

Analysis of the EU Small Business Act



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1. INTRODUCTION

This Analysis was drawn up under the terms of the contract No. SEC004 / 2018-002 concluded between the Secretariat of the Eastern Partnership Civil Society Forum and Sabit Baghirov, President of Entrepreneurship Development Foundation for provision of the consulting services. The subject of the Contract – project implementation: Development of methodology for assessing the degree of convergence of the business climate in the Eastern Partnership countries and the EU.

The Project partners include:

- Entrepreneurship Development Foundation (EDF) Azerbaijan;
- Center for cross-border cooperation, Ukraine (CCBC);
- The Georgian Association “Women in Business” (GAWB), Georgia;
- Support for Economic Initiatives Public Union (SEI), Azerbaijan.

This report provides: a brief description of the Small Business Act and the results of the analysis of the OECD report on three countries: Ukraine, Georgia and Azerbaijan.

2. OECD SME Policy Index 2016 EaP¹

The OECD SME Economic Policy Index is an assessment of compliance with the principles of the Small Business Act for Europe², which proclaims the following 10 principles:

- | | |
|-------|--|
| I. | Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded |
| II. | Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance |
| III. | Design rules according to the “Think Small First” principle |
| IV. | Make public administrations responsive to SMEs’ needs |
| V. | Adapt public policy tools to SME needs: facilitate SMEs’ participation in public procurement and better use State Aid possibilities for SMEs |
| VI. | Facilitate SMEs’ access to finance and develop a legal and business environment supportive to timely payments in commercial transactions |
| VII. | Help SMEs to benefit more from the opportunities offered by the Single Market |
| VIII. | Promote the upgrading of skills in SMEs and all forms of innovation |
| IX. | Enable SMEs to turn environmental challenges into opportunities |
| X. | Encourage and support SMEs to benefit from the growth of markets |

The table below shows the comparative values of the Eastern Partnership countries in 12 directions (indicators for each area are evaluated on a five-point scale, where "1" means the lowest level of economic policy reform, and "5" is the highest). For each of these 12 areas, several indicators are evaluated, the total number of which is 124. Therefore, it is fair to say that the OECD SME Economic Policy Index is a fundamental study. However, the cumbersome nature of this study makes it difficult to conduct annual assessments. For this reason, only two studies have been conducted since 2012. The results of the latter are published in 2018 and cover the figures for 2016.

¹ <http://www.oecd.org/countries/belarus/sme-policy-index-eastern-partner-countries-2016-9789264246249-en.htm>

² https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en

Table 5

		Scores						
		AM	AZ	BY	GE	MD	UA	Average for EaP
I	Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded							
1	Entrepreneurial learning and women's entrepreneurship	2,63	2,59	2,39	2,70	2,57	2,25	2.52
II	Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance							
2	Bankruptcy and second chance for SMEs	3,16	2,87	2,57	2,94	2,68	2,05	2.71
III	Design rules according to the "think small first" principle							
3	Regulatory framework for SME policy making	3,38	2,47	2,41	3,48	3,51	2,45	2.95
IV	Make public administration responsive to SMEs							
4	Operational environment for SMEs	4,05	4,23	4,09	4,33	3,56	3,81	4.01
V	Adapt public policy tools to SME needs							
5a	Support services for SMEs and start-ups	3,93	2,98	2,99	3,69	3,35	1,84	3.13
5b	Public procurement	3,42	2,42	3,21	4,04	2,89	2,73	3.12
VI	Facilitate SME access to finance and develop a legal framework and business environment supportive of timely							
6	Access to finance for SMEs	3,53	2,70	3,08	3,76	3,40	3,22	3.28
VII	Help SMEs to benefit more from the opportunities offered by the Single Market							
7	Standards and technical regulations	3,33	3,32	3,22	4,22	4,12	4,34	3.76
VIII	Promote the upgrading of skills and all forms of innovation							
8a	Enterprise skills	2,67	2,94	2,28	3,00	2,50	2,56	2.66
8b	Innovation	2,91	2,47	2,91	2,70	2,54	1,86	2.56
IX	Enable SMEs to turn environmental changes into opportunities							
9	SMEs in a green economy	2,39	1,54	2,10	2,48	2,19	1,22	1.99
X	Encourage and support SMEs to benefit from growth markets							
10	Internationalisation of SMEs	3,37	2,50	2,59	3,60	3,07	1,63	2.79
	Average rating for 12 indicators	3.23	2.75	2.82	3.41	3.03	2.50	2.95

As we can see from this table, the economic policy of EaP countries is averaged at 2.95 on a five-point scale. This indicates that the governments of EaP countries still have a lot to do to achieve full compliance with the principles of the Small Business Act for Europe.

The economic policy of the government of Georgia most closely complies with the requirements of the Small Business Act for Europe. Armenia is in second place, and Ukraine closes the list.

The main disadvantages of this study are that it uses only opinions of experts (governmental and independent) and businessmen. The objective macroeconomic results of government policies are not analyzed.

3. ANALYZES FOR THE THREE EASTERN PARTNERSHIP COUNTRIES

UKRAINE³

The Small and Medium-Sized Enterprises (SME) Policy Index defines the criteria for evaluating progress in the state policy with regard to small and medium enterprises in the six Eastern Partnership countries in order to assess the application of the ten principles defined in the Small Business Act for Europe. According to the assessment results of the SME Policy Index, Ukraine's progress in SME development remains insignificant.

Two important factors, indicated in the SME Policy Index 2016, should be noted in the assessment of the policies for the development of small and medium-sized businesses. First, the assessment of Ukraine's progress ranges close to 2 points, which is significantly lower than the best practice level (5 points, the highest score). Secondly, compared to the previous assessment by the countries of the Eastern Partnership region, Ukraine lags behind in almost all indicators, Georgia holds a leading position in the region, and Armenia comes second.

Evaluation of Ukraine based on the Small Business Act



³ This section is prepared by the Center for cross-border cooperation, Ukraine (CCBC)

Ukraine has made certain progress in deregulating business and simplifying administrative procedures, including reducing the period for registering companies, expanding e-government services (especially for tax returns and payments), and implementing legal reforms in areas such as licensing, bankruptcy and secured loans. When it comes to technical barriers to trade, four key laws were adopted to modernize infrastructure in the country.

There has been very little progress on the various indicators of SME policy. The highest scores on the indicators such as operational environment (indicator 4) and technical barriers to trade (indicator 7) are recorded as a result of the recent reforms, particularly those carried out in 2014-2015. The scores on the indicators such as targeted support for SME competitiveness (indicator 5a) and human capital development (indicators 1 and 8a) remain low (less than 3) mainly due to the lack of special measures to support SMEs and a relative reluctance to integrate entrepreneurship into the education system. Thanks to the regulatory reforms (eg, regulating the activity of credit bureaus, expanding credit guarantees, etc.), Ukraine retained a rather high score on indicator 6 (access to finance), although their impact on the access to finance for SMEs is actually limited in the light of the current macroeconomic situation. Starting from 2012, the score on innovation policy (indicator 8b) dropped due to the lack of implementation measures. Ukraine has the lowest score in the region in terms of “greening” of SMEs (indicator 9).

AZERBAIJAN⁴

The measures have been taken to support enhancing the role of SMEs in the economy of Azerbaijan in recent years, especially after 2015. The government's Resolution aims at improving the normative-legal base and enhancing access of the SMEs to finance. These measures are consistent with some of the following principles of *the Small Business Act for Europe*.

I. Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded

- "ABAD" public legal entity was established under the ASAN State Agency by the Decree of the President of the Republic of Azerbaijan No. 1047 dated September 23, 2016. According to the Decree, the "ABAD" (ASAN Support to Family Business) Centers are established to carry out socially-oriented projects aimed at developing small and medium-sized entrepreneurship, raising employment rate of the population and supporting the formation of competitive family businesses. "ABAD" Centers was already established in Masalli, Balakan and Guba regions of the country. Certification and sale of the products manufactured by “ABAD” family households is carried out under the one-stop-shop principle.⁵

⁴ This section is prepared by the Support for Economic Initiatives Public Union (SEI)

⁵ <https://www.economy.gov.az/article/sahibkarligin-inkishafi-sahesinde-apanilmish-islahatlar/28700>

II. Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance

- During the period of 2015-2018, various changes were made to the Law No. 326-IQ on *Insolvency and Bankruptcy* dated June 13, 1997. As a result of these changes, the Law incorporated the provisions about recovery plan for enterprise-debtor and rules for its approval, terms of recovery process, and legal consequences of initiation of recovery process. The amended Law also envisages simplification of bankruptcy procedures through it does not give a new chance to bankrupt enterprise.

III. Make public administrations responsive to SMEs' needs

- The Decree No. 1313 of the President of the Republic of Azerbaijan dated 4 April 2017 approves the Rules on design and issuance of technical specifications, project documentation, including connection of existing entrepreneurial facilities or those under construction to the required electric power of up to 150 kW (generating from the existing 0.4 kV network, including 150 kW). According to the Rules, applications are made only through the ASAN Service Center (ASAN Service) and connection procedure is composed of three stages (customer application to the service centers, payment for connection fees, preparation (delivery) of technical specifications, project documentation to the customer, installation work and connection to the network, supply of power to the construction site) and maximum 24 days. It also envisages setting up technical boards consisting of representatives of the relevant agencies at the ASAN Utilities Center (ASAN Service Center until the ASAN utility centers are established) in order to provide technical specifications and project documentation as well as deal with network connection.

IV. Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions

The Strategic Roadmaps on the National Economy and Main Sectors of the Economy was approved by the Decree of the President of the Republic of Azerbaijan December 6, 2016. This Decree adopted 12 Strategic Roadmaps covering various sectors of Azerbaijan's economy. 3 of these Roadmaps below envisage the mechanisms of state support for funding and enhancing access of the SMEs to finance.

1) One of the 5 strategic targets in *the Strategic Road Map on Production of Consumer Goods at the Small and Medium-Size Enterprise Level in the Republic of Azerbaijan* is dedicated to ensuring effective and efficient access to financial resources for the SMEs. The document envisages four priority measures to achieve this strategic target:

- *Conduct reforms to solve winding-up and insolvency issues*
- *Create SME Loan Guarantee Fund*
- *Improve activities related to property issues and increase access to finance*
- *Develop leasing and alternative financial instruments (forward, futures, option, swap, factoring, etc.) market to ease access to finance*

2) “Facilitating access to finance” is one of the five strategic targets in *the Strategic Roadmap on production and processing of agricultural products in the Republic of Azerbaijan*. The document envisages three priority measures to achieve this strategic target:

- *Upgrade financing mechanisms in agricultural field*
- *Develop agrarian insurance*
- *Promote attracting investments in agrarian field*

3) “Developing the financial markets” remains one of the 5 strategic targets in *the Strategic Road Map for Development of Financial Services in the Republic of Azerbaijan*. The document envisages three priority measures to achieve this strategic target:

- *Create favorable environment for emitters and financial intermediaries*
- *Increase access of investors to financial markets*
- *Increase active participation in inter-bank exchange market*

Under the Decree of the President of the Republic of Azerbaijan on Improving *the State Support Mechanism for Entrepreneurship Development in the Republic of Azerbaijan* dated 31 July 2018, the National Fund for Entrepreneurship Support was abolished and Entrepreneurship Development Fund public legal entity was established on its basis.

V. Promote the upgrading of skills in SMEs and all forms of innovation

- By the Order No. 2296 of the President of the Republic of Azerbaijan dated 1 September 2016, AZN800,000 were allocated for developing tourism in the country and expanding the possibilities of using modern information and communication technologies in this sphere, including AZN400,000 for creating tourism register and AZN400,000 for shopping festival.

VI. Encourage and support SMEs to benefit from the growth of markets

- A new public legal entity - Agency for Small and Medium Enterprise Development of the Republic of Azerbaijan was established by the Decree of the President of the Republic of Azerbaijan dated December 28, 2017 on *Further Improvement of Small and Medium Enterprise Management*. According to the Decree, the Agency will support the development of micro, small and medium enterprises in the country and provide a range of services, including financial services to the SMEs. To this effect, small and medium business houses, a Center for Development of State and Business Partnership, small and medium business development funds will be established under the auspices of the Agency⁶.
- *Rules on the procedure for granting interest-rate subsidies on loans received by entrepreneurs in manat* was approved by the Decree of the President of the Republic of Azerbaijan dated 29 November 2017 on *Ensuring the Activity of the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan*. These Rules define conditions and procedure for granting interest-rate subsidies on loans received from the banks in manat by resident entrepreneurs operating in non-oil sector, and guarantee loans issued by the Mortgage and Credit

⁶ <http://www.e-qanun.az/framework/37470>

Guarantee Fund of the Republic of Azerbaijan. According to the rules, interest-rate subsidy is issued for a maximum of 3 years, with annual interest rate not exceeding 20%. The interest-rate subsidies do not apply to concessional loans granted through the public financial resources.

- On 28 October 2016, the Law of the Republic of Azerbaijan on *Credit Bureaus* was adopted that created a legal basis for the activity of private credit bureaus. In December 2017, the first private credit bureau - Azerbaijan Credit Bureau was set up by 8 banks, and the Bureau started operating on January 15, 2018. From 06 March 2018, the Bureau started providing data users with information on debt liabilities. According to Article 23.3 of the Law of the Republic of Azerbaijan on Credit Bureaus, providing data users with information from the centralized credit register terminated as of 1 April 2018.
- The presidential Decree No. 667-VQ of 2 May 2017 approved the Law on *Encumbrance of Movable Property*, which aims at enhancing accessibility of the SMEs to secured loans. The Law provides for legal regime of encumbrance of movable property related to the performance of obligations, rules for exercising the rights of encumbrancers of movable property, levy of execution on movable property, state registration of the encumbrance and other issues regarding the use of the registry. For a long time, lack of a unified system for registration of movable property in Azerbaijan has restricted access of the SMEs to loans by pledging movable property. According to the World Bank, only 22% of the assets of the SMEs in Azerbaijan remain land and real estate, while receivables make up 34%, machinery and equipment are 44%. 73% of mortgages received by lenders constitute land and real estate, and only 27% are movable property. The banks in Azerbaijan prefer real estate as collateral, which creates serious restrictions for entrepreneurs, and most of them can't afford to meet the bank's financing requirements. Most small and medium businesses do not take interest in applying for traditional collateral loans due to lack of real estate property, such as land.

GEORGIA⁷

As studies show The SME Policy Index 2016 Eastern Partnership countries the Georgia received a good result in seven components and was named as the best performing and reforming country among the EaP countries. Areas for improvement are insolvency, the regulation framework, support services for SMEs and start-ups, standards and technical regulations and innovations.

⁷ This section is prepared by the Georgian Association "Women in Business" (GAWB)



In order to achieve economic goals and improve business climate in the country, the government shall create not only basic conditions for doing business, but also the environment that supports business development. The past period revealed that the government successfully accomplishes a series of reforms aimed at developing micro, small and medium enterprises (MSME). Georgia's business environment remains favorable having undergone significant structural reforms over the past several years, in areas such as starting business procedures, improved the operational environment for businesses with the roll-out of one-stop-shop Public Service Halls and the extension of e-government services, deregulation of business by cutting red tape and simplifying licensing and permitting regimes, as well as tax and customs reforms. In particular the tax system is simplified with 6 types of taxes. Georgia was improved the operational environment for businesses with the roll-out of one-stop-shop Public Service Halls and the extension of e-government services. According to Georgian legislation, export or re-export from Georgia is exempt from customs duties, was created for SME better opportunities for trade with the European Union and in addition ways are open for EU countries to business investments in Georgia. Georgia offers unique opportunities to the businessmen to implement successful business and get access to both – European and Asian markets. It should also be noted that the agreement was signed the Free Trade Agreement with China. the Free Trade Agreement with European Union (EU) and China are expected to boost trade integration. Georgia's 2017 SME Policy Index scores reflect the continued improvement of the institutional and operational environment for SMEs.

In January 2017 external merchandise trade (excluding non-declared trade) in Georgia amounted to USD 651 million, 22 percent higher year-on-year. The exports equaled USD 177 million (45 percent higher), while the imports stood at USD 474 million (15 percent higher). The negative trade balance was USD 297 million and its share in external trade turnover constituted 46 percent. Export excluding re-export amounted to USD 143 million, 47 percent higher year-on-year.

Adoption of the Government Program "For a strong, democratic and united Georgia", SME Development Strategy of Georgia 2016-2020 and the Action Plan are particularly worth noting. The documents are based on the essential principle of the Small Business Act (SBA) for Europe - Think Small First - which places SMEs at the forefront of policy-making and ensures that new regulations don't increase the burden faced by businesses. Strategy was

prepared with consideration to Georgia's priorities and recommendation of SME Policy Index. It envisages a comprehensive approach to establishing a special framework for streamlining functions of governmental institutions in terms of support fostering and facilitating the development of small and medium enterprises in Georgia. The strategy focuses on five major directions:

- Further improvement of the legislative and institutional framework as well as the operational environment for SMEs;
- Improvement of Access to Finance;
- SME skills development and promotion of entrepreneurial culture;
- Export Promotion & SME Internationalisation;
- Facilitation of innovation and R&D in SMEs.

In March 2014 in the framework of building a knowledge-based and innovation-driven economy and to support SMEs development under the Ministry of Economy and Sustainable Development Entrepreneurship Development Agency (EDA) or "Enterprise Georgia" and Georgia's Innovation and Technology Agency (GITA) were established. The main activities of EDA are Entrepreneurial learning, Improvement of access to finance, Export Promotion, Consultancy services. The agency supports SME development using both financial and non-financial instruments, including business skills development, entrepreneurial learning, export promotion, and access to finance.

In May 2016 the first Technology Park was opened with business incubators, innovative and fabrication laboratories equipped with high technology. The facility works with a one-stop-shop principle; it provides different types of services to transfer ideas to businesses. The facility is attracting foreign direct investments and encouraging international tech-based organizations and start-ups to open offices in Georgia.

According to the World Bank Group "Doing Business-2018" Flagship Report - Business production rating, Georgia has improved its position, and it has moved from 9th to 6th place among 190 countries of the world and has been recognized as the leader country of the region, where the phrase "simplicity in business" is a realistic Business climate in country. Today, Georgia has a positive dynamic of sales with the EU countries, which in time coincides with the DCFTA's launch. The above indicates that better opportunities for trade with the European Union have been created for medium and small businesses and in addition ways are open for EU countries to business investments in Georgia.

However, issues remain. The SME policy framework should give due consideration to peculiarities of each stage of economic development in the country:

- The State support to SMEs is not systematic and is not oriented on long-term results. SME policy Furthermore, targeted actions to raise awareness of small and medium entrepreneurs about the Agreement on Trade Area are not enough. It is especially important to strengthen the work in the regions, particularly among companies without much innovative potential and from remote region,
- There are still no special programmes on entrepreneurial skills and access to education, information and modern technologies, events being implemented are not systematic.

- Access to finance is one of the major factors hindering SME development in Georgia. The interest rates on long-term loans in commercial banks vary from 16% to 24%, which is still high for small and medium entrepreneurs. In addition, most of the entrepreneurs are not able to provide collaterals for the loans because they are set at as high as 120% of the loans. Particularly acute is the issue of start-up micro and small businesses including women entrepreneurs, as the owners of real estate are mostly men.
- It is highly desirable to encourage entrepreneurship with a credit guarantee system and a cheap credit state program, and to attract private investment and venture capital funds, which could significantly improve access of small and medium-sized entrepreneurs to credit resources. Innovative non-lending financing channels such as private equity, venture capital or crowd funding although being targeted by the SME initiative are still underdeveloped. It is necessary to implement legislative amendments to simplify financial accounting rules and procedures for small and medium businesses, and create more solid legislative support for its development
- Create an SME-friendly environment at the policy framework, to meet the requirements EU Small Business Act Assessment by adopting the new Law on the 'Small Business', which ensures protection of small business interests;
- Systematically apply regulatory impact analysis to assess the positive or negative impact of regulatory changes on the SME sector;
- The issues of raising awareness of small and medium enterprises and their active participation in economic policy and decision-making at all stages, planning and implementation of reforms envisaged by the Association Agreement, including the implementation of DCFTA remain unsolved. This indicates that there are gaps in the dialogue between public and private sectors (PPD). Rapid institutional change has sometimes taken place in the absence of a strategic direction, whilst a lack of formal mechanisms for public-private consultations and regulatory impact assessment (RIA) means that the private sector is not always fully included in the reform process.

SBA assessment results at regional level

Most EaP countries have started to implement **business climate reforms** to create a conducive environment for private sector development;

However, they still face significant challenges in developing **a comprehensive approach towards the SME sector** to complement these efforts with more targeted measures

EaP countries are supporting SMEs and entrepreneurship through business environment reforms;

Institutional frameworks for SME policy are developing at different paces in EaP countries;

More targeted SME policy tools are still needed to further support SME growth across the region;

Data on SMEs remains scarce across the EaP region.

Georgia and Belarus have managed to integrate all registration and notification procedures within one-stop-shops, while Georgia has introduced Public Service Halls, integrating one-stop-shops with a range of other government services.

Armenia, Georgia and the Republic of Moldova have started to develop the institutional framework through on-going public-private consultations and effective policy co-ordination mechanisms;

Historically outside of the policy making process, the private sector in Eastern Partner countries – especially SME associations – needs to be further integrated into the policy debate at all stages to increase responsiveness of policies to the fast-moving needs of the marketplace. Buy-in from the business community will also ensure more effective implementation of reforms.

According to the World Bank's "Doing Business" report, radical reforms of the business environment have been implemented by Georgia in recent years. Due to the success of these reforms, Georgia moved from 112th (according to "Doing Business" report from 2006) to 8th place in 2014. In addition, the country received the leading reformer's status during 2005 – 2012. All of these contributed to foreign direct investment (FDI) and economic growth, reaching 9% annually over the period from 2005 to 2008.

For improvement of business environment, government shall ensure macroeconomic stability, support increase of private sector's productivity, ensure that regulations are clear and explicit, create effective mechanisms for resolving business disputes, and support increase of access to finance.

In order to achieve economic goals and improve investment climate in the country, the government shall create not only basic conditions for doing business, but also the environment that supports business development

However, sustained economic growth has not led to the creation of new jobs and reduction of unemployment, which remains high (over 13%).