etc. Most of these activities are conducted by regional entities. The Ministry of Economy is responsible for implementation, while support through the BFSSE is limited to financial assistance.

The business support infrastructure in Belarus remains largely confined to a network of organisations (77% of which are private) receiving government funding. Between June 2011 and January 2015, the network of registered SME support organisations has expanded: the number of business support centres increased from 55 to 95 and the number of small business incubators rose from 12 to 16. The regional executive committees and the Minsk City executive committee also provide funding to these organisations, mainly for acquisition of fixed assets (premises and equipment) and reimbursement of costs of participating in exhibitions and fairs and other activities. In 2014, the government provided funding to business support organisations to the tune of BYR 6.2 billion (EUR 468 500).

Business support centres mainly provide SMEs with consulting services, training and seminars, mostly free of charge. These services are primarily aimed at helping SMEs develop a marketing strategy, boost online sales and position a product. Tailored services such as accounting, business plan development, and marketing strategy preparation are provided for a fee. In addition, city executive committees and regional administrations offer legal consultations to SMEs free of charge. In 2014, 86 000 people received consultations on various aspects of entrepreneurial activity from business support organisations and more than 28 000 people participated in about 1 600 business courses and seminars. The Ministry of Economy also organises the Best Entrepreneur Competition every year to improve the skills of business people and cultivate a positive image of entrepreneurship.

Since 2012, the Ministry of Economy, city executive committees and business support organisations have prepared annual action plans for start-up development in the context of the broader three-year programmes. The action plan for 2015 includes the organisation of 178 start-up events throughout the country. There have been some ad hoc attempts to get feedback from SMEs, but no systematic surveys have been carried out on SME needs, use of or satisfaction with the services provided.

Similarly, the provision of business support infrastructure lacks a clear strategic approach and a formal mechanism for monitoring and evaluating the quality, efficiency and effectiveness of existing schemes. No analysis of market failures has been conducted either.

Public support for the development of a private market for business development services is limited to subsidies and direct funding for private organisations. A more proactive and market-friendly approach could be developed through greater emphasis on information services (e.g. providing the contact details of private providers in the regions) and voucher schemes requiring some degree of co-financing by SMEs, so as to develop a sustainable market for consulting and other support services. A key priority should be to organise awareness campaigns on the value of these services. The 2015 OECD company survey revealed that 67.6% of small companies and 87.4% of medium enterprises are not aware of any government initiatives in this area.

Public procurement

Some progress has been achieved in this dimension as Belarus adopted a new Public Procurement Law in July 2012, establishing harmonised procedures for public tenders and providing for the possibility of electronic auctions. A dedicated public procurement web portal was also created (icetrade.by).

Belarusian legislation allows for tenders to be divided into lots; however, this happens in practice only in a limited number of cases. Information on public procurement opportunities is centrally available in electronic format and free of charge.

Belarus still needs to establish an independent review body. The current system creates a potential conflict of interest as the Ministry of Trade is responsible for both public procurement policy and review procedures. Although Belarus has concluded agreements to open the public procurement market to foreign enterprises, the share of foreign enterprises is very limited in practice. There is no law regulating late payments to contractors; neither does the legislation allow companies to bid jointly or contain provisions ensuring proportionate qualification levels and financial requirements for SMEs.

Innovation policy

Belarus has a relatively well-developed institutional framework for innovation. The country's innovation strategy is outlined in the "State Programme of Innovation Development 2011-2015". The programme gives the State Committee on Science and Technology responsibility for implementing state policy on science, technology, innovation and intellectual property rights, while a dedicated commission under the Council of Ministers is responsible for inter-agency co-ordination. The strategy incorporates information on new projects, implementation plans, funding and timelines. Some elements of innovation policy are also included in the "Programme on State Support for Small and Medium Enterprises (2013-2015)".

The provision of institutional and infrastructure support for innovation has declined in recent years. The "State Programme of Innovation Development" aimed to establish 28 technology transfer offices, 12 technology and science parks, 1 venture capital organisation and 1 high technology park. In practice, the number of technology transfer offices has fallen, from 4 in 2012 to 2 in 2015. In 2012, there were five innovation centres providing a range of service to innovative enterprises, including help with business plan drafting, real estate on lease basis, conducting feasibility studies and market research and others. However, none of these innovation centres is currently active. On the other hand, a hi-tech park has been created to promote the development of the ICT sector, which is already quite dynamic in Belarus.

Financial support to innovation takes place through both direct funding schemes and tax incentives. In 2013, the State Committee on Science and Technology provided

BYR 43 330 million (approximately EUR 3.6 million) for developing innovation support organisations. Though the State Committee publishes periodic reports, no robust monitoring and evaluation mechanism exists to assess the efficiency of innovation support services. In May 2013, Presidential Decree No. 229 introduced additional support measures for innovation projects. For example, the Belarusian Innovation Fund provides grant funding for the pre-production stage. At the design stage, innovation vouchers of up to USD 25 000 are available. At the engineering and design stages it is also possible to get a grant of up to USD 100 000 (with a minimum 10% counterpart contribution by the enterprise). Vouchers and grants are awarded through a competitive selection process. At the production stage, financing can be provided through subsidised lending by the Belarusian Innovation Fund or by the BFSSE. As this financing scheme is relatively new, no information is yet available on the recipients of innovation vouchers and grants. However, SMEs appear not to be the main beneficiaries. In 2013, the Belarusian Innovation Fund provided BYR 4.4 billion (just 6.5% of the total funding) to innovative SMEs (State Committee on Science and Technology, 2014).

The government also provides tax incentives to innovative enterprises. In 2013, these amounted to BYR 67.5 billion (approximately EUR 5.7 million) in profit tax, BYR 503 billion (EUR 42.5 million) in VAT, and BYR 38.6 billion (EUR 3.2 million) in land and real estate taxes. Again, these incentives do not only target SMEs.

A "Concept for the Creation and Development of Innovation and Industrial Clusters in the Republic of Belarus" has been prepared to lay down the institutional framework for a cluster policy. A number of pilot innovation and industrial clusters centred on SMEs were to be selected and implemented in 2014-15. Financial support to clusters is outlined in a draft presidential decree. However, this document had not been adopted as of May 2015.

Overall, innovation policy in Belarus appears to be well developed, with a wide array of incentives and other support measures. However, links among actors in the innovation ecosystem are still weak. The absence of monitoring and evaluation systems means it is unclear to what extent SMEs (as opposed to other economic actors, such as SOEs) benefit from these measures and what concrete impact they are having.

Green economy

There is no specific environmental policy for SMEs in Belarus. Some environmental policy concepts have been defined in basic strategic documents, such as the "State Programme of Social and Economic Development for 2011-2015" and the "Strategy of Environmental Protection to 2025". The "State Programme of Innovation Development" also states the importance of developing energy and resource-saving technologies and "green" production. However, these programmes do not contain specific measures or targets.

The government is taking steps to reduce the environmental administrative burden on small businesses. The "National Strategy for the Implementation of Integrated Environmental Permits for 2009-2020" intends to simplify the administrative procedures for environmental permitting of enterprises with low environmental impact by 2015, but this reform has not yet been implemented.

The government supports the certification of an environmental management system (EMS) that meets ISO 14001 requirements. Companies with an ISO 14001-certified EMS benefit from financial incentives for calculating their environmental tax on air emissions, wastewater discharges and waste disposal. Information related to environmental certification is widely available (www.iso14000.by).

Economic incentives for environmental protection activities are provided in the form of grants, offsets of pollution taxes, interest-free loans, tax incentives, accelerated depreciation of environmental equipment, etc. The list of eligible activities is approved in a presidential decree. However, there are no specific support programmes targeting green practices by SMEs.

Supporting SME internationalisation (Dimensions 10 and 7)

Belarusian SMEs export more than their regional peers. A national programme on export promotion exists, although it does not contain specific measures, targets or monitoring systems. Belarus does not have a dedicated export promotion agency, although various state and non-state actors are active in this field and various support schemes are available. Belarus' EEU membership makes alignment with EU technical regulations difficult. Nonetheless, harmonisation with World Trade Organisation (WTO) principles and rules, as well as the adoption of international standards, should facilitate access to the EU market.

Export promotion

The "National Programme for Export Development 2011-15" sets the main strategic directions for the government's export promotion efforts. The programme outlines various incentives targeting SME exports, but does not include any specific measures or sources of financing. An action plan with clearly-defined responsibilities and targets would therefore be a positive development. The Ministry of Foreign Affairs is currently working on the next programme, covering 2016-20.

Export promotion activities are performed by the Ministry of Foreign Affairs, Ministry of Trade, the Belarusian Chamber of Commerce and Industry and other government agencies. While there is no dedicated export promotion agency, the Belarusian Chamber of Commerce and Industry performs some of the functions typically assigned to such an agency. Most of the export programmes implemented in the country are of an informative or promotional character. In 2014, for example, the Chamber of Commerce and Industry organised 780 promotional activities, including meetings with foreign embassies, trade fairs in the country and abroad, foreign visits, seminars, and trainings. While these activities are commendable, there is a need to expand services beyond promotional activities to include more sophisticated products. Lack of market intelligence was mentioned as the biggest obstacle to exporting by respondents to the 2015 OECD company survey, followed by insufficient working capital. More also needs to be done to raise awareness of existing initiatives (only 11% of respondents to the OECD company survey were aware of the existence of export support programmes in Belarus).

A dedicated website (www.export.by) provides information to Belarusian exporters in promoting their products in foreign markets and supports the export potential of domestic producers. Moreover, the government has developed a legal framework for the provision of financial support to export-oriented companies. An export insurance entity (Eximgarant) was created in 2001. Presidential Decree No. 218 of 7 May 2014 also facilitated access to export credit and export risk insurance with government support.

Trade facilitation is another remaining challenge for exporting SMEs. At present the number of documents required by exporters is eight (twice the OECD average), while the average time involved in exporting is approximately 15 days (5 days more than the OECD average) (World Bank, 2014).

Some measures to support the integration of Belarusian SMEs into global value chains are defined in the "Programme on State Support for Small and Medium Enterprises (2013-2015)". In practice, the Belarusian Chamber of Commerce and Industry holds business matchmaking events between Belarusian and foreign companies. For example, two business forums with French and Spanish companies were organised in February and March 2015 respectively. Belarus has recently also joined the Enterprise Europe Network as a Business Co-operation Centre. These initiatives remain ad hoc and limited in number and scope, however. A more comprehensive programme is needed for supporting the integration of SMEs in global value chains.

Standards and technical regulation

As a member of the EEU, Belarus must apply EEU technical regulations where these exist. This makes it difficult to align with EU technical regulations, which would benefit Belarusian SMEs aiming at exporting to the EU market. Nonetheless, harmonisation with WTO principles and rules, as well as adoption of international standards, should facilitate access to the EU market. There is an action plan for state standardisation, which includes activities for harmonising national standards with international and European standards.

Although there is no general strategy for adopting and implementing legislation for industrial products in Belarus, there are programmes for some sectors in place. The Belarusian State Institute of Standardisation and Certification operates as an umbrella organisation in the field of technical regulations, standardisation, conformity assessment and management systems. The State Committee for Standardisation is another body responsible for standardisation activities in Belarus. Although it provides for the involvement of SMEs in the standard-setting process, in practice SMEs are not active in this process. The State Committee for Standardisation is a member of the European Committee for Standardisation (CEN) and the European Committee for Electrotechnical Standardisation (CENELEC).

Belarusian legislation for accreditation, conformity assessment and metrology is based on international requirements and is partially in line with European requirements. The Belarusian State Centre for Accreditation is a member of the European Organisation for Accreditation. Information about accredited bodies is available online. The main body in charge of market surveillance is the State Committee for Standardisation. Although there is a strategy in this area, it lacks a detailed action plan.

The way forward

The 2016 SBA assessment suggests the following as priorities for Belarus to continue improving its SME policy framework:

- **Establish the basic pillars of a robust institutional environment for policy making** aimed in particular at creating a level playing field for SMEs so that all economic actors, regardless of size or ownership status, are given equal opportunities. These pillars include: *(a)* a medium-term strategic framework identifying policy priorities, targets, and co-ordination and monitoring structures to unleash the potential of Belarusian SMEs; *(b)* continued economic liberalisation efforts to create the conditions for SME growth; *(c)* the creation of a dedicated SME agency responsible for policy implementation, under the guidance of the Ministry of Economy and in co-ordination with other government entities; *(d)* a clear legal mandate to establish a dedicated forum for public-private consultations on SME development; and *(e)* a revision of the current SME definition, in particular to move beyond employment-only criteria.

- **Adopt a more strategic and market-oriented approach to the development of business support infrastructure.** Expanding the menu of support services for SMEs beyond financial assistance alone is key for greater SME competitiveness. This should be accompanied by improving monitoring and evaluation mechanisms for existing support programmes to promote capacity upgrading and innovation; tailoring schemes for each SME segment (e.g. start-ups, high-growth SMEs, exporting firms, etc.); and strengthening the links between SMEs and research organisations to promote the commercialisation of innovations. In addition, better co-ordination of export promotion efforts (e.g. through the creation of a dedicated export promotion structure) could further enhance SME internationalisation.
- **Build all the pillars of entrepreneurial competence:** not just financial literacy, but also creativity, and the ability to deal with risks and opportunities. These efforts should be linked to policy efforts to develop and "mainstream" the key competence approach across different policies and levels of education. **Women's entrepreneurship** should be promoted systematically at the national level, backed up with a dedicated action plan and resources. Strong institutional capacity for SME skills development should be built through relevant strategies, action plans and budget allocations. Agreement on **SME training quality assurance measures and adoption of national training needs analysis framework** is also needed.
- **Resolve legal and regulatory bottlenecks and facilitate more sustainable and commercially viable access to finance through the banking sector**. This would remove significant constraints to SME growth. Particular attention should be paid to improving the legal framework for secured transactions (including the protection of secured creditors under the insolvency legal framework) and to operationalising a registry for pledges over movables.

Table 13.4 outlines a potential policy roadmap to guide SME development policy over the short, medium and long term, based on the findings of the SBA assessment.

Table 13.4. **Belarus: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• **Prepare and finalise new SME strategy, including new institutional arrangements, public-private dialogue structures and M&E systems**	S/M
• Revise the current SME definition to address shortcomings (e.g. add a turnover criterion)	S/M
• Develop an RIA mechanism with an SME test	S/M/L
• Further streamline business registration, in particular to improve the link between the register and other entities	S/M/L
• **Review the insolvency legislation in line with international best practices** (e.g. **creditors' rights); remove discrimination against failed entrepreneurs**	M/L
2. Facilitating SME access to finance	
• **Improve the legislative and regulatory framework, in particular by strengthening creditors' rights, improving access to the credit information registry and adopting legislation on a registry for securities over movable assets**	S/M
• Enhance competitiveness of the banking sector, promote SME-specific products	S/M/L

Table 13.4. **Roadmap for policy reforms** *(continued)*

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
3. Promoting skills and entrepreneurship development	
• Integrate entrepreneurship key competence and "learning outcomes" into the education system: review curricula, develop learning processes, implement teacher training, and promote active learning in the formal education environment	S/M/L
• Finalise and pilot the Entrepreneurial University concept (as well as Entrepreneurial VET College, etc.)	M
• Improve SME training statistics to capture each target group (pre-start-up, start-up, growth and internationalisation of enterprises, women, youth, etc.); including sex-disaggregation	S/L
• Promote and fund e-training for SMEs	M/L
4. Enhancing SME competitiveness	
• **Undertake a needs assessment for information, training and consulting services; develop a programme to encourage the emergence of a private business development service market (e.g. online portal, potential voucher schemes)**	M/L
• Introduce monitoring and evaluation of targeted schemes for business support services, innovation and business infrastructure	M/L
• Promote SME participation in public procurement	S/M/L
• Further enhance links between actors of innovation ecosystem and commercialisation of innovations	M/L
• Develop a policy framework and targeted support for SME "greening"	M/L
5. Supporting SME internationalisation	
• Consider establishing an adequate institutional framework for export promotion (e.g. an export promotion agency), and offer a broader menu of services (e.g. trade finance, market intelligence, promotion of FDI linkages)	S/M/L
• Improve quality infrastructure (including institutional set-up) and market surveillance, and develop a general strategy for adopting and implementing legislation for industrial products taking into account SME needs	M/L

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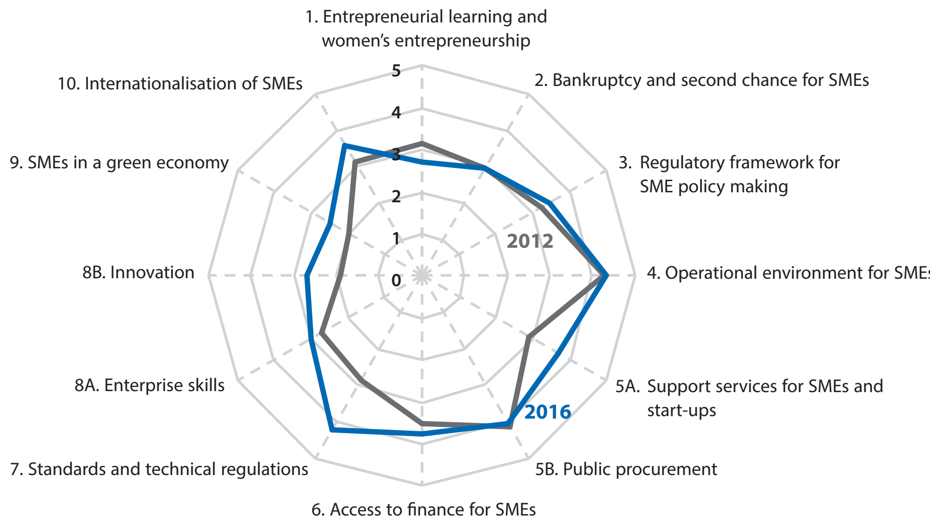
Chapter 14

Georgia: Small Business Act country profile

Building on a solid track record as a top reformer, Georgia has made considerable progress since 2012 in adopting a more proactive approach to SME development through targeted initiatives. Continued progress in business registration and e-government services has further improved the operational environment for SMEs. Many of the recommendations of the 2012 assessment have been, or are being, implemented. A dedicated agency in charge of SME policy implementation has been created, and participatory public-private consultations are currently being held on a national development strategy and a new policy framework to boost innovation and technology absorption.

Going forward, the implementation of the new SME strategy will likely require an effort to build capacity in existing institutions and improve inter-agency co-ordination. Targeted support to exporting SMEs and upgraded quality infrastructure will also be necessary to seize the opportunities offered by the Deep and Comprehensive Free Trade Area with the European Union, such as greater market access and firm productivity. Upgrading the insolvency framework, developing capital markets as an alternative to bank finance, strengthening the links between foreign direct investment and local businesses, and enhancing entrepreneurial skills (including through a more proactive involvement of the university network and more policy attention to women's entrepreneurship) are other important policy priorities for increasing SME competitiveness in Georgia.

Figure 14.1. **SBA scores for Georgia**



Key findings

A strong reformer in the region, Georgia has made significant improvements to its institutional framework for SME policy since the 2012 assessment. The country maintains a resilient macroeconomic environment – despite external pressures – and a favourable business environment with simplified regulations and business procedures. The ease of doing business has been further strengthened with the expansion of e-government services and further improvements in business registration. Since 2012, the government has broadened its approach to SME development beyond horizontal reforms by introducing targeted support measures. In particular, two new institutions, Enterprise Georgia and Georgia's Innovation and Technology Agency (GITA), have been created to provide financial and technical assistance for entrepreneurship, innovation and export promotion. In addition, multi-stakeholder consultations are currently being held to draft a comprehensive SME development strategy and action plan, as well as an innovation strategy. These should improve co-ordination across government agencies and other actors.

Georgia's 2016 SME Policy Index scores reflect the continued improvement of the institutional and operational environment for SMEs (Dimensions 3 and 4, in particular,); Georgia continues to be the region's best performer on these dimensions. Significant progress has been made on the indicators for business support infrastructure, access to finance technical barriers to trade and SME internationalisation (Dimensions 5a, 6, 7 and 10). Areas for improvement include SME greening (Dimension 9) and, despite considerable progress, innovation (Dimension 8b). Progress has also been made in human capital dimensions (Dimensions 1 and 8a), although the score for Dimension 1 has decreased due to the additional indicators which have broadened the assessment since 2012 (see Annex A).

The Association Agreement and Deep and Comprehensive Free Trade Area (DCFTA) signed with the EU in June 2014 represent both an opportunity and a challenge for Georgian SMEs. As well as providing a boost to exports and FDI, the agreement could catalyse institutional and regulatory reform, helping align standards with those of the EU. The DCFTA could also help exploit the largely untapped potential of certain economic sectors (e.g. tourism, agriculture), and could create the conditions for technology and knowledge transfer as Georgian businesses integrate into global value chains. However, to take full advantage of these opportunities, Georgia should address some remaining weaknesses in its SME policy framework (see also Table 14.1):

- Rapid institutional change has sometimes taken place in the absence of a strategic direction, whilst a lack of formal mechanisms for public-private consultations and regulatory impact assessment (RIA) means that the private sector is not always fully included in the reform process. Statistics collection is limited to structural business statistics, and there are two conflicting SME definitions, one of which does not identify micro-enterprises. The creation of Enterprise Georgia and GITA needs to be accompanied by a strong capacity-building effort to maximise their impact.
- Access to finance is a key obstacle to SME growth in Georgia. High interest rates (at around 16%) and collateral requirements (up to 220% of the value of the loan), together with relatively underdeveloped non-bank financing, make it difficult for SMEs to finance investments and the working capital required to increase their competitiveness, innovate and export. Despite a robust legal and regulatory framework, lending to the SME sector remains low, representing only 16% of all loans (IMF, 2013).
- Entrepreneurship promotion across all levels of education still requires more concerted policy effort, in particular through greater involvement of higher education institutions. Improvements to SME skills intelligence are required to support policy implementation. Finally, support for women’s entrepreneurship requires more emphasis on women’s contribution to the national competitiveness agenda.
- Georgian SMEs innovate and export less than their regional peers. The adoption and implementation of the new innovation strategy is an opportunity to boost SME competitiveness through financial and non-financial incentives for R&D and innovative entrepreneurship. For Georgian SMEs to benefit from the opportunities provided by the DCFTA, the government needs to further bring its quality infrastructure in line with the EU *acquis* in order to eliminate technical barriers to trade, while a more proactive approach to export promotion is also required.

Table 14.1. **Georgia: Challenges and opportunities**

Strengths	Weaknesses
• Stable macroeconomic environment; high and resilient growth trajectory	• Despite 2012 reform, inefficient bankruptcy procedures (high cost, low recovery ratio)
• Top reformer of the business environment, e.g. just 2 days requires for business registration; Public Service Halls are a best practice worldwide	• Public-private consultations: lack of structured institutional set-up; SMEs not properly represented
• Favourable tax environment	• SME definition needs improvement to align with EU
• Best-practice e-government services, e.g. tax filing and payment, e-signature, e-procurement	• Gaps in statistical data availability
• Notable progress in anti-corruption efforts (corroborated by BEEPS and other surveys)	• Limited access to bank finance (in particular high collateral requirements); other sources underdeveloped
• Policy focus on support measures since 2012: creation of Enterprise Georgia and GITA, Produce in Georgia, start-up support	• Skills mismatch partly responsible for high, persistent unemployment (~13%); declining employment in SMEs
• Well-capitalised financial system	• Relatively low level of internationalisation, undiversified and unsophisticated exports, low export survival rates
• Diverse range of good practice in entrepreneurial learning and SME skills	• Limited attention to SME greening, with few regulatory or financial incentives

Table 14.1. **Challenges and opportunities** *(continued)*

Opportunities	Threats
• Ongoing work on an SME Strategy and Action Plan is an opportunity to address weaknesses in the institutional environment and gaps in support to SMEs • Sustained increased in FDI offers scope for FDI-SME linkage programmes and integration in global value chains • DCFTA with EU should boost exports, FDI and general economic growth • RIA pilots can be scaled up into fully-fledged RIA with SME test • Significant sector opportunities for exports and domestic consumption: agri-business (in particular under DCFTA), and services (including tourism) • Privileged geographic position as a potential logistics and transportation hub	• Exposure to regional instability (e.g. exports to Russia) and developments in the Eurozone • Capacity constraints in new agencies with new mandates (Enterprise Georgia, GITA) • Potential overlaps and lack of co-ordination due to absence of a single strategic framework in certain areas (e.g. innovation) • Statistical gaps hamper monitoring and evaluation of government policies • DCFTA will create challenges for SMEs as well as opportunities (e.g. technical regulations, awareness)

Overview

Economic snapshot

Georgia's economy has proven to be resilient to internal and external shocks, including the 2008 military conflict with Russia and the spillover effects of the global financial crisis. Following an average annual gross domestic product (GDP) growth rate of 6.6% between 2010 and 2012, Georgia's economy slowed to 3.3% growth in 2013, affected by lower investment and post-election political uncertainty (Table 14.2). Growth picked up again to reach 4.7% in 2014, however, boosted by the opening up of the Russian market to Georgian products (especially beneficial for the wine sector) in July 2013, and increased trading opportunities with the EU following the signing of the Association Agreement (AA) and DCFTA in June 2014. However, sustained economic growth has not translated into net job creation, with unemployment remaining at consistently high levels (above 13%). Neither has it improved productivity. In addition, economic growth since the early 2000s has been largely concentrated in non-tradable sectors. While exports expanded considerably – from 28% of GDP in 2008 to 45% in 2014 – they suffer from low product diversification and sophistication. Base metals, wine and other agricultural products, and re-export of cars remain the key areas of activity, only supplemented by tourism (World Bank, 2014a).

Compared to other countries in the region, the impact of the geopolitical tensions in the region has been relatively limited in Georgia, with spillover effects on exports and remittances only starting to take effect in the last quarter of 2014 (EBRD, 2014). In 2015, economic slowdown and currency devaluations in some of its main trading partner countries (e.g. Azerbaijan, Armenia, Ukraine, Russia) led to sizeable decreases in exports (30%) and remittances (20%) compared to the previous year. In the first six months of 2015 the Lari depreciated significantly (by more than 20%). Given the significant dollarisation of the economy, this is expected to have additional spillover effects on the financial sector and the real economy. Economic growth is therefore forecast to be cut in half in 2015, to 2.3%, and is likely to be 2.6% in 2016 (EBRD, 2015).

Georgia continues to have a significant current account deficit (an estimated 9.5% of GDP in 2014) due to its heavy dependence on manufacturing and energy imports and the confluence of the above external shocks. While more modest than their pre-crisis levels (19.6% in 2007), net FDI levels have recovered to 6-7% of GDP, a trend that is expected to continue in the short to medium term as a consequence of increased trade opportunities under the DCFTA. The main sectors of interest for foreign investors include transport and communication, construction, manufacturing, energy, real estate and finance. In the long run, the increase in Georgia's national income as a result of greater market access to the EU is estimated to reach about 4.3% of GDP (European Commission, 2014). At about 83.3% of GDP in 2014, high levels of external debt are a source of potential vulnerability, however.

Table 14.2. **Georgia: Main macroeconomic indicators, 2010-15**

Indicator	Unit of measurement	2010	2011	2012	2013	2014[a]	2015[b]
GDP growth	Percent, y-o-y	6.2	7.2	6.4	3.3	4.7	2.0
Inflation	Percent, average	7.1	8.5	-0.9	-0.5	3.1	3.0
Government balance	Percent of GDP	-4.8	-0.9	-0.8	-1.2	-1.8	-3.1
Current account balance	Percent of GDP	-10.3	-12.7	-11.7	-5.7	-9.7	n.a
Exports of goods and services	Percent of GDP	35.0	36.2	38.2	44.7	42.9	n.a
Imports of goods and services	Percent of GDP	52.8	54.8	57.8	57.6	60.4	n.a
Net FDI	Percent of GDP	5.8	6.2	3.9	5.6	6.5	n.a
External debt	Percent of GDP	86.8	80.1	83.5	81.7	n.a	n.a
Gross reserves	Percent of GDP	19.5	19.5	18.1	17.5	16.3	n.a
Credit to private sector	Percent of GDP	30.5	32.1	33.7	39.4	n.a	n.a
Unemployment	Percent of total active population	16.3	15.1	15.0	14.6	12.4	n.a
Nominal GDP	USD billion	11.6	14.4	15.8	16.1	16.5	13.8

Notes: **a.** 2014 figures on government balance, GDP growth and nominal GDP are IMF projections, figures for net FDI and unemployment are from GeoStat; **b.** 2015 figures are IMF projections.

Source: EBRD (2014), *Transition Report 2014*; IMF (2015), *World Economic Outlook*; World Bank (2015), *World Development Indicators 2015*; GeoStat (2015), *Business Statistics*, dataset available at http://geostat.ge.

Business environment trends

Georgia continues to be one of the region's best performers in business environment reforms, and was ranked 15th in the World Bank's *Doing Business 2015* report (World Bank, 2014b), a dramatic improvement over its 122nd ranking in 2005. The country scores particularly well on the indicators for registering property (1st in the world), dealing with construction permits (3rd), and starting a business (5th), although there is ample room for improvement in resolving insolvency (122nd). Since the early 2000s, Georgia has undergone radical reforms to reduce government intervention, cut red tape and simplify business regulations. Between 2004 and 2012, approximately 84% of licenses and permits were eliminated. Significant progress has also been made in the fight against corruption, with corruption perceptions at the lowest level among the 19 countries of Eastern Europe and Central Asia (Transparency International, 2014). The Business Environment and Enterprise Performance Survey (BEEPS V) further confirms the success of these efforts, as just 2.2% of firms declare having received a bribery request (compared to 18.1% on average in the ECA region) (EBRD, 2014). SMEs surveyed in the BEEPS V cited political instability (42%), access to finance (20.9%) and tax rates (15.2%) as the main obstacles to doing business in Georgia (EBRD, 2014).

In recent years, the government has embarked on second-generation reforms to improve the business enabling environment. For instance, more streamlined tax administration for micro and small enterprises was introduced by the new Tax Code, in force since January

2011. Small businesses are subject to low tax rates (either 3 or 5% of their taxable income), while micro-businesses are exempt from income tax altogether. More generally, the "Georgia 2020 Strategy" (Georgia's socio-economic development strategy), approved in June 2014, emphasises the need for inclusive and sustainable economic growth and prioritises strengthening private sector development, developing human capital and deepening access to finance.

SMEs in Georgia

Georgia currently has two definitions of SMEs, one set by the Law on Georgian National Investment Agency and another (in the Tax Code) used exclusively for tax purposes (Table 14.3). The Tax Code definition is limited to micro and small enterprises owned and/or operated by self-employed entrepreneurs. The main definition does not define micro-enterprises and does not include a balance sheet criterion.

Table 14.3. **Definitions of micro, small and medium enterprises in Georgia**

	Employment		Turnover	
	Definition 1	Definition 2 (for tax purposes only)	Definition 1	Definition 2 (for tax purposes only)
Micro		Self-employed (no hired labour)		≤ GEL 30 000 (EUR 12 800)
Small	≤ 20 employees	Self-employed (no hired labour)	≤ GEL 500 000 (EUR 213 000)	≤ GEL 100 000 (EUR 42 700)
Medium	≤ 100 employees		≤ GEL 1 500 000 (EUR 640 000)	

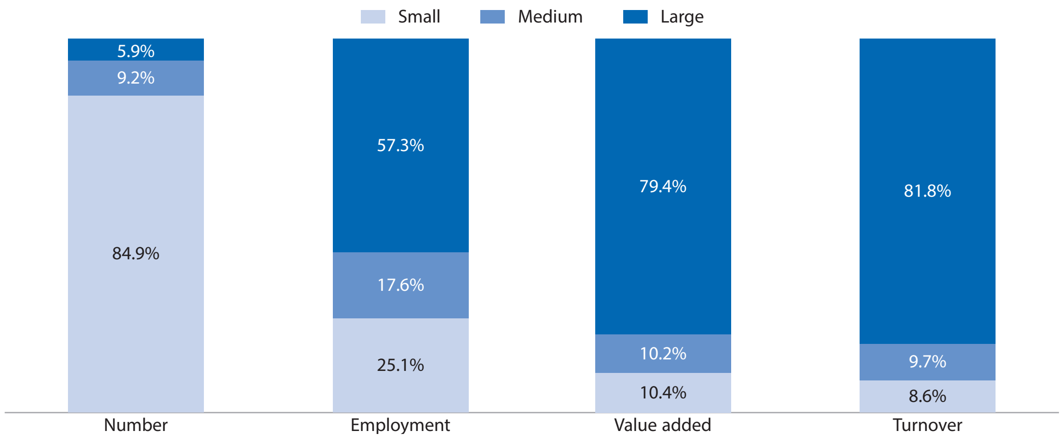
Note: exchange rates as of May 2015.

Source: Law of Georgia No. 519 of 19 June 2012 on the Georgian National Investment Agency; Tax Code of Georgia.

SMEs make a relatively significant contribution to Georgia's economy, making up 94.1% of enterprises (5 427 medium and 50 536 small enterprises), 42.7% of employment and 20.6% of value-added in 2013 (Figure 14.2). No appreciable changes have been observed in recent years, although there has been a slight decrease since 2010 in their contribution to employment and in the total number of enterprises, and only a modest increase in SME contribution to total value added. Despite an increase in turnover of 230% between 2006 and 2013 (from GEL 2.4 billion to GEL 8.1 billion), SMEs' contribution to total GDP remains low, at about 15%. Moreover, the relative weight of medium-sized enterprises within the SME sector has been reduced, suggesting that businesses face problems in scaling up.

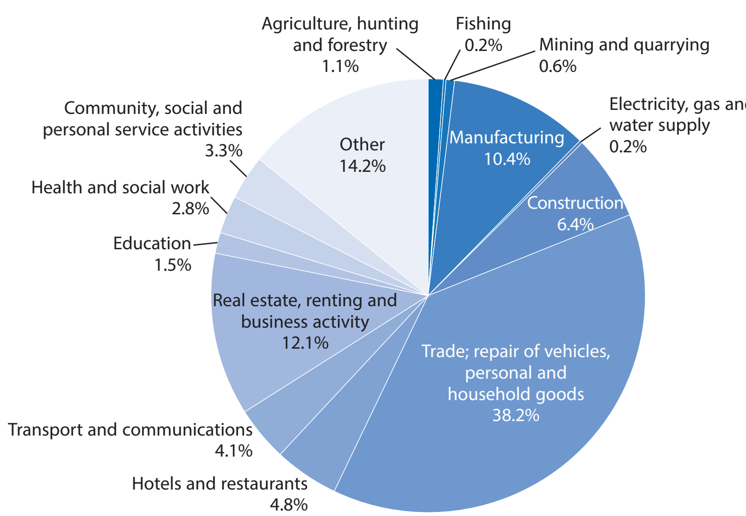
Just under 40% of SMEs operate in the trade sector (including repair of vehicles), followed by 12% in real estate (Figure 14.3). Only 10% of SMEs are active in manufacturing, a significant decrease from 15% in 2010. The concentration of SMEs in low value-added activities accounts for their weak performance in terms of overall contribution to value added. Geographically, half of all SMEs are located in Tbilisi, with the rest being concentrated in two major regions, Adjara (11%) and Imereti (11%).

Figure 14.2. **Business demography indicators in Georgia, 2013**



Source: GeoStat, *Business Statistics*, dataset available at http://geostat.ge accessed July 2015.

Figure 14.3. **Sectoral distribution of SMEs in Georgia, 2013**



Source: GeoStat, *Business Statistics*, dataset available at http://geostat.ge accessed July 2015.

SBA assessment results

This section outlines the main results for Georgia from the 2016 SBA assessment of EaP countries. It also highlights the changes that have occurred since the previous assessment in 2012 (OECD, 2012). The assessed policy dimensions are grouped under five key thematic pillars, reflected in the section headings below.

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

Georgia has made significant progress in its institutional environment for SME development since the 2012 assessment, in particular with the establishment of two major agencies dedicated to SME support. Georgia has also continued to improve the operational environment for businesses with the roll-out of one-stop-shop Public Service Halls and the extension of e-government services. A new SME development strategy will likely improve policy co-ordination and public-private dialogue.

Institutional framework

The Ministry of Economy and Sustainable Development continues to be responsible for SME policy making in Georgia. Since the previous assessment, a major breakthrough has been the creation of Entrepreneurship Development Agency (Enterprise Georgia) in February 2014. Falling under the Ministry of Economy and Sustainable Development, the agency is in charge of implementing policy on entrepreneurship and support to SME development, as well as export promotion. Enterprise Georgia supports SME development using both financial and non-financial instruments, including business skills development, entrepreneurial learning, export promotion, and access to finance. One of Enterprise Georgia's main activities is to help businesses comply with DCFTA requirements. Enterprise Georgia's board had not been appointed as of June 2015, but it is expected to include private sector representatives.

With a staff of 35 and a budget of GEL 21.7 million in 2014, Enterprise Georgia is currently executing the state programme "Produce in Georgia", launched in June 2014. The programme targets industrial and agricultural production and has three components: financial assistance, technical assistance (advisory services, innovation etc.) and support for physical infrastructure. Produce in Georgia is implemented in close co-operation with commercial banks, which provide loans for beneficiaries. As of July 2015, 92 projects were supported under this programme, more than half of them in the regions. The total volume of expected investment is around GEL 256.4 million, and around GEL 123 million in loans has been approved by commercial banks (EUR 104 million and EUR 50 million, respectively). The average loan size was approximately EUR 1.5 million, which suggests that beneficiaries are not limited to SMEs. Enterprise Georgia is involved in the implementation of 70 projects with an industrial profile, and 22 in the agriculture sector. Under this programme the government has granted state-owned property with preferential terms to 37 investment projects. In 2015, a new project – Supporting Micro and Small Businesses in Georgia – was launched in addition to the Produce in Georgia initiative. This aims to support micro and small businesses in the regions. On the financial front, co-matching grants are provided of up to GEL 5 000 (about EUR 2 000), with a minimum 20% cash participation by beneficiaries for single entrepreneurs, and up to GEL 15 000 (approximately EUR 6 000) for groups of entrepreneurs. Enterprise Georgia also provides consultancy services to beneficiaries. GEL 20 million (approximately EUR 8 million) has been allocated for the micro and small businesses component for 2015-17. A monitoring framework for Produce in Georgia is in place and independent evaluations are expected to assess its impact over the medium term.

In addition, a new SME strategy covering 2016-20 is in the process of being drafted in collaboration with the EU, the ETF and the OECD. The strategy will focus on five strategic directions: *(a)* improving the legislative, institutional framework and operational environment for SMEs; *(b)* improving access to finance; *(c)* developing competitive human capital, promoting entrepreneurial culture and improving business skills; *(d)* export promotion and SME internationalisation; and *(e)* facilitating SME innovation and R&D.

The SME strategy is an opportunity for the Georgian government to address some of the current weaknesses in SME policy, as well as to create a coherent framework on which to base the activities of the various institutions working on SME-related activities. As such, it is an important step forward in the creation of a more co-ordinated approach to SME policy in Georgia. The authorities are currently aiming to approve the strategy by the end of 2015. However, a number of challenges remain:

- The establishment of new programmes and institutions (including Enterprise Georgia) has partly been undertaken in the absence of a formal strategy or a structured consultation process. SME policy co-ordination remains ad hoc, lacking a formal framework for interactions among the various ministries and agencies involved. While consultations do take place (e.g. for the launch of the Produce in Georgia programme), the creation of a structured consultation forum and the adoption of clear rules and procedures for public-private dialogue would be highly beneficial. The working groups established to develop the draft strategy could be maintained and formalised to continue playing a co-ordination role during implementation.
- SME statistics collection must be improved in terms of scope and quality. Although the National Statistics Office of Georgia (GeoStat) collects basic structural business statistics (number, employment and value-added by sector and size class), data on business demographics, including the birth, death and survival rates of enterprises, are currently unavailable. Information on SME exports or innovation is also not being collected. More generally, there is a need to identify and address data gaps for SME policy making.
- Lack of data extends to the informal economy. There are no government policies explicitly targeting business formalisation. While the simplification of business registration, the reduction of taxes for small businesses and other regulatory reforms have considerably lowered entry barriers, the size of the shadow economy is still significant, particularly in the construction and services sectors (World Bank, 2013). According to government estimates, the non-observed economy represented 12.1% of GDP in 2013, down from 32% in 2004.
- Existing legislation constrains the newly created agencies in providing financial assistance to SMEs. The 1996 Law on Grants limits potential beneficiaries to individuals and “non-profit juridical persons”, thus excluding firms. This limitation should be reviewed to maximise the impact of existing and planned matching grant schemes.
- Georgia’s two conflicting definitions of SMEs are a problem for consistent policy making and statistics collection. In particular, the absence of a legal definition of micro-enterprises means that there are no statistics on this sub-section of the economy. In addition, neither definition includes a balance sheet criterion. The government is planning to develop a new definition following the adoption of the new SME strategy.

Legislative simplification and regulatory impact analysis

A legislative guillotine process took place between 2006 and 2010. This reviewed about 21 000 pieces of legislation, 12 000 of which were abolished. However, impact on SMEs was not an explicit criterion in this process. There is no formal mechanism for conducting periodic legislative reviews in the future, although legislative simplification is listed as a priority in Georgia's National Anti-corruption Strategy.

Regulatory impact assessment has yet to be established, and there is currently no formal requirement to conduct RIA for business related legislation. The Business Activity Regulatory Impact Assessment Division in the Ministry of Economy and Sustainable Development is responsible for analysing the impact of laws and regulations on the business environment, but does not conduct these activities on a regular basis or as part of a formal framework. Pilot RIAs have been conducted for several technical regulations and laws, and ad-hoc capacity building for public officials is ongoing. In line with the "Georgia 2020 Strategy", the government is planning to develop a fully-fledged RIA system for priority economic legislation by the end of 2016. It is expected that that this RIA will include an SME test, mainstreaming the "Think Small First" principle into every business-related piece of legislation.

Public-private consultations

Public-private consultations (PPCs) are sporadic and ad hoc in Georgia. Some draft laws and legislation are published for comments on the Ministry of Justice website. Depending on the specific initiative, the private sector is able to comment on draft legislation and call exceptional meetings and the Economic Council regularly engages with stakeholders to discuss policy priorities. The Tax/Business Ombudsman Office, created in 2011, acts as a mediator, transmitting private sector concerns to the government.

However, Georgia lacks a formal framework for public-private consultations, including guidance on how PPCs should be conducted and with whom. There is a formal requirement for a minimum consultation period with business and civil society, but only for very specific matters (e.g. urban planning).

Further, it is not clear to what extent SMEs are able to access PPCs. The main mediators and organisers of PPCs are the large business organisations, such as the Employers' Association of Georgia, the International Chamber of Commerce and the Georgian Chamber of Commerce (over 1 000 members, more than 90% of which are SMEs), whereas the Georgian Small and Medium Enterprises Association, founded in 2010, appears to be limited in capacity and influence.

Interaction with government services (e-government)

E-government services have been extended in Georgia, with more than 100 different types of government services now offered online, including business registration, and filing and payment of taxes and customs declarations. In 2012, Georgia simplified the procedure for filing VAT returns and introduced an electronic platform for tax declarations and payments, which was subsequently upgraded in 2013.

Provided that they possess a new ID card, individuals can use e-signatures on the government's e-service portal (my.gov.ge). E-signatures have also been accepted at Georgian banks since February 2014. Partly due to these innovations, managers of Georgian firms spend on average less than 1% of their time dealing with regulations, compared to 11% in the ECA region as a whole (EBRD, 2014). However, awareness of e-government services is currently low, with the e-services portal having fewer than 10 000 users in total. Nearly 50% of SMEs interviewed in the OECD SME survey said they do not use any government website.

Online reporting for enterprise statistics was introduced in 2013; currently GeoStat collects quarterly business statistics through an online questionnaire. Further, the Data Exchange Agency allows public institutions to share data electronically. In practice, however, only a limited number of institutions supply data to the agency – GeoStat, the Revenue Service and the National Agency of Public Registry.

Company registration

Georgia continues to be one of the easiest places to open a business, currently ranking 5th out of 189 economies in the World Bank *Doing Business* "Ease of Starting a Business" indicator (World Bank, 2014b). In 2012, Georgia simplified business registration further by eliminating the need to visit a bank to pay the registration fees. Currently, registration involves two days and two procedures according to the World Bank. In practice, however, the two procedures can be completed in a single day (paying the registration fee and registering at the Entrepreneurial Registry, and opening a bank account). The registration fees are minimal: GEL 100 (about EUR 40) for regular registration (which can be completed in one day in practice) and GEL 200 (EUR 80) for fast-track registration (the same day). Since 2012 it is no longer necessary to pay the registration fee through a bank so entrepreneurs can do this directly at registration.

The registration can be carried out at a Public Service Hall. These opened in 2012, and combine the functions and services of the National Agency of Public Registry, the National Bureau of Enforcement, and the Notary Chamber. They operate as a one-stop shop for about 300 different administrative procedures. Public Halls exist in Tbilisi and in 12 other cities throughout Georgia and are widely regarded as an international best practice (see Box 4.1, Chapter 4). Company registration is also available online through the my.gov.ge website for holders of the new Georgian electronic identity card. On the other hand, the silence-is-consent principle has not yet been introduced to business registration (i.e. businesses still need an express decision by the authorities to start their operations), although it is in force in other areas, such as for licenses and permits.

Bankruptcy procedures and second chance

Resolving insolvency is Georgia's weakest area in the *Doing Business* index, where it ranks 122nd (World Bank, 2014b). This is explained by a series of weaknesses in the overall framework (including re-organisation and creditor participation) and the low recovery rate (28.7% of the estate, compared to 71.9% for the OECD average).

Georgia has made modest improvements since the 2012 SBA assessment, however. A new insolvency law was adopted in June 2012. This reduces the maximum length allowed for bankruptcy procedures to 207 or 225 days, depending on whether they are initiated by the debtor or the creditor. It also allows for the management of insolvency cases through an electronic system, which is expected to be operational by early 2016.

However, a number of weaknesses identified in 2009 in the legal framework still exist (EBRD, 2009). These include the fact that the law does not provide for a general suspension of all court proceedings against the debtor; it is difficult for creditors to initiate proceedings; and, more generally, the framework for creditor protection and creditor participation is not strong. In particular, the requirements for a given creditor to initiate bankruptcy procedures against a debtor are very burdensome. There are also currently no incentives for post-petition financing to facilitate the reorganisation of viable businesses (World Bank, 2013). Last but not least, it is unclear whether the timelines set out in the law are complied with in practice. Overall, these weaknesses in the legal framework lead many entrepreneurs to cease their operations without recourse to formal insolvency procedures. This in turn has a negative impact on the accuracy of official SME statistics, as many inactive companies are still showing up on official records.

While there is no discrimination against business re-starters, the government could consider developing a more proactive approach to promoting second chance through awareness campaigns and other tools. The OECD company survey revealed that more than 85% of the 360 Georgian SMEs that were surveyed consider it difficult to resume business after failure; access to finance was cited as the most significant barrier (see Box A.3, Annex A).

Facilitating SME access to finance (Dimension 6)

Georgia has made some progress in improving SMEs' access to finance, in particular by further strengthening the legal and regulatory framework. Annual SME credit has accelerated in recent years, although the overall share of SME lending remains low and access to finance is still considered a key obstacle to SME development. Alternative sources of SME financing are mainly limited to micro-finance lending and could benefit from further development. Low levels of financial literacy amongst the SME population further hinder their ability to successfully access finance.

Legal and regulatory framework

SMEs in Georgia benefit from a well-developed and robust legal and regulatory framework, which supports lending to the segment. The National Bank of Georgia has taken important steps to align banking regulation and supervision with Basel core principles, and is committed to continue implementing Basel II and III.

Coverage of the private credit bureau has increased significantly in recent years, extending to 56.8% of the adult population. Amendments to the Law on Protection of Personal Data in November 2014 have strengthened borrowers' rights with regards to credit information. The system could benefit from specific legal provisions to ensure accuracy of collected data, thus increasing its reliability. A real estate cadastre is fully operational and a central register for securities over movables is in place. However, usability of the register for securities could be improved by providing broader access online. In 2012, an amendment to the civil code increased the range of assets that can be used as collateral.

Creditors' rights are ensured through the Law on Enforcement Issues. Insolvency procedures, however, do not envisage any limitations on the automatic stay in case of re-organisation, which would inhibit the seizing of collateral in such cases.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

SME lending has grown in recent years on the back of lower interest rates. Nevertheless, the overall share of SME lending in credit to the private sector remains chronically low, at around 16%. Collateralisation requirements remain high, coupled with relatively low acceptance of movable collateral in particular. Loan dollarisation also continues to be high, albeit decreasing as a result of a number of measures by the National Bank of Georgia to encourage local currency lending. This poses significant currency risks, especially for SMEs that tend to be non-exporters and thus are not naturally hedged against exchange rate fluctuations. The banking sector is highly concentrated, with the top five banks controlling more than 80% of assets. More competition in this sector could increase sustainable access to finance for SMEs.

The government's new programme, Produce in Georgia, is implemented in close co-operation with the commercial banks and includes interest rate subsidies (see above). Given the novelty of the programme, its effectiveness has yet to be evaluated. In general, more commercially based support programmes, such as a credit guarantee scheme, would prove more sustainable in the long term and be potentially less distortive for credit allocation.

Micro-finance institutions are the main alternative sources of financing in Georgia. Competitive pressures in this segment have increased in recent years, and there are now over 70 micro-finance institutions active in the market. Despite their wide presence, micro-finance institutions lack capital and continue to rely mainly on international donor support. Other sources of non-bank finance remain underdeveloped and lack diversification. Leasing operations are gradually being developed, but do not yet provide a viable alternative for SMEs. Factoring services remain largely unused; improving the contract law framework for factoring transactions would support their development. Despite some developments in the regulatory framework governing investments and venture capital (through the adoption of the Law on Investment Funds), the private equity sector in general and venture capital activities in particular are at an early stage.

Georgia's capital markets are small and illiquid and in need of reform. Market infrastructure needs modernising, particularly the equity exchange. The authorities have taken steps towards capital market reform by establishing a working group. A first diagnostic report identifying reform recommendations was made available in May 2015 (Capital Markets Working Group, 2015). Public consultations were being held in July 2015.

The government is committed to developing a more holistic approach to tackling constraints to financing. This is illustrated by the drafting of the SME strategy, as well as the joint comprehensive analysis of obstacles to financing SMEs by the World Bank and KfW, the German development bank.

Financial literacy

Georgia lacks a national strategy or initiative to promote financial literacy. However, the number of deposit holders has increased in recent years, indicating a modest rise in financial awareness. Overall, however, financial reporting quality amongst SMEs remains low and further constrains them in accessing bank finance. There are good examples of financial literacy promotion in secondary schools. These should be evaluated with a view to determining how financial literacy can be mainstreamed in formal education.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Lifelong entrepreneurial learning

Entrepreneurship promotion in the schooling and university system is evolving, with a number of factors offering an important opportunity for the education and training system to take forward the entrepreneurship agenda.

Firstly, both Georgia's socio-economic development strategy, Georgia 2020, and the forthcoming SME strategy include entrepreneurial learning, providing impetus for policy changes in education and training. Secondly, the newly established Enterprise

Georgia plays an important policy co-ordination role in lifelong entrepreneurial learning. Thirdly, the Georgian Chamber of Commerce and Industry's interest in and commitment to entrepreneurial learning reflect market demand for entrepreneurship competence and better entrepreneurship skills. This provides an important impetus for the formal education system to respond to these demands. Finally, the forthcoming EU Entrepreneurship Competence Framework (which includes entrepreneurial learning outcomes) to be published in 2016 will be a policy reference tool which education policy makers could possibly adapt to school, college and university curricula. The learning outcomes should ideally be piloted across all levels of education and evaluated to determine implications for schools, assessment arrangements and teacher training.

Developments in formal education should continue to be matched, and where possible connected, with entrepreneurship promotion in non-formal entrepreneurial learning. For example, a joint initiative of the Academy of the Georgian Chamber of Commerce and Junior Achievement Georgia for promoting entrepreneurship in secondary schools engages entrepreneurs directly in the teaching and learning process. Children learn how to set up and run a mini-company, providing them with concrete business experience. The authorities should consider how to integrate direct entrepreneurship experience into the mainstream curricula. Meanwhile, a more strategic approach should be explored to promotimh high -otential youth entrepreneurship in key sectors (e.g. information and communication technology, ICT) (Loughran, 2014). This should involve vocational schools and universities, sector associations, the banking/credit sector and recognised business mentors. Engaging the Georgian entrepreneur diaspora to support youth mentoring should also be explored.

The SBA assessment pointed to excellence in entrepreneurship promotion in tertiary education. One excellent example of entrepreneurship ecosystem building is a start-up initiative (Business Incubator Project) involving both the Georgian Technical and Tbilisi state universities, the Municipality of Tbilisi, GITA, and the Ministry of Economy and Sustainable Development. This project engages the universities as drivers of innovation and local economic development. However, the wider higher education system still needs to buy into the SBA agenda if higher education is to more directly contribute to an entrepreneurial economy. This will require a dedicated debate involving education and economy policy makers, the higher education community and the private sector. The aim should be to develop entrepreneurship across all faculties of all universities, as well as to upgrade university-business co-operation in R&D areas with good market potential.

Overall, a more strategic approach to harnessing good practice in entrepreneurial learning from within Georgia, as well as from abroad, is still required. This will provide the opportunity to not only generate innovation at home, but to also bring efficiency to national efforts by flagging up what works well, and what doesn't (Gribben, 2013).

Women's entrepreneurship

The primary policy drivers of women's entrepreneurship are a 2010 Gender Equity Law and a 2014 gender equity action plan. While equity concerns remain important for the economic empowerment of women, women's entrepreneurship potential in the country's wider competitiveness drive requires more targeted consideration. In particular, more emphasis is needed on maximising the real economic value of women's entrepreneurship (Bekh, 2013). To this end the forthcoming SME strategy should dedicate attention to how women's entrepreneurship can be reinforced. As in other market and transition economies, tackling the main barriers is key. These include weak policy advocacy, poor information and communication, underdeveloped management and leadership skills, poor support systems (incubator support and networks) and difficulties for women entrepreneurs in accessing finance. To this end, the Georgian authorities should consider drawing up a dedicated women's entrepreneurship strategy and action plan. A dedicated commission on women's entrepreneurship reporting to the Standing Council on Gender Equality would be a positive development in this regard.

The strategy exercise and a commission on women's entrepreneurship would send an important signal to institutions, and particularly to citizens, that an entrepreneurial economy requires an equal contribution by men and women. The strategy and action plan should not only address necessity entrepreneurship (e.g. women's micro-enterprise developments) but should also focus on opportunity entrepreneurship (e.g. support to women-owned businesses with high-growth potential). The gender-sensitive support already available for women entrepreneurs through key institutions like GITA is good practice. This needs to be developed and widened across the institutional network. Building a credible data set on women's entrepreneurship, and sustaining the data drive, will also be important for monitoring progress. On a more practical level, women entrepreneurs' access to credit should be combined with dedicated mentoring support.

SME skills

A central role of the recently founded Enterprise Georgia is to build up SME skills intelligence. Its establishment marks an important turning point in Georgia's efforts to meet SBA human capital requirements. Enterprise Georgia will track training needs and training provision in the pre start-up phase and new ventures in the early phase development, as well as businesses with growth and international trading potential.

Importantly, data development will be essential to enable both the policy and training provider communities to make training more targeted, more available and more relevant to the specific needs of Georgia's economy. While Enterprise Georgia is already developing its own role in data collection and analysis, it will need to connect with other organisations with skills intelligence (e.g. employment data, skills data developed by sector specific interest groups) to allow for a comprehensive overview of SME skills in the country.

An emerging feature of GITA's work is to offer online training for SMEs, building on its "Fab Labs", which provide a mix of technological and business support to budding entrepreneurs. This is an important development, but quality issues in online training will need to be addressed. Further, online training provision should not be confined to technology businesses. It must accommodate the wider business community.

Finally, supporting training to help SMEs grow, and particularly to support SMEs in accessing international markets, will be critical in the wider drive to boost enterprise performance, economic growth and jobs (Lasku and Gribben, 2013). Particularly important will be to offer training and advisory support for businesses keen on taking advantage of the opportunities now available through the EU-Georgia DCFTA. This will have implications for sector organisations with regulatory training mandates. It will also have follow-through implications for vocational and tertiary education institutions as they improve their co-operation with businesses.

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Greater access to business support infrastructure, innovation and opportunities provided by public procurement and green practices will be key for improving the competitiveness of Georgian SMEs. The creation of Enterprise Georgia and GITA has been a major boost for the provision of business development services, although more can still be done to stimulate the private market. While significant progress has been made in the roll-out of e-procurement systems, SME participation remains low. Innovation support has been limited to date, but an ambitious strategy is being finalised. Finally, despite some piecemeal efforts, regulatory and financial incentives for SME greening are still largely lacking in the country.

Business information and services

The Georgian government has introduced a wide range of support services through its two new institutions, Enterprise Georgia and GITA. Enterprise Georgia currently provides SMEs with training in entrepreneurial learning, management, business planning and marketing, as well as export-oriented training in foreign and local market requirements and the DCFTA. GITA organises training for SMEs on intellectual property rights and project management, led by international innovation experts. In addition, the Georgian National Intellectual Property Centre (*Sakpateenti*) has launched a new training programme on intellectual property rights for SMEs. Efforts have also been made to increase access to business information. For instance, a comprehensive guide on how to start a business has been published on the Ministry of Economy's website.

Enterprise Georgia will also co-finance private consulting services for SMEs already receiving financial support under the Produce in Georgia programme. Enterprise Georgia is creating a list of consulting companies whose services will be co-financed up to GEL 20 000. A memorandum of understanding has also been signed between Enterprise Georgia and EBRD to enable EBRD's Small Business Support programme to provide technical assistance to Produce in Georgia beneficiaries. Other institutions have developed business support services, including the Tbilisi Entrepreneurship Promotion Centre, which began operations in March 2015 with a budget of GEL 2 million.

Going forward, Enterprise Georgia could adopt a more strategic approach to supporting the growth of a private market for business development services. The existing co-financing arrangements are a good basis on which to build, but data from the OECD SME survey suggest that more awareness and communication campaigns could help to sell the benefits of these services to SMEs. At present, 63% of surveyed companies would not consider using external advisory services, such as management consulting, while 78% said they were unaware of the existence of any government business support programmes. Likewise, Enterprise Georgia could consider developing a dedicated website providing information and contact details on private providers and training opportunities.

Public procurement

Georgia has made progress since 2012, with the DCFTA leading to an even greater opening of the country's public procurement market, which is now largely open to foreign economic operators. E-procurement has fully replaced the former paper-based system and led to clearer and more transparent rules, which is particularly beneficial for SMEs. The State Procurement Agency regularly provides training for SMEs to facilitate their participation in public procurement.

Georgia's Law on State Procurement enables contracting authorities to permit joint bidding and the division of tenders into lots; this is also applied in practice. The Disputes Resolution Board is an independent government body for the review of public procurement cases. However, its functions should be further separated from the regulatory functions of the State Procurement Agency in order to avoid potential conflicts of interest. Information on procurement opportunities is available centrally and free of charge and information collected from companies is stored in a database for future tender procedures. There are provisions in place ensuring that SMEs do not suffer from excessive turnover and staff qualification requirements.

Despite these efforts, SME participation in public procurement remains low in Georgia and should be increased. Major efforts will be required to seize the full potential offered by the DCFTA – Georgia will have to reform its institutions and align its legislation with the EU's public procurement *acquis*. This will require a more strategic approach to public procurement policy making and regulation. Currently, price is the only award criterion, which contradicts European and international rules and best practices. Georgia should further encourage the use of the most economically advantageous tender award criterion, including in electronic procedures, to achieve better quality tenders. There is also no law regulating late payments to contractors.

Innovation policy

Technological development and innovation remain insufficient in Georgia, with high-tech exports accounting for only 2.6% of manufactured exports. Innovative activity is particularly low among SMEs, with only 3% reporting having made any R&D expenditure in the past three years, and only 8.1% having introduced a new or substantially improved product or service in the same period (EBRD, 2014). This is well below regional peers.

In order to address these shortcomings, the Georgian government has made a number of important institutional reforms to its innovation policy. The first was to establish GITA in February 2014. With an initial budget of GEL 25 million and housed under the Ministry of Economy and Sustainable Development, GITA is the government agency responsible for implementing innovation policy, leading technology infrastructure development, promoting the commercialisation of research, and supporting innovation by SMEs through financial and non-financial assistance. GITA also acts as the secretariat of the Research and Innovation Council, established in February 2015 and chaired by the Prime Minister with the participation of various ministries, academics, and private sector representatives. This new platform for public-private innovation dialogue has established four working groups to prepare a new "National Innovation Strategy 2020", which is expected to be finalised in July 2015. The draft strategy is expected to include legal reforms (including the adoption of a new innovation law and amendments to intellectual property and procurement legislation), the development of innovation support infrastructure, and a new approach to innovation skills development and links with the education system.

Despite its recent creation, GITA has already launched various programmes to promote innovation, with an emphasis on infrastructure development and technology commercialisation. A grant programme with a total budget of GEL 2 million in 2015 is open to individuals, research entities and NGOs. However, one barrier to this grant programme is the law on grants, which prevents public institutions from providing grants to companies. Amending this law will be an important step to ensure that SMEs can receive matching grants from public institutions. In addition, the modest amount of the grants (up to USD 25 000, or approximately EUR 22 700) limits their effectiveness. GITA has plans to scale up its existing programme through a matching grant scheme which would provide larger amounts to both individuals and companies. Other GITA initiatives include the construction of the country's first technology park (which is expected to be operational in 2015) and the piloting of two fabrication labs and three university-based innovation labs targeting start-ups in the ICT sector. Over the medium term, GITA plans to establish a network of four regional innovation hubs and about 500 community innovation centres across the country.

Despite this progress, some challenges remain for innovation policy. The implementation of the new strategy should prioritise capacity building at GITA and other government agencies. It should also ensure co-ordination with other key stakeholders in the innovation ecosystem, such as the Shota Rustaveli National Science Foundation (SRNSF) under the Ministry of Education, which continues to be responsible for promoting the implementation of fundamental and applied research. The new policy framework should address other shortcomings too, including the weak link between research centres and universities on the one hand and SMEs on the other, as well as difficulties in the commercialisation of innovations and technology transfer. It should replace the current focus of innovation policy on the ICT sector with a more holistic approach. Finally, in addition to GITA's plans to expand the matching grant scheme, the government may want to consider other forms of targeted support (e.g. tax credits for R&D activities).

Green economy

The Ministry of Environment and Natural Resources Protection (MENRP) has been putting significant emphasis on raising environmental awareness. It set up an Environmental Information and Education Centre in 2010 to provide compliance advisory services to companies and individuals. However, these information services rarely reach small businesses. More recently, the Georgian Green Business Award was announced by the MENRP in October 2013. The award is made in the green company, green product and green building categories and seeks to motivate entrepreneurs in environmental protection and social responsibility.

The Ministry of Economy and Sustainable Development has provided private companies with reliable and actionable industry data and analysis, and made them aware of opportunities for implementing sustainable business practices. One of the main functions of the ministry's Sustainable Development Department is to raise private sector awareness of green business opportunities. A special website, www.greengeorgia.ge, has been established for this purpose under the ministry's Green Growth Initiative. It also provides information on environmentally friendly investment projects in hydro-power generation, tourism and agriculture.

International donor-sponsored initiatives to promote SME green development play a substantial role in improving access to finance and know-how for SMEs. While they are not sustainable in the long term, they help to build social and environmental responsibility in private banks. In Georgia, a few banks have established environmental management units, and the Bank of Georgia has formally adopted an environmental and social policy and related procedures.

Supporting SME internationalisation (Dimensions 10 and 7)

The DCFTA has been provisionally applied since 1 September 2014. The Georgian government has adopted an action plan for 2014-17 on the implementation of the DCFTA. This covers legislative alignment with EU technical regulations, trade facilitation, public procurement, transparency and other relevant areas. Progress has been made in adopting legislation on technical barriers to trade. Georgian SMEs will be confronted with short-term costs in order to comply with quality standards and to improve competitiveness for exporting to the EU. Government support in the area of export promotion will therefore be key for SMEs to benefit from increased trade opportunities.

Export promotion and integration into global value chains

Georgia is a strong regional performer in customs and trade regulations, with exports taking an average of 2.9 days to clear customs (compared to a regional average of 4.8). Only 2.9% of firms identified customs and trade regulations as a major constraint in the BEEPS V survey (EBRD, 2014). Despite this, only 2.9% of small and 15.2% of medium-sized enterprises export, either directly or indirectly (compared to the regional average of 15% and 25.6% respectively). Furthermore, a recent study of Georgia's export patterns identified low export survival as a major problem, with 70% of all export products failing to survive past their first year (World Bank 2014a). Shortage of working capital to finance exports was considered as the greatest barrier to a company's access to international markets by a third of the 200 respondents to the OECD company survey.

On the regulatory front, as of June 2015 a new Customs Code and secondary legislation were being finalised to adapt existing rules to the DCFTA and further improve efficiency in clearing exports and imports. Import tariffs have been eliminated for about 90% of goods and tariff rates have been greatly simplified.

Export promotion is now the responsibility of the newly established Enterprise Georgia, which took over from the Export Unit of the Georgian National Investment Agency. It provides export training, certified courses (with a focus on DCFTA regulations), and financial and technical assistance support for participating in international trade fairs. It also organises outbound and inbound trade missions. However, further outreach efforts may be required, as 92% of respondents in the OECD company survey were unaware of any export promotion programmes. In addition, Enterprise Georgia's new responsibilities are likely to require additional capacity to provide more sophisticated services, such as market intelligence.

The government is also planning to create an export credit agency within the Partnership Fund, a state-owned investment fund. SACE, the Italian export credit agency, is currently advising Georgia on its establishment and the financial products to be put on offer, which may include loans, guarantees and insurance schemes.

Finally, Georgia has no structured programmes to help SMEs integrate into global value chains. And, other than some isolated initiatives (e.g. matchmaking through Enterprise Georgia) there is no systematic effort to ensure that incoming FDI translates into business opportunities for SMEs. The development of an FDI-SME linkage programme in which the government plays a facilitating role and provides incentives for technology and know-how transfer, quality standards upgrading amongst local providers, and supply and financing schemes should be considered to exploit this significant opportunity for SMEs.

Standards and technical regulation

The DCFTA between the EU and Georgia provides a good framework for the formulation of policy and legislation for Georgia's industrial products. Legislation covering standardisation, metrology, accreditation, conformity assessment and market surveillance is in place, which generally corresponds to EU norms and best practices.

Following the DCFTA timetable, Georgia has already approximated its legislation to six EU New Approach directives. National legislation has been amended to reflect EU legislation in the relevant sectors, while the training needs of the institutions implementing technical regulation have been assessed, and personnel have been subsequently trained. Standardisation legislation is in line with EU principles for standardisation, and up to 25% of the European standards have been adopted in priority sectors. By the end of 2015 the total number of European and international standards adopted will exceed 7 000.

Five technical committees have been established and an online catalogue and standard distribution systems are operational.

In the field of metrology, a strategy and legislation have been adopted, and in 2012 the Agency of Standardisation and Metrology (GeoSTM) was created with the aim of developing the metrology system. In the framework of the EU's Comprehensive Institution Building programme, GeoSTM's physical premises were renovated as an essential step for the proper functioning of metrological reference laboratories. Georgia is the first country in the region to achieve international recognition in the field of metrology.[1]

Secondary legislation on accreditation and conformity assessment that is in line with EU *acquis* has been adopted. The accreditation system is developing according to EU best practices and the Georgian Accreditation Centre (GAC) has applied to initiate procedures for a Bilateral Accreditation Agreement with the European Co-operation for Accreditation. In 2015, the National Accreditation Council was established at the GAC with the representation of all relevant stakeholders (e.g. conformity assessment bodies, business associations, consumer protection NGOs).

A strategy for market surveillance has been adopted; however the legislation is still in draft phase. Certain procedures for effective market surveillance are in place on the basis of the legislation adopted in 2012. Independent monitoring and evaluation is missing from Georgia's institutional landscape. In 2015, a new EU assistance project began a gap and needs assessment of the Georgian market surveillance system and the main market surveillance authority (Technical and Construction Supervision Agency). Two additional EU projects launched in 2015 will help to further strengthen GeoSTM and GAC to allow them to become more reliable and competent institutions able to meet the market needs.

The way forward

The 2016 SBA assessment considers the following to be priorities for Georgia in improving its SME policy framework:

- **Adopt the "SME Development Strategy for 2016-2020"** as Georgia's main strategic document for continued reforms and support to SMEs. This should be the top priority for the short term. The strategy should identify concrete steps for resolving outstanding challenges in the institutional and operational environment, including a consistent SME definition, upgrading the bankruptcy legislation, expanding the breadth and depth of data collection amongst SMEs, as well as creating formal frameworks and structures for legislative reviews, RIA and public-private consultations.
- **Support greater competitiveness in the banking sector to facilitate more sustainable access to finance for SMEs.** Allowing secured creditors to seize collateral after re-organisation would help increase bank lending to SMEs. In addition, online access for the registry of movable assets should be improved to help increase efficiency and ease of use, particularly for smaller users.
- **Improve entrepreneurial learning by adopting the EU's entrepreneurship competence framework.** This will require bold leadership by the education authorities to implement a three-year strategic pilot at each level of education, followed by a five-year roll-out. Establishing a Women's Entrepreneurship Commission would encourage a more strategic policy approach to encouraging women to contribute to an entrepreneurial economy. This needs to be accompanied

by clearly defined targets and outcomes. Sustained technical and financial support for the newly established Enterprise Georgia will enable **capacity building in skills intelligence to better focus SME training services**.

- **Create concrete support measures to encourage innovative entrepreneurship.** Following the adoption of the new "National Innovation Strategy to 2020", the government should focus on the design and implementation of matching grants and programmes to encourage and support innovation in SMEs, including – but not limited to – encouraging technology transfer and closer links between businesses and research institutions.
- **Develop new instruments for export promotion.** Implementing the various measures identified in the "DCFTA Action Plan 2014-2017" will be crucial to ensure that Georgian SMEs reap the benefits of closer trade integration with the EU. Particular attention should be paid to creating an export credit facility and supporting SMEs in upgrading their quality standards to meet EU requirements.

Table 14.4 presents a potential policy roadmap to guide SME development policy over the short, medium and long term, based on the findings of the SBA assessment.

Table 14.4. **Georgia: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• **Complete the work on the "Georgia SME Development Strategy (2016-2020)" and action plan; use the new strategy to create a structured framework for inter-agency co-ordination and PPC on SME policy**	S
• **Introduce a single SME definition aligned with EU standards**	S/M
• **Address existing constraints in legislation on grants for targeted SME support**	S/M
• Roll-out RIA systematically and include an SME test	M
• Undertake a legislative guillotine process specifically for SMEs	M/L
• Adopt a concrete action plan to improve statistics data collection	M/L
• Reform the insolvency legal framework to improve efficiency and reduce timeframes, including access for creditors, incentives for post-petition financing	M/L
2. Facilitating SME access to finance	
• **Introduce legislation to allow secured creditors to seize collateral after re-organisation**	M
• **Improve online access for the registry of movable assets, particularly for smaller users**	M
• Adopt a new capital markets strategy/action plan; establish a framework for early-stage venture capital	M
• Consider the establishment of a credit-guarantee scheme to address high collateral requirements	M/L
• Develop an SME financial literacy programme, including both demand and supply	M
3. Promoting skills and entrepreneurship development	
• Ministry of Education to establish an entrepreneurship key competence task force to develop a national entrepreneurship competence framework set against wider qualifications development	S/M/L
• Establish a National Commission on Women's Entrepreneurship with policy development competence and oversight of evaluation (a first deliverable should be a women's entrepreneurship strategy and action plan)	S/M/L
• In co-operation with the Enterprise Europe Network, reinforce Enterprise Georgia's capacity for intelligence and analysis of SME skills, with a specific focus on sectors with high potential for trade with the European Union	S/M

Table 14.4. **Roadmap for policy reforms** *(continued)*

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
4. Enhancing SME competitiveness	
• Approve and implement the draft "National Innovation Strategy 2020" and any necessary legal reforms, with a focus on incentives and financial support, knowledge transfer and university-SME links	S (M for implementation)
• Build on existing schemes (e.g. Produce in Georgia, EBRD Small Business Support) to promote the use of private business development service providers through e.g. disseminating a list of providers, voucher schemes)	M/L
• Promote greater SME participation in public procurement (e.g. adopting most-economically-advantageous tender criteria); implement DCFTA provisions	S/M
5. Supporting SME internationalisation	
• **Strengthen targeted support to exporting SMEs through Enterprise Georgia** (e.g. **matching grants for quality upgrading, market research, DCFTA adaptation costs) and establish export credit facility to develop trade finance**	S/M/L
• Upgrade Georgia's quality infrastructure in line with the DCFTA Action Plan	S/M/L
• Develop targeted programmes to foster FDI-SME linkages (e.g. matchmaking schemes, knowledge transfer)	M/L

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Note

1. For instance, GeoSTM's Metrology Institute has introduced a quality management system in accordance with international standard ISO/IEC 17025; and three GeoSTM metrology laboratories (electrical, mass and temperature measurement labs) have been recognised by the CO-OMET Quality Forum Technical Committee. Their calibration and measurement capabilities have been published in the database of the *Bureau international des poids et mésures* (BIPM).

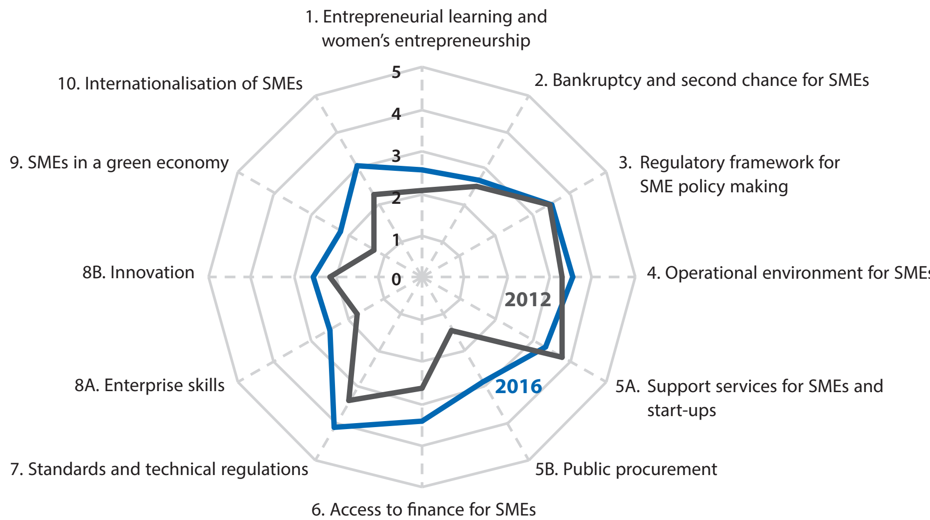
Chapter 15

Republic of Moldova: Small Business Act country profile

Since 2012, the Republic of Moldova has made considerable progress in developing a comprehensive institutional framework for the SME sector. An SME development strategy has been designed under the leadership of the Ministry of Economy, to be implemented by an experienced SME agency. The main challenge now for the authorities is to ensure that strong policy design is matched by systematic implementation, monitoring and evaluation. Substantial progress has also been achieved in improving the operational environment for SMEs, through new e-government services and streamlined business registration procedures.

To foster SME competitiveness and reap the benefits of the Deep and Comprehensive Free Trade Area with the EU, the government needs to address the remaining challenges confronting SMEs: burdensome regulations in key areas (e.g. customs, technical barriers to trade, permits and licenses, and inspections) which imply high transaction costs for SMEs; difficulties in obtaining access to finance due to structural challenges in the banking sector and lack of alternative sources of financing; and a significant need for skills upgrading and innovation through training and other business support infrastructure.

Figure 15.1. **SBA scores for Moldova**



Key findings

The macroeconomic environment in the Republic of Moldova (hereafter, Moldova) is volatile and vulnerable to internal and external shocks, including structural challenges in the financial sector and regional geopolitical instability.

In the past few years, Moldova has taken significant steps to put in place a comprehensive institutional framework for SME development. In 2012, the government approved the "Small and Medium Enterprise Sector Development Strategy for 2012-2020". New e-government services have been introduced, business registration processes have been considerably streamlined, a new innovation strategy has been adopted, and major progress has been achieved in upgrading the country's quality infrastructure to facilitate SME internationalisation.

Moldova's performance across most dimensions in the 2016 SME Policy Index shows steady progress in many areas (Figure 15.1). Particularly noteworthy are improvements in the institutional environment (Dimension 3), thanks to the new strategy, as well as SME internationalisation and technical regulations (Dimensions 10 and 7). The country has also improved its scores in human capital dimensions (Dimension 1 and 8a), mostly by prioritising these dimensions in its new SME strategy, implementing entrepreneurial learning curricula and teacher training programmes and adopting measures on women's entrepreneurship in the new strategy. Improvements have also been observed in Dimension 6 (access to finance), with Moldova completing significant work on its legal and regulatory framework. Access to banking and non-banking finance is still limited, while a slight deterioration in the score for business support services (Dimension 5a) underlines the need to step up implementation efforts. Dimensions 8b and 9 (innovation and SME greening, respectively) continue to offer the most room for improvement.

In June 2014, Moldova signed an Association Agreement with the EU including a Deep and Comprehensive Free Trade Area (DCFTA). This agreement provides a broad and ambitious roadmap for policy reform in Moldova, including in the area of SME development. The DCFTA also offers significant export and investment opportunities for increasing SME productivity. Nevertheless, SME development policies in Moldova still face important risks. Its small internal market and heavy dependence on remittances and exports (although the latter to a lesser extent) mean the country is vulnerable to macroeconomic developments in the wider region. Moreover, weaknesses and instability in the financial sector may have significant consequences for SMEs' access to finance. Many SME support instruments are heavily dependent on donors – measures should be adopted to ensure the sustainability of some of these schemes (e.g. adequate "exit" strategies while building the capacity of government structures).

The SBA assessment has revealed a number of outstanding challenges:

- Government efforts across the policy cycle need to be rebalanced. While policy design is generally strong, as demonstrated by well-articulated strategies, more attention should be paid to the implementation of strategies and initiatives in practice, as well as to the monitoring and independent evaluation of actual results. This will require more emphasis on co-ordination across ministries and government agencies (including institutionalising policy partnerships for entrepreneurial learning and women's entrepreneurship), enhanced capacity in key SME support institutions and a more active involvement of the SME community in policy making.
- Structural shortcomings in the banking sector (e.g. low levels of transparency and corporate governance standards and limited competition), together with legal and regulatory gaps in key areas for SME access to finance (e.g. insolvency, non-banking financial institutions and capital markets), represent major obstacles to accessing finance in Moldova. The SME market is perceived as risky and costly by banks, while complex loan application processes are cited as a problem by SMEs (OECD, 2014a). In addition, the government could adopt a more proactive approach to lending transparency by ensuring a fully functional online registry for pledges over movables and improving the credit information system. Lending could be further supported by a strengthened and more efficient guarantee scheme. The financial capabilities of SMEs could be improved with targeted programmes.
- Enhancing support initiatives for SME competitiveness, innovation and internationalisation and adopting greening practices would help Moldovan SMEs to compete at the EU level under the DCFTA. Further efforts to enhance the business acumen and skills of small businesses through business support infrastructure and the introduction of entrepreneurship key competence into learning practice across all levels of education would be particularly beneficial, as would the introduction of greater incentives to encourage co-operation between research institutions and SMEs.

Table 15.1. **Moldova: Challenges and opportunities**

Strengths	Weaknesses
• Well-articulated, targeted strategies (“Moldova 2020”, “SME Sector Development Strategy”, “Roadmap for Competitiveness”, strategies on innovation, investment and export promotion) • Significant track record in legal and regulatory reform relevant to the Doing Business indicators (business registration, insolvency, etc.), regulatory impact assessment • Comprehensive institutional framework for innovation, insolvency, and other areas critical for SME development • Growing digitalisation of governmental services (e.g. Digital Moldova 2020) • Availability of targeted SME support services • Growing emphasis on human resources development, training at enterprise level • Generally reliable physical infrastructure (cf. BEEPS V)	• Reforms often lacking implementation, monitoring and evaluation • Inefficient dialogue and co-operation among enterprises and public authorities • Low level of innovation development and absorption and R&D partly due to limited private involvement and financial support • Low levels of SME internationalisation due to regulatory barriers and limited export support measures • Access to finance below regional levels (e.g. high collateral, low number of firms with loans); reliance on government/donor support; incomplete regulatory framework • Corruption perceptions main obstacle for business (cf. BEEPS); weak justice system and regulatory enforcement capacity potential bottlenecks for reform implementation
Opportunities	**Threats**
• DCFTA should boost exports, FDI and general economic growth • Participation in EU’s COSME Programme (including the Enterprise Europe Network) and Horizon 2020 • Favourable geographical location between the EU and CIS countries • Declining imported energy prices • Relatively competitive and educated labour force (high literacy rate) • Trade openness (e.g. Moldova has signed FTAs with 43 countries). • Large diaspora offering a source of expertise and remittances	• Exposure to regional instability and developments in the Eurozone (leu depreciation, inflation) • Considerable youth migration • High level of informality • Weak competitiveness (89th out of 148 countries in 2013-14 WEF Global Competitiveness Index) • Dependence on donor funding for key initiatives run by ODIMM and other SME-related agencies • Regulatory gaps in the financial sector (e.g. non-bank financial institutions) • Political instability cited as a constraint by business (cf. BEEPS)

Overview

Economic snapshot

The Moldovan economy has experienced overall growth since 2000, despite considerable volatility. Periods of high growth have alternated with recessions. For example, in 2009 the global financial crisis affected trade and remittances, while in 2012 the economy contracted by 0.6% as a result of the Eurozone crisis and a severe drought, which crippled agricultural output.

Moldova’s economy grew by an estimated 4.6% in 2014, but the outlook has deteriorated recently. Projections by the EBRD and the IMF suggest that 2015 may witness negative growth (between -1% and -2%), before resuming positive growth in 2016 (Table 15.2). A significant depreciation (over 20%) of the country’s currency (the leu) in early 2015 has led to rising inflation and to a tightened monetary policy. Remittances and exports have contracted substantially, reflecting challenges to redirect trade away from Russia to the EU. Developments in the financial sector are further exacerbating the impact of external shocks. Three banks were placed under special administration by the National Bank in late 2014 following the detection of a series of unsecured loans which potentially compromised their financial stability.

More generally, Moldova continues to be the poorest country in Europe, with an annual GDP per capita of USD 2 239 in 2013. Its small internal market and an economy largely dependent on remittances (about 25% of GDP in 2013) make Moldova highly vulnerable to regional dynamics. Furthermore, relatively high economic growth between 2000 and 2013 did not result in significant job creation, with employment to total population decreasing from 58% to about 41%. This pattern is largely explained by the constant large-scale outflow of labour to both the EU and Russia.

Moldova's Association Agreement and DCFTA with the EU define the policy roadmap for the country's economic development over the longer term. The DCFTA is expected to boost exports and investment – key sources of growth in the absence of a large domestic market or sizeable natural resources. In 2014, Moldovan exports to the EU increased by 9.6 percentage points, to reach 53% of total exports. Although total exports increased moderately over the previous decade, in 2013 they fell to 43% of GDP – down from 50% in 2000. They are also concentrated in only a few sectors (wine, fruit and nuts, and textiles). The agriculture sector as a whole still represents 25% of the total export product basket. Privatisation transactions and several greenfield investments increased the FDI stock seven-fold between 2000 and 2012. However, this increase is still below other countries in the region, such as Armenia (10 times) and Georgia (14 times) (UNCTAD, 2013).

Table 15.2. **Moldova: Main macroeconomic indicators, 2012-15**

Indicator	Unit of measurement	2010	2011	2012	2013	2014[a]	2015[b]
GDP growth	Percent, y-o-y	7.1	6.8	-0.7	9.4	4.6	-1
Inflation	Percent, average	7.4	7.7	4.6	4.6	5.0	7.5
Government balance	Percent of GDP	-2.5	-2.4	-2.2	-1.8	-1.7	n.a.
Current account balance	Percent of GDP	-7.5	-11.0	-7.4	-5.0	-5.5	-4.5
Exports of goods and services	Percent of GDP	39.2	45.0	43.5	43.3	42.1	n.a.
Imports of goods and services	Percent of GDP	78.5	85.8	83.9	80.6	78.9	n.a.
Net FDI	Percent of GDP	3.5	3.8	2.1	2.5	2.5	n.a.
External debt	Percent of GDP	81.6	77.0	82.2	83.2	n.a.	n.a.
Gross reserves	Percent of GDP	29.5	28.0	34.5	35.4	n.a.	n.a.
Credit to private sector	Percent of GDP	33.3	33.6	37.9	39.7	n.a.	n.a.
Unemployment	Percent of total labour force	7.4	6.7	5.6	5.1	4.0	4.5
Nominal GDP	USD billion	5.8	7.0	7.3	8.0	7.9	6.1

Notes: **a.** 2014 figures on government balance and net FDI are EBRD projections; **b.** 2015 figures are IMF projections.

Source: EBRD (2014), *Transition Report 2014*; IMF (2015), *World Economic Outlook*; World Bank (2015), *World Development Indicators 2015.*

Business environment trends

Moldova has made considerable progress in reforming its business environment, significantly improving the country's ranking in the World Bank's *Doing Business* report (World Bank, 2014). In the 2014 edition it was ranked 82nd out of 189 economies; a year later this had risen to 63rd. Business registration procedures have been greatly improved, ranking the country 35th globally. However, performance in other areas offers considerable room for improvement (e.g. trading across borders, ranked 152nd; and dealing with construction permits, ranked 175th). Reforms in 2013 simplified tax filing and streamlined bookkeeping requirements, and a new competition law was adopted in 2012.

Much remains to be done, however. Firm-level data suggest that Moldovan companies have made very limited progress in enhancing efficiency and competitiveness in recent years. For instance, one recent study notes that total factor productivity was negative in both the agriculture and industrial sectors between 2003 and 2011, with only modest improvement in the services sector (World Bank, 2013). The Business Environment and Enterprise Performance Survey (BEEPS V) sheds light on the main barriers to business: perceptions of corruption (23.6% of respondents), political instability (18.1%), an inadequately educated workforce (14.5%) and poor access to finance (10.3%) (EBRD, 2014a). Furthermore, weak capacity in the judicial sector and among regulators is perceived as an obstacle to implementing reforms (EBRD, 2014b).

In the past few years the government has developed several strategies to increase competitiveness and establish a level playing field for entrepreneurs. The "Moldova 2020 Strategy", adopted in 2012, prioritises improving the business climate, promoting competition policies and streamlining the regulatory framework. These priorities are echoed and further defined in the "SME Sector Development Strategy for 2012-2020", the "Entrepreneurial Activity Regulatory Reform Strategy 2013-2020", the "Roadmap for Improving Competitiveness" approved in January 2014, and the "National Strategy for the Development of Information Society: Digital Moldova 2020". More generally, the AA and DCFTA also constitute a major anchor for policy reforms in this area. Furthermore, in September 2014 Moldova became the first EaP country to join the EU Competitiveness of Enterprises and Small and Medium-Sized Enterprises Programme (COSME; see Box 0.2 in the Policy Framework and Assessment Process chapter). Together, these developments demonstrate the government's growing emphasis on private sector development as a key pillar of economic growth. However, the effective implementation and enforcement of policies and regulations remains a challenge.

SMEs in Moldova

The Moldovan definition of SMEs, included in the 2006 law on supporting the SME sector, follows best international practice. It includes employment size, turnover and balance sheet criteria and is used consistently across all government agencies, laws and regulations (Table 15.3). Turnover and balance sheet thresholds in Moldovan law differ from the EU definition, however, as lower levels reflect the small size of the Moldovan economy.

Table 15.3. **Definition of micro, small and medium enterprises in Moldova**

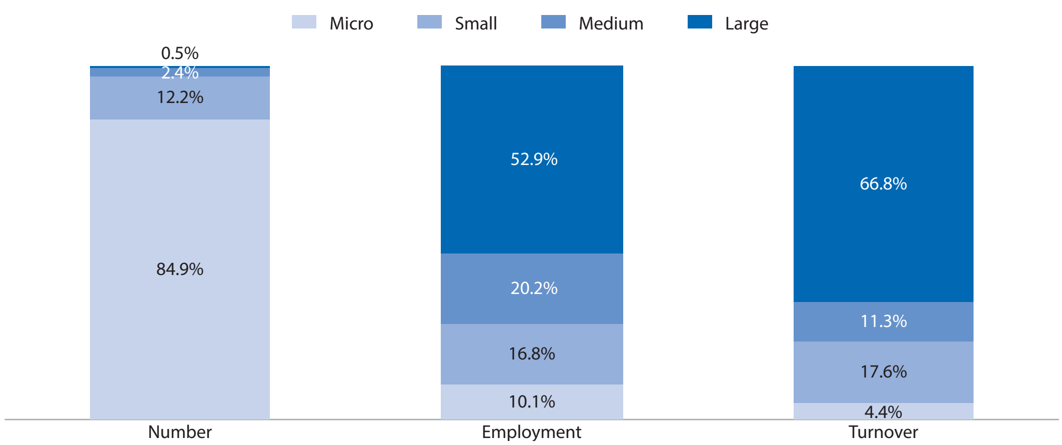
	Micro	Small	Medium
Average number of employees	< 10 employees	< 50 employees	< 100 employees
Average annual revenues in MDL (EUR)	< MDL 3 million (EUR 182 000)	< MDL 25 million (EUR 1.5 million)	< MDL 50 million (EUR 3 million)
Average annual total assets	< MDL 3 million (EUR 182 000)	< MDL 25 million (EUR 1.5 million)	< MDL 50 million (EUR 3 million)

Source: Law No. 206-VXI of July 2006 on supporting the SME sector, Republic of Moldova.

Over the past few years, the SME sector has grown slightly more slowly than the overall private sector in terms of number of enterprises, employees and turnover. At the end of 2013 there were 50 9000 SMEs, representing 99.5% of all enterprises – about the same proportion as in 2010 (Figure 15.2). About 85% of enterprises were micro-enterprises, with an average of two to three employees. The share of micro-enterprises in SMEs has increased since 2012, when they amounted to 80% of SMEs. On the other hand, the share of small and medium enterprises has slightly fallen since 2012 – by about 1% each.

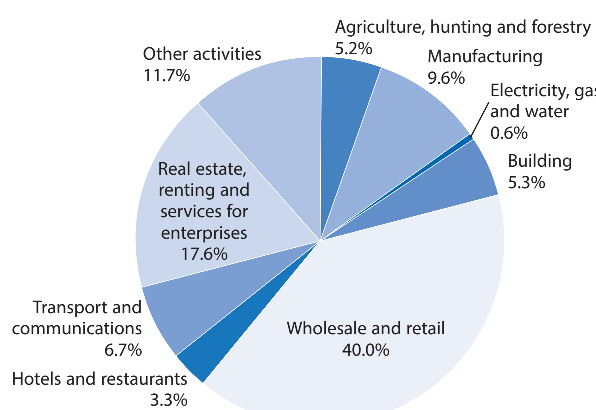
In 2013, SMEs' total turnover was MDL 77.4 billion (approximately EUR 3.5 billion), representing 33.4% of the turnover of all Moldovan companies. This represents a decrease from 37% in 2010. SMEs employed 298 400 people in 2013, or 57% of the total workforce, compared to 59% in 2010. SMEs are unequally distributed geographically across the country, with about 66% operating in Chisinau, the capital. Most SMEs are involved in low value-added sectors of economy. In 2013, more than 40% were involved in trade and retail activities. Only 9.6% and 5.2% of SMEs operated in manufacturing and agriculture respectively (Figure 15.3).

Figure 15.2. **Business demography indicators in Moldova, 2013**



Source: National Bureau of Statistics of the Republic of Moldova.

Figure 15.3. **Sectoral distribution of SMEs in Moldova, 2013**



Source: National Bureau of Statistics of the Republic of Moldova.

SBA assessment results

This section outlines the main results for Moldova from the 2016 SBA assessment of EaP countries. It also highlights the changes that have occurred since the previous assessment in 2012 (OECD, 2012). The assessed policy dimensions are grouped under five key thematic pillars, reflected in the section headings below.

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

Moldova has continued to improve the institutional and operational environment for SMEs since 2012. Key developments in this area include the adoption of a new SME strategy and three-year action plans, the expansion of e-government services, and the simplification of business registration. The main challenge for the authorities is to match sound policy design with adequate implementation, monitoring and evaluation. A more structured approach to public-private consultations and a more consistent application of regulatory impact analysis would also improve policy design.

Institutional framework

In September 2012, the Moldovan Government approved the "Small and Medium Enterprise Sector Development Strategy for 2012-2020". This comprehensive strategy aims to apply the Small Business Act principles to Moldova and improve the business environment for SMEs by facilitating access to finance, increasing competitiveness, stimulating innovation and promoting SMEs development in the regions. The SME Sector Development Strategy was accompanied by an action plan containing 86 policy measures. These have largely been implemented. New legal and regulatory improvements related to SME activities have been approved, including regulations for streamlining bookkeeping for SMEs, customs procedures, fiscal reporting and tax payment requirements. Other measures implemented include the creation of business clusters and innovation incubators, the development of e-government services and provision of training and advisory services to SMEs. The number of tax payments, hours spent paying taxes and days required for exporting goods have also been reduced. Some measures are still unimplemented, including new laws on SMEs and business angels and micro-finance organisations. Measures aimed at re-directing remittances to SMEs have yielded only modest outcomes, as the level of funding of the main programme in this area (PARE 1+1) has been quite limited. As of May 2015, the Ministry of Economy was in the process of finalising a new action plan for 2015-17.

In addition to the SME Sector Development Strategy, there are more than 15 other strategies and policy documents which outline measures relevant for SME development. This large number of policy documents and their sometimes overlapping content can potentially raise problems in ensuring a smooth co-ordination across government departments and undertaking monitoring and evaluation. A potential reduction in the number of strategies could be envisaged, but perhaps more importantly, effective co-ordination mechanisms should be introduced. The Ministry of Economy is the main government authority in charge of policy development for SME support, but the effectiveness of policy co-ordination varies widely depending on the area.

Moldova's informal sector is estimated to represent a sizeable portion of the economy (42% in 2010 according to World Bank, 2013). While regulatory simplification is meant to reduce barriers to formalisation, no comprehensive plan exists to address this problem.

Legislative simplification and regulatory impact analysis

Between 2011 and 2013, the Moldovan authorities enacted a set of regulations intended to eliminate regulatory constraints, bureaucratic procedures and unjustified costs for business. Over the past few years, the Moldovan government has reviewed permits and authorisations issued to businesses and reduced their number from more than 400 to 269. Likewise, a structured legislative guillotine process was introduced by Law 160/2011. However, the complexity of administrative procedures is still perceived to be a problem by about 50% of SMEs surveyed by the OECD during the present SBA assessment.

Since January 2008 a regulatory impact assessment (RIA) has been required for any new law or regulation affecting businesses (according to Law 235/2006, "Guillotine 2+"). RIAs are conducted by the agency proposing the new measure, reviewed by a dedicated RIA Secretariat, and discussed at the Working Group of the State Commission for Regulation of Entrepreneurial Activity, which comprises an equal number of government and private sector representatives. The RIA platform has become a powerful mechanism for allowing the private sector and SMEs to influence the business regulatory framework. Between 2008 and 2014, over 500 RIAs of primary and secondary legislation were carried out. Though there is no unified RIA database, most RIAs are placed on the Ministry of Economy's website and those of the various public authorities preparing new regulations. The Ministry of Economy is developing a package of amendments to align the RIA mechanism with international best practice and eliminate loopholes that currently allow some authorities to avoid RIA requirements in practice.

In addition, in 2014, the government adopted the so-called "Plus one, minus two" principle, requiring government entities introducing a new regulation to propose the elimination of two older regulations or, where this is not feasible, reduce compliance costs by at least 20%. Tax policy, transposition of EU regulations and standards, and cases of *force majeure* are excluded. In practice, implementation of this principle has been uneven. For instance, between July and December 2014, government agencies were planning to introduce 79 new regulations, but only proposed the elimination of 15 old ones (Prime Minister's Economic Council, 2014).

Public-private consultations

Several laws and regulations require public authorities to ensure transparency and public participation in new regulatory initiatives affecting businesses. However, public authorities do not always comply with these requirements.

Information on ongoing consultations and new draft regulations are placed on the web portal www.particip.gov.md, though there is no formal requirement to list new regulatory initiatives on a single central government website. In general terms, SME participation in this and other platforms for public-private consultations is limited. To address this problem and create a dedicated platform to channel SME concerns and initiatives, the 2015-17 Action Plan of the SME Sector Development Strategy will propose creating a Consultative Council on SMEs with equal representation from business and government agencies.

Although not specifically targeting SME participation, an important development has been the creation, in December 2012, of the Prime Minister's Economic Council as a forum to discuss initiatives to improve the general business environment. Headed by the Prime Minister and with the participation of key ministers, business associations and donor representatives, periodic council meetings address specific problems and agree on remedial actions. In 2014 alone, four meetings were organised to discuss e-government services, constraints to agricultural trade, and streamlining the State Registration Chamber. A Secretariat, funded by EBRD and operational since February 2014, is responsible for preparing the meetings, monitoring and following-up on decisions adopted by the council, as well as communications and outreach activities (Prime Minister's Economic Council, 2014).

Interaction with government services (e-government)

In 2013, the "National Strategy for Information Society Development: Digital Moldova 2020" was approved to promote information technologies in public services for businesses and citizens. A web portal has already been developed allowing businesses to obtain information and request public services online. As of April 2015, the portal provided access to 424 public services, of which 99 can be effectively delivered online. The government plans to develop and launch on average 12 new electronic public services every year.

Over 30 agencies regularly conduct inspections in Moldova. The 2012 Inspection Law (Law 131/2012) was approved to streamline inspection processes and set up clearer criteria for inspections. An online State Inspections Registry became operational in April 2015. About 28 agencies are expected to publish their inspection plans online in an effort to improve transparency, encourage risk-based inspection planning and reduce the opportunities for corruption.

E-invoicing was launched in February 2014 to improve tax compliance, transparency and efficiency in business transactions. E-reporting for the National Bureau of Statistics was piloted in 2014 and became available in 2015. Finally, the State Registration Chamber now provides online access to key information by registered companies (e.g. directors, contact details, scope of activity) through the government's open data portal. The information is updated on a monthly basis and covered 204 000 entities as of September 2014 (of which 172 000 are active). The existing portal is a first step towards an entirely new online business register expected to be launched in 2015 by the Ministry of Justice, which will also allow for online business registration.

Remaining areas for digitalisation include the issuance of permits for construction work and for internal and external trade. There is also no electronic system for filing tax returns online.

The SME Sector Development Strategy aimed at consolidating the various reporting requirements for SMEs into a one-stop-shop. However, this has not materialised in practice, and SMEs continue to report to different agencies, in many cases through physical rather than electronic means. The 2015 OECD survey of Moldovan SMEs suggests that burdensome government regulations continue to be a challenge for businesses, with 79% of small firms and 82% of medium-size firms considering complex administrative procedures to be a problem (see Box A.3, Annex A).

Company registration

Moldova's ranking in the "Starting a Business" indicator of the World Bank's *Doing Business* report has improved over the last few years due to its more streamlined registration process (World Bank, 2014). The overall process to set up a new company now takes just six days (compared to an average of nine for OECD countries). However, the cost of registration remains slightly higher in Moldova (4.6% of income per capita compared to 3.4% in OECD countries), mostly due to the stamp fees required to process the registration. In 2014, the minimum capital requirement to start a business was abolished (World Bank, 2014).

The "National Development Strategy: Moldova 2020" and "Entrepreneurial Activity Regulatory Reform Strategy for 2013-2020" aim to reduce the number of business permits and authorisations. Law 260/2011 (Guillotine 2+) requires all "permissive acts" (e.g. permits, authorisations, certificates etc.) to be included in the Official Nomenclature of Permissive Acts. Despite this, the number of permits and authorisations has increased – from 269 in 2011 to 292 in 2015 (as of September 2015) – and many of them are issued for a fee. In addition, there is some evidence of redundant and overlapping license and authorisation requirements in different areas (World Bank, 2013).

Legislation was adopted in 2012 to introduce a one-stop-shop mechanism for company registration housed in the State Registration Chamber.[1] After some delays, in July 2014 the registration procedure was streamlined from five steps and five days to just one step and one day. Streamlined registration procedures have saved the approximately 6 000 companies established every year an estimated 50 000 working hours (Prime Minister's Economic Council, 2014). The introduction of an online registration platform, expected in 2015, will further increase efficiency and reduce costs for start-ups. By the end of 2014, however, only five one-stop-shops had been created in the country. In addition, some one-stop-shops, particularly in rural areas, still do not offer multiple services in a single place.

Moldovan law recognises the silence-is-consent principle. However, the principle does not appear to operate automatically in practice, as SMEs typically need to resort to judicial review to obtain a formal authorisation or permit if the administrative authority in question does not adopt a formal decision.

Bankruptcy procedures and second chance

The Government of Moldova has implemented measures to improve the insolvency framework and ensure the protection of creditor rights. In 2009 the EBRD had categorised the country as only achieving "medium compliance" with international best practice in these areas. A new insolvency law was enacted in 2012 (Law No. 149) to address the weaknesses of the previous legal framework.

In addition to allowing for out-of-court settlements and making it easier to initiate insolvency procedures, the new law limits the duration of the overall bankruptcy procedure to two years as a general rule. The maximum period for restructuring is set at three years (with a possible extension of up to two additional years) from the date of confirmation of the plan by the court. An expedited restructuring procedure is also available. In addition, some categories of debtors (including individual entrepreneurs) can benefit from a simplified bankruptcy procedure with a maximum duration of 150 days. On the other hand, the new law is still quite restrictive of creditors' rights to initiate insolvency procedures as the applicant needs to provide a writ of execution regarding its claim against the debtor, which can be obtained following a previous court decision (EBRD, 2014a). In 2014, the Law on Authorized Administrators was enacted to improve the professional qualifications of insolvency administrators by raising requirements and strengthening state supervision.

Despite these recent reforms, however, international benchmarks suggest that there is ample room for improving the overall efficiency of the insolvency framework. In the 2015 World Bank *Doing Business* report, Moldova ranks 58th out of 189 countries in the "Resolving Insolvency" indicator (World Bank, 2014). The average time for insolvency procedures is 2.8 years and related costs are 15% of estate, which are higher than the average for Eastern Europe and Central Asia (2.3 years and 13.3% of estate) and significantly higher than OECD countries (1.7 years and 8.8% of estate) (World Bank, 2014). Moreover, the effective implementation of the new legislation critically depends on the capacity of the justice system.

Since 2012, no specific measures have been taken to give a second chance to entrepreneurs and SMEs whose businesses have failed. While the legal framework does not discriminate against owners or managers of bankrupted firms or prevent them from starting a new business (except for banking and investment services), in practice, new ventures by previously failed entrepreneurs are likely to face major obstacles, particularly in access to finance and bidding for public procurement. Indeed, according to the OECD company survey of 310 Moldovan SMEs, more than 50% of SMEs reported finding it "very difficult" to start a new business after a previous failure, with access to finance is cited as the main constraint.

Facilitating SME access to finance (Dimension 6)

Like other countries in the region, SME access to finance in Moldova is dominated by bank finance and microfinance. There is an acute lack of external finance and domestic resources are normally only short term. Public support is limited to a public credit guarantee scheme, which has yet to reach its full potential. Alternative sources of finance are scarce. Despite improvements to the legal framework for access to finance, effective implementation remains a challenge.

Legal and regulatory framework

Since 2012, several changes have been made to the legal and regulatory framework relevant to SME access to finance. In 2012 creditor rights were strengthened by introducing additional reasons for relief from automatic stay. The last assessment noted that procedures for re-organisation and liquidation were well-defined.

The legal framework for collateral was amended in July 2014, aiming to facilitate the use of movable collateral and align it with EU legislation. However, the enforcement of titles is subject to lengthy and unpredictable court proceedings. In addition, re-selling collateral remains cumbersome. The use of movable collateral could be strengthened by setting up an online registry, which would improve reliability and ease of use. Some banks provide credit without any collateral requirements. Since 2012, the National Bank of Moldova has increased the limits of uncollateralised loans that banks can extend by making a provision of 5% of the loan amount, from MDL 30 000 to MDL 100 000 (approximately EUR 1 400 to EUR 4 700) for consumer loans and from MDL 100 000 to MDL 500 000 (EUR 4 700 to EUR 23 700) for business loans.

The coverage of the private credit information bureau, the Credit History Bureau (CHB), remains low – at around 8.8% of the adult population. This is because few market participants other than banks provide data. A proposed law to oblige non-bank financial institutions to report information has failed to materialise due to strong resistance because of high costs and the limited usefulness of the services provided. However, since 2015, three micro-finance institutions have started reporting and others are due to follow. A law currently under preparation would enable the CHB to include data from telecommunication companies and utilities. This should help increase coverage significantly. While the CHB is licensed to operate by the National Commission of Financial Markets (NCFM), its regulatory oversight is mainly limited to the initial licensing process. A draft law to strengthen regulatory oversight is being prepared.

In 2013, a new capital market law was introduced to align the legal framework with EU legislation and international practice. This law, which stipulates a transition period to the new framework of 18 months, came into effect in March 2015. However, there have been delays in re-licensing some capital market operators (such as the Moldovan Stock

Exchange) and secondary legislation still needs to be passed in order to allow certain concepts of the new law to work effectively.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

Despite increasing between 2011 and 2013, lending has since declined, not least due to banking sector difficulties that saw three banks placed under special administration by the National Bank of Moldova since 2014. The decline has hit SMEs disproportionately. Availability of long-term finance continues to be scarce and interest rates as well as collateral requirements remain high.

The public credit guarantee scheme by the Organization for SME Sector Development of Moldova (ODIMM) and the private GarantInvest scheme are still in place, but have not yet reached their full potential. The effectiveness of the public guarantee scheme could be improved by increasing its efficiency, while the fund size of the private guarantee scheme is relatively limited, at MDL 7 million (approximately EUR 330 000).

Non-bank financing opportunities are available, including micro-finance, leasing and factoring. The number of micro-finance institutions has increased from 53 in 2011 to 85 in 2014, with total assets increasing from MDL 2 billion in 2011 to MDL 2.5 billion in 2013 (approximately EUR 118 million). The NCFM is responsible for monitoring the market, but effective oversight remains limited. Leasing and factoring are not major sources of financing for SMEs. Leasing mainly covers vehicle leasing rather than equipment. Factoring is almost non-existent and not supported by a specific legal framework. Such a framework could reduce the existing legal uncertainty.

Risk capital remains scarce. Some foreign investment funds operate in the country, but a challenging business and banking environment and limited investment and exit opportunities limit their appetite. No hybrid instruments such as mezzanine finance exist and there is no local institutional investor base to support market development. Incubators exist, but are not used at full capacity and suffer from a lack of suitable applicants. The effects of the new capital markets law on the performance of Moldovan capital markets remain to be seen.

Financial literacy

Even though both public and private initiatives to improve financial literacy exist in Moldova, co-ordination among providers could be improved. This was also an observation of the assessment in 2012 (OECD, 2012). According to the provisions of the "National Roadmap for Improving the Competitiveness of the Republic of Moldova" (approved in January 2014), the National Bank of Moldova is expected to lead the preparation of a "National Strategy on Financial Education" (NSFE), supported financially by the Development Facility of the European Fund for South East Europe. This technical assistance project is envisaged to start in September 2015 and will last for about six months.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Lifelong entrepreneurial learning

Human capital receives continuous support by the Government of Moldova. The "National SME Sector Development Strategy 2012-2020" features human capital development, including entrepreneurial learning and SME skills, and provides a policy framework for the systematic promotion of entrepreneurship key competence and enterprise training, underpinned by the government's activity programme and the state budget allocation.

The general policy context has been further strengthened through dedicated institutional arrangements and the division of implementation responsibilities among the Ministry of Education; the Ministry of Economy; the Ministry of Labour, Family, and Social Protection; as well as local authorities, private specialised entities and non-governmental organisations. This institutionalised national policy partnership, bringing together the key stakeholders around the common objective of building the entrepreneurial learning agenda, is an excellent achievement for Moldova. Furthermore, the "Education Strategy 2020" emphasises both lifelong learning and key competences as priorities for education reforms, and the development of entrepreneurship key competence is explicitly mentioned in various other policy documents.

Our analysis suggests that Moldova is one of the leaders in the region for its practical implementation of entrepreneurial learning and promotion of the key competence approach in formal education. Moldova has been selected as a good practice example for several reasons which make it especially valuable for the other EaP countries:

- The entrepreneurial learning agenda is driven by the Ministry of Education, unlike many other EU partner countries, where the agenda is driven initially by the ministries of economy with education policy makers joining at a relatively later stage.
- A policy partnership and policy framework have been established simultaneously, including the implementation of specific measures for curricula at several levels of formal education.
- There has been strong attention to teacher training alongside the co-ordinated development of teaching materials to support entrepreneurship key competence, such as entrepreneurial learning kits for teachers developed through a partnership between government institutions and non-governmental organisations and experts, with financial support by international donors.

These achievements demonstrate strong government ownership by the education stakeholders and a focus on the sustainability of policy efforts.

In Moldova, entrepreneurial learning is on offer at all levels of pre-university education (either as obligatory or optional elements of the curricula), as well as in non-formal learning. All vocational education and training (VET) institutions have adopted implementation measures for entrepreneurial skills development and entrepreneurship career potential promotion required by the national policy documents. Opportunities for practical entrepreneurial experience have been created in many schools across the country, such as student-run farms and companies.

Progress in promoting entrepreneurial learning has been more modest in higher education, however, despite numerous good examples of university-business co-operation and the availability of entrepreneurial learning courses and activities as part of higher education programmes.

Building on its achievements to date, Moldova should now focus on system building, linking entrepreneurial learning to the national qualification system, improving the quality of education and training, implementing comprehensive quality assurance measures and ensuring flexible transitions by learners between various education programmes and forms of on-the-job training and non-formal learning. Effective co-operation with the world of business should be given a high priority, and be tailored to the specific objectives for different categories of learners. While it is important to test and scale up the current initiatives, a strong focus should also be put on impact evaluation and establishing effective and comprehensive monitoring and evaluation frameworks and mechanisms. Finally, our assessment suggests the need for more attention and budget support to the sustainable development of education and training institutions to transform them into "entrepreneurial" schools, colleges and universities. In this way they would become part of the entrepreneurship development "ecosystem", contributing to innovation development.

Women's entrepreneurship

The area of women's entrepreneurship is developing, with policy led by a cross-stakeholder body – the National Council on Development of Women's Entrepreneurship. An Action Plan 2015-17 of the SME Sector Development Strategy was approved by the government in 2015. It has seven priority directions based on SBA principles, including a new priority direction on women's entrepreneurship development. The main SME stakeholders participate in policy discussions on the importance of women's entrepreneurship for national growth and job creation, and an analysis of recent SME policies shows a growing focus on women's entrepreneurship. However these are rather ad hoc. In this regard, the launch in 2013 of a women's platform hosted by ODIMM could be an opportunity for more strategic engagement by the main stakeholders in policy discussions on promoting women's entrepreneurship.

SME skills

Moldova is well positioned to build entrepreneurial skills thanks to its recognised SME support agency – ODIMM – and the availability of government support programmes and state budget funds for SME training. Training for enterprise growth and internationalisation is now very high on the national agenda, but these programmes require substantial investment, agreement and consolidation of efforts of public and private training providers. Reaching agreement between public and private training providers on a training needs analysis framework remains a challenge. E-training is rather ad hoc; if implemented promptly it could strongly leverage investment in training and support to SMEs, as well as increase quality, accessibility and flexibility of training opportunities for all categories of SMEs. Data on SME training needs are collected regularly and systematically using standard data collection instruments. However, statistics are not disaggregated by sex.

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Progress has been made since 2012 to develop targeted support to improve SME competitiveness. Existing ODIMM initiatives could be complemented by greater emphasis on developing a private market for business development services. Key priorities in the area of public procurement should be the implementation of DCFTA provisions and the introduction of an independent review body, as well as regulations on payments to contractors. Despite improvements in recent years, public support for SME innovation and greening remains limited.

Business information and services

Moldova has a well-developed range of business development service providers offering diverse tools and support, including state agencies, private firms, donors and NGOs (OECD, 2014b). Training and consulting programmes for SMEs are offered free of charge by ODIMM and the Chamber of Industry and Commerce. By the end of 2014, these authorities had implemented a number of training programmes, including a training course on Efficient Business Management (GEA) designed for SMEs.

ODIMM and other government agencies have also enhanced the provision of information to SMEs. For instance, the government launched a web portal in July 2014 to provide information on grants, concessional loans and other instruments (www.finantare.gov.md). ODIMM also has a web portal providing information on business support services for SMEs (www.businessportal.md), but the information is sometimes outdated and SMEs do not see it as a comprehensive source of business information. An electronic guide developed by the Ministry of Foreign Affairs and European Integration to help business companies to find new trade opportunities abroad is also outdated and impractical.

Amongst the non-government initiatives, a business plan competition is organised yearly by the National Association of Young Managers. The association provides e-learning business training for young entrepreneurs participating in the business plan competition.

Despite these initiatives, the provision of business support infrastructure in Moldova faces a number of challenges (OECD, 2014b):

- A lack of policy co-ordination and adequate monitoring and evaluation mechanisms, which jeopardise the effectiveness of existing support services. Since 2012, no monitoring schemes have been put in place to evaluate the impact of business training and consulting programmes.
- Capacity and resource constraints among government entities in charge of providing business support infrastructure to SMEs (e.g. ODIMM and the Moldova Investment and Export Promotion Organisation, MIEPO). The regional (*rayons*) Economic Divisions require additional capacity building to support ODIMM's initiatives outside Chisinau and especially in the rural areas.
- The lack of differentiation in training offered to the various segments of the SME sector (e.g. start-up and high-growth SMEs).
- The underdeveloped private market for business development services. At present, donors such as the EBRD's Small Business Support Programme and the World Bank are running co-financing schemes to promote the use of private providers amongst Moldovan SMEs, while ODIMM is in the process of compiling a list of business development service providers to be posted on their website. Additional measures could include the announcement and launch of voucher schemes for business consultancy (for which new service providers are encouraged to register for accreditation of new service offerings) and quality certification programmes for private providers, the creation of an association of professional consultants, and technical assistance programmes focused on the business development service providers themselves. Furthermore, the sector could benefit from a legal change to formally consider consulting as a listed profession, which would in turn facilitate the contracting of such services by public entities as well as firms (as consultant fees would obtain a more favourable tax treatment). Finally, the current free-of-charge provision of ODIMM services could be revised to avoid the crowding out of private providers.

According to the 2015 OECD company survey, less than 20% of SMEs are aware of the existence of these services. This figure calls for intensified outreach efforts and a more proactive role by ODIMM in promoting its own services as well as bridging the gap between private suppliers and SMEs. Recognising the important remaining capacity gaps of Moldovan SMEs, the 2012-14 Action Plan of the SME Strategy identified the provision of business support services for SMEs as a priority, but no quantifiable targets were set out.

Public procurement

Some progress has been achieved in this dimension, with Moldova opening its public procurement market further to international participation. In June 2014 it concluded an Association Agreement with the EU to establish a DCFTA, including on public procurement. There has been major progress in Moldova's accession to the WTO Government Procurement Agreement, with the country submitting a third revised offer in June 2014. The implementation of the public procurement chapter of the DCFTA will require major efforts for its potential to be fully realised, as Moldova will have to implement institutional reforms and align its public procurement legislation with the EU *acquis*, notably the latest EU directives on public procurement and concessions (April 2014).

Information on public procurement procedures is available for free on the Public Procurement Agency's website (http://tender.gov.md), but tenderers must pay a fee to receive the tender documentation. The legislation provides for the possibility to cut tenders into lots and this happens in three out of four procedures. The public procurement law states that information from selected companies must be stored in a central database for future tender procedures, but it is unclear whether this happens in practice. Contracting authorities can allow joint bids and SMEs do participate in these. However, there are currently no provisions regulating late payments to contractors and no training courses on public procurement for SMEs. A final remaining challenge is the establishment of an impartial and independent review body.

Innovation policy

In the past few years, the government has approved a number of policy documents to enhance the contribution of innovation and research to the Moldovan economy. These include the "Innovation Strategy of the Republic of Moldova for 2013-2020", the "Concept of Industrial Cluster Development of the Republic of Moldova", and the "Research and Development Strategy of the Republic of Moldova to 2020". The SME Sector Development Strategy and related action plans also include concrete measures to promote innovative entrepreneurship. In 2014, Moldova also joined Horizon 2020, the European Union's research and innovation funding programme.

Some practical steps have been taken over the last few years in co-operation with government agencies and other key stakeholders in the innovation ecosystem. The Agency for Innovation and Technology Transfer (AITT) offers important financing tools in the shape of innovation and technology transfer projects, as well as establishing innovation and technological parks, clusters and incubators. In 2013, AITT implemented 22 transfer projects with an aggregated budget of MDL 16.4 million (about EUR 0.8 million). An Innovation Voucher Competition organised by the AITT in 2014 allowed SMEs to purchase research and development services from knowledge providers to implement their projects and to establish or intensify their relationship with research institutions and international partners.

In addition, a co-operation agreement between the government and the Academy of Sciences of Moldova aims to stimulate the creation of innovative SMEs through technological parks, clusters and incubators, and develop technology transfer projects. As of May 2015, there were nine scientific clusters, eight innovation incubators, and three technological parks in Moldova.

Despite these developments, a number of challenges remain. Innovation levels amongst Moldovan SMEs, although comparing favourably with most countries in the region, could be higher. According to the results of the OECD company survey, 11% of small enterprises and 15% of medium-sized enterprises introduced one new or significantly improved good to the market in 2014. Average SME investment in R&D remains low, at 2% of SME annual turnover. The Moldovan research and development system is still highly centralised, largely in the hands of public research institutions. Links among universities, research institutes, the private sector and SMEs remain underdeveloped. Although public expenditures on R&D are relatively high in Moldova compared to other countries in the region, access by the private sector to R&D funding is limited, representing an obstacle to technology transfer to private companies.

On the policy front, innovation strategies and action plans partially overlap with the Action Plan of the SME Sector Development Strategy and sometimes contain the same measures, but with different deadlines and responsible bodies. Co-ordination efforts amongst the different actors in the innovation field, as well as monitoring and evaluation mechanisms, should therefore be strengthened.

Green economy

The Government of Moldova has recently declared green economic development to be one of its top priorities. In April 2014, the Ministry of Economy, the Ministry of Environment and the Ministry of Agriculture and Food Industry signed a joint declaration of their commitment to ensuring the effective co-ordination of activities for sustainable green development in Moldova.

The government is currently in the process of revising several strategic documents to introduce instruments to facilitate the transition to a green economy. The "SME Sector Development Strategy for 2012-2020" and its 2015-17 action plan are being complemented by actions to promote the greening of SMEs.

The Ministry of Economy is planning a number of measures to raise SMEs' awareness of resource-efficient and cleaner technologies, as well as a programme to support SMEs in rural areas while encouraging them to adopt green business practices. However, the dissemination of regulatory information to SMEs by the government is not very proactive. The websites of the Ministry of Environment and its Environmental Information Centre (http://cim.mediu.gov.md) are the main official sources of information on environmental regulations, but they are poorly designed and very few SMEs use them.

According to an OECD greening survey of 400 Moldovan SMEs, the vast majority (88%) undertake some resource efficiency measures, mostly to save energy, water or raw materials, or plan to do so in the future. The main driver for such actions is purely economic: businesses already experience and anticipate further price increases for these resources. The smaller the business, the more it feels the impact of resource price changes. However, there is very low market demand from business customers to adopt environmental management systems (EMSs), which means that the market benefits of investing in an EMS are uncertain.

Among the key obstacles to engaging in green practices quoted by Moldovan SMEs in the OECD greening survey are costs and poor access to finance, as well as various bureaucratic barriers, such as complex administrative procedures and obsolete technical requirements. Over three-quarters of the companies that undertake resource-efficiency measures receive no technical or financial support. Just over 7% receive technical assistance from government authorities: this figure is over 15% for medium-sized businesses and only 4% for micro-enterprises. Public funding is only a significant source of resource-efficiency investments in agriculture (11%).

There has been progress in offering environmental financing to SMEs. Both the public Energy Efficiency Fund and three local private banks provide financing for energy efficiency projects (the latter using credit lines extended by the EBRD through the Moldovan Sustainable Energy Financing Facility). However, the offer remains limited and relies heavily on foreign funding sources.

Another priority direction of the SME Sector Development Strategy is to adjust the regulatory framework to match SME needs. At present, the environmental permitting regimes in Moldova are not diversified by the level of environmental risk: there are separate, enterprise-specific permits for air emissions, wastewater discharges and disposal of solid waste. There have been several attempts to introduce risk-based planning of environmental inspections, but it has not been integrated into national policy for compliance monitoring. SMEs have recently been given preferential treatment regarding compliance monitoring: for the first three years of their existence all inspections are advisory and do not entail sanctions, except for serious offences.

Supporting SME internationalisation (Dimensions 10 and 7)

SME internationalisation has received increased government attention given the limited size of the domestic market and the recent signing of the DCFTA. Improving compliance with technical requirements will be necessary for Moldovan SMEs to export to the EU under the DCFTA. This is likely to require additional capacity in the agencies responsible for providing quality infrastructure, with a particular attention to market surveillance. The adoption of a new strategic framework for export promotion and investment attraction also calls for a restructuring of existing support institutions and renewed efforts in trade facilitation.

Export promotion

Data suggest that Moldovan SMEs have low levels of internationalisation. For instance, according to the BEEPS V only 10-12% export directly or indirectly – well below the average for the Europe and Central Asia (ECA) region (22.8%) (EBRD, 2014a). Respondents to the OECD survey listed lack of government assistance, shortages of working capital and low access to reliable foreign representation as the top three export obstacles. In addition, the average time to clear customs is 21.4 days (approximately five times the ECA average; EBRD, 2014a). This suggests that regulatory and non-tariff barriers to trade remain the main obstacles for SME internationalisation.

The Moldovan authorities have adopted various measures to improve the regulatory framework for exporting and importing activities, as well as developing export promotion services.

On the regulatory front, in 2013 the government launched e-Customs – an electronic tool allowing SMEs to submit customs declarations online and clear goods in less than one hour. In 2014, the government implemented the Authorized Economic Operators certification. This has simplified procedures for export-related transactions, introducing a fast-track procedure for obtaining the sanitary and phytosanitary standards (SPS) certificate for export and eliminating four out of the seven documents required for the application. Work is underway to create on a one-stop-shop for the SPS and veterinary-sanitary authorisations for import-export operations.

In the past few years, the Ministry of Economy, MIEPO and ODIMM have implemented measures to promote exports by SMEs. Priority has been given to promotional activities that enhance the country's image, including advertising events. In 2013-14, 40 promotional events were organised, including business-to-business meetings, export forums and economic missions to other countries. MIEPO has also launched a Diplomatic Economic Club as a platform for co-operation with diplomatic missions in the country and foreign investors. MIEPO and ODIMM also provide various coaching and consultancy programmes to exporting SMEs. However, according to the OECD company survey, more than 80% are not aware of any export promotion activities. Non-governmental entities have also been active in this area. For instance, when the DCFTA came into force the Chamber of Commerce and Industry and the European Business Association launched a project to inform businesses in the agro-processing and textile sectors of the new opportunities and the importance of quality upgrading for trade with EU countries.

A major challenge for developing a comprehensive export promotion programme will be to build capacity. MIEPO's role to date has been primarily limited to supporting the participation of exporting businesses in international trade fairs. It lacks a comprehensive approach to export promotion and fails to provide more sophisticated services (e.g. market intelligence, advice on quality upgrading). In 2014, the government began restructuring MIEPO in order to upgrade its capacities to offer broader and deeper support to exporting companies. At the policy level, a new "Export Promotion and Investment Attraction Strategy (2016-2020)" is being prepared to replace its 2006 predecessor.

Finally, the government could consider developing targeted programmes to support the development of FDI-SME linkages and other initiatives to promote SME integration into global value chains. Isolated success stories exist in the beverage sector involving local farmers and the creation of packaging companies, but no comprehensive government policy exists in this area (UNCTAD, 2013). As of January 2015, there were two active programmes funded by the International Fund for Agricultural Development (IFAD) to facilitate the integration of SMEs in global value chains: the Rural Financial Services and Agribusiness Development Project (IFAD V), with a total budget of USD 34.8 million; and the Inclusive Rural Economic & Climate Resilience Program (IFAD VI), with a total budget of USD 26.06 million. Under both programmes applicants benefit from credits with a tenure of up to eight years and a grace period of up to four years, with subsidised interest rates in both local and foreign currency. These programmes also include a capacity-building component.

Standards and technical regulation

The DCFTA provides a framework for developing a Moldovan quality infrastructure system and aligning industrial products regulations to EU *acquis*. According to the agreement, Moldova must gradually conform to the EU's standards, metrology, accreditation, conformity assessment, and market surveillance system, as well as transpose a significant number of EU's sectorial technical regulations.

A wide range of "horizontal" regulations aiming to improve the quality infrastructure system and bring it in line with international practices have been adopted in Moldova since the mid-1990s. In 2012-13, the government carried out an important institutional reform by creating separate institutions responsible for standardisation, accreditation and metrology. The level of conformity of Moldovan standards to international standards is quite high, which enhances the export possibilities for Moldovan manufacturers.

A government document on the "Concept of the Quality Infrastructure" sets out an ambitious action plan for reform. However, implementation progress is not subject to permanent monitoring and there have been no evaluation reports of the plan over recent years.

Strengthening the institutional capacities of the authorities in charge of the quality infrastructure system, and modernising and re-equipping (e.g. machines for conducting conformity assessment) the conformity assessment bodies remain key challenges.

The way forward

The 2016 SBA assessment considers the following to be priorities for Moldova in improving its SME policy framework:

- **Continue to improve the institutional environment for SME policy making**, giving special attention to the key measures in the 2015-16 action plan of the SME Sector Development Strategy. These include adopting a new law on SMEs so as to enshrine many of the priorities contained in the strategy in the legislation, as well as formalising public-private dialogue on SME-related matters. The **development of a private market for business development services** to complement support by ODIMM should also be prioritised.
- **Address regulatory shortcomings** so as to reduce compliance costs for SMEs. Special attention should be paid to reducing licensing requirements, adopting a risk-based approach to inspections, and streamlining customs procedures. This can be done through an effective one-stop-shop mechanism and greater use of electronic systems.
- **Pay more attention to the structured promotion of entrepreneurial learning** in higher education, entrepreneurship promotion in non-business faculties, and introduction of key competence and cross-campus approaches. The systematic **exchange of good practice on entrepreneurial learning** across all levels of education and non-formal learning, as well as on women's entrepreneurship, is also recommended. To ensure systematic monitoring and evaluation of entrepreneurial learning initiatives and assess training needs, statistical data should be consistently collected and disaggregated by target groups (e.g. pre-start-up, start-up and growth enterprises, women, young entrepreneurs) and sex.
- **Improve corporate governance and transparency in the banking sector.** This would increase stability and competition and thus facilitate SMEs' sustainable access to finance. Once the current instability in the banking sector is resolved, the government may want to **remove the regulatory barriers to the emergence of alternative sources of finance.** This would include introducing a legal framework for venture capital and business angels and effective regulation of leasing and microfinance. Likewise, revamping existing credit guarantee schemes could stimulate bank lending to SMEs, while better co-ordination of financial literacy programmes could enhance the range and outreach of training to businesses and individuals.
- **Undertake more effective export and investment promotion efforts and upgrade quality infrastructure.** This will be required for DCFTA opportunities to materialise. The new "Export Promotion and Investment Attraction Strategy (2016-2020)" should prioritise the revamping and capacity building of MIEPO and the development of targeted programmes for FDI-SME linkages so as to encourage quality upgrading and knowledge transfer.

Table 15.4 presents a potential policy roadmap to guide SME development policy over the short, medium and long term based on the findings of the SBA assessment.

Table 15.4. **Moldova: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• Prepare and finalise the new SME law	S/M
• Formalise public-private consultation mechanisms, including the creation of a consultative council on SME development	S/M
• **Continue regulatory simplification in key areas (e.g. reduction of licensing requirements, simplified accounting for SMEs, online business registration, one-stop-shop and database integration)**	S/M/L
• Complete the streamlining of the RIA mechanism in line with EU and international best practices	M
• Strengthen capacity of Economic Divisions and ODIMM contacts in the regions	M/L
• Promote out-of-court insolvency settlements and second chance	M/L
• Adopt a concrete action plan to improve SME statistics data collection	M/L
2. Facilitating SME access to finance	
• Review existing credit guarantee schemes to improve their capacity and effectiveness	S/M
• **Improve corporate governance and transparency in the banking sector, including strengthening the capacity and mandate of regulators**	S/M/L
• Introduce a legal framework for venture capital organisations and business angels	M
• **Fill regulatory gaps regarding non-bank financial institutions (e.g. leasing, microfinance)**	M
• Promote Internet/mobile banking and other instruments to increase access to finance, particularly in rural areas; develop a financial literacy programme	M/L
• Allow for full online access and use of the registry for securities over movable assets and easing of possibilities for re-sale of collateral; improve coverage of credit information and oversight of the private credit bureau	S/M
3. Promoting skills and entrepreneurship development	
• Develop a methodology/mechanism for evaluating entrepreneurial learning impact. Establish monitoring and evaluation arrangements and review policies based on the evaluation of their impact	M/L
• Introduce a national vocational school graduates' tracking system for effective policy development, implementation, monitoring and evaluation in the area of entrepreneurial learning and beyond	S/M
• Conduct policy consultations on training needs assessment and quality assurance frameworks with the provider community and agree on the main principles	S/M
• Further develop and offer e-training for SMEs	S/L
4. Enhancing SME competitiveness	
• **Improve existing support to the development of a business development service market** (e.g. **promotion activities and database, M&E of incubators, consulting as a listed profession)**	S/M/L
• Implement DCFTA provisions for public procurement; introduce independent review mechanism; regulate late payment to contractors	S/M/L
• Expand and promote the use of existing financing schemes for innovation (e.g. vouchers); promote intellectual property commercialisation and academia-SME links	M/L
• Introduce regulatory and financial incentives for SME "greening"	M/L
5. Supporting SME internationalisation	
• **Adopt "Export Promotion & Investment Attraction Strategy (2016-2020)", including capacity building of MIEPO and other entities; introduce FDI-SME linkage programme**	S/M/L
• Implement measures in DCFTA Action Plan (2014-16), e.g. quality infrastructure, adoption of EU standards	S/M/L
• Reduce regulatory, non-tariff barriers to export (one-stop-shop, e-Customs, etc.)	S/M/L

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Note

1. The State Registration Chamber also interacts with entrepreneurs on behalf of the National Bureau of Statistics, the Tax Inspectorate, the National Social Insurance House and the Medical Insurance Company and issues environmental authorisation for special use of water, authorises permissive acts in medicine and in fire protection, and issues certificates for construction specialists and phytosanitary certificates for export.

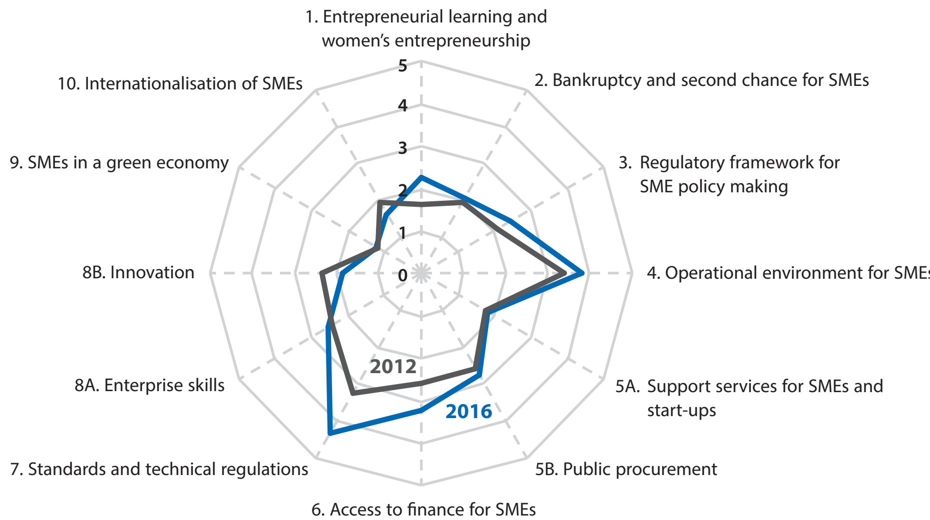
Chapter 16

Ukraine: Small Business Act country profile

Ukraine faces several large-scale challenges stemming from the conflict in the east of the country and a long-standing absence of key reforms. Its economy has been stagnant since 2012 and in deep recession since mid-2014, and is a major constraint for the development and implementation of SME support policies. Progress since the 2012 SBA assessment has therefore been modest in most areas. Nevertheless, a major deregulation programme is currently being implemented and key measures have been introduced to simplify business registration, expand e-government services, strengthen entrepreneurial learning and vocational training, address technical barriers to trade and adopt EU standards.

On the other hand, access to finance continues to be a major constraint, with bank lending to SMEs falling since 2012. Deregulation efforts have not been matched by targeted SME support. Various government support programmes have been adopted but remain unimplemented and unfunded. Going forward, the government could prioritise, as part of its structural reform programme, the adoption of a viable and realistic SME strategy. SME development in Ukraine has a major role to play, not only in enhancing economic competitiveness and restoring sustainable growth, but also in developing a level playing field for business and investment in the country. Over the longer term, the government may want to consider the progressive introduction of selected support measures to promote skills development, innovation and SME internationalisation.

Figure 16.1. **SBA scores for Ukraine**



Key findings

Ukraine's macroeconomic situation has deteriorated significantly in recent years. A confluence of external and internal factors, especially the unfolding conflict in the east where many industries are located, has plunged the country into a deep recession. Ukrainian SMEs are thus experiencing the negative impact of high inflation, currency devaluation, credit contraction, tight capital controls and limited fiscal space for the government to provide them with targeted support.

Since 2014, the government has started to implement an ambitious agenda of horizontal and structural reforms. Still, Ukraine's policy environment for SME development remains weak. No single strategy or operational action plan is currently in force. Even before the crisis, government policies and initiatives were fragmented and often unimplemented as a result of a combination of wavering political will, insufficient funding, or limited institutional capacity in key agencies. The effectiveness of policy making has also been impaired by frequent changes to the institutions responsible for SME policy design and implementation, weak co-ordination across government ministries and agencies, and limited public-private dialogue involving the SME community.

Notwithstanding the challenging environment, some areas of progress have been identified. Ukraine has made some achievements in business deregulation and simplifying administrative procedures, including reducing the time needed to start a business, extending e-government services (including, most notably, tax declaration and payments), and implementing legal reforms in areas such as licensing, insolvency and secured lending. In the area of technical barriers to trade, four key laws to upgrade the country's quality infrastructure have recently been adopted.

Progress across the various SME policy dimensions has been very modest (Figure 16.1). Higher scores for the operational environment (Dimension 4) and technical barriers to trade (Dimension 7) reflect recent reforms, particularly in 2014-15. Scores for the dimensions involving targeted support for SME competitiveness (Dimension 5a) and human capital development (Dimension 1 and 8a) remain low (below 3), mostly due to the lack of implementation of specific SME support measures and weak commitment to entrepreneurship promotion through the education system. Regulatory improvements (e.g. credit bureau coverage, scaling up of credit guarantees, etc.) have helped Ukraine maintain a relatively high score in Dimension 6 (access to finance), although the impact on actual access to finance by SMEs is limited by the macroeconomic situation. The score for innovation policies (Dimension 8b) has decreased as no major implementation efforts have been made since 2012. Ukraine has the lowest score in the region for SME greening (Dimension 9).

SME development policies should be an integral part of Ukraine's structural reform efforts. It would help diversify the country's sources of economic growth, which, since independence, have mostly involved agriculture and highly energy-intensive industries (OECD, 2012a). Furthermore, SME growth is an opportunity to enhance competitiveness in key economic sectors and to ensure a level playing field for business in the country. The government may want to consider a two-track approach when addressing current shortcomings:

- In the short term, the government could focus on laying the foundations for an adequate institutional environment for SME development. The first step could be the development and adoption of a comprehensive but realistic SME strategy and action plan. It could usefully focus on institutional reforms (e.g. the creation of an agency or structure in charge of SME policy implementation), monitoring and evaluation, and the introduction of easy-to-achieve support measures in areas such as access to finance, enterprise skills, women's entrepreneurship, SME internationalisation and innovation. Donor support is likely to be crucial at this stage. The strategy should be implemented under the supervision of a single ministry.
- In the medium term, as the economy recovers and the government fiscal situation improves, targeted support measures could be rolled out, such as to improve the business support infrastructure, encourage innovation in co-operation with research centres, and implement an export support programme allowing Ukrainian enterprises to reap the benefits of the Deep and Comprehensive Free Trade Area (DCFTA) with the EU.

Access to finance is a key obstacle to SME growth in Ukraine; this could also be addressed in the short term through legal and regulatory reforms to close outstanding gaps. While some progress has been made, SME bank lending has decreased since 2012 and certain key regulations are missing. According to the Business Environment and Enterprise Performance Survey (BEEPS V) (EBRD, 2014), access to credit is a particular problem for medium-sized enterprises (mentioned as a constraint by almost 35% of such enterprises surveyed). The smaller and larger enterprises felt corruption to be a more serious problem. Interest rates are high (over 20%), though banks remain the main source of finance for SMEs.

Table 16.1. **Ukraine: Challenges and opportunities**

Strengths	Weaknesses
• Adoption of "Ukraine 2020 Strategy" • Improving business environment through reforms in 2014-15 (deregulation, licensing, one-stop-shops, e-government services) • Significant progress in addressing technical barriers to trade, adoption of new legislation (laws on technical regulations, standardisation, metrology in 2014-15) and EU standards • Relatively developed non-banking finance (e.g. leasing); attention to financial literacy (although focus on SMEs is missing); financial infrastructure (e.g. credit bureaus, collateral registry) • Reliable infrastructure (few power outages, etc.) • Improvements in public procurement (2014 law, e-tender pilot)	• Lack of comprehensive SME strategy, implementation agency or structured co-ordination • Outstanding regulation challenges (21 days to start a business; customs regulations; insolvency, ~20% of management time spent on compliance) • Poor financial access is top constraint for business (e.g. low levels of firms with bank-financed working capital) • Lack of policy co-ordination and funding in the areas of innovation and business support • Absence of export promotion schemes (no implementation, funding for 2013); low internationalisation (just 3.3% of sales, cf. BEEPS survey) • Weak capacity of justice system; corruption perceptions (cf. BEEPS survey) • Need for quality upgrading by exporting and non-exporting firms in the light of DCFTA opportunities
Opportunities	**Threats**
• The DCFTA, which should boost exports, FDI and general economic growth and act as an anchor for reform • The country's strategic geographical situation between the EU and CIS countries • Sector opportunities in agriculture (60% of land held by small and medium-sized farmers), nascent ICT sector, energy efficiency • Participation in EU's Horizon 2020 and Enterprise Europe Network programmes; EU's COSME Agreement under negotiation • Competitive and well-educated labour force (high literacy rates) • Forthcoming education legislation on lifelong entrepreneurship promotion • Relatively developed private market for business development services (e.g. private incubators, consulting) • Quick adjustment in western regions (increase in exports)	• Conflict in the east affecting macroeconomic environment (Hryvnia devaluation, inflation, financial stability, etc.) and investment attractiveness • Debt sustainability, negotiations with creditors • Institutional instability in SME policy making (e.g. frequent changes in responsible agencies); initiatives adopted without funding or implementation • Lack of competition in key markets (SME policy can be seen as an opportunity to establish a level playing field) • High levels of informality, weak accounting and corporate governance standards

Overview

Economic snapshot

The global financial and economic crisis hit the Ukrainian economy hard, provoking a severe recession in 2009 (-15% real GDP growth), followed by a period of economic stagnation in 2012-13. In early 2014, the government undertook a major macroeconomic adjustment in an attempt to address large fiscal and external imbalances (significant budget and current account deficits and very low levels of investment). The contractionary impact of the adjustment was exacerbated by the escalation of the conflict in the east of the country. This caused major economic disruption in Ukraine's most industrialised region and undermined investor and consumer confidence, reflected in significant capital outflow. Real GDP contracted by 6.8% in 2014 (EBRD, 2015).

Inflation reached 24.9% at the end of 2014, driven mostly by a sharp exchange rate depreciation and energy price increases. As of May 2015, the hryvnia had lost nearly two-thirds of its value compared to a year before. Capital and currency controls, together with a tight monetary policy, have managed to stabilise the exchange rate in 2015. Nevertheless, sharp currency depreciation combined with a strong fiscal consolidation drive and a very restrictive monetary policy triggered a significant decline in consumption and investment.

In 2014, investment in fixed capital declined by 23% and household consumption shrank by 9.6% compared to 2013. Credit to the private sector has also contracted significantly, while non-performing loans have skyrocketed to around 24%, mostly as a result of the downturn in the real economy but also due to endogenous weaknesses (EBRD, 2015). The total number of banks had decreased from 180 at the end of 2013 to 148 in April 2015. Foreign reserves dropped to just one month of imports by the end of 2014, heightening the pressure on the balance of payments.

In March 2015, the IMF approved a USD 17.5 billion loan programme for Ukraine covering 2015-18. The IMF programme is complemented by more than USD 7 billion of bilateral assistance and significant support from bondholders (estimated at USD 15 billion by the IMF). IMF calculations in March 2015 estimate total funding requirements to be close to USD 40 billion over the four-year period (IMF, 2015). To move towards economic recovery, the authorities are currently implementing much-needed macroeconomic and structural reforms. These include a deep restructuring of the banking and energy sectors, as well as various initiatives to improve the business and investment climate, including tax administration reform.

Ukrainian exports continue to be dominated by low value-added sectors and commodities (e.g. steel, agriculture, minerals). They have been severely affected by the crisis, with exports to Russia falling by 34% in 2014. However, some exports have been re-directed towards the EU in sectors such as agriculture, metals and minerals (EBRD, 2015). The EU is now the country's first export destination (31.5%), with Russia coming second (18%). The Association Agreement and DCFTA are expected to strengthen this trend from 2016, when the DCFTA is envisaged to be provisionally applied. While the DCFTA is expected to increase trade and investment relations with the EU over the medium to long term, it also raises the need to increase firm-level competitiveness.

Table 16.2. **Ukraine: Main macroeconomic indicators, 2010-15**

Indicator	Unit of measurement	2010	2011	2012	2013	2014	2015[b]
GDP growth	Percent, y-o-y	0.3	5.5	0.2	0.0	-6.8	-5.5
Inflation	Percent, average	9.4	8.0	0.6	-0.3	12.1	33.5
Government balance	Percent of GDP	-2.8	-3.2	-4.6	-4.8	-3.1	-3.2
Current account balance	Percent of GDP	-2.2	-6.3	-8.1	-9.2	-4.0	-1.4
Exports of goods and services	Percent of GDP	50.7	49.8	47.7	43.0	49.2	n.a.
Imports of goods and services	Percent of GDP	53.6	56.4	56.4	52.1	53.2	n.a.
Net FDI	Percent of GDP	4.2	4.3	3.8	1.8	0.1[a]	n.a.
External debt	Percent of GDP	86.0	77.2	76.5	78.6	n.a.	n.a.
Gross reserves	Percent of GDP	24.5	18.6	12.9	10.6	n.a.	n.a.
Credit to private sector	Percent of GDP	62.4	56.5	53.6	59.1	n.a.	n.a.
Unemployment	Percent of total labour force	8.1	7.9	7.5	7.3	10.5	11.5
Nominal GDP	USD billion	136.0	163.3	175.7	179.6	130.7	85.4

Notes: **a.** EBRD projection; **b.** 2015 figures are IMF projections.

Source: EBRD (2014), *Transition Report 2014*; IMF (2015), *World Economic Outlook*; World Bank (2015), *World Development Indicators* 2015.

Business environment trends

In addition to the impact of the ongoing crisis, the Ukrainian private sector is also confronted with a number of challenges and deep-rooted obstacles, including corruption, a weak investment climate and low levels of innovation and competition. In spite of a well-educated workforce, Ukraine has the lowest labour productivity in the entire Europe and Central Asia (ECA) region (IMF, 2015). The country ranks 77th out of 144 countries analysed in the 2014-15 World Economic Forum Global Competiveness Index (World Economic Forum, 2014). It scores particularly low for the quality of institutions, explained by the weak protection of property rights and minority shareholders' interests, low judicial independence and inefficient government spending. The concentration of economic activity in a limited number of individuals and large conglomerates calls for a proactive approach to competition policy, as well as for SME development initiatives to level the playing field and encourage market contestability. A recent study confirms the low levels of firm entry and exit in the Ukrainian economy (World Bank, 2014a). It also reveals that FDI flows are not very different from those of much smaller economies, with limited development of export-oriented investments (World Bank, 2014a). Despite progress in reducing entry barriers, Ukraine still has high levels of informality (accounting for an estimated 20% of employment) (EIB, 2013).

A key challenge for Ukraine is the actual implementation of its reforms. Even before the crisis it was not uncommon to see policy initiatives being launched without adequate implementation mechanisms, including funding (e.g. the 2012 law on support to SMEs). Budget constraints caused by the economic recession in 2014 and 2015 have seen allocations for SME development in the national budget to fall close to zero.

Finally, corruption is often quoted as one of the major reasons for the stunted growth of Ukraine's private sector, the low diversification of economy and exports, and the low productivity levels. In the 2014 Transparency International Corruption Perceptions Index, Ukraine is ranked 142nd out of 177 countries (Transparency International, 2014). BEEPS V respondents mention access to finance (21.3%), corruption (19.2%), tax rates (15.5%), political instability (11.9%) and practices of the informal sector (7.7%) as their top five constraints (EBRD, 2014). Access to finance appears to be a particular obstacle for medium-sized firms (nearly 35% of respondents in that category mentioned it as a constraint), while corruption appears to be a concern for all firms regardless of size. In 2012-13 the informal payments reported by firms to secure government contracts drastically increased, from 3.8% of the contract value in 2009 to 14.2%. Almost 100% of firms declared making informal payments to secure a public contract (EBRD, 2014).

Since 2012, Ukraine has taken several steps to improve its business enabling environment. In an attempt to simplify the regulatory framework and encourage private sector development, the government has adopted a number of reforms to its bankruptcy procedures, business registration, permitting and licensing, and e-government services. These reforms saw Ukraine improve its ranking in the latest World Bank *Doing Business* report to reach 96th place – up from 152nd in 2012 and 112th in 2014 (World Bank, 2014b).

The reform trend has accelerated in 2014-15. Recent initiatives include the adoption of new procurement legislation in 2014 to encourage transparency, the enactment of anti-corruption laws (including providing for the creation of an anti-corruption agency and investigative bureau), and deregulation initiatives in various areas. In 2014, a new tax code was introduced to reduce the tax burden and streamline procedures for taxpayers (including a reduction in the number of corporate income tax declarations to be filled every year). In April 2015, a comprehensive deregulation action plan was adopted by the Cabinet of Ministers and a draft law on investor protection has also been prepared. Limits on inspections have also been introduced. Judicial reform is also a top priority as the current system undermines the effectiveness of most other initiatives.

SMEs in Ukraine

A new definition of SMEs was introduced in March 2012 through the Law on Development and State Support of Small and Medium Entrepreneurship in Ukraine, which amended the Commercial Code of Ukraine (Table 16.3). The new definition includes micro-enterprises for the first time. It is mostly aligned with the EU definition although it does not include a balance sheet criterion. The State Statistics Service has started to produce data using this new definition.

Table 16.3. **Definition of micro, small and medium enterprises in Ukraine**

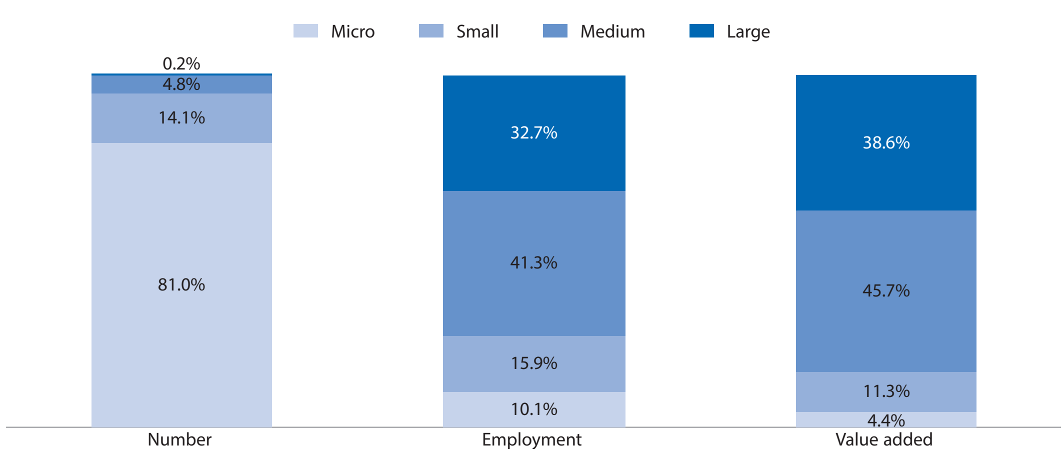
	Micro	Small	Medium	Large
Headcount	≤10	≤ 50	All enterprises that do not fall into the category of small or large enterprises	≥ 250
Annual turnover	≤ EUR 2 million	≤ EUR 10 million		≥ EUR 50 million

Source: Commercial Code of Ukraine No. 436-IV of 16.01.2003 (as amended).

In 2013, SMEs made up 99.8% of the total legal business entities (Figure 16.2). The total number of SMEs has increased by almost 4% since 2010 (from 378 200 to 392 700 in 2013). In 2013, the private sector comprised 81% of micro-enterprises, 14.1% of small enterprises and 4.8% of medium enterprises.

The number of people employed by SMEs decreased from 5 436 100 in 2010 to 4 901 900 in 2013. However, the share of SMEs in employment remained stable over these years (except for a 1.1% decrease from 2010 to 2011 and 1% decrease from 2011 to 2012) and amounted to 67.3% in 2013. The value added of SMEs has only been calculated by the State Statistics Service of Ukraine since 2012. In 2013, value added increased by 11.8% compared to 2012 and amounted to UAH 676.4 billion (EUR 63.7 billion), representing 61.4% of value added.

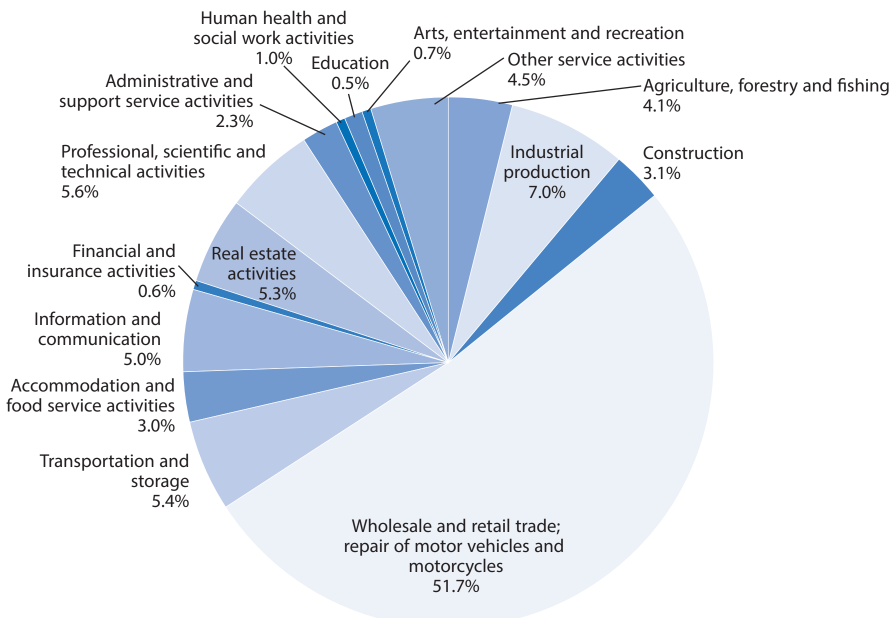
Figure 16.2. **Business demography indicators in Ukraine, 2013**



Source: State Statistics Service of Ukraine, 2015.

In terms of the sectoral distribution of the overall SME universe, SMEs operate mainly in low productivity sectors (Figure 16.3). In 2013, most SMEs (51.7%) – particularly micro-enterprises – operated in the wholesale retail and trade sectors, followed by industrial production (7%), and agriculture (4.1%).

Figure 16.3. **Sectoral distribution of SMEs in Ukraine, 2013**



Source: State Statistics Service of Ukraine, 2015.

SBA assessment results

This section outlines the main results for Ukraine from the 2016 SBA assessment of EaP countries. It also highlights the changes that have occurred since the previous assessment in 2012 (OECD, 2012b). The assessed policy dimensions are grouped under five key thematic pillars, reflected in the section headings below.

Strengthening the institutional, regulatory and operational environment (Dimensions 3, 4 and 2)

These dimensions reveal progress in some areas but major challenges in others. Since 2012 major progress has been achieved in the deregulation of economic activity, the streamlining of business registration, and the use of e-government tools. Outstanding challenges remain in the areas of bankruptcy and regulatory impact assessment, while Ukraine still lags behind other EaP countries in terms of the overall regulatory burden for businesses. Significant gaps also exist in the institutional framework for SME development. No comprehensive SME strategy or action plan exists, co-ordination is hampered by an unclear allocation of responsibilities and frequent institutional changes, and public-private consultations are not carried out in a systematic way.

Institutional framework

The “Strategy for Sustainable Development of Ukraine 2020”, adopted in January 2015, includes developing a favourable business environment for SMEs among its priorities, together with attracting investment, facilitating trade and improving the efficiency of the labour market. Ukraine has several other policy documents and laws which underline the importance of SME development as part of broader reform plans. However, no single, comprehensive SME development strategy exists.

The Law on Development and State Support of Small and Medium Entrepreneurship in Ukraine – adopted in March 2012 – defines the objectives, principles and main directions of SME development policy; the functions of the government bodies involved in SME policy; and the types of state support and conditions for its provision. In 2013, a draft “Concept of National Programme on Small and Medium Entrepreneurship Development for 2014-2024” was drafted, but has never been formally enacted. While the concept identified a series of potential actions to be implemented in the medium to long term, it fell short of a structured and comprehensive strategy.

In early 2015, the Ministry of Economic Development and Trade prepared a preliminary draft strategy for the development of small and medium businesses (“Draft Concept of Governmental Programme of SME Development”). The government aims to develop the new concept and hold parliamentary hearings in September 2015. It is structured around four pillars: improving the general business culture (e.g. entrepreneurial learning, awareness campaigns); education and training (e.g. consulting services, seminars); improving the operational environment (e.g. ease of doing business, deregulation reforms, taxation, public-private partnerships); and providing opportunities to grow (e.g. access to finance, innovation, export support). The document provides some indications of a reform roadmap, but needs further elaboration and an action plan backed up with measurable targets.

In addition to the lack of a comprehensive strategy, the policy framework for SME development has other significant weaknesses:

- At the institutional level, the effectiveness of SME policy making is hindered by frequent restructurings and changes of mandate of the responsible agencies, plus high staff turnover and limited co-ordination. In December 2014, the State Administration of Ukraine for Regulatory Policy and Entrepreneurship Development (SARPED) – in charge of SME policy implementation since March 2012 – was restructured. It lost its entrepreneurship support functions, which were handed instead to the Ministry of Economic Development and Trade in January 2015. However, the ministry’s Business Climate Development Department, which is expected to handle SME development policy formulation, is still being staffed. The new department is expected to review the Concept of National Programme described above, adapt it as needed, and start implementation, although the timeline is unclear.
- At the operational level, the various action plans and other initiatives to promote SME development and entrepreneurship have seen only limited or no implementation efforts. The state budgets for 2014 and 2015 contained no allocation for SME support. Until 2015, SME policy in Ukraine was driven by the “National Programme for Fostering Small Entrepreneurship Development” adopted in 2000 and supplemented by annual action plans. Though the 2014 action plan has been developed, it has not been approved and no budget has been allocated for its implementation at the state level. On the other hand, action plans for entrepreneurship support for 2013-14 and for 2015 have been developed at the local (*oblast*) level, with limited funds being

allocated from the local budgets. Until 2014, SARPED published reports on the implementation of SME support measures at both the central and local (*oblast*) level, although these fell short of a comprehensive monitoring system.

In recent years, the only stable and continuous support to SME development has been provided by donors through a series of projects. These include the Small and Medium Enterprises Support Project financed by the German government, the Small and Medium Enterprise APEX Credit Project implemented by the World Bank, and the Small Business Support (SBS) programme implemented by EBRD and others.

Legislative simplification and regulatory impact analysis

Since 2012, Ukraine has made significant progress in business deregulation and simplifying administrative procedures. In April 2014, the government adopted the Law on Amendments to Certain Legislative Acts of Ukraine to Reduce the Number of Permits. This law abolished the need for permits for 86 types of economic activities, most of them in agriculture. The law also allowed an issuing authority to grant a permit for an activity on behalf of several authorities (a one-stop-shop), thus reducing the time required for obtaining permits.

In February 2015, the Law on Amendments to Several Legislative Acts of Ukraine on Simplification of the Business Environment (Deregulation) was adopted. The law eliminated 16 types of permits in agriculture, construction and machinery. It also transferred the responsibility for issuing permits from various permitting centres to the Centres of Administrative Services (one-stop-shops present in the main cities). The law also simplified and streamlined the company registration procedure and stimulated the use of e-services. The Law on Licensing of Economic Activity adopted in March 2015 cuts the types of economic activities subject to licensing by nearly one-third (from 57 to 40). It also allows for further rationalising the list of licensing activities, in particular through implementing licensing principles defined by the EU-Ukraine Association Agreement, and introduces principles for remote and online licensing.

The 2003 Law on Principles of Business Regulatory Policy mandated SARPED to review any new regulations (between 2 000 and 2 500 every year) for their likely impact on business. The methodology used includes a cost-benefit analysis although the quality and degree of implementation have been mixed. The restructured State Regulatory Service is expected to develop a regulatory impact analysis (RIA) mechanism aligned with international best practice and to conduct proper RIAs of any new regulatory proposals. The government is also considering introducing an SME test in the new mechanism. In addition, the concept of "regulatory guillotine" is envisaged as one of the next steps in the deregulation process, subject to donor support.

Public-private consultations

In Ukraine, public hearings remain the most popular mechanism for co-ordinated consultations, though in practice their effectiveness is limited. According to the 2003 Law on Principles of Business Regulatory Policy, draft regulatory documents must be shared for consultations with any interested party. Information on public-private consultations must be published online and the process must last at least one month. Each central executive body (e.g. ministry) and *oblast* has a Public Council that acts as a permanent consultative and advisory body allowing for public participation in government affairs. Draft laws (including those that are SME-related) are usually discussed during parliamentary hearings organised by the various committees of the *Verkhovna Rada* (Ukraine's Parliament), in which representatives of civil society and national executive authorities are invited to participate. Even though the opinion of civil society is expected to be taken into consideration when drafting legislative acts and regulations, their formal influence remains weak.

Interaction with government services (e-government)

Since 2012, Ukraine has continued to make progress in the provision of e-government services, including online filing and payment of tax returns and social contributions. In 2013, a single social security payment (including pension funds and other social security payments) was introduced, administered by the State Fiscal Service (SFS). However, it has suffered from implementation problems and there is little evidence that any entrepreneurs have benefitted from it. The SFS tax returns system was also simplified and improved. The SFS online platform has been fully operational since 2013 for submitting tax and social contributions and, since 2015, for collecting enterprise statistics (although in practice information for the State Statistics Service is submitted separately). The 2015 OECD company survey of 403 SMEs indicates that more than half of surveyed companies (60%) consult government websites (see Box A.3, Annex A).

Following the adoption of the Law on State Land Cadastre in 2011, the government is developing a website that will provide a free online access to a variety of information, including land plots' cadastre numbers, borders, intended function, form of ownership, usage restrictions and other information. Access to an estimated money value, purpose, and soil evaluation would also be available for a fee. The development of an e-cadastre would considerably reduce the time required to register property (currently 27 days, according to the 2015 *Doing Business* report; World Bank, 2014b). As of May 2015, only the cadastre map is accessible to the public.

A legal framework for electronic signature has been in place since 2003 and e-signatures are widely used.

Notwithstanding this progress, there is still ample room for improvement. Ukrainian business managers are reported to spend almost 20% of their time dealing with regulatory compliance, almost twice the average in the Eastern Europe and Central Asia region (EBRD, 2014). This percentage increases to 25.5% for medium-sized enterprises, which is particularly worrying as it suggests that "regulatory diseconomies of scale" are hampering enterprise growth.

Company registration

The company registration process has been considerably simplified since 2012. In 2014, the number of procedures and the number of days required to open a business were reduced from 9 to 6 and from 24 to 21 respectively compared to 2012. According to the 2015 *Doing Business* report, registration with the State Fiscal Service and obtaining a VAT number take the longest time (10 days) (World Bank, 2014b). The 2015 Law on Amendments to Several Legislative Acts of Ukraine on Simplification of the Business Environment (Deregulation) allows for company registration to be completed in a single day. In 2015, the Ukrainian Parliament also prepared a draft law to simplify the state registration of legal entities. It is however too early to assess the impact of these changes.

Since 2014, the Single State Register of Legal Entities and Individual Entrepreneurs has allowed company registration data to be shared with the State Statistics Service, the State Fiscal Service, the Pension Fund of Ukraine and the Social Security Fund. This is a significant step forward as it eliminates the need for entrepreneurs to submit registration documents to each of these authorities in person. On the other hand, a visit to the State Fiscal Service is still needed to select a taxation form (common or simplified) and, if necessary, register for VAT payment. The tax registration takes 10 days, accounting for almost half of the total length of company registration (World Bank, 2014b).

Another improvement is the creation of 661 regional one-stop-shops (Centres of Administrative Services), which provide 52 administrative services, including company registration, property-related transactions and permits. To get registered at the one-stop-shop, an entrepreneur needs to provide the State Registration Service with a set of documents, including a confirmation of the registration fee being paid. The documents can be submitted at the local Centre of Administrative Services, by post or online. The registration fee can be paid in a kiosk often situated in the same premises. The minimum capital requirement and the notarisation of the company's by-laws and registration documents have been eliminated.

The silence-is-consent principle has been generally applicable since 2010 for licensing and other business regulations. The only exception remains business registration, although its introduction was under discussion in May 2015.

Bankruptcy procedures and second chance

Bankruptcy procedures covering both legal entities and individual entrepreneurs in Ukraine continue to be regulated by the Law on Restoring Debtor Solvency or Declaring a Debtor Bankrupt, adopted in 1992 and revised in 1999 and 2011. In 2013 new amendments were introduced:

- The old law did not provide for any period for setting aside transactions entered into by a debtor prior to the insolvency procedures. The amended law has introduced a new procedure for determining which transactions may be set aside. In addition, the amended law allows shareholders and directors of the insolvent debtor entity to be liable to creditors if the debtor's assets are not sufficient and the actions of the shareholders or directors had caused the debtor's insolvency.
- The new provisions ensure that creditor claims that are secured with collateral are paid first. In addition, unsecured claims not submitted to court within 30 days of the initiation of the bankruptcy procedure are no longer automatically discharged. Instead, unsecured creditors failing to meet the 30-day deadline are given lower preference. In addition, the 2013 amendment allows for a new expedited restructuring procedure in situations where a majority of the debtor's shareholders and creditors agree to such procedure.
- The new provisions set maximum timelines for the four main steps in bankruptcy procedures, bringing Ukraine's bankruptcy procedures more in line with international best practice: *(a)* 14 calendar days until the preparatory hearing (compared to 30 days prior to the reform); *(b)* 115 calendar days with a possibility of a two-month extension for property management (i.e. the initial phase of most procedures), compared to half a year in the past; *(c)* six months with a possibility of a one-year extension for reorganisation/rehabilitation; and *(d)* one year for the liquidation process.

The new provisions have not yet had an impact on the effectiveness of rehabilitation or liquidation processes. In 2014, the average recovery rate was just 8.6%, a slight improvement on 8.2% one year earlier. The costs of proceedings were still high, at 42% of the estate's value, and the average duration of a typical insolvency process was 2.9 years (World Bank, 2014b).

The national bankruptcy register system was introduced at the end of 2011. Handled by the Ministry of Justice, it is free of charge for enterprises seeking to obtain an information certificate on themselves. A fee of UAH 170-221 (approximately EUR 7-9) is charged for obtaining information on other enterprises. While according to the law, all insolvency publications must be posted on the High Commercial Court's website, the site is still being tested.

Though there are no discriminatory provisions preventing entrepreneurs who have undergone a non-fraudulent bankruptcy from starting a new business, individual entrepreneurs who were not able to cover all the liabilities during the bankruptcy process are not allowed to register a new enterprise, get credit or seize a guarantee agreement for three years following the bankruptcy. The 2015 OECD company survey noted that the vast majority of SMEs (75%) consider it difficult to re-start a business after failure in Ukraine. Access to finance was quoted as the most important obstacle (39% of SMEs surveyed), followed by government laws, procedures and regulations (28% of respondents). To correct these perceptions, the government could consider implementing campaigns to encourage failed entrepreneurs to start afresh.

Facilitating SME access to finance (Dimension 6)

Ukraine has made progress in strengthening institutional efforts to improve SME access to finance since the 2012 SBA assessment: the coverage of private credit bureaus has increased and the government has stepped up efforts to improve the use of state guarantee funds and increase financial literacy among the population. However, the recent economic slowdown which saw widespread bank insolvencies, currency fluctuations and high interest rates, has made it substantially more difficult for SMEs to access finance from banks. High barriers discourage entrepreneurs from seeking finance.

Legal and regulatory framework

A basic creditor protection legal framework is in place, which strengthens the protection for secured creditors in particular. However, enforcement of collateral through the court system is notoriously slow and inefficient, in part due to widespread corruption. A 2013 legal provision allows secured creditors to be paid earlier, though in practice only 8.6% of creditors' claims were met in 2014 (8.9% in 2012). The government has further deepened its secured transaction framework by establishing a unified cadastre in 2012. While the cadastre's geographical coverage and online availability have been continuously improved, neither are fully comprehensive. As in the 2012 assessment (OECD, 2012b), the Ukrainian State Register of Encumbrances over Movable Property does register movable assets, but is neither regulated nor fully accessible for the general public or online. Ukraine does not have a public credit information bureau, but it has seen a significant growth in the coverage of private credit information bureaus over the past three years. Since 2012, coverage of the adult population has increased, from 17% to 48%, with a legally secured right to access one's credit history once a year for free. Regarding banking regulations, while capital adequacy rules have been largely implemented, most other Basel II recommendations have not. The legal framework for capital markets remains unchanged, as does the number of companies listed in the Ukrainian Stock Exchange.

Sources of external finance for SMEs (bank financing, non-bank financing, venture capital)

Banks remain the primary source of finance for SMEs in Ukraine. However, according to BEEPS V only 19% of all firms surveyed used bank credit in 2014, 10 percentage points lower than the average for the Eastern partner region (EBRD, 2014). While a growing number of businesses name complexity and interest rates as primary obstacles, the high rate of non-performing loans, particularly among SMEs, has significantly reduced banks' capacity and willingness to lend. The downturn in the Ukrainian economy has had a significant effect on the Ukrainian banking sector, with over one quarter of all banks launching insolvency proceedings in 2014. This, along with increased credit requirements, has led to a drop in SME loan financing of up to 30-40%. The government's support for SME bank financing consists primarily of interest rate subsidies or partial compensation of loan payments, though these incentives are almost entirely used by agricultural SMEs and the amounts are relatively small. While the international financial institutions offer extensive credit projects in Ukraine, these are denominated in foreign currency. This is problematic in light of the instability of the local currency and is of limited help for non-exporting SMEs. The credit guarantee system is not independently monitored and is difficult for SMEs to access. The government's microloan entity, the Ukrainian Fund for Entrepreneurship Support, did not provide any financing in 2014 and is currently being audited. Its impact prior to that is unclear due to the absence of sound monitoring and evaluation systems and transparency over its beneficiaries.

Micro-financing is a widespread non-bank finance channel in Ukraine, primarily offered through credit unions. The 589 active credit unions are regulated by the 2015 Law on Credit Unions. Savings and loan association regulations and activities have ceased to exist in Ukraine after a 2010 ministerial concept was cancelled in 2012. The Ukrainian leasing sector was previously well developed compared to regional peers, amounting to approximately 3% of GDP in 2010. However, in the first nine months of 2014 the amount of leasing contracts decreased by 82% compared with the same period in the previous year. Venture capital remains underdeveloped in Ukraine and venture funds operate under the law on Institutes of Joint Investment. The existing legal framework stifles venture capital development by inhibiting institutional investor participation and restricting public offers of venture funds, and lacks shareholder protection.

Financial literacy

Following donor-funded assessments of financial literacy, the government's education and information programmes have expanded noticeably since 2012. That year, the National Bank of Ukraine initiated the development of a central programme on financial literacy, and individual initiatives, such as the inclusion of financial education into school curricula and an annual week of financial literacy, have been visible. However, a centralised monitoring and evaluation system for these initiatives is missing.

Promoting skills and entrepreneurship development (Dimensions 1 and 8a)

Lifelong entrepreneurial learning

An assessment in October 2014 highlighted good institutional support for lifelong entrepreneurial learning in Ukraine. SARPED's policy co-ordination functions have since been transferred to the Ministry of Economic Development and Trade. The ministry is currently developing an SME strategy and programme which reflect the SBA policy provisions, including entrepreneurial learning. This could be an opportunity for the Ministry of Education to assume a clear leadership role within the entrepreneurship strategy, co-ordinating a joined-up policy effort to support entrepreneurship through education and training (e.g. employment, innovation and enterprise). The Ministry of Education will have an important role in developing a comprehensive approach to entrepreneurship across all levels of formal education under a forthcoming Framework Law on Education. A dedicated working group should be considered to develop a comprehensive entrepreneurial learning framework. The crux of the issue here will be to introduce entrepreneurship as a key competence; the forthcoming "European Entrepreneurship Competence Framework" will be an important policy reference.

While there are excellent examples of non-formal entrepreneurial learning (general, vocational and higher education), formal education needs to explore how it can build on this experience. One important area for consideration is how young people can be given entrepreneurial experience during secondary schooling. The School Academy of Entrepreneurship initiative supported by Poland is a good example of innovation in the teaching and learning process for secondary schools, and includes teacher training. It has generated great interest in participating schools; the national authorities could determine which aspects of the project could be incorporated into the wider school curriculum. Another good practice example is the business internship programme at the Kyiv Business Lyceum, through which pupils have work placements in leading companies.

More broadly, the benefits of good practice in entrepreneurial learning are still to be tapped. A more developed framework should be considered for bringing education and training providers together to exchange know-how, and to allow their experience to directly shape policy. While all levels of formal and non-formal education should feature in the good practice knowledge-sharing framework, a starting point could be to leverage the experience of entrepreneurship promotion in vocational education and training, which develops specific business skills (e.g. accounting and finance). This should be reinforced with careers guidance, including on self-employment, and better business start-up information and sign-posting.

Finally, entrepreneurship promotion through higher education needs more considered policy attention and support. A policy dialogue involving the higher education community (practitioners and policy makers), economic policy leaders and the private sector would be a first step.

Women's entrepreneurship

While there are no specific policy lines for women's entrepreneurship, equal opportunities legislation that includes provisions for women's entrepreneurship would offer a good basis for moving the policy agenda forward. It is important, however, that women's entrepreneurship is not considered solely in terms of equity (Bekh, 2013). Policy dialogue and development should clearly recognise women's entrepreneurship as a direct contribution to the country's wider drive for competitiveness, innovation and jobs. An important starting point in a renewed policy agenda will be to develop reliable data on women's entrepreneurship that will continue to shape policy and support in the area. The upcoming national entrepreneurship strategy is considering establishing a working group specifically to address women's entrepreneurship. This would provide an excellent opportunity to build policy advocacy and support for promoting women's entrepreneurship across the country.

While there are excellent examples of good practice sharing on women's entrepreneurship through one-off events (e.g. Lviv Business School's 2015 spring symposium on women and business), a more dedicated dissemination framework is required to not only raise awareness of women's entrepreneurship achievements, but also to allow others to learn from experience and know-how. Sharing good practice in training for women's entrepreneurship, in particular, could help training providers, policy makers and wider stakeholders (e.g. finance institutions) learn which types of training/mentoring are most effective, and at what cost.

SME skills

A challenge to Ukraine's SME policy agenda, and in particular training support, is the lack of systematic intelligence on SME training interests and needs. A forthcoming ministerial decree will provide an opportunity to build data on SME knowledge and skills requirements. This should draw on the manpower intelligence of sector support organisations and the wider training provider community.

Start-up training provision, as well as training for growing businesses, is good and there are excellent examples of e-training provision. For example, Shevchenko University provides an online course on brand management and also demonstrates how third-level education institutions can bring value and innovation to SMEs.

Finally, there is good training for SMEs keen to enter or already operating in international markets. This area will become more important given the new trade opportunities provided by the Association Agreement (including a DCFTA) between the EU and Ukraine signed in 2014. This will have implications for those sector organisations in particular which provide regulatory training, as well as for the wider vocational and management training community (Lasku and Gribben, 2013).

Enhancing SME competitiveness (Dimensions 5a, 5b, 8b and 9)

Very limited progress has been made since 2012 in developing and implementing targeted initiatives to improve the competiveness of Ukrainian SMEs. The government's provision of business support infrastructure remains limited and constrained by insufficient funding and a lack of a clear strategy. The private market for business development services is relatively developed by regional standards, but the government has not yet put in place any structured co-operation mechanisms. Institutional and infrastructural support for innovative SMEs exists on paper, but in practice it is not fully operational. There are no co-ordinated efforts to promote and incentivise environmental compliance or SME greening. On the other hand, the adoption of new procurement legislation aiming to comply with EU standards offers an opportunity to increase access to this market by Ukrainian SMEs.

Business information and services

The provision of business development support services was listed as one of the priorities in the draft "Concept of National Programme on Small and Medium Entrepreneurship Development for 2014-2024". However, there was no action plan for implementing this programme and no budget allocation either. Likewise, the "National Programme for Fostering Small Entrepreneurship Development", adopted in 2000, prioritised business support service development. However, the 2014 action plan for the programme was never adopted and there is no budget to implement any activities in 2015. Most recently, the 2015 "Draft Concept of Governmental Programme of SME Development" incorporates professional consultancy services and training provision as a part of an education and skills upgrade.

In the absence of any strategy or action plan in this area, the provision of business information and other types of capacity development support in Ukraine up until now have been limited to some scattered initiatives by the SARPED, mostly implemented through local authorities using their budgets for entrepreneurship support. Services provided include entrepreneurship training programmes, engagement of SMEs in public procurement, information support and various business consultancy services. Local authorities also sometimes provide support, such as a rent discount for start-ups looking for an office. These actions remain very limited in terms of number, scope and impact. Lack of funding for business infrastructure support does not only lie in the current crisis, as this was also a finding of the 2012 SBA assessment (OECD, 2012b). In addition, there is no specific government programme promoting the use of private business development service providers, even though this market in Ukraine is relatively well developed and includes some dynamic players. Privately owned incubators, for instance, have been established in Ukraine's main cities in recent years with some public support for office space and related services as well as some seed finance (there were 15 in 2013).

In 2013, the Law on the Employment of the Population introduced free support for unemployed individuals wanting to start and manage entrepreneurial activities; this benefitted around 36 000 people that same year. Nevertheless, the potential benefits of these activities are questionable as they present entrepreneurship as a "last resort" rather than as an opportunity in its own merit.

In June 2015, the government announced plans to open 15 regional business centres to support SMEs under the programme "EU Support to Ukraine to Re-launch the Economy" (EU SURE). It also announced plans to launch an outreach programme on how to start a business and how to get support for business development. If implemented, this programme could be the first step in filling the gap in the provision of SME business development support.

The limited reach of business support measures has been confirmed by the 2015 OECD company survey, in which more than 80% of respondents declared being unaware of any business support services provided by the government. The OECD company survey suggests that there is ample room to raise awareness by developing information campaigns on the value of consulting services and the potential benefits for SME competitiveness. Even though most of the surveyed companies (80%) had faced difficulties in their business in the previous three years, less than half (44%) had considered using external advisory services and preferred to rely on internal resources. Donor initiatives have attempted to fill this gap, in particular by trying to promote the use of private providers. For instance, the EBRD Small Business Support programme maintains an active portfolio of Ukrainian consulting firms and provided assistance to 95 SMEs in 2014 alone.

Public procurement

Ukraine took a step forward in April 2014 with the adoption of a new Public Procurement Law. This contains a new definition of procuring entities that is in line with EU directives, and has significantly decreased the number of exemptions. However, frequent amendments to the legislation jeopardise legal stability. The conclusion of the Association Agreement (including a DCFTA) between Ukraine and the EU in June 2014, and the progress achieved in the accession to the WTO Government Procurement Agreement (GPA), have further opened the public procurement market and created opportunities for Ukrainian companies abroad. However, Ukraine will have to undertake major reforms to implement the DCFTA and finalise GPA accession, including institutional reform and aligning its legislation to the EU Public Procurement Directives and international standards.

The most pressing problem in public procurement in Ukraine is corruption, with 71% of surveyed companies viewing corruption as the main barrier to their participation in public tenders. There are no provisions to ensure proportionate qualification levels and financing requirements for SMEs. Late payments occur very often and pose serious problems for SMEs. The Anti-Monopoly Committee is an independent review body for public procurement, but its functioning should be further strengthened. The legislation provides the possibility to cut tenders into lots, but the large size of contracts remains a barrier for SMEs. Ukrainian and international enterprises can participate in tenders on equal terms.

The e-procurement system needs to be further developed. In February 2015, the Ministry of Economic Development and Trade introduced an e-procurement system ("ProZorro") to ensure transparency in public procurement, improve business confidence and tackle corruption by publishing procurement tenders, proposals and signed contracts. However, this system so far only allows for selection based on the lowest price. In order to meet its international obligations, Ukraine will have to adapt ProZorro so as to allow quality-related criteria to be taken into account so as to select the most economically advantageous tender.

Innovation policy

Adopted in 2011 and amended in 2013, the Law on Priority Directions of Innovative Activities in Ukraine aimed to define the strategic priorities for innovation policy between 2011 and 2021. Largely unimplemented, the law requires further development in the form of a comprehensive strategy and a clear roadmap for reform. Though the legislation envisaged the adoption of one-year action plans with measurable targets, none of these has been developed to date. Currently, innovation policy is scattered across more than 70 legal and policy documents, including the Law on State Regulation of Activities in Technology Transfer, adopted in 2007; and the Law on Science Parks adopted in 2009. In 2015, a draft law on Industrial Parks went through the readings at the Ukraine Parliament. The law provides for attractive terms for foreign and national investors. References to innovation are also included in the "Strategy for Sustainable Development of Ukraine 2020" and the "Concept of National Programme on Small and Medium Entrepreneurship Development for 2014-2024", although no concrete actions have been adopted. While the State Committee for Science, Innovation and Information had been the body in charge of implementing innovation policy and technology transfer since 2011, the Ministry of Education and Science assumed those functions in October 2014.

The state budget does provide funding for research and development, although the focus is clearly on academia and research organisations, with limited emphasis on the commercialisation of innovations. Financial support for innovative SMEs was expected to be available through the Fund for Small Innovation Business Support, but no state funding has been provided to this facility since 2013. The key barriers to innovation by Ukrainian SMEs are cost, according to 41% of SMEs surveyed by the OECD in the context of the present SBA assessment. Financial support in the form of grants and tax incentives could trigger innovative activities.

Some innovation infrastructure exists, although its effectiveness remains curtailed by funding problems and lack of targeted support. A specific state programme was developed between 2009 and 2013 to scale up infrastructure. In 2014 there were 82 incubators for innovative start-ups, though only 27 of them were functioning according to SARPED data. Of the 50 technology parks, only 13 were operational. The linkages between entrepreneurs and R&D institutions remain weak. The Law on State Regulation of Technology Transfers envisages the development of a national network of technology transfer platforms. Some higher educational institutions have their own technology transfer centres. However, co-operation between research institutions and SMEs occurs mainly through the science and technology parks and technology transfer offices. Given the low operational capacity of technology parks, other means of technology transfer are needed.

In March 2015 Ukraine joined Horizon 2020, the European Union's research and innovation funding programme. This agreement opens up a wide range of new opportunities to Ukrainian research institutions, universities and businesses across the whole research and innovation value chain, from fundamental research to close-to-market activities. To reap the benefits of Ukraine's participation in this programme and, more generally to enhance the innovation ecosystem in the country, the government would need to review the current institutional and strategic framework, mobilise resources for its implementation (leveraging private sector support as much as possible) and create mechanisms for multi-stakeholder co-ordination at the policy level, and technology transfer and co-operation between SMEs and research centres at the operational level.

Green economy

The "Concept of National Programme on Small and Medium Entrepreneurship Development for 2014-2024" envisaged providing incentives for SMEs to adopt high-tech, innovative, energy-saving technologies. The draft action plan for this programme includes financial support for adopting energy saving and eco-friendly technologies and environmental and social labelling. However, the only financing schemes available depend exclusively on donor funding. In 2011, a technical regulation on eco-labelling was adopted by the government. Since then, several eco-labelling schemes have been developed by the Living Planet independent eco-labelling board: the national Green Crane label is applied to alternative motor fuel, certain beverages, furniture and other wood products, with over 60 producers certified as of 2014. Several international eco-labels are also present on the Ukrainian market.

There is some risk-based diversification of environmental regulatory regimes: the frequency of inspections varies depending on the environmental risk class of the facility. Low-risk installations also enjoy a simplified permit regime for air emissions. The Ministry of Economic Development and Trade is currently leading the effort to reduce the regulatory burden on economic entities. However, the recent Law on Deregulation (February 2015) does not affect the legal framework for environmental management.

The Ministry of Ecology and Natural Resources and its State Environmental Inspectorate are not engaged in any activities to promote environmental compliance and green business practices. Information-based promotional instruments are underdeveloped. Some promotional work is carried out by the Cleaner Production Centre of Ukraine (established in 2013), and by some business associations, such as the Union of Small and Medium-sized Enterprises of Ukraine. More generally, however, the role of Ukrainian business associations in promoting green practices is very limited.

Supporting SME internationalisation (Dimensions 10 and 7)

The signing of the DCFTA with the EU in June 2014 is a major breakthrough for Ukraine, opening the largest market in the world to Ukrainian exports while offering opportunities for increased foreign investment. Provisional application of the DCFTA has been delayed until 1 January 2016, as part of the overall efforts towards a comprehensive peace process in Ukraine. To reap the benefits of this agreement, the government has made major progress in removing technical barriers to trade. This has involved the adoption of four new laws in 2014-15 on standardisation, metrology and conformity assessment and the adoption of sectoral legislation aligned with EU regulations. However, Ukraine lacks a comprehensive export promotion strategy which would complement these regulatory efforts and support initiatives in this area remain limited in scope and number.

Export promotion

The EU will continue to apply autonomous trade measures for the benefit of Ukraine until the end of 2015, granting Ukrainian exporters preferential access to EU markets without waiting for the trade provisions under the AA to come into force. Limited measures have already been implemented to support potential SME exports under the DCFTA. Yet only 11.7% of Ukrainian small firms and 19.9% of medium-sized firms described themselves as exporters in the BEEPS V survey (EBRD, 2014).

In August 2013, the “Concept of Development of Export Support State System of Ukraine” was adopted by the Cabinet of Ministers. The concept aims to develop financing mechanisms for export support (including export credit and insurance), state support for participation in international tenders and international trade fairs, as well as improvements in legislation. However, the concept remains unimplemented and unfunded. In 2009, an action plan to enhance SME exports was approved but was also not implemented. The development of an export programme is also one of the priorities of the 2015 “Strategy for Sustainable Development of Ukraine 2020”. In addition, the Ministry of Economic Development and Trade has developed an action plan to increase and support Ukrainian export potential by 2020, although the impact of this plan is still unclear. The Ministry of Economic Trade and Development is currently working on a draft law on State Financial Export Support to protect Ukrainian exporters from the risk of non-payment and financial losses and to create an export credit agency.

The main source of information on export opportunities for SMEs is a website created by the Ministry of Economic Development and Trade to promote Ukrainian exports and link exporters and foreign investors (ukrexport.gov.ua). The website contains basic information on the trade patterns and economy of many of Ukraine’s trading partners, a database of Ukrainian exporters, requests from foreign companies interested in importing from Ukraine, Ukraine’s export legislation and custom tariff and non-tariff regulation. However, this website has not been systematically updated and the government is currently improving it.

The OECD company survey suggests that the vast majority of SMEs (more than 80%) are not aware of any programmes encouraging companies to export or link to multinational companies. The most important barriers for access to international markets quoted by SMEs are lack of home government assistance and incentives, shortage of working capital to finance exports and excessive transportation costs. While the DCFTA is expected to boost FDI in Ukraine, there are no specific government policies promoting or facilitating the integration of Ukrainian SMEs into global value chains (GVCs) and/or FDI backward linkages benefiting local entrepreneurs.

More generally, trade regulations appear to be an obstacle for SME internationalisation. The country scores very low (154th out of 177 countries) in the 2015 World Bank *Doing Business* ranking on trading across the border (World Bank, 2014b). It takes 29 days to export a product from Ukraine, almost three times longer than the OECD average (10.5 days). Eight documents are required for export, twice as many as the OECD average. The simplification of export procedures should therefore go hand-in-hand with the development of a comprehensive export support programme.

Standards and technical regulation

The DCFTA provides a framework to develop a Ukrainian quality infrastructure system and to align industrial products regulations with EU *acquis*. Despite the delay of the application of the DCFTA, the Partnership and Co-operation Agreement which entered into force in 1998 already offers a sound basis for aligning the Ukrainian quality infrastructure system with that of the EU.

In 2014-15, Ukraine made progress by adopting four new laws on technical regulations, standardisation, metrology and conformity assessment. The new standardisation law adopts principles that comply with EU and WTO rules and introduces the concept of voluntary standards. The government's programme for 2015 envisages the withdrawal of all outdated standards adopted by the former Soviet Union up until 1991. However, further progress is needed in the development of product-related technical legislation to align it with the corresponding EU directives, as well as to strengthen the institutions (i.e. the new standardisation body, the metrological inspection, and market surveillance authorities). Amendments to the law on market surveillance (in force since 2011) are being prepared to address the implementation issues faced in the past. Ukraine is in the process of developing a system comparable to RAPEX (Rapid Alert System for dangerous non-food products) and aims for integration in the EU system. However, effective tools for market surveillance still need to be developed. Further necessary reforms and actions are set out in the "Strategy and Action Plan for the development of Technical Regulation System until 2020", adopted by the Cabinet of Ministers on 19 August 2015.

The way forward

Ukraine's macroeconomic situation is not only having a negative impact on SME growth in the country, it is also constraining the policy (and, crucially, fiscal) space to introduce and implement new initiatives. The government should therefore focus its immediate efforts on continuing its ambitious agenda of horizontal and structural reforms, starting by laying the foundations of a comprehensive institutional framework for SME development, with a clear implementation strategy and well-defined role for the ministry in charge. This should involve, first and foremost, a comprehensive but realistic SME strategy and action plan with a focus on institutional reforms (e.g. to create an agency or structure in charge of SME policy implementation), monitoring and evaluation, and the introduction of selected targeted support measures in areas such as access to finance, SME internationalisation and innovation. Past experience suggests that the country should be realistic when designing new interventions, trying to match strategies with the resources available for implementation. As a result, the roll-out of targeted support measures (which generally requires larger amounts of resources) may be undertaken cautiously in the short to medium term, leveraging donor and private sector involvement at first and scaling up when feasible.

The 2016 SBA assessment considers the following to be priorities for Ukraine in improving its SME policy framework:

- **Develop a comprehensive SME strategy or programme, accompanied by a realistic action plan for the medium to long term** (i.e. for the duration of the Ukraine 2020 Strategy). Adapted to Ukraine's specific circumstances (and in particular the limited availability of budgetary resources for the next few years), the strategy could: *(a)* address the institutional aspects of SME policy making (e.g. lay the foundations for an agency in charge of policy implementation under the guidance of the Ministry of Economic Development and Trade, as well as structures for inter-agency co-ordination and public-private dialogue on SME issues); *(b)* set up strong monitoring and evaluation mechanisms for SME support initiatives; and *(c)* focus government efforts on a selected number of targeted support measures, with donor and private sector involvement where feasible. In addition, the government should **continue the ongoing deregulation agenda,** including improving the business registration framework, where Ukraine still lags behind other countries in the region; revamping RIA to include an SME test, and streamlining accounting and documentation requirements for SMEs.
- **Fill the financial sector regulation gaps to improve SME access to finance**. These include making further efforts to improve creditors' rights, and implementing the 2013 insolvency legal provisions to increase recovery rates; setting up an online platform for the collateral registry; and improving the legal framework for venture capital. The introduction of an SME credit guarantee scheme (with the initial participation of international financial institutions to ensure efficiency and transparency) would improve SME access to local bank financing.
- **Introduce, over the longer term, targeted support measures for business support infrastructure, human capital development, innovation, export promotion and SME greening.** Strategies or policy documents for some of these areas already exist but may need to be reviewed. The current institutional settings may also need to be reconsidered as policy design by ministries may require separate implementation agencies or structures. Private sector involvement in these areas (e.g. in business development services and technology transfer) will maximise impact and leverage limited public funding. Some support measures (e.g. the creation of an online portal with information for SMEs) would not require a large budget. Support measures should ideally differentiate between the different segments of the SME sector e.g. micro-entrepreneurs, medium-sized and innovative growing companies, women's businesses, high-potential young entrepreneurs etc. They could include the development of clusters to promote innovation and exports, and the introduction of export finance and schemes to help SMEs upgrade their quality standards to tap into DCFTA opportunities. More attention should also be paid to entrepreneurship promotion and human capital, such as including entrepreneurship as a key competence in the national curriculum, further strengthening women's entrepreneurship efforts, and adopting a more structured approach to skills upgrading through the new SME agency or another national body in charge of skills intelligence.

Table 16.4 presents a potential policy roadmap to guide SME development policy over the short, medium and long term based on the findings of the SBA assessment.

Table 16.4. **Ukraine: Roadmap for policy reforms**

Policy recommendations (priority reforms in bold)	Timeline (short, medium, long term)
1. Strengthening the institutional, regulatory and operational environment	
• **Prepare and adopt an SME strategy and action plan adapted to Ukraine's context, which emphasises: *(a)* institutional arrangements, policy co-ordination and PPC; *(b)* monitoring and evaluation; and *(c)* selected targeted measures**	S/M
• Adopt and implement a revamped RIA mechanism including an SME test	S/M
• Deepen and broaden the deregulation agenda with an SME focus, including business registration (improving interaction with tax authorities), SME accounting and documentation requirements, licenses and permits	S/M/L
2. Facilitating SME access to finance	
• Continue to strengthen creditors' rights by allowing them to seize their collateral; enforce court decisions after re-organisation and improve implementation of the 2013 legal provisions to increase recovery rates	S/M
• Increase access, ease of use and reliability of the registry of movable assets from the Ukrainian State Register of Encumbrances over Movable Property via an online platform	S/M
• Improve the legal framework for venture capital by allowing institutional investors to invest, broadening exit opportunities for venture funds and improving shareholder protection	M/L
• Introduce an SME credit guarantee scheme, probably with the initial participation of IFIs	M/L
3. Promoting skills and entrepreneurship development	
• Ministry of Education should assume a greater leadership role for entrepreneurial learning; appoint an entrepreneurial learning "ambassador" (e.g. Deputy Minister of Education, Chair of Parliamentary education committee, or a high-profile entrepreneur with good policy advocacy skills)	S/M/L
• Conduct an independent evaluation of the key activities of the School Academy for Entrepreneurship to determine areas for improvement (entrepreneurial experience) and for integration into the national education system	S
• Build on the already good institutional support for women's entrepreneurship by improving data and intelligence on high-potential women's entrepreneurship	S
• Collect SME skills intelligence through regular surveys and sectoral working groups, and ensure that data updates and analysis are available for policy makers and the training provider community (public and private)	S/M/L
4. Enhancing SME competitiveness	
• Develop and implement an action plan to support the development of the private BDS market and consider potential public support schemes (e.g. online portal with information for SMEs)	M/L
• Review existing structures and develop a strategic and institutional framework for innovation policy; introduce support schemes in co-operation with the private sector	M/L
• Promote SME participation in public procurement	S/M/L
• Introduce regulatory and financial incentives for SME "greening"	M/L
5. Supporting SME internationalisation	
• Continue to develop systematic market surveillance; adopt the "Strategy of Technical Regulation System Development"; build capacity of the new standardisation body	S/M/L
• Review existing policy and develop and implement an export promotion programme: consider a new institutional framework and the introduction of export finance and targeted promotion initiatives	M/L

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Annex A

Methodology for the Small Business Act assessment – Technical annex

The SME Policy Index 2016 uses two separate scoring methodologies depending on the dimensions being assessed: one for the human capital dimensions (Dimensions 1 and 8a), and another for the rest. Both are described below.

Scoring methodology for Dimensions 1 and 8a

While the methodology for the 2016 assessment has been slightly improved on the 2012 assessment (see Box A.1), the human capital dimensions (Dimensions 1 and 8a) are assessed in the same way as before. This involves the use of a framework of 22 qualitative indicators to give a score based on the level of policy development in a certain policy area, where level 1 is the weakest policy framework and level 5 the strongest (Table 0.19).

The levels are assigned to each indicator through a participatory and analytical process, conducted in two parallel assessments: *(a)* a self-assessment by the government; and *(b)* an independent assessment by local consultants (see section "Policy framework and assessment process"). In both cases, the levels have been set in the assessment grid and the assessment focuses on scoring the countries according to the given levels.

Aggregated levels for each dimension are calculated by allocating weights to each indicator according to its relative importance, as determined by a process of expert consultation within the ETF. Core indicators are given a weight of 3; secondary indicators are weighted 2 or 1.

Box A.1. **What's new in the 2016 methodology?**

In 2014, the partner organisations agreed, following consultation with the SBA co-ordinators in the six EaP countries, to introduce certain improvements to the 2016 SME Policy Index. The objective of these changes was twofold:

- To better capture the intensity, quality and effect of policies and reforms. To this end, detailed policy assessment questionnaires have been developed with detailed questions to assess performance throughout the entire policy cycle, from policy design to actual implementation and monitoring and evaluation.
- To complement the information used for the scores with other sources of data that better capture the context and "broader picture" of SME development policies in the EaP countries, such as national statistics and firm-level survey data.

The modifications introduced in 2014 have preserved the fundamental features of the SME Policy Index and the core elements of the original methodology, including the multi-dimensional approach based on the 10 SBA principles, the intra-regional benchmarking focus, the participative assessment method, and the five-level scoring framework, so as to ensure comparability over time.

Scoring methodology for the other dimensions

For all other dimensions, the indicators and assessment grids used in 2012 (see OECD, 2012) have been replaced by detailed questionnaires comprising approximately 430 questions, filled out by national governments and independent experts. These questionnaires allow more precise information to be obtained and cross-checked, in particular on the actual implementation of policies and measures. The questionnaires have been carefully designed to ensure comparability with the 2012 indicators and assessment grids.

Although, like the 2012 assessment, the questionnaires have been structured by dimensions and sub-dimensions, the sub-dimensions have now been divided into thematic blocks, each with their own set of questions (Table A.1). These thematic blocks are typically broken down into the three components or stages of the policy process (design, implementation, monitoring and evaluation), with some deviations in certain dimensions. This approach is aimed at allowing governments to identify and target specific weaknesses within their policy processes, and to increase the emphasis on implementation and monitoring and evaluation of policies.

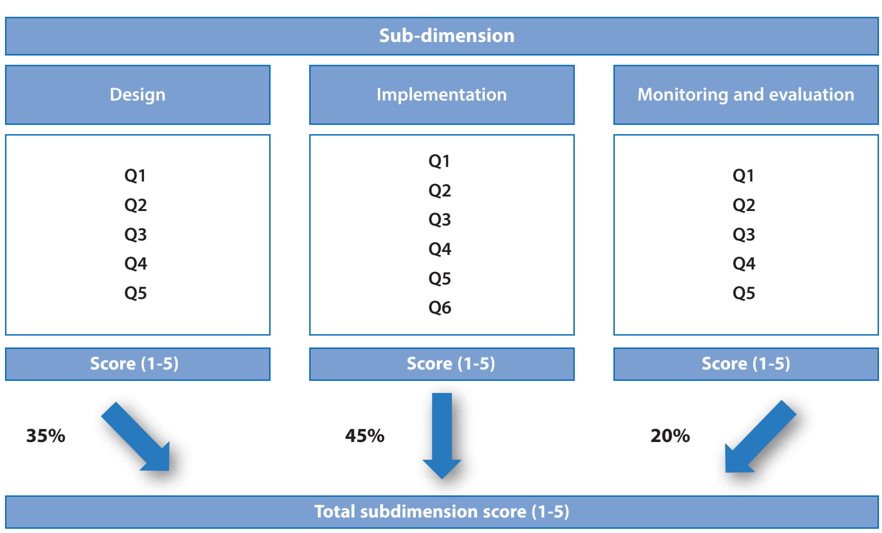
Table A.1. **Example of thematic blocks for the "Institutional framework" sub-dimension**

Design	Implementation	Monitoring & evaluation
Is there a multi-year SME strategy in place?	Has budget been mobilised for the action plan?	Are there any monitoring mechanisms in place for the implementation of the strategy?

Each questionnaire contains two types of questions: *(a)* core questions to determine the assessment score; and *(b)* open questions to acquire further descriptive evidence.[1] Each of the core questions (Q1, Q2, Q3, etc.) is scored equally within the thematic block. For binary questions, a "Yes" response is awarded full points and a "No" response receives zero points. For multiple choice questions, scores for the different options range between zero and full points, depending on the indicated level of policy development.

The core questions are scored individually and then added to provide a score for each thematic component. Scores are initially derived as percentages (0-100) and then converted into the 1-5 scale (Figure A.1). Scores for the thematic blocks are then aggregated to attain a score for the sub-dimension, which each component being attached a weight based on expert consultation. In general terms, a 35-45-20 percentage split has been attributed to emphasise the importance of policy implementation. The sub-dimensions are then aggregated using expert-determined weightings based on the relative significance of each policy area to reach an overall 1-5 level per dimension (see below).

Figure A.1. **Questionnaire scoring**



Since 2012, several dimensions in the assessment have been revised in order to assess a broader range of SME policies (e.g. integration of SMEs into global value chains) and address potential gaps in measurement (e.g. performance of bank financing in terms of actual levels of financial inclusion) as well as to undertake a minor reorganisation and streamlining of sub-dimensions. The weightings of the sub-dimensions have been adjusted to allow for these additions whilst maintaining comparability with the 2012 assessment as much as possible. An overview of the changes to the dimensions is provided in Table A.2 (for more details see the thematic chapters in Part I of this report).

Table A.2. **Overview of changes to SBA assessment dimensions**

Dimension	Changes introduced since the 2012 assessment
Entrepreneurial learning and women's entrepreneurship (Dimension 1)	Eight new indicators have been added under the entrepreneurial learning sub-dimension. The indicators reinforce *(a)* the policy environment, in particular through interfacing entrepreneurial learning policy with a country's wider entrepreneurship policy drive; and *(b)* policy implementation, with more specific attention given to entrepreneurship promotion in vocational and tertiary education. Three new indicators have also been introduced under the women's entrepreneurship sub-dimension: institutional support, good practice exchange and training.
Bankruptcy and second chance for SMEs (Dimension 2)	All questions relating to laws and procedures have been grouped under the first sub-dimension ("Laws and procedures"), leaving only discharge procedures and targeted government programmes to promote second chance under the "Promoting second chance" sub-dimension.
Support services for SMEs and start-ups (Dimension 5a)	This dimension has been streamlined into two sub-dimensions covering the public provision of SME support infrastructure and services and measures to stimulate private sector provision of business support services to SMEs. Previously, the dimension was broken down into various sub-dimensions based on the type of support instrument and the promotion of private markets was not explicitly considered.
Public procurement (Dimension 5b)	The public procurement dimension was kept as a single dimension with the same indicators as in the previous assessment. However, the dimension was restructured in line with the thematic blocks (regulatory framework, implementation and monitoring and evaluation).
Access to finance for SMEs (Dimension 6)	The dimension has been expanded with the addition of sub-dimensions on bank financing and financial literacy. BEEPS results, macro statistics (e.g. credit registry coverage, leasing penetration rate and factoring penetration rate), and indicators from international benchmarks (e.g. World Bank *Doing Business*), have been integrated to better capture policy outputs and outcomes. The extent of the changes means the scores are not directly comparable with the 2012 scores for this dimension.
Standards and technical regulations (Dimension 7)	The dimension on standards and technical regulations was kept as a single dimension with the same indicators as in the previous assessment. However, the dimension was restructured in line with the thematic blocks (regulatory framework, implementation and monitoring and evaluation).
Enterprise skills (Dimension 8a)	In view of developments in the EU and the EaP region's SME policy agenda, two new indicators have replaced the "Access to training" indicator: "E-training for SMEs" and "Training for internationalisation of enterprises".
Innovation policy for SMEs (Dimension 8b)	The dimension has been restructured from two sub-dimensions to three by dividing "Support services for innovation" into financial and non-financial support.
SMEs in a green economy (Dimension 9)	The dimension has been substantially revised based on the *OECD Greening Toolkit for Eastern Partnership Countries*. Two sub-dimensions have been created, measuring the strategic framework and existing tools to promote SME greening. 2012 scores for Dimension 9 have been recalculated based on the updated methodology to allow for direct comparison between 2016 and 2012 scores
Internationalisation of SMEs (Dimension 10)	The existing export promotion sub-dimension has been expanded to assess the role and performance of the export promotion agency/body in the implementation of SME internationalisation strategies. A second sub-dimension has been introduced to measure the integration of SMEs into global value chains.

Supplementary data

The 2016 SME Policy Index has also tried to supplement the formal assessment framework described above with additional data and statistics. With a few exceptions (e.g. for Dimension 6), this additional data has not been incorporated into the scores. Instead this information is used to support the policy narrative with additional details on policy outcomes and SME perceptions. Two types of additional data have been collected:

- Structural business statistics and business demography data (on enterprise birth, death and survival rates) were requested from the six national statistics offices, along with statistics on policy outputs related to the SBA policy dimensions based on the EU SBA fact sheets, which benchmark EU countries based on the principles of the SBA. Significant gaps in data collection and inconsistencies in data collection methodologies in the EaP countries prevent the regional comparison of statistics. However, structural and business demography statistics are included in the country profiles (see Part II). In addition, this effort was useful as a mapping exercise to highlight statistical data gaps across EaP countries as a significant constraint for policy making (see Part I, Chapter 3).
- Firm-level surveys, namely the Business Environment and Enterprise Performance Survey (BEEPS) conducted by the EBRD and the World Bank (Box A.2) and a series of OECD company surveys carried out in all six EaP countries (Box A.3), have been used to feed into the narrative assessment of countries and dimensions. The BEEPS results have also been integrated into Dimension 6 scores (see above and Part I, Chapter 6) and analysed in the relevant thematic chapters (e.g. access to finance for SMEs, enterprise skills and innovation, SME internationalisation) to provide insights into the potential impact of policy measures on firms. Finally, BEEPS results (including perceptions regarding constraints to business in each EaP country) have also been analysed in the six country profiles included in Part II of this report.

In addition, the country profiles (Chapters 11 to 16) now include a more in-depth analysis of the key challenges facing the SME sector, as well as more detailed recommendations to help EaP countries monitor reforms. Firstly, country-specific challenges and opportunities have been summarised using a SWOT analysis (strengths, weaknesses, opportunities and threats; see the tables at the start of each country chapter). This not only includes the main findings of the SBA assessment, but also broader macroeconomic and business environment challenges affecting SMEs and SME policy making that may not be directly captured by the different SBA dimensions. Secondly, the "Way forward" section of the country profiles now includes a detailed reform roadmap outlining the country's short, medium and long-term policy priorities.

Box A.2. **BEEPS**

The Business Environment and Enterprise Performance Survey (BEEPS) is a joint initiative of the European Bank for Reconstruction and Development (EBRD) and the World Bank Group (the World Bank). It is a firm-level survey based on face-to-face interviews with managers. The survey was first undertaken on behalf of the EBRD and the World Bank in 1999-2000, when it was administered to approximately 4 100 enterprises in 25 countries of Eastern Europe and Central Asia (including Turkey) to assess the environment for private enterprise and business development. Since then, five rounds of the survey have been carried out.

Box A.2. **BEEPS** *(continued)*

The fifth round of BEEPS in 2011-14 (BEEPS V) covered almost 16 000 enterprises in 30 countries, including an Innovation Module covering product, process, organisational and marketing innovation, as well as management practices in manufacturing enterprises with at least 20 employees. All six EaP countries were surveyed in 2013 (Table A.3).

Table A.3. **BEEPS V in the EaP countries**

Country	Sample size	Sectoral breakdown
Armenia	360 companies (175 small, 137 medium, 48 large)	Manufacturing (111), retail (119), other services (130)
Azerbaijan	390 companies (208 small, 147 medium, 35 large)	Manufacturing (121), retail (124), other services (145)
Belarus	360 companies (195 small, 99 medium, 66 large)	Manufacturing (117), retail (124), other services (119)
Georgia	360 companies (237 small, 96 medium, 27 large)	Manufacturing (111), retail (129), other services (118)
Moldova	360 companies (213 small, 113 medium, 34 large)	Manufacturing (110), retail (133), other services (116)
Ukraine	1002 companies (513 small, 346 medium, 143 large)	Manufacturing (737), retail (128), other services (137)

Note: Firm size levels are 5-19 (small), 20-99 (medium), and 100+ employees (large-sized firms).

Source: http://ebrd-beeps.com/.

Box A.3. **OECD company surveys**

For the 2016 SBA assessment, company surveys were carried out by the OECD in all six EaP countries in partnership with local experts. Fieldwork for all surveys was carried out in December 2014 and early 2015. The aim of the surveys was to measure SMEs' perceptions of the effectiveness of policy measures as well as the obstacles to firm growth and performance. The survey used a common questionnaire in each country, consisting of 51 questions relating to the SBA assessment's 12 policy dimensions.

Survey samples were compiled based on official records on business entities and using the legal SME definition of each country, except in the case of Azerbaijan where unofficial company listings were used due to confidentiality issues regarding official data. The sample included two stratification criteria: region and company size. The sampling frame focused on businesses operating in agribusiness, manufacturing, construction, transport, retail, information and communication sectors. The number of enterprises within each sector was defined based on each sector's contribution to GDP, with oversampling of higher-value-added sectors. Similarly, medium-sized enterprises were oversampled given their interest as greater contributors to employment and GDP. The surveys were carried out using both telephone and face-to-face interviews, depending on the country and the company's location and availability.

Box A.3. **OECD company surveys** *(continued)*

Due to the differences in methodology across the region and the divergence of SME definitions across countries, caution should be taken in comparing results across countries. As a result, company survey results have been largely used to illustrate specific findings or recommendations at the level of each of the EaP countries (see Part II of this report). Table A.4 summarises the details of the survey design in the six countries.

Table A.4. **Company survey design**

Country	Survey design	Sampling by size	Sampling by sector
Armenia	150 micro, small and medium enterprises using written, telephone and face-to-face interviews	Micro – 34% Small – 48% Medium – 18%	IT and communication – 27% Retail – 23% Restaurants, hotel, culture and leisure – 15% Processed manufacturing – 13% Agribusiness – 11% Construction – 7% Transport – 4%
Azerbaijan	200 small and medium sized enterprises using face-to-face interviews	Small – 70% Medium – 30%	Manufacturing – 33.5% Retail – 33.5% Construction – 21.5% Transportation and communication – 11.5%
Belarus	220 small and medium enterprises using computer assisted telephone interviews	Small – 83.2% Medium – 16.8%	Agriculture, Forestry and Fishing – 3.2% Mining and Quarrying – 1.8% Manufacturing – 13.2% Construction – 16.4% Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles – 30% Transportation and Storage – 10.9% Information and Communication – 7.7% Other Services – 15.5% Others – 1.4%
Georgia	200 small and medium sized enterprises using face-to-face interviews	Small – 70% Medium – 30%	Manufacturing – 35% Retail – 15.5% Construction – 27.5% Transportation and communication – 20.5%
Moldova	310 small and medium enterprises using computer assisted telephone interviews	Small – 67.4% Medium – 32.6%	Agriculture, Forestry and Fishing – 17% Mining and Quarrying – 2% Manufacturing – 16% Utilities – 2% Construction – 11% Wholesale and Retail Trade – 22% Transportation and Storage – 9% Information and Communication – 3% Other Services – 8% Others – 10%
Ukraine	403 small and medium enterprises using telephone interviews	Small – 65.3% Medium – 34.7%	Construction – 12.2% Information and telecommunication – 5% Retail and wholesale trade – 28.5% Industrial manufacturing – 26.6% Agriculture – 19.6% Transportation – 8.2%

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OECD (2012), *SME Policy Index: Eastern Partner Countries 2012: Progress in the Implementation of the Small Business Act for Europe*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264178847-en.

World Bank (2014), *Doing Business 2015,* World Bank, Washington, DC.

Note

1. Core questions include: *(a)* binary or yes-no questions (e.g. "Does a legal definition of SMEs exist in your country?"); and *(b)* multiple choice questions (e.g. "Does a multi-year SME strategy exist?" for which various responses are available, e.g. "Strategy is in the process of development", "Draft strategy exists but yet not approved by the government", "Strategy exists, has been approved by the government and is in the process of implementation", or "There is no strategy in development"). In either case, countries are requested to provide evidence (source and/or explanation) for the answers. Open questions (e.g. "What is the budget for the SME implementation agency?"; "How many people work in the agency?" or "How many ministries are represented in the governance board?") are used to provide further details on the responses to the core questions, but are not directly scored.

Annex B

Organisation profiles

Organisation for Economic Co-operation and Development (OECD), Eurasia Competitiveness Programme

The OECD Eurasia Competitiveness Programme, launched in 2008, helps accelerate economic reforms and improve the business climate to achieve sustainable economic growth and employment in two regions: Eastern Europe and South Caucasus (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine), and Central Asia (Afghanistan, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan).

The programme works to improve the business climate through a comprehensive approach to evaluate policy, define priorities and support capacity building and implementation of reform. It achieves impact by helping countries align to OECD standards, such as the "OECD Declaration on International Investment and Multinational Enterprises". It helps foster the implementation of OECD tools and instruments, such as the "Policy Framework for Investment" and supports countries in the Eurasia region in conducting OECD flagship reviews in collaboration with respective committees. OECD experts work closely with public authorities, the private sector and civil society to design and implement tools and instruments that lead to policy reforms and improve the business climate.

European Commission, Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW)

The Directorate-General (DG) for Internal Market, Industry, Entrepreneurship and SMEs is the European Commission service responsible for:

- Completing the internal market for goods and services.
- Helping turn the EU into a smart, sustainable and inclusive economy by implementing the industrial and sectorial policies of the flagship Europe 2020 initiative
- Fostering entrepreneurship and growth by reducing the administrative burden on small businesses; facilitating access to funding for small and medium-sized enterprises (SMEs); and supporting access to global markets for EU companies. All of these actions are encapsulated in the Small Business Act.
- Generating policy on the protection and enforcement of industrial property rights, co-ordinating the EU position and negotiations in the international intellectual property rights (IPRs) system, and assisting innovators on how to use IPRs effectively.

- Delivering the EU's space policy via the two large-scale programmes Copernicus (European Earth observation satellite system) and Galileo (European global navigation satellite system), as well as research actions to spur technological innovation and economic growth.

European Training Foundation

The European Training Foundation (ETF) is a specialised EU agency that supports 30 partner countries to harness the potential of their human capital through the reform of education, training and labour market systems in the context of the EU's external relations policy. The ETF's vision is to make vocational education and training in the partner countries a driver for lifelong learning and sustainable development, with a special focus on competitiveness and social cohesion.

The ETF's added value comes from its neutral, non-commercial and unique established knowledge base – consisting of expertise in human capital development – and its links to employment. This includes expertise in adapting the approaches to human capital development in the EU to the partner countries' contexts, thereby supporting the development of home-grown solutions.

European Bank for Reconstruction and Development

The EBRD is an international financial institution that supports projects in Central and Eastern Europe, Central Asia and, since September 2012, the Southern and Eastern Mediterranean. Investing primarily in private sector clients whose needs cannot be fully met by the market, the bank fosters the transition towards open and democratic market economies. In all its operations the EBRD follows the highest standards of corporate governance and sustainable development. Owned by 64 countries and two intergovernmental institutions, the EBRD maintains a close political dialogue with governments, authorities and representatives of civil society to promote its goals.

Box B.1. **The Eastern Partnership**

The Eastern Partnership was launched in 2009 at a summit in Prague. It is a political initiative joining the EU, its Member States and the Eastern European partners (Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova and Ukraine) in an effort to promote political, economic and social reforms, bringing the EaP countries closer to the EU. The Eastern Partnership supports and encourages reforms in the EaP countries for the benefit of their citizens. It is based on a shared commitment to international law and fundamental values that include democracy, the rule of law and respect for human rights and fundamental freedoms, as well as the market economy, sustainable development and good governance. The partnership is founded on mutual interests and commitments as well as shared ownership and mutual accountability. The main goal of the Eastern Partnership is to create the conditions to accelerate political association and deepen economic integration between the EU and the Eastern European partner countries. The Eastern Partnership is part of the EU Neighbourhood Policy.

The Eastern Partnership bilateral and multilateral tracks are complementary. The numerous challenges EaP countries share are jointly addressed through the multilateral track by promoting co-operation, networking and the exchange of best practice. Multilateral co-operation work is guided by four thematic platforms, supported by various expert panels, flagship initiatives and projects.

For more details on the Eastern Partnership, see the Policy Framework and Assessment Process chapter.

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SME Policy Index

Eastern Partner Countries 2016

ASSESSING THE IMPLEMENTATION OF THE SMALL BUSINESS ACT FOR EUROPE

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