



# SME Development Strategy of Georgia 2016-2020

*November, 2015*

*Draft*

## List of Abbreviation

<b>GoG</b>	<b>Government of Georgia</b>
<b>SMEs</b>	<b>Small and Medium Sized Enterprises</b>
<b>EDA</b>	<b>Entrepreneurship Development Agency – Enterprise Georgia</b>
<b>GITA</b>	<b>Georgian Innovation and Technology Agency</b>
<b>OECD</b>	<b>Organization for Economic Cooperation and Development</b>
<b>WB</b>	<b>World Bank</b>
<b>EC</b>	<b>European Commission</b>
<b>EU</b>	<b>European Union</b>
<b>AA</b>	<b>Association Agreement</b>
<b>DCFTA</b>	<b>Deep and Comprehensive Free Trade Area</b>
<b>GDP</b>	<b>Gross Domestic Product</b>
<b>FDI</b>	<b>Foreign Direct Investment</b>
<b>IFI</b>	<b>International Financial Institution</b>
<b>FTA</b>	<b>Free Trade Agreement</b>
<b>GSP</b>	<b>Generalized System of Preferences</b>
<b>MFN</b>	<b>Most Favoured Nation Regime</b>
<b>GEL</b>	<b>Lari – Georgian National Currency</b>
<b>ICT</b>	<b>Innovation and Communication Technologies</b>
<b>TBT</b>	<b>Technical Barriers to Trade</b>
<b>ETF</b>	<b>European Training Foundation</b>
<b>GEOSTAT</b>	<b>Georgian National Statistics Office</b>
<b>SBA</b>	<b>Small Business Act for Europe</b>
<b>PPD</b>	<b>Public Private Dialogue</b>
<b>VET</b>	<b>Vocational Education and training</b>

## **Contents**

Preface .....	4
1. Overview of the Economy and Government Priorities.....	5
1.1 Economic Trends and Indicators.....	5
1.2 Government Economic Priorities .....	7
2. Overview of the SME Sector.....	8
2.1. Business Environment, Legal and Institutional Framework for SMEs.....	8
2.2. Performance of SMEs.....	14
2.3. SME Policy Index (2012) .....	15
3. SWOT-Analysis of SME Sector.....	17
4. Aim and Objectives of SME Development Strategy for Georgia 2016-2020.....	18
5. Strategic Directions of SME Policy .....	18
6. Implementation and Monitoring.....	31
6.1 Coordination and Institutional Framework for SME Strategy .....	31
6.2 Funding for the SME Strategy implementation .....	31
6.3 Donor Involvement and Coordination.....	31
6.4 Monitoring and Evaluation .....	32

## Preface

The business sector and especially the Small and Medium-sized Enterprises (SMEs) play an important role in the development of the economy, contributing significantly to the sustainable and inclusive growth. SMEs, having enormous potential in employment generation and job creation, as well as in fostering economic growth, could be considered as a backbone of each country's economy. A strong and well-developed SME sector significantly contributes to export, innovation, and creation of modern entrepreneurial culture, playing at the same time a significant role in achieving prosperity in the country.

Usually in advanced economies (e.g. those of the European Union (EU) countries) SMEs constitute the overwhelming share of operating enterprises, generate more than 50% of turnover and provide two out of every three jobs in the private sector. In OECD countries, more than 99% of companies are SMEs and generate about two-thirds of GDP on average. In developing countries or in countries in transition, SMEs represent more than 90% of the total number of companies, but their contribution to GDP is generally quite low – in many cases less than 20% (European Commission, 2010<sup>1</sup>).

During recent years, Georgia has undertaken broad and comprehensive reforms, including economic reforms, which have touched upon every aspect of people's life. The main aim of those reforms was the creation of favourable environment for doing business and foreign direct investment (FDI) via liberalization of the economy, reduction of administrative barriers and tax burden, streamlining public services, fighting against corruption, etc. Due to these reforms, Georgia achieved high rates of economic growth and significant FDI inflows. Georgia's economic policy was positively evaluated by different rating agencies and International Financial Institutions (IFIs) and the results are reflected in different indices and ratings evaluating economic freedom and policies. For example, Georgia was recognized as the top improver country by the WB/IFC Doing Business (2015).

Despite the improvement of general business environment, Georgia faces broadly the same challenges in terms of SMEs development as many developing countries. Notwithstanding the fact that SMEs constitute the largest share of operating enterprises, their contribution to GDP is still very low and their performance remains weak.

The Government of Georgia (GoG) recognizes the importance and role of SMEs in economic development and is committed to the further improvement of the business environment in order to enable SMEs to develop and grow.

Support of the private sector development in general, and especially the development of SMEs, is one of the main aims of the GoG's economic policy. Consequently it is one of the priorities of the "Socio-Economic Development Strategy of Georgia" – Georgia 2020 (June, 2014), as well as the Programme "For a Strong, Democratic and United Georgia" (July, 2014).

The GoG attaches particular importance to the enhancement of private sector competitiveness and especially enhancement of SMEs' competitiveness, in the context of the EU-Georgia Association Agreement (with its integral part – the Deep and Comprehensive Free Trade Agreement (DCFTA)), which was signed in June 2014 and ratified by the Parliament of Georgia in July, 2014. DCFTA started being provisionally applied from September 1, 2014. DCFTA provides Georgia with a unique opportunity to achieve deeper integration with the EU market and, at the same time, increases the potential to attract FDI. Adaptation to and implementation of DCFTA requirements is essential for Georgia in order to enable businesses to gain maximum benefit from the DCFTA by maximising the

---

<sup>1</sup> Source: European Commission: *Dialogue on «SME Policy» with regard to the multilateral framework of the Eastern Partnership*

export potential. The GoG is dedicated to implement its reform agenda under the DCFTA commitments.

With consideration of discussions above, a clear strategy and vision is essential in order to facilitate SMEs development and support the enhancement of competitiveness.

The main aim of this Strategy, which is based on “Think Small First” principle, is the enhancement of SME sector competitiveness, which will create solid base for inclusive and sustainable economic growth. Strategy sets targets to be achieved by 2020.

Strategic Directions and relevant Policy Actions laid down in the Strategy are elaborated based on the analysis of existing economic situation, institutional and operational environment for SMEs and with consideration of existing evaluations, assessments and recommendations. Effective implementation of policy measures provided in the strategy should lead to achieving of targets by 2020. Specific actions are provided in supplementary Action Plan. Strategy considers establishment of monitoring and evaluation mechanisms.

SME Development Strategy is elaborated in close cooperation with OECD and GIZ support.

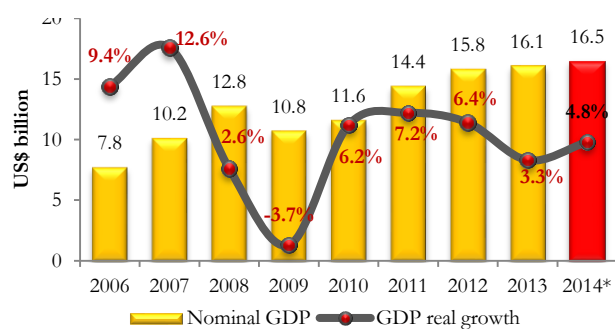
## 1. Overview of the Economy and Government Priorities

### 1.1 Economic Trends and Indicators

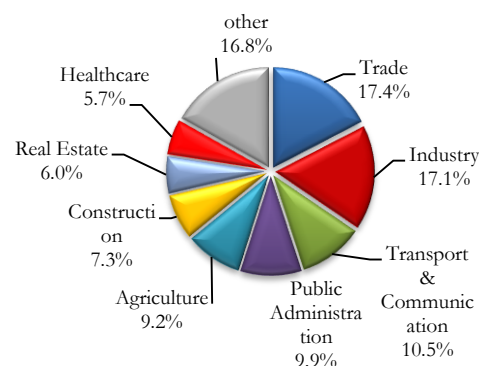
**Economic Growth:** Due to the reforms being implemented by the GoG, the economy has both diversified and achieved high rates of economic growth. The highest (12.3%) rate of Gross Domestic Product (GDP) real growth was achieved in 2007. During 2003-2007, the average GDP real growth amounted to 9.6%. The Georgian economy showed itself to be exceptionally resilient to the external double shock of 2008, namely the military invasion by the Russian Federation, followed by the global financial crisis. In 2008, GDP growth amounted to 3.2% and declined in 2009 to -3.8%, but recovered quickly, achieving 6.3% growth in 2010. During 2011 and 2012, GDP grew by 7.2% and 6.2% respectively. The growth rate declined slightly in 2013 due to the decline of FDI growth rate, but in 2014, despite overall non-favourable economic situation in the region and in Georgia’s main trade partner countries, Georgia’s economy grew by 4.8%.

The largest shares of GDP in 2014 were in trade, industry, transport & communication and agriculture sectors. The top 5 fastest growing sectors in the same period were as follows: construction (13.5%), financial intermediation (10.0%), real estate (8.5%), communication (7.1%), , transport (6.4%) and trade (6.1%).

**Graph 1: nominal GDP and Real Growth**



**Graph 2: Components of GDP (2014)**



**Foreign Trade:** Georgia's foreign trade was growing rapidly. In 2004-2013 foreign trade turnover, export and import increased more than four-fold. In 2014, the foreign trade turnover reached \$11.5 bln, exports \$2.9 bln and imports \$8.6 bln. The top 5 export commodities during this period were: motor cars, ferro-alloys, copper ores, nuts and wines. The top 5 import commodities were: petroleum and petroleum oils, motor cars, petroleum gases and other gaseous, medicaments and telephones for cellular networks or for other wireless networks. The top 5 trade partners were: Turkey, Azerbaijan, Russian Federation, China and Ukraine. In 2014, the external trade of Georgia with the EU countries amounted to \$2,993.8 mln, up by 4.3% compared to the corresponding indicator of the previous year. Exports amounted to \$ 624.1 mln (2.8% higher) and imports to \$2,369.7 mln (4.7% higher). The share of trade with the EU in the external trade of Georgia amounted to 26%, 22% in exports and 28% in imports (in 2013 26%, 21% and 28% respectively).

Georgia has had a Free Trade Agreement (FTA) with Commonwealth of Independent States (CIS) and Turkey since 2008, Most Favoured Nation (MFN) – with WTO member countries, Generalized System of Preferences (GSP) – with USA, Canada, Japan, Switzerland, Norway and Generalized System of Preferences (GSP +) – with the EU (7200 items) since 2005.

Georgia signed an Association Agreement (AA) with the EU, which includes the DCFTA, on 27<sup>th</sup> of June 2014. The Parliament of Georgia ratified the AA on 18<sup>th</sup> of July 2014. DCFTA provisionally applied since September 1, 2014. The DCFTA represents a unique opportunity for Georgia to integrate into the EU market and to increase the attraction of FDI. At the same time, DCFTA requires gradual approximation of Georgian legislation and systems to the respective EU norms and systems (i.e. the EU *Acquis*).

Negotiation with European Free Trade Association started in 2015 and it is expected to finalize it during one year.

**FDI:** Due to an improving business, investment and institutional environment, the FDI inflow in Georgia was significant and in 2007 amounted to approximately 20% of GDP. During 2006-2014, the cumulative FDI in Georgia amounted to \$9.8 bln. The largest shares of FDI in 2014 were in transport and communications (25%), construction (18%), manufacturing (12%), energy (11%), real estate (8%), hotels and restaurants (7%) and financial sector (6%). The largest investor countries during the same period were Netherlands (21.3%), Azerbaijan (19.4%), China (12.4%), USA (10.3%), Luxemburg (6.2%) and UK (6.1%). The highest share (46.6%) of FDI is originated from the EU countries and 25.5% - from CIS countries.

**Business Performance:** During 2006-2014, the overall turnover of the business sector increased by 3.4-fold and amounted to GEL 50 bln in 2014, while during the same period output increased by 3.5-fold and amounted to GEL 26 bln. The number of employed persons increased from 361.000 to 592 147. The largest share of employees (in 2014) in the business sector was employed in trade (23.5%), industry (19.6%), construction (11.4%), real estate (10.0%), transport and communication (10.0%) and health (9.8%). The average monthly remuneration in this period increased from GEL 286 to GEL 801. The value added by business sector during 2006-2014 increased from GEL 3,5 bln to GEL 12,8 bln. And the growth of investment in fixed assets - from GEL 2,1 bln to GEL 3.6 bln. The largest share in total turnover by economic activities (in 2014) was in trade (50.5%), industry (18.0%) and transport and communication (10.3%), while the volume of output was highest in industry (31.5%) followed by trade (17.1%) construction (15.7%) and transport and communication (13.8%).

## 1.2 Government Economic Priorities

Two main documents - “Socio-Economic Development Strategy of Georgia – Georgia 2020” (2014) and Governmental Programme “For a Strong, Democratic and United Georgia” (2014) - set out the general framework for Georgia’s future development, including economic policy. The importance of the creation of a strong private sector, with special emphasis on SMEs, is underlined in both documents.

### **Georgia 2020**

The main priorities of Georgia’s economic policy until 2020 are set out in “Georgia 2020”, which was adopted by GoG in June 2014. The economic policy vision of GoG is built on the following principles: rapid and effective economic growth based on a competitive private sector; economic policy oriented at inclusive growth; and rational use of natural resources.

Georgia 2020 stresses that the actions and policy measures under the AA and the DCFTA are main directions of Georgia’s future economic policy.

Georgia 2020 is based on the principle of freedom of the private sector in terms of effective, transparent and optimal government. Georgia 2020 identifies the main factors hindering inclusive economic growth and sets out horizontal measures for the achievement of inclusive growth. Enhancement of private sector competitiveness is the main priority for the GoG, since the private sector is the key driver of inclusive economic growth. Within this priority, special attention is paid to strengthening the SME sector.

Georgia 2020 sets three main priority actions and relevant policy measures:

#### **Priority Action 1: Increase private sector competitiveness**

**Policy measures:** further improvement of the investment and business environment; promotion of innovations and new technologies; export promotion and development of infrastructure; and maximization of Georgia’s transit potential.

#### **Priority Action 2: Develop competitive human capital**

**Policy measures:** development of market oriented human capital; streamlining social security system; and securing affordable and quality health care.

#### **Priority Action 3: Increase access to finance**

**Policy measures:** mobilization of investment resources and development of financial intermediation for insurance of long-term investment resources.

The key preconditions for the effective implementation of Georgia 2020 are macroeconomic stability and effective public governance.

### **Governmental Programme “For a Strong, Democratic and United Georgia”**

The Governmental Programme sets number of priorities in different directions, including economic policy direction. Overcoming unemployment and poverty are among the main goals to be achieved in the near future. In this regard, special attention is given to the development of SME sector. The GoG will further work to develop entrepreneurship and enhance competitiveness of SMEs in order to increase its role and share in the economy. The importance of entrepreneurship support, especially SMEs and start-ups development (*via provision of capacity building and entrepreneurial learning, improvement access to finance, strengthening export potential, access to innovation and new technologies, etc.*), is underlined by the Programme.

## **Other Relevant Strategic Documents**

There are several policy documents which also underline the importance of SME development.

**Regional Development Strategy of Georgia for 2010-2017 (2010):** special attention is paid to support of SMEs development and start-ups in the regions of Georgia in terms of trainings, improvement of access to finance and innovations, development of different SME supportive institutions, mechanisms and tools, SMEs internationalization and establishment of cooperation with international trade partners.

**Agriculture Development Strategy of Georgia for 2015-2020 (2015):** considers support to businesses and especially SMEs operating in agribusiness and also, start-ups, development of small and medium farming industries. Strategy also considers enhancement of competitiveness of enterprises operating in agriculture via delivery of information on market demands, support to adaptation to DCFTA requirements, specific trainings, support to export, etc.

**Action Plan for Implementation of DCFTA for 2014-2017 (2014):** includes special measures for SME support, such as preparation of Georgian businesses for the implementation of approximated legislation in the frame of DCFTA, support SMEs through various financial and nonfinancial tools (e.g. access to finance, export promotion, products' development, consultations and others).

**Vocational Education Reform Strategy for 2013-2020 (2013):** aims at development of labour market oriented human resources, insurance of access to vocational education, development of high level qualifications for the development of competitive human capital and etc. For effective implementation of the strategy special attention is given to the involvement of social partners, including business-sector at all levels in decision-making process, which is important for the development of labour market oriented human capital.

## **2. Overview of the SME Sector**

### **2.1. Business Environment, Legal and Institutional Framework for SMEs**

#### **Business Environment**

Due to the reforms implemented by GoG during the recent years, business and investment environment of Georgia is significantly improved - administrative barriers were significantly reduced and public services streamlined, but there is still room for improvement of SMEs development.

#### ***Reforms, which make business operation easier:***

**Tax Policy:** The number of taxes and tax rates were significantly declined along with improvements to tax administration. Georgia now has the most liberal tax jurisdiction in Europe. According to Forbes' Tax Misery and Reform Index 2009 Georgia had the 4<sup>th</sup> lowest tax burden country globally after Qatar, United Arab Emirates and Hong Kong. Currently, Georgia has 6 flat taxes compared with the 21 that existed until 2004.

**Customs Policy:** Customs reforms have significantly simplified and sharply reduced the costs related to foreign trade. The number of import tariffs was abolished for approximately 85% of products and only 3 tariff rates (0%, 5% and 12%) exist instead of 16. Georgia sets custom taxes only on several kinds of agricultural goods and constructing materials. In addition, there are no quantitative restrictions (quotas) on imports and exports. As far as DCFTA provisionally applied from September 1 2014, trade between EU Member Countries and Georgia is conducted duty free.

**Licenses and Permits:** Due to the reform of the system, since 2005 the number of licenses and permits was reduced approximately by 90%. Currently, licenses and permits are only required in the production of highly risky goods and services, as well as for usage of natural resources and for some specific



activities. The procedures of issuing licenses and permits were significantly simplified; the “One-Stop Shop” and “Silence is Consent” principles were introduced. Fees for licences and permits vary according to types of activities.

**Public Administration:** Procedures related to dealing with public institutions, including business related services, are provided according to “One Stop Shop” principle. Most of the services can be done online. In addition, Georgia established a unique system – Public service Halls (Houses of Justice) – throughout the country, where more than 400 types of services are provided in one space, decreasing cost and time for obtaining needed services and reducing risk of corruption.

GoG undertook significant measures for eliminating corruption, among others, liberalization of economy (decrease of number of taxes and tax rates, simplification of customs procedures), reforms of public institution, introduction of easy and transparent procedures for dealing with public services.

Due to liberalization of economy and significant decrease of corruption, the share of non-observed economy in country’s economy (share of non-observed output in total output) was decreased significantly – from 32% in 2004 to 12.9% in 2013) (*GEOSTAT: National Accounts of Georgia 2014*).

**International Ratings:** The WB/IFC „**Doing Business 2016**”<sup>2</sup> placed Georgia on 24<sup>th</sup> place among 189 countries in terms of ease of doing business. According to Doing Business 2016 “Globally, Georgia improved the most in the areas measured by Doing Business over the past 12 years.. Georgia made improvements in all 10 areas included in the aggregate distance to frontier score, through 39 regulatory reforms... Georgia stands out in Europe and Central Asia for having made big strides toward better and more efficient business regulation”. (*WB Doing Business 2016; Page 14*). In the last year, Georgia made 2 following significant reforms: Dealing with Construction Permits - Georgia made dealing with construction permits easier by reducing the time needed for issuing building permits and Enforcing Contracts Georgia made enforcing contracts easier by introducing an electronic filing system for court users. Georgia still needs improvement in several areas, such as Resolving Insolvency in which Georgia is on 101<sup>st</sup> place.

In the “**Index of Economic Freedom 2016**” of the Heritage Foundation, Georgia ranks on 23<sup>rd</sup> position among 178 countries and remains in Mostly Free Group. Georgia is 12<sup>th</sup> among European countries. Georgia still needs to further streamline protection of property rights, financial freedom (to reach the highest score), among other areas.

In the “**Index of Economic Freedom 2015**” published by the Fraser Institute, Georgia was promoted by 50 stages from 2003 and is placed on 12<sup>th</sup> position. Georgia still needs to improve its policy in governmental consumption, legal enforcement of contracts among other areas.

Georgia also improved its sovereign ratings, thereby sending an important message to businesses and investors. **Fitch, Moody and Standard&Poor’s** have all upgraded Georgia’s sovereign ratings. Currently Georgia has a “BB-” rating in Fitch, “BB-“rating in Standard & Poor and “Ba3” - in Moody’s Investors Service.

Despite the above-mentioned improvements of general business environment, SMEs are still facing difficulties in terms of development and growth, as proved by the SMEs’ current contribution to the economy, as well as different surveys carried out by international organizations such as e.g. WB Enterprise Survey 2013.

<sup>2</sup> WB: In *Doing Business 2016*, WB changed methodology: the new calculation of the rank based apart from the distance to frontier, methodology and its scope was broadened and measurements for quality of regulations were added 3 new indicators were added and 3 were changed ; Due to this changes Georgia’s position was changed for 2015 as well when Georgia was on 15 place. According to DB 2016, in 2015 Georgia’s Position (adjusted) was the same 24<sup>th</sup>.

## Legal and Institutional Framework for SMEs

### *SME Definitions*

The SME definition is based on employment size and turnover customized to Georgia's specificities and is used for the compilation of official statistics on the SME sector. Medium enterprises employ up to 100 persons annually and have a turnover up to GEL 1,500,000 annually. Small enterprises employ up to 20 persons annually and have an annual turnover up to GEL 500,000.

Table 1: Georgian SME Definition<sup>3</sup>

Type	Employment	Turnover
Small	Up to 20 employees per year	Up to 500,000.0 GEL per fiscal year
Medium	Up to 100 employees per year	Up to GEL 1, 500,000.00 per fiscal year

The Georgian Tax Code, which has been in force since January 2011, provides a different definition for small enterprises and also sets out the criteria for micro businesses. This definition is used for taxation purposes only and was introduced to allow the provision of preferential treatment for small and micro businesses. According to the Georgian Tax Code, small enterprise status is granted to entrepreneurs (natural persons), whose gross income from their economic activity during a calendar year does not exceed GEL 100,000. The status of micro business – to entrepreneurs (natural persons), who does not use hired labour, conduct economic activity independently and have an annual gross receivable up to GEL 30,000.

Table 2: Georgian MSB<sup>4</sup> (Micro and Small Business)

Type	Total Gross Income
Micro	Up to GEL 30,000.00
Small	Up to GEL 100,000.00

### *Taxation of Micro and Small Businesses*

Small businesses are taxed either at 3% or 5% of their taxable income. The taxable income of small businesses is taxed at 5%. The 3% rate of income tax applies if the entrepreneur can prove that his/her costs incurred (except for the cost of salary paid to employees) amounts to 60% of the gross income. Micro businesses are exempted from income tax. The main purpose of introducing the micro and small business status and preferential tax treatment was two/fold: facilitation of registration of such businesses

<sup>3</sup> Source: Law on the Georgian National Investment Agency

<sup>4</sup> Source: Tax Code of Georgia (2010)

and reduction of the tax burden. According to Revenue Service statistics, after introduction of new Tax Code, 83 231 micro and small enterprises have been registered, out of which 39 470 are micro and 43 761 small.

According to the Tax code of Georgia, businesses turnover not exceeding GEL 100,000 per annum are exempt from VAT. In addition, the supply of primary agricultural products is not subject to VAT. Certain businesses defined by the government are rated with taxes rate.

### ***Bankruptcy: 2<sup>nd</sup> chance***

The Georgian Law on Insolvency Proceedings provides procedures for insolvency, as well as for reorganization of enterprises. Nevertheless, debtors still face difficulties related to insolvency proceedings. According to Doing Business 2016, enterprises in Georgia face difficulties closing business and the recovery rate is low (39.9 cent on the dollar) compared to OECD countries (72.3 cent on the dollar), but higher compared to Europe and Central Asian countries (38.3).

Due to bottlenecks in implementation procedures, enterprises, especially SMEs, are facing difficulties in closing business. Therefore, part of enterprises, which are registered cannot close their business and thus remain in the business registry. In order to re-start operation and/or shift their operation into a new business, it is easier to establish new businesses rather to go through business closing procedures. This situation means that the number of active firms is not the same as the number of registered firms.

### ***Regulatory Impact Assessment: Think small first/SME Test***

There is not yet an official Regulatory Impact Assessment (RIA) system established in Georgia. Nevertheless a brief/simple RIA is conducted on new legislative proposals for evaluation of the possible regulatory burden on the business and public sectors, as well as for evaluation of estimated government expenditure.

Currently an ad hoc RIA capacity building programme focusing on public servants is being implemented. The GoG plans to establish a RIA system in Georgia, as stipulated by both Georgia 2020 and the Programme “For Strong, Democratic and Unified Georgia”.

## **SME Institutions**

### *National Institutions*

In order to promote SMEs creation, development and support the growth of their competitiveness through the innovative approaches, in February 2014 the Entrepreneurship Development Agency (Enterprise Georgia) and the Innovation and Technology Agency (GITA) were established under the oversight of the Ministry of Economy and Sustainable Development (MoESD).

**Enterprise Georgia:** Enterprise Georgia is responsible for coordination of implementation of SME supportive policies and programmes. The main aims of Enterprise Georgia are: improve private sector competitiveness; support start-ups; facilitate establishment of modern entrepreneurial culture; support diversification of export of goods and services, etc. Enterprise Georgia’s main functions are: support businesses to adapt the DCFTA requirements; to provide consultancy services in different areas, collect and deliver information to SMEs on demand and specific requirements of export markets and on demand of local market; assist SMEs in business planning and development, growth of competitiveness and productivity, entrepreneurial learning; assistance in cooperation with donor and financial institutions; provision of financing via special schemes, support in marketing of goods and services on international markets, etc.

**GITA:** GITA is a main coordinator and mediator in the process of building a national innovation ecosystem. The main mandate of GITA is: to create ecosystem and coordinate its development process; stimulate innovation, modern technologies and R&D, facilitate commercialization and usage of R&D; support to innovative start-ups and their competitiveness growth, facilitate cooperation between the representatives of scientists and businesses; cover whole country with high-speed internet connection and computerization process and etc. among the main functions of GITA are: contribute to building capacity and developing skills, support the enhancement of SMEs competitiveness through innovative approaches and technology solutions; provide the infrastructure for innovation and R&D; facilitation and financing of knowledge-based initiatives, innovative projects and products; implementation of programmes for stimulation of R&D in the business sector; cover whole country with high-speed internet connection and computerization process, etc.

Institutional strengthening of Enterprise Georgia and GITA is important in order to address SMEs needs and provide target-oriented services. As Enterprise Georgia is expected to provide consultancy and technical assistance on the DCFTA requirements to SMEs, as well as support them to adapt to these requirements, capacity building of this institution on DCFTA/related issues is essential.

#### *Business Associations providing support to SMEs*

There are number of organizations assisting Georgian SMEs, among which are:

- **Georgian Chamber of Commerce and Industry (GCCCI):** GCCCI is established as an independent public agency. Among the main functions of GCCCI is the provision of information and consultancy for businesses, support to improvement of business skills and business planning, promotion of export, support to internationalization of enterprises, etc. GCCCI membership is voluntary. Currently GCCCI has 1.007 members, more than 90% of which are SMEs. Membership fee varies from GEL 0 to GEL 10,000 and depends on services provided. SMEs do not pay membership fee. GCCCI has five regional offices located in the Regions.
- **Georgian Employers' Association (GEA):** GEA is an independent non-profit organization which unifies more than 1.000 SMEs. GEA provides consultancy services to SMEs and carries out different programmes related to entrepreneurial learning, business skills development. GEA membership is fee based and varies from \$600 up to \$2,000, according to size of enterprise.
- **Georgian Small and Medium enterprises Association:** GSMEA is an independent organization that aims at protecting the interests of small and medium enterprises. Organization cooperates actively with the business related to developing business skills, providing the consultancy and etc. Association unifies 106 members.

Business associations also require strengthening their capabilities on EU policies and DCFTA requirements in order to support SMEs. In addition, closer cooperation with business sector, as well as between SME institutions is needed in order to provide target-oriented services to SMEs and avoid overlaps.

## **SME Programmes and Initiatives**

In order to support SMEs development and establishment of new competitive industries, in 2014, the GoG launched the following state Programmes.

**“Produce in Georgia”:** The Government launched the state programme "Produce in Georgia" in order to support entrepreneurs related to industrial production and agri-processing, facilitate to create new enterprises/expand/reequip existing enterprises, increase competitiveness of private sector and export potential to finance through the access to real estate and technical assistance.

The programme is implemented by Enterprise Georgia, GITA and National Agency of State Property (NASP) and the Ministry of Agriculture of Georgia (via the Agriculture Project Management Agency) and is supervised by the MoESD. A dedicated web-portal ([www.qartuli.ge](http://www.qartuli.ge)) was created for effective implementation of this Programme. In 2015, two new directions were added to “Produce in Georgia”: i) support to the development of hotels, in terms of financing franchise costs and ii) support to movies production.

Since 2015, Enterprise Georgia started Project - “Micro and Small Business Support Programme” in order to facilitate economic activities in the regions. Project includes two components: financial assistance and technical assistance. Under the technical assistance component beneficiaries are provided with business and individual consultancy support, training services.

With the aim to increasing programme efficiency and identifying bottlenecks, evaluation and monitoring of the programme will be conducted for identification of bottlenecks.

## **Cooperation within the initiative of Eastern Partnership**

Georgia actively participates in the Eastern Partnership SME Panel and cooperates closely with the OECD, ETF, EBRD and other international organizations in order to further improve SME policy according to international best practices.

There are a number of SME-oriented projects implemented under the Eastern Partnership initiative.

Under the EGP (Enterprise Growth Programme) and BAS (Business Advisory Services) programmes (EU support), which are implemented by EBRD over 800 SMEs had been supported. Georgia actively participated in East-Invest Programme, under which SMEs are provided a variety of supports.

In 2015, Georgia and the EU signed the DCFTA and SMEs support agreement (budget - EUR 44.5 mln). The specific objectives of this Programme are: i) to further strengthen the DCFTA policy framework for trade and SME development; ii) to improve the overall functioning of priority trade and private-sector related institutions; and iii) to strengthen economic actors and SMEs along the DCFTA process.

**“Greening Economies in the Eastern Neighborhood”** (EaP Green) is being implemented, the overall objective of which is to move towards a green economy. Under this programme, OECD started implementation of the project on “Promoting better environmental performance of small and medium-sized enterprises”, the main aim of which is development of energy-efficient technologies in SMEs and promote government-to-business and business-to-business dialogue for sustainable production and the growing importance of green markets.

The GoG has close cooperation with the business community in the process of elaborating business-related legislation. In order to increase awareness of AA and DCFTA on the part of stakeholders and especially the business sector, regular meetings and conferences are held. The GoG elaborated and approved the AA and DCFTA action plans, which, among others, consider policy measures, informational campaigns etc.

## 2.2. Performance of SMEs<sup>5</sup>

In 2014 the number active enterprises amounted to 70 760, out of which 6 170 are medium and 60 640 small sized enterprises. The share of SMEs in the total number of active enterprises constitutes 94% (medium – 9% and small – 85%).

During 2006-2014, the turnover of SMEs increased by 269%, from GEL 2,4 bln up to GEL 9,0 bln and output - by 269.7%, from GEL 1,4 bln up to GEL 5,2 bln. The largest share of turnover (71.8%) and output (64.6%) falls on Tbilisi.

Value added by SMEs in total value added of enterprises during 2006-2014 varies and does not exceed 20%, with the exemption of 2011 and 2014, when it reached 21.8% and 21.1%. In 2013, this figure was 20.6%, and in 2014 - 21.1%. The largest share of value added (71.1%) is generated in Tbilisi.

SMEs' contribution to GDP is still very low (about 18% in 2014), which indicates, that SMEs do not play significant role in country's economy.

During 2006-2014, employment in SMEs increased by 53.7%, from 168.7 thousand up to 259.4 thousand, while employed (contractual) people increased by 58%, from 148.1 thousand up to 233.9 thousand. The share of employment in SMEs in total employment in enterprises is not high (43.8% in 2014), considering that the share of SMEs in total number of enterprises is high (94% in 2014). 63% of employed people in enterprises (in total) are employed in enterprises operating in Tbilisi.

The average monthly remuneration in medium size enterprises during the same period, increased by 3.4-fold from GEL 185 to GEL 636,9 and in small enterprises by 2.7%-fold from GEL 141.4 to GEL 375,2.

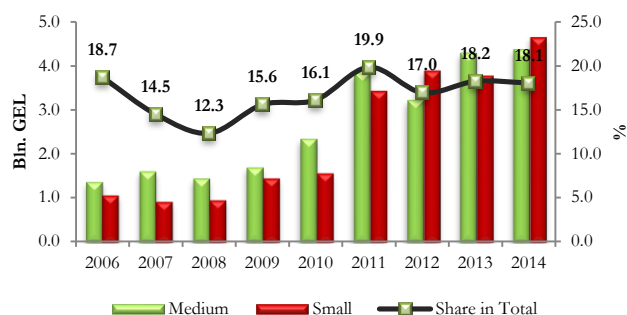
In this period, intermediate consumption of SMEs increased by 220% from GEL 767.6 mln to GEL 2.5 bln and investment in fixed assets – by 208%, from GEL 272.4 mln to GEL 839.5mln. The highest share of investment in fixed assets (62%) is allocated in Tbilisi. Consumption of goods and services in 2007-2014 almost tripled (from GEL1,9 bln up to GEL 7.1bln).

The graphics presented below illustrate the situation with respect to important SME indicators.

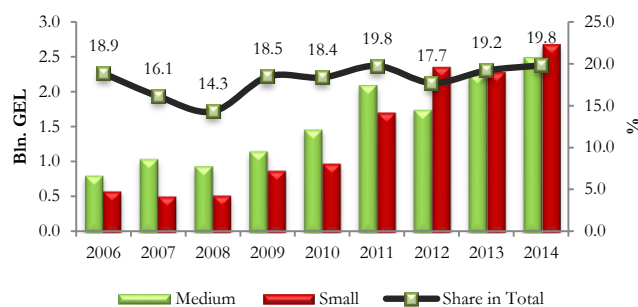
---

<sup>5</sup> Source: GEOSTAT and MoESD calculations

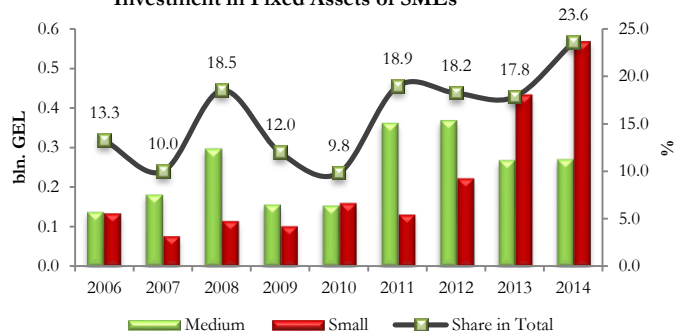
Turnover of SMEs



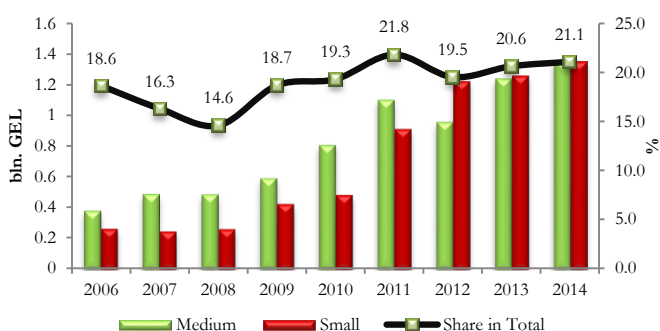
Output of SMEs



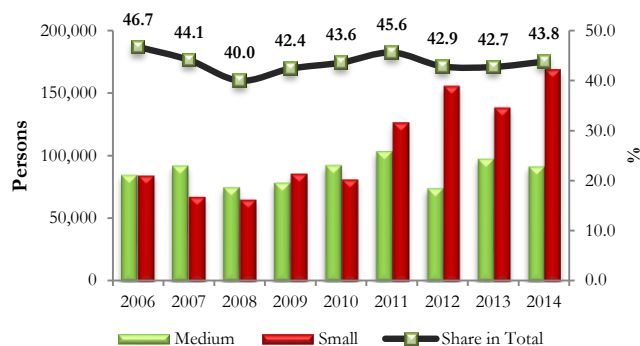
Investment in Fixed Assets of SMEs



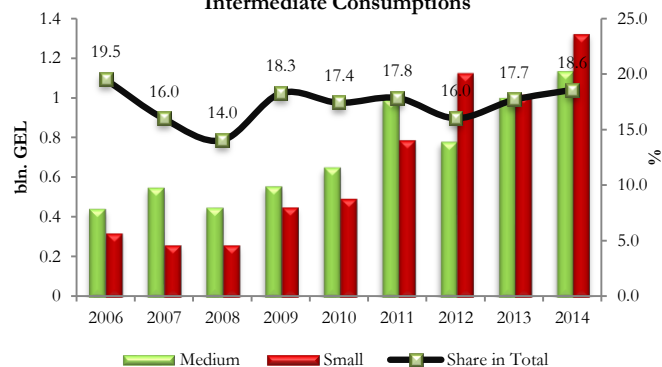
Value added in SMEs



Employment in SMEs



Intermediate Consumptions

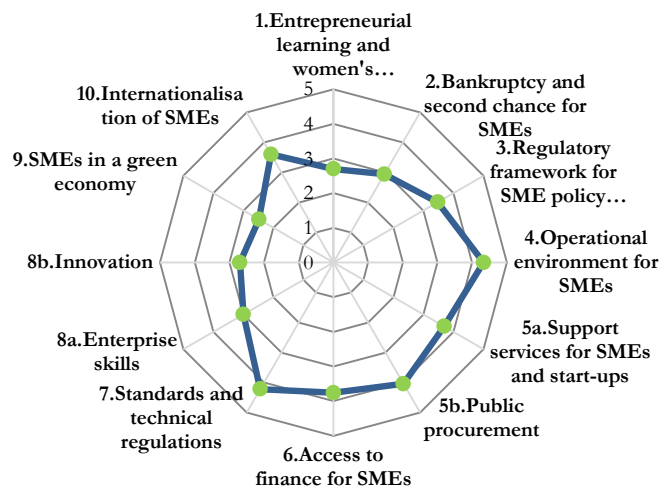


### 2.3. SME Policy Index (2016)

In 2016 SME Policy Index of Georgia together with Eastern Partner (EaP) Countries (Armenia, Azerbaijan, Belarus, Moldova and Ukraine) was evaluated based on the 10 principles of the Small Business Act (SBA) for Europe. Georgia received the highest scores amongst the EaP countries in 7 out of 12 dimensions, as illustrated below. According to the SME Policy Index, Georgia performed several changes in certain dimensions (e.g. innovation policy for SMEs and Bankruptcy and Reorganization).

**Georgia is on the 1<sup>st</sup> place in 7 out of 12 dimensions amongst EaP Countries Dimensions & Scores (out of 5)**

- **Dimension 1:** Entrepreneurial learning women's entrepreneurship (score 2.7)
- **Dimension 4:** Operational environment for SMEs (score 4.33)
- **Dimension 5b:** Public procurement (score 4.04)
- **Dimension 6:** Access to finance for SMEs (score 3.76)
- **Dimension 8a:** Enterprise skills (score 3)
- **Dimension 9:** SMEs in green economy (2.48)
- **Dimension 10:** Internationalization of SMEs (score 3.60)



### Key findings from the SME Policy Index 2016

According to SME Policy Index of Georgia 2016, Georgia as a top reformer country among Eastern Partner (EaP) Countries, has made significant improvements to its institutional framework for SME policy since the 2012 assessment. Despite external shocks, Georgia maintained macroeconomic stability, as well as an attractive business environment and simplified regulations and procedures. After 2012, Georgia has expanded its approach towards SME support and carried out targeted measures, including:

- ✓ 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
- ✓ significant progress has been made on the indicators for business support infrastructure, access to finance, technical barriers to trade and SME internationalization
- ✓ 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. Reforms to be implemented according to the Agreement, will facilitate implementation of European norms and will lead to increased competitiveness of businesses and their involvement in the global value added chain.

### The 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
- Support to facilitate access to finance for SMEs
- Improve entrepreneurial learning in accordance to EU's practices
- Create concrete support measures to encourage innovative entrepreneurship
- Develop new instruments for export promotion

Implementation of SME policies in accordance with the principles of the Small Business Act, is stipulated in AA in the chapter 5 – Industrial and Enterprise Policy and Mining. Monitoring of the implementation process will be carried out through regular dialogue between the EU and Georgia.



### 3. SWOT-Analysis of SME Sector

The SWOT analysis below shows strength and weaknesses, opportunities and threats of SME sector.

**Table 3: SWOT Analysis for the SME Sector in Georgia**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Favourable business environment</li> <li>• Simplified administrative procedures and well developed public services</li> <li>• Easy procedures for starting a business</li> <li>• Advisory and consultancy services for SMEs</li> <li>• Corruption free government</li> <li>• Low tax burden and preferential tax regime for micro and small businesses</li> <li>• Easy and low cost access to regional and international markets</li> <li>• Liberal foreign trade regimes: DCFTA with the EU and FTAs with SIC countries and Turkey, GSP with USA, Canada Switzerland and Norway</li> <li>• Well-developed infrastructure</li> <li>• Existence of SMEs supportive institutions</li> <li>• Governmental programmes for SMEs promotion</li> <li>• Foreign language skills among young population</li> <li>• Low cost for electricity</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Lack of business skills and business experience</li> <li>• Low level of competitiveness</li> <li>• Low productivity</li> <li>• Limited access to finance – to long-term investment resources</li> <li>• Low level of innovation and R&amp;D and insufficient collaboration between public R&amp;D institutions and SMEs</li> <li>• Limited capacities for technology absorption</li> <li>• Insufficient level of human resources</li> <li>• Lack of knowledge on foreign markets</li> <li>• Low capacity for export and internationalization</li> <li>• High costs for new technologies/manufacturing equipment</li> <li>• High cost for consultancy services for SMEs</li> <li>• Difficulties in closing business</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Increased access to finance</li> <li>• Well-developed alternative financing</li> <li>• Effective utilization of DCFTA - opportunities for export diversification</li> <li>• Support to SMEs in adaptation of DCFTA requirements</li> <li>• Existence of strong and well-functioning public institution in charge of implementation of DCFTA requirements</li> <li>• FTA with EFTA countries and China</li> <li>• Labour market demand oriented VET system</li> <li>• Well-developed quality infrastructure, decreasing technical barriers to trade (TBT)</li> <li>• Diversification of production</li> <li>• Enhancement of international cooperation and internationalization of SMEs</li> <li>• Well-developed advisory and consulting services</li> <li>• Increased innovation capacities and technology absorption potential</li> <li>• Establishment of modern entrepreneurial culture</li> <li>• Development of lifelong entrepreneurial learning</li> <li>• Integration in European Enterprise network - trade links with EU based companies</li> <li>• Target oriented support to SMEs by SMEs institution</li> <li>• Increased involvement of SME sector in policy elaboration process via establishment of structured format of PPD</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Possible external economic factors (financial crisis, decrease of demand on international markets, etc.)</li> <li>• Possible downturn of economy</li> <li>• Political uncertainty</li> <li>• Low investment in SME sector</li> <li>• Insufficient export capabilities</li> <li>• Low capabilities of SMEs in terms of international competition</li> <li>• Insufficient knowledge of DCFTA requirements and low level of adaptation</li> <li>• Insufficient participation of SMEs in business educational programmes</li> <li>• Insufficient knowledge of export market requirements</li> </ul>

#### 4. Aim and Objectives of SME Development Strategy for Georgia

**Aim of SME Development Strategy:** SME Development Strategy for Georgia aims at achieving creation of favourable environment for SMEs, enhancement of their competitiveness, innovation capacities, which will lead to income generation and job creation resulting in inclusive and sustainable economic growth.

Based on the current situation and institutional framework related to SME policy, barriers hindering SME development were identified and relevant policy measures will be developed.

**Targets** of effective implementation of SME Development Strategy are as follows (baseline – 2013):

1. Growth SMEs output by average 10% annually by 2020;
2. Growth of number of employees in SMEs by 15% by 2020;
3. Productivity growth by 7% by 2020.

**Main objectives** of the SME Development Strategy for Georgia 2016-2020 are:

- Enhancement of competitiveness of SMEs in domestic and international markets;
- Improvement of SME skills and establishment of modern entrepreneurial culture;
- Support modernization and technology upgrading of SMEs.

In order to meet targets and main objectives of SME Development Strategy, Strategic Directions with relevant Priority Actions were identified based on analysis, which are reflected in relevant Action Plan (for 2016-2017). Action Plan includes Priority Actions (together with specific, more detailed actions), responsible institutions and time-frames for each action and sources of financing.

SME Strategy is based on Think Small First principle of Small Business Act for Europe (SBA).

#### 5. Strategic Directions of SME Policy

For strengthening SME sector in Georgia and increase its competitiveness in domestic and international markets, following Strategic Directions are prioritized:

**Strategic Direction 1:** Further improvement of legislative, institutional framework and operational environment for SMEs;

**Strategic Direction 2:** Improvement of access to finance;

**Strategic Direction 3:** SME skills development and promotion of entrepreneurial culture;

**Strategic Direction 4:** Export promotion and SMEs internationalization;

**Strategic Direction 5:** Facilitation of innovation and R&D in SMEs.

**Strategic Direction 1: Further improvement of legislative, institutional framework and operational environment for SMEs**

Despite the improvement of legislation and general operational environment for business activity, the SME sector still faces difficulties in a number of areas, which negatively influence their competitiveness.

SME supportive institutions play a crucial role in relation to SMEs growth and development. Despite the existence of SME support institutions in Georgia, there is still a need for greater involvement in SMEs promotion. The recently established Entrepreneurship Development Agency (Enterprise Georgia) needs to strengthen its operation in order to better address SMEs needs. Business associations and NGOs, providing support to SMEs lack information on SMEs needs. Analysis of the priority needs of SMEs is essential for the provision of targeted and effective support. In this regard, close cooperation and consultation with the private sector will greatly contribute to establishing result-oriented support programmes.

The Think Small First principle of the Small Business Act for Europe underlines the importance of consultation with SMEs in order to take into consideration their needs and avoid disproportionate burden being imposed on SMEs. In this regard, an effective mechanism of Public Private Dialogue (PPD) would play an important role in terms of involvement of businesses in the policy elaboration process at an earlier stage. Currently, there is no effective formal platform for cooperation with SMEs; This would ensure that private sector perspectives are taken into account when developing business-related regulations, thus improving stability and predictability of regulation over time. PPD is conducted on an ad-hoc basis. The Tax Ombudsman's Office, which was established in 2011 (according to new Tax Code in force since 2011) is actively cooperating with the private sector in order to identify problems (if any) for business development and serves as a mediator between business and the government. Public authorities are organizing roundtables with the private sector, among others reasons, for provision of information related to legislative changes, DCFTA requirements and discussion of other topics. PPD needs to be strengthened and transformed into a structured mechanism for deeper involvement of businesses and especially SMEs in the policy-making process, which, will facilitate effective implementation of policies.

In order to obtain data and statistics on SMEs, it is important to have a proper definition, which takes into consideration the country's economy and is consistent with European criteria of **statistics**. The SME definition which is used currently by GEOSTAT for the collection of business statistics was elaborated in 2002 and takes into consideration turnover and employment of enterprises. In general, the SME definition is in line with the criteria used in the EU's SME definition, except for the thresholds and consideration of balance sheet. Consequently, the existing SME definition should be revised consistent with the existing stage of development of the Georgian economy. In addition, the Tax Code definition of small enterprises does not fit with the definition of small used for statistical calculations. Accordingly, the revision of the SME definition is important for statistical reasons, as well as for designing relevant policies and assessing their impact.

In recent years GEOSTAT significantly broadened its coverage of the enterprises, but quantity of measures as well. Nevertheless, some information (e.g. export/import figures by size of enterprises) is not collected that is important for identification of challenges that enterprises are facing and for the elaboration of targeted activities of the development. of targeted measures.

Currently, there is no Regulatory Impact Assessment (RIA) system in Georgia. Only a simple assessment of the possible impact (as on the operational environment, as on the state institutions) of new regulation is conducted. For the creation of business and especially an SME-oriented regulatory environment enabling SME sector to grow and develop, new legislative proposals as well as the existing legislation requires assessment in terms of regulatory burden imposed on SMEs and estimation of the compliance costs of such regulations. The Think First Small principle of Small Business Act for Europe requires countries to develop an entrepreneurial environment which promotes SMEs growth and competitiveness. In this regard, it is important to assess rigorously the impact of forthcoming legislative and administrative

initiatives on SMEs (“SME test”) and take the results into account when designing legislative proposals. The application of RIA is important for avoidance of disproportionate burden on SMEs, as well as for removal of obstacles for SME growth.

### **Priority actions for further improvement of the legislative, institutional framework and operational environment:**

#### **Priority Action 1.1: Improvement of business closure and insolvency procedures**

Analysis of existed legislation related to bankruptcy and liquidation will be conducted in order to eliminate obstacles for insolvency proceedings and closing business, which will support companies to move from inefficient into efficient businesses, increase recovery rate, which is comparatively low in Georgia, according to Doing Business evaluation. Simplification of closing business procedures will also support the improvement of business statistics related to business registry (elimination of inactive enterprises from the business registry). In this regard, government will analyse existing legislation and in close cooperation with business sector, elaborate relevant changes to legislation.

#### **Priority Action 1.2: Revision of the SME definition**

Introduction of a new SME definition with consideration of current level of economic development of Georgian companies, as well as to align it with the International and European criteria will support the collection of more accurate statistics on enterprises and enable the design of targeted SME support efficient policies and activities.

#### **Priority Action 1.3: Improvement of SMEs statistics**

Improved SME statistics will lead to the collection of more detailed information on enterprises that will enable policy-makers to better analyse SME performance and design effective policies and measures for fostering SME development. In this regard, European experience in the collection of enterprise statistics will be reviewed. Collection of statistics will be also extended to business demographics and SMEs international trade.

#### **Priority Action 1.4: Strengthen SME support institutions**

Strong SME support institutions will greatly contribute to the development of the SME sector and support the enhancement of their competitiveness. In order to strengthen SME support institutions, a precise analysis of their operation (institutional review) will be conducted and the needs for further institutional strengthening will be identified. Cooperation and exchange of experience between private and public institutions is very important in order to ensure target oriented support and avoid overlapping of offered services.

#### **Priority Action 1.5: Strengthen Public Private Dialogue (PPD)**

The introduction of an institutional platform for PPD will help the government to develop effective policies for SMEs and eliminate obstacles to SMEs growth and development. Effective PPD will support building trust between the government and private sector, possibility to analyse problems jointly and identify policies and institutional reforms that will contribute to a more conducive environment for private sector development. Regular and structured dialogue with private sector will create the basis for creation more predictable environment and ensure that private sector perspectives are taken into account.

#### **Priority Action 1.6: Establishment of RIA system for priority economic legislation**

Establishment of a RIA system and application of RIA will help government to evaluate as new, but existing regulatory impact as well as on the public as on the private sector and those burden and compliance cost that can be triggered by regulation. Establishment of a RIA will facilitate to avoid imposing disproportionate burden on SMEs, as well as lead to elimination of existing regulations which are burdensome for SMEs. Government, in cooperation with international experts, will elaborate and establish an appropriate RIA system for Georgia.

### **Strategic Direction 2: Improvement of access to finance**

Access to finance is one of the major challenges for SMEs, hindering development and growth. According to Global Competitiveness Index 2015-2016, the second most problematic factor for doing business is access to financing. 13.6% of surveyed entrepreneurs identified it as a main obstacle for doing business. Access to finance is also identified second among the top 10 constraints for business environment according to the WB Enterprise Survey 2013. According to the WB, total intermediation in SME lending is insufficient to meet Georgia's growth and development needs; the SME sector remains relatively underserved. The share of loans granted to SMEs by banks accounts only 24.4% of total business loans in banks' loan portfolio<sup>6</sup>.

The interest rate for servicing loans required by commercial banks and micro financial organizations is quite high for SMEs. During the last 10 years (2005-2015) interest rates on long-term loans requested by commercial banks decreased from 20% to 15.7% in national currency and from 15.6% to 10.6% in foreign currency, which is high for SMEs. In addition, SMEs are not able to meet collateral requirements for loans that are usually requested by banks (more than 100% of loans).

Furthermore, SMEs lack information and capacities about fund raising tools, as well as about institutions that could be considered as alternative sources of financing. With consideration to the requirements of banks and Micro Finance Institutions (MFIs), stimulating the development and use of alternative sources of financing is important for SME development and growth.

MFIs are very well developed in Georgia. Currently, 72 MFIs operate on the market and they are especially active in SMEs financing. MFIs had 393 service centres/branches throughout Georgia and employed 4,899 people. Despite the fact that MFIs are very active in SMEs financing, there is still a lack of communication between private sector and MFIs, which is very important in terms of identification of gaps and implementation of relevant actions for further improvement of access to finance for SMEs by both side – business sector and MFIs.

According to Georgian law on Accounting and Auditing (2012), SMEs are not required to carry out accounting according to International Financial Reporting Standards for SMEs (IFRS for SMEs). Under the EU-Georgia Association Agreement, Georgia is committed to implement accounting and auditing according to EU norms. Financial reporting according to international standards will improve transparency of reporting, as well as access to additional financial resources and possibility to acquire new business partners. SMEs lack capacity to implement accounting according to IFRS that prevents access to capital and consequently, growth and development of SMEs.

There is a limitation related to grant beneficiaries in the Georgian legislation related to grants (Law on Grants, 1996). Namely, companies (e.g. Limited Liability Company, Individual/Sole Entrepreneur, etc.) cannot receive a grant. This creates an obstacle for SMEs to obtain grants as an alternative source of financing and benefit from the different grant programmes offered by the state and/or international

<sup>6</sup> Source: WB – Access to Finance Challenges 2014

donor organizations (e.g. grant for innovations). This is a barrier to the promotion of R&D and innovation in SMEs.

Improvement of access to long term and affordable investment resources that are crucial for SMEs necessitates the elaboration of a wide range of measures, which help support the growth and development of SMEs.

**In order to improve access to finance following priority actions need to be implemented:**

**Priority Action 2.1: Improvement of financial literacy among SMEs**

With the aim of improving financial literacy, the relevant needs will be identified, based on which educational programmes will be elaborated for the trainings. Financial literacy will facilitate to increase SMEs capacity, to attract and use effectively financial resources. The improvement of financial literacy will facilitate to raise the awareness about existing requirements on financial market, financial products and liabilities. This will support companies to make efficient financial decisions for further growth and development.

**Priority Action 2.2: Support SMEs in the implementation of IFRS in accounting**

Promotion of using IFRS for SMEs and targeted support will help SMEs to conduct financial reporting according to internationally recognized norms that stipulate the transparency of financial reporting and will improve investment capital and access to financial resource. the transparency of financial reporting is also significant to establish partnership business. Raising awareness will be ensured to facilitate the implementation of IFRS for SMEs. Training modules will be elaborated and targeted trainings will be provided for small and medium enterprises.

**Priority Action 2.3: Increase knowledge about fund-raising among SMEs**

Raising the levels of SMEs' knowledge and capacity in fund raising is essential for SME development and growth, as their knowledge about attraction of additional financial resources is limited (except of banks and micro-financial organizations).

Activities will be implemented for the support SMEs to increase their knowledge and capacity related to attracting financial resources. The education of entrepreneurs will be ensured regarding connection with alternative sources/funds and participation in targeted programmes.

**Priority Action 2.4: Attraction of SMEs oriented private equity funds and venture capital funds for start-up financing**

Attraction of SME-oriented private equity funds in Georgia will support improvement of SMEs' access to alternative sources of finance, company growth, development and competitiveness increase and attraction of venture capital funds will support the start-up development.

At the same time, the readiness of SMEs to cooperate with equity and venture capital funds is a prerequisite for the attraction financial resources from the funds. In this regard, together with facilitation of establishment of equity and venture capital funds in Georgia, SMEs and start-ups with potential to attract financing will be identified and capacity building will be conducted to assist them to become investment ready.

**Priority Action 2.5: Support to SMEs to increase access to finance through commercial banks and micro financial organizations (MFIs)**

In order to improve access to get the finances for SMEs from the commercial banks, state program “Produce in Georgia” improve and enhance existing scheme of SMEs financing. With the aim of improving the finances from micro-financial organizations, cooperation between SMEs and MFIs, through organization of roundtables will be supported, the ultimate goal of which is to overcome the obstacles and identify the gaps related to finances and financial awareness. Such cooperation will facilitate the improvement of products and services provided by MFIs that hinder the financing of SMEs from commercial banks. Therefore, as well as improvement of SMEs capacities to better meet requirements of MFIs.

### **Priority Action 2.6: Improvement of SME finance through grants**

In order to improve SMEs access to grant financing, the Georgian legislation related to grants will be revised and the relevant legislation changes will be developed. The resulting improved legislative framework will support the attraction of finances for R&D and innovative growth by SMEs. GITA will implement innovative ideas support programs as well.

### **Strategic Direction 3: SME skills development and promotion of entrepreneurial culture**

Development of competitive human capital is very important for growth of competitiveness of SMEs and considers development of vocational education and training (VET) system that will insure formation of high qualified and competitive workforce meeting labour market needs. Despite the ongoing reform in vocational education and training (VET), there is still job mismatch on the labour market - mismatch between the skills available and those required by the labour market.

Job mismatch on the labour market negatively influences employment tendency. Georgia faces relatively high level of unemployment, despite the decrease of this indicator to 12.4% in 2014 (from 14.6% in 2013).

The development of competitive human capital is one of the main directions of Georgia 2020 for improvement of private sector competitiveness.

Scarcity of high-qualified labour is a barrier especially to SMEs growth and development while SMEs’ resources devoted to human capital development are limited. Therefore, a target oriented approach is very important to facilitate employment of highly qualified people in SMEs. Identification of labour market needs for SMEs is essential for the elaboration of relevant programmes for skills development.

Establishment of entrepreneurship as a key competence at all levels of education is crucial for private sector development, as well as for self-employment. Currently, entrepreneurial learning is not established in Georgia’s education system according to EU and international best practices. There is need to develop modules and curricula for all levels of education which include an entrepreneurial learning component.

In order to support development of labour market-oriented human resources, the “Labour Market Formation Strategy” related Action Plan for 2015-2018 was developed and approved (August, 2013), which covers non-formal education issues on professional and entrepreneurial skills development institutionalization of labour market study, establishment/development of informational bases and etc. The special department for Labour and Employment Policy was created under the Ministry of Labour, Health and Social Affairs (MoLHSA) that coordinates the implementation of activities, determined by strategy. A portal (<http://worknet.gov.ge>) was created where the registration of vacancies (provided by employers) and jobseekers is ongoing. For the promotion of employment appropriate vocational courses will be elaborated and implemented.

Promotion of a modern entrepreneurial culture and improvement of business skills is crucial for SMEs growth and enhancement of competitiveness.

Lack of business skills is one of the most problematic factors hindering SME development and growth that is caused by soviet history. Despite the improvement of entrepreneurial skills after transition to the free market, this remains the challenging factor, especially for SMEs. The level of business planning and development, of marketing and capacity is low.

To promote inclusive growth, it is important to reinforce female entrepreneurship. Women are less active in entrepreneurial activities rather than men so it is important to develop specific mechanisms to stimulate deeper involvement of women in entrepreneurial and economic activities.

**In order to develop SME skills and promote entrepreneurial culture, following priority actions will be implemented:**

**Priority Action 3.1: Identification of labour market needs for SMEs and development of relevant employment programmes**

Within the framework of labour market formation strategy, the needs for human resources of small and medium enterprises and evaluation/survey of job seekers will be implemented. If needed, relevant recruitment programmes for jobseekers will be elaborated to meet employers' demand through special recruitment programmes.

**Priority Action 3.2: Training Needs Assessment - TNA of Small and medium Enterprises**

To develop Small and medium enterprises and increase their competitiveness, Training Needs Assessment need to be implemented in order to define entrepreneurs' requirements and the relevant trainings be ensured. Enterprise Development Agency with the cooperation of international partners will elaborate TNA concept and relevant tools, including questionnaires that will be implemented minimum in three priority sectors. As a result, provided services will be improved. capacity of Enterprise Development Agency will be enhanced in order to implement TNA periodically for various priority sectors.

**Priority Action 3.3: Establishment of Life Long Entrepreneurial Learning (LLEL) at all levels of the education system**

In order to introduce LLEL system at all levels of the education system, special, an interagency working group will be created which, in close cooperation with relevant international organizations (e.g. ETF), will conduct gap assessments and needs analyses in relation to the education system. International experience and best practices in LLEL will be analysed for elaboration of an appropriate for Georgia model of LLEL. An Action Plan for introduction of LLEL at all levels of education will be developed.

**Priority Action 3.4: Support engagement of SMEs in the formation of VET System at all**

Partnership at the macro level implies the involvement of the private sector in the process of VET **policy formation**. The mechanism should be systematic, formal (National VET Council, thematic working groups) and provide opportunities to consider the position of private sector at all level of VET policy development.

Effective mechanisms for SME sector involvement at mezzo level should be established at the stage of formation and development of VET **qualifications**. The role and function of private sector regarding



skills development should be positioned within the framework of the systematic vision. The system of skills assessment and forecasting should be developed with the active engagement of SMEs.

Partnership at micro/institutional level implies cooperation with and the **direct engagement of educational institutions**. In this regard a “Knowledge Partnership” is very important, which would represent a complex process and implies integration of various linked spheres. The basis of this partnership is cooperation among educational institutions, public and private sector in education, research and innovation issues. The appropriate platforms and incentives mechanisms should be established for SMEs, in order to support effective implementation of “knowledge partnership”.

This partnership should encourage, inter alia: work-based learning; continuous improvements of training content, infrastructure and methodology; development of key competences together with the professional knowledge; development of entrepreneurial competences; development of cooperation networks between VET institutions and business sector and establishment of start-up companies by VET students.

### **Priority Action 3.5: Facilitation of access to non-formal training for SMEs**

In order to promote employability and lifelong competitiveness of the workforce in Georgia, cooperation between stakeholders will be streamlined, which is important for the improvement of recognition and trust in the non-formal education and training. For institutionalization of recognition of non-formal learning, rules and mechanisms will be elaborated by MoESD. Pilot programmes will be developed and implemented prior to the establishment of this system.

### **Priority Action 3.6: Ensuring Technical Assistance (TA) for SMM**

SME, in case of necessity, will be rendered with Technical Assistance (TA), within the scope state program “Enterprise in Georgia”. Entrepreneurship Development Agency in close cooperation with entrepreneurs and international organizations will develop and implement training programs. With purpose of export capabilities’ development, in cooperation with educational institutions, retraining courses for export managers will be carried out. For implementation of modern, result-oriented and successful business-practice, adoption of EFQM production model (EFQM Excellence Model) will be promoted, as well.

### **Priority Action 3.7: Development of educational component on the web-site of Enterprise Georgia**

Lack of educational materials is one of the main challenges for modern entrepreneurship, especially for successful development of SME. There is no accessibility to online libraries, as well. In this regards, Enterprise Georgia is developing a web-site with a component dedicated to educational topics, where a number of tutorials and business literature for SMEs will be available.

### **Priority Action 3.8: Expansion of Business Service Center for Entrepreneurs**

Enterprise Georgia aims to provide standardized services to its beneficiaries through the Business service centres, which will improve SMEs access to technical assistance as well as enhance competitiveness of private sector through access to information and education, easing administrative burdens and logistics, establishing linkages, etc. The business service centre is based on “open-space” principles and will provide various educational services: library with more than 100 business literature books and computer space with free wi-fi and access to the electronic library and analytical materials. Moreover, lectures, seminars and workshops for SMEs will be provided.

### **Priority Action 3.9: Encouragement of female entrepreneurship**

In order to foster entrepreneurship and involvement of women in business activities, gap assessments and needs analyses of women's involvement in entrepreneurial activities will be conducted. Based on the results, a specific approach to promote women entrepreneurship will be developed. In addition, a platform for cooperation with women in business, with the involvement of relevant stakeholders, will be established which will facilitate women's involvement in entrepreneurial activities.

### **Priority Action 3. 10. Promotion of green practices among SMEs**

For promotion of "Green practice" among SMEs, it is important to develop training programmed related resource efficiency and clean production, which will serve as the support mechanisms for the improvement of SME skills as well as provision of trainings on environmental performance. GoG will support effective implementation of environmental managers' courses in order to develop capacities of companies related to environmentally friendly management.

## **Strategic Direction 4: Export promotion and SME Internationalization**

Promotion of export has the utmost importance for enhancement of competitiveness of SMEs. To raise awareness on DCFTA requirements and assist the adaptation of businesses to those requirements, it is crucial to be able to maximise the benefits that DCFTA potentially offers to Georgian producers.

This is an issue which is also underlined in Georgia 2020: one of the main tasks of the GoG is to support Georgian businesses to enhance competitiveness and to generate products and services, which will be competitive not only on the local market, but also, on the EU and international markets. At the same time, it must be considered, that some regulations covers European markets as well as Georgian markets, which enhance importance of strengthening of companies' capabilities to meet DCFTA requirements

Conformation to DCFTA requirements for now, is a challenge especially for small and medium entrepreneurs, as far as, it requires knowledge of demands of export markets, as well as, additional financial resources for proper development of this requirement.

For the rising up of awareness in connection of DCFTA requirements in specific fields, members of Government permanently carry on meetings with representatives of private sector, as well as, with parties interested. The DCFTA Action Plan for 2014-2017 includes measures related to rising awareness about DCFTA regulations with special emphasis on SMEs. Notwithstanding the above-mentioned, DCFTA knowledge among SMEs should be further improved.

SMEs are lacking information related to export market demand and specific export requirements, both of which restrict their export potential. To conduct or outsource these analyses requires additional human or financial resources, which SMEs cannot afford.

Development of national quality infrastructure (standardization, metrology, accreditation, conformance evaluation) is very important in terms of eliminating technical barriers to trade. Georgia continues its reform agenda for the development of national quality infrastructure according to EU best practices and DCFTA requirements. It should be underlined that despite these developments, the private sector does not have comprehensive information on the importance on quality infrastructure and on benefits that it can bring in international trade.

Another obstacle in terms of export promotion and internationalization is the lack of knowledge in marketing and promotion combined with a lack of financial resources for marketing activities abroad. Most of the goods exported from Georgia are produced by large companies. Apart from this, SMEs are

lacking capacity to establish international trade relations that is important for the inclusion in global value chains.

SMEs do not have enough financial resources to participate in international trade fairs that are very useful for finding new trade partners or potential investors, as well as for popularization of products and services, produced by them.

In 2015, EDA and GITA have become partners of Enterprise Europe Network (EEN), that enclose about 600 European and international organizations, chambers of commerce & industry, technology centres, development organizations. Participation in EEN promotes building of relations between local and European companies, contributes transfers of technologies and development of companies in accordance with the best European practice.

Usually, large companies are looking to outsource some products and services to the local market, rather than import them from abroad. Currently, there is no structured mechanism for linking local SMEs to investors or large companies operating in Georgia. Establishment of efficient mechanism of FDI-SME linkages will support local SMEs' inclusion in supply chains.

International companies are paying much attention to the principles of Responsible Business Conduct (RBC) in partner companies, which implies responsible attitude with environment, introduction of principles of corporate social responsibility, development of modern entrepreneurial relations and other. This stimulates private sector to contribute more to the sustainable and inclusive development of economy. Georgia lacks knowledge of RBC and those benefits, which country might receive in attracting international trade partners and investors, from implementation of principles of RBC. Correspondingly, it is important enhancing of knowledge of private sector of RBC and their principles. Promotion of introduction of principles of RBC and popularization of OECD guidelines are one of the directions of Association agreement (AA, Article 352).

**In order to support export promotion and SMEs internalization GoG will implement following priority action:**

**Priority Action 4.1: Raising awareness on perspectives offered by DCFTA and its requirements**

Raising awareness about the potential that DCFTA offers to Georgian companies is very important, as it will help companies to design development plans for future. Apart from the potential, SMEs should be aware about the new reforms and regulations that Georgia should implement under EU-Georgia DCFTA commitments and which also requires changes in the operation of companies. In this regard, government will play an active role and held regular roundtables and meetings with SMEs. Delivery of information in regard of quality infrastructure (metrology, standardization, accreditation and compliance evaluation) will be implemented, that is very important to reduce technical barriers in trade.

**Priority Action 4.2: Support businesses to adapt to DCFTA requirements**

Adaptation to DCFTA requirements, together with development of suitable human capital, requires financial resources. Government will elaborate target-oriented instruments and support schemes (including financial ones) in order to support SMEs to bring their operations in line with DCFTA requirements, while also diminishing regulatory burdens and increasing companies' competitiveness.

**Priority Action 4.3: Promotion of export of SMEs**

The cost of market research is quite high and SMEs are not able to dedicate financial resources to it. Raising awareness on international market demand and special requirements among SMEs will enable export-oriented industries to diversify production/services and increase export. In this regard regular market research will be conducted, including product specific research, and information will be easily

available for SMEs. The online trade portal ([www.tradewithgeorgia.com](http://www.tradewithgeorgia.com)), will be developed by Enterprise Georgia with the support of GIZ. The portal will contain the information regarding Georgian exporter companies and their products, platform for direct communication between traders, export destinations and analytical information for Georgian export companies.

Cooperation with the Euromonitor will enable to access to the analytical information by 28 economic sectors in 10 countries. This service consists of market reports, related market news and trend notes, historic statistics and forecasts. It is planned to prolong and upgrade the cooperation with Euromonitor International after the expiration of the current contract.

With the purpose of export promotion a corresponding tools will be developed for the improvement and support of SME's marketing, as well as, for popularization of goods and services in the international markets.

#### **Priority Action 4.4: Support SMEs to establish international trade relations**

Support to SMEs in the establishment of international trade relations will: help companies to increase and diversify exports; attract additional investment to companies with growth potential; and facilitate establishment of modern entrepreneurial culture in Georgian SMEs. In this regard, the government will elaborate targeted services for SMEs. Enterprise Georgia will regularly organize inbound and outbound trade missions as well as facilitate the participation of Georgian SMEs in international fairs.

Participation of Enterprise Georgia and GITA will ensure Georgia's participation in the European Enterprise Network (EEN) that will support Georgian SMEs to find trade and/or investment partners among European companies and promote export of products and services.

#### **Priority Action 4.5: Responsible Business Conduct (RBC) promotion.**

Enhancing of awareness in connection of RBC principles is important for companies' sustainable development, as well as, for foreign investments and establishing international trade relations. For this purpose, cooperation with OECD, which has elaborated guidelines of adoption of RBC in companies, is important. With the view of awareness enhancing and popularization of RBC in the private sector, identification of companies for this purpose, will be carried out. Mechanism of popularization of RBC in private sector will be worked out and implemented.

#### **Priority Action 4.6: Support to the establishment of FDI-SMEs linkages**

Establishment of FDI-SMEs linkages will facilitate inclusion of Georgian SMEs in supply chains and encourage growth and development. The GoG will elaborate efficient mechanisms and supportive instruments in order to enable SMEs to meet demand and/or other requirements of investors or large companies. Enterprise Georgia will regularly promote and facilitate B2B matching activities for Georgian SMEs as standalone projects, as well as part of international events. Enterprise atabase, which will include companies' profiles will be created and updated regularly. Assessment of potential suppliers for large investors/companies will be conducted, with the aim to facilitate and promote linkages. In case of identification of perspective linkages, additional support will be provided to SMEs, if there will be a special need from SMEs side to meet investors' demand.

### Strategic Direction 5: Facilitation of innovation and R&D in SMEs

Supporting the development of innovation and R&D is crucial for competitiveness and productivity. The value added of products, produced by Georgian companies, especially by SMEs is very low. An insufficient level of technology development combined with a lack of innovations can be considered among the main reasons for low levels of value added generated in Georgia.

Expenditures on R&D are very low both by the government and by the private sector. In the Global Innovation Index 2015 (GII), produced by INSEAD, Georgia ranks 73<sup>rd</sup> among 141 countries with a 33.83 score (out of 100). In the Business Sophistication component, Georgia stands at 105<sup>th</sup> place with a 28.0 score.

In the Global Competitiveness Report (GCI) 2015-2016 of World Economic Forum, Georgia ranks 66<sup>th</sup> (rising from 93<sup>th</sup> place in 2010-2011) among 144 countries. Georgia's position according to the specific indicators measuring the level of technologies and innovations in the countries reinforces a lack of innovation in the country.

Georgia's position in respect to indicators measuring the levels of innovation and new technologies (GCI 2014-2015) is illustrated below:

- Capacity for innovation – 121 place;
- Companies spending on R&D – 127 place;
- Availability of latest technologies – 97 place;
- Firm-level technology absorption – 103 place

The lack of innovation as a one of the main hindering factors of private sector competitiveness is also underlined in Georgia 2020.

While SMEs are experiencing shortages in financial resources, they are not able to afford investment in innovation, R&D, as well as new technologies. Even the capacities to absorb new technologies are very low. Therefore, a targeted approach which facilitates the development of innovation and also improves access to new technologies is urgently needed.

Currently, there is insufficient infrastructure to support start-ups and SMEs in the development of innovations and R&D, to transfer ideas into products and facilitate commercialisation. Apart from this, the whole country is not yet covered with high speed internet infrastructure.

GITA, which was created in order to support innovations, R&D, commercialization of innovations, development of ICT in businesses etc., has initiated programmes dedicated to support SMEs and innovative start-ups. Since GITA is newly established Agency (created in 2014), institutional strengthening is needed, together with the development of new - SME oriented programmes.

**For facilitation of innovation and R&D in SMEs GoG will implement the following priority actions:**

#### **Priority Action 5.1: Stimulation of innovations among SMEs**

In order to promote innovation and R&D among SMEs it is essential to raise awareness about the importance of innovative entrepreneurship. Apart from this, assessment of innovative capacities and potential of innovation development, as well as human capital is very important for elaboration of efficient, targeted policies. Apart from the awareness raising campaign, a training programme needs to be provided to the entrepreneurs and new enterprises to raise their capacity and improve their innovative

business skills. In order to stimulate innovation, the GoG will provide incentives for Georgian innovative entrepreneurs and inventions.

#### **Priority Action 5.2: Elaboration of effective schemes of innovation and R&D financing**

Innovation remains a risky business and therefore, there is low level of access to finance for it. Since none of the financial institutions is intended to finance innovation, government assistance is needed to support innovation and R&D development. Currently the private sector is not investing in R&D, but purchasing their products abroad (which is also important for technology transfer). Part of GITA's mandate is to improve access to finance for innovation via the provision of various types of grant programmes. There is a need to elaborate an effective scheme of financing, which improve access to finance for R&D (including applied researches) via alternative sources of financing (e.g. Angel Network) and grant programmes.

#### **Priority Action 5.3: Support to commercialization of innovations and R&D**

The lack of commercialization of innovations and R&D (including applied researches) hinders its' use in the economy. Research institutions, in general, are not focused on commercialization. Awareness raising activities and promotion of applied research needs to be done with a focus on the researchers, to help them start thinking about commercializing their activities. Along with this, it is important to promote the use of Georgian products - innovations and inventions by local businesses. Government will encourage cooperation of research institutions and inventors with private sector and elaborate mechanisms for facilitation research-industry linkages, which is important for commercialization of innovations and R&D. In addition, GITA, trough technology transfer centre, will support commercialization of innovations and R&D.

#### **Priority Action 5.4: Improvement ICT Skills among businesses**

Improvement of ICT skills are the main factors of development of innovations among SMEs. Without using modern technologies, it will be difficult to enhance competitiveness or to maintain it. Besides this, transferring ideas into products, internationalisation, attraction of investment and cooperation with foreign partners requires modern, innovative approaches in different areas of business activity, including management, marketing, etc. While the most of SMEs, especially in the regions, lack financial resources, they cannot attract highly qualified people or increase capacity of existing staff. Therefore, provision of trainings on modern approaches and international best practices in using modern ICT and technologies will support growth and development of SMEs. Training of Trainers program will be carried out to improve export-oriented ICT skills.

#### **Priority Action 5.5: Providing infrastructure for innovation (FabLabs; iLabs; TechPark; BroadBand; Computerization)**

Provision of infrastructure for SMEs and start-ups is important for boosting the creation of innovative businesses, therefore, government will support establishment of innovative labs by providing facilities, equipment and trainings for enterprises with high innovative potential, which will be selected competitively. This could take the form of innovation centres (business and innovation centres) and technology parks. Such centres will support transformation of ideas into products. In order to foster innovation and use of ICT, the Government will cover the whole country with high-speed internet and provide assistance in computerization (especially in the regions of Georgia).

The above represent the main measures, which will be implemented during 2016-2020. Detailed Actions, with implementation periods, responsible bodies and funding are provided in Action Plan 2016-2017.

## 6. Implementation and Monitoring

In order to achieve the goals, set in SMEs strategy, coordination of the implementation of activities, defined by strategy and relevant action plan, and monitoring its implementation is very significant. For the effective implementation of strategy and action plan, it's highly important to involve private sector and civil society. The involvement of international organizations in regard of technical and financial support is very important as well.

### 6.1 Coordination and Institutional Framework for SME Strategy

The Ministry of Economy and Sustainable Development of Georgia (MoESD) will coordinate the activities envisaged under the Strategy and ensure the necessary co-operation between the government and stakeholders in implementing the content of the Action Plan.

Co-operation between the government, private sector, including business service providers and civil society will guarantee transparency and accountability, which is important for the effective implementation of SME Strategy and Action Plan.

### 6.2 Funding for the SME Strategy implementation

The SME Strategy and Action Plan will be implemented with the use of current or future policy documents of the Government of Georgia, including the State Budget, Basic Data and Directions (BDD).

The resources required for the implementation of the SME Strategy will be determined according to the details set out in the related Action Plan.

- **State budget:** is the main source of funding. The Action Plan will set out, on an annual basis, the resources, related to the implementation of the SME Strategy. Responsible bodies, indicated in Action plan will assign resources from their annual budgetary allocations.

The Government of Georgia will closely and proactively cooperate with the international community in order to establish an efficient and effective resource mobilisation process, based on measures and activities identified. This will ensure that state funding is supplemented by resources from the international donor community in a timely and coherent manner. The resource mobilisation process will be guided by the framework of the SME Strategy and related Action Plan.

### 6.3 Donor Involvement and Coordination

For effective implementation of SME Strategy and related Action Plan, the Government of Georgia will communicate and the MoESD will coordinate cooperation with international donor community and international financial institutions for mobilization of resources and technical assistance.

#### **6.4 Monitoring and Evaluation**

The high level Steering Group, established for monitoring of the elaboration of SME Strategy and Action Plan for SMEs will oversee implementation.

The Steering Group will meet twice a year, but further meetings can be held on the basis of request of Steering Group Members and/or Working Group members, if necessary.

Working Groups, with coordination of MoESD will prepare annual and semi-annual implementation reports, which will be discussed at the Steering Group meetings and presented to the Government of Georgia.

For the involvement of stakeholders in the monitoring process, Public-Private Dialogue will be held semi-annually.