

# SME DEVELOPMENT INSTITUTIONS IN GEORGIA

## ANNOTATION

SME development is strategically important for the country's economic development. This field is responsible for employment growth and job creation. Due to these main reasons and considering its contribution to economic development and growth, we can say, SME sector performs the function of backbone of the economy for any country. SME has a social significance in countries with developed economy. It promotes the formation of the middle class in society. This is why stable development of this field is the prerequisite of sustainable economic development. 50 to 70% of developed countries' GDP is produced by small and medium-sized enterprises. Taking all this into consideration, keeping the fast pace in development of SME is regarded as a priority by the governments of developed countries.

In the presented work we analysed and discussed the definition of SME, its role and development trends in Georgia, state support policy.

**Key words:** SME sector, state policy, business law, government regulations.

## INTRODUCTION

SME development is fast paced in developed countries (Western Europe, USA) because this kind of enterprises are considered a priority and supported by governments. These businesses promote the formation of the middle class, sustainable economic development (for the last decade, 50 to 70% of GDP is produced by them) and employment growth (2/3 of new jobs are created by them).

Small enterprises are working quite effectively in processing industry. For example, manufacturing small mechanisms, parts and semi-finished products is unprofitable for large enterprises, so the western countries have established systematic approach to small enterprises.

For the economy of Georgia as for the post-soviet country growth of SME, where the large quantities of added value and jobs are created, is a top priority. But 25 years of reform did not have a desired outcome and the economy of our country can still be considered as transitional. This was caused by the mistakes that were made in reform process and they literally turned some of the reforms into pseudo-reforms.<sup>1</sup>

Studying SME development and also developing suitable recommendations to raise sector efficiency has been a priority for Georgia after transiting into market economy.

The state, as the powerful institution, is playing an immeasurably big role in providing SME development. To underline this role we conducted scholar inquiry by the short questionnaire with Georgian entrepreneurs. The inquiry reflects their attitude towards state policy. The criteria for selection were: a) the size of the enterprise (number of workers and annual turnover); b) activity field. Activities of



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the enterprises that participated in the research are: 25% trade, 17% personal and household services (beauty salon, sewing shops, etc.), 10% manufacturing (food products, bakery, confectionery, etc.), 10% hotels and restaurants (restaurant, café, hostel, etc.), 7% healthcare (dental and other healthcare services), 7% construction, 7% IT (internet café, computer services, etc.), 5% educational. Therefore, research results show arguments, problems and recommendations of entrepreneurs from almost every fundamental economy field. Research results are representative because the inquiry concerned the enterprises of different size and activity. In particular, according to the number of workers 22% of the enterprises were micro-enterprises, 71% small enterprises and 6% medium-sized enterprises. What concerns the annual turnover, 80% of the enterprises has less than 100 GEL, while 20% has more than 100 GEL.

By the data of the year 2018 there are 251732 Ltd companies (among them 68404 are active) and 440416 individual entrepreneurs (among them 91394 are active) are registered in Georgia. We inquired 500 SMEs in the capital area and, therefore, we can say that the results are relevant and close to reality.

## STATE POLICY AND SME SECTOR

After Georgia gained independence from Soviet Union there were attempts of creating institutions and legislative base for SME. Since then supporting small business was considered as a priority for economic development. Accordingly, Law on "Small Enterprise Support" issued in 1999 defined fundamental principles of SME sector devel-

<sup>1</sup> Papava V., Georgia's Economy, Tbilisi 2015

opment. Also, by order of the president Small Enterprises Development and Promotion Centre was created, which carried out special events and support programs for these enterprises.

Therefore, the process of SME activity was getting bigger and became stable and effective. The results of studies show the essential supportive international experience for this sector, by the example of countries with transitional economy and international organizations had begun the bringing of this experience in practice. But social and economic situation and ineffective governance in 90s created complications in SME sector development: high corruption, avoided taxes and hidden revenue that caused constant budget deficit, inflexible tax system, bureaucracy, corruption in public service, the Shadow Economy, etc.

In 2002, President Saakashvili issued a Decree No. 309 "On Approval of Small and Medium Enterprise State Support Program for 2002-2004 in Georgia". Thanks to these activities, a healthy environment for the SME sector would be created, which would increase the efficiency of their activities and facilitate entrepreneurs' access to information, attract qualified personnel to their business, reduce the level of differentiation between regions and contribute to solving social problems. Since 2006, legislative amendments have been more actively initiated to strengthen the SME as an institution. Existing laws were modified, some were completely abolished and completely new ones were adopted: for example, the single-window principle, etc.

Experts often criticize governments, as if supporting small and medium entrepreneurs and improving the business environment are not a priority. This assumption is based on the argument that no measures are being taken to support SME at the level of economic policy. We also face a serious problem with the SME terminological definitions. As a result of the abolition of a special law and regulations intended for the SME sector, business indicators in this area have worsened. However, it would be inaccurate to unambiguously accuse the government in this matter, because as a result of the global financial crisis and the Russian-Georgian conflict, production has turned out to be in an unenviable position.

This is partly as a result of the fact that the government does not have a long-term vision and does not set out those prospects for small and medium enterprises that will be spread over a wide range of time. In 2009, the government was again heavily criticized not discussing a bill on small enterprises, drawn up by the civic movement Solidarity, despite the fact that this bill offered many interesting views on the regulation of this sphere.

When discussing a strategic development plan, it is necessary to discuss the draft "Social-Economic Development Strategy of Georgia 2020", developed by the Government of Georgia. The strategy describes in detail the priorities and problems that need to be addressed to ensure a long-term, sustainable and inclusive economic development. "The government's strategy defines a number of priority areas,

including: improving the investment and business environment; supporting innovation and technology development; promoting export growth; infrastructure development and maximum use of transit potential; labor force development focused on labor market demands; improvement of the social security system; providing affordable and quality health care; mobilization of investment resources and development of financial intermediation.<sup>1</sup>

Among government initiatives aimed at supporting small businesses, the Tbilisi City Hall's program "Start Your Business with the help of the City Hall" is worth mentioning. In addition, the state has allocated budget funds to help the SME and finance the following programs:

- o In 2007, the "Targeted State Program for In-Service Training" was financed in the amount of GEL 20 million.
- o In 2008, GEL 62.5 million were allocated within the framework of the "Cheap Loan" program, where GEL 49.5 million were spent on the export promotion subprogram.
- o In 2009, GEL 2.5 million was spent on the "Cheap Loan" program, after which the "Cheap Loan" program was no longer financed.

It is worth mentioning the projects implemented by international donor organizations to support the SME. These projects have been implemented in Georgia since the second half of the 1990s. Thanks to them, it became possible to form a business environment, improve regulations, finances became available, they began to take care of improving the skills of small business personnel, etc. Among donor organizations, UNDP, USAID, GIZ, IFC, Millennium Challenge Georgia, Swiss Agency for Development and Cooperation, the Norwegian Refugee Council and other governmental and non-governmental organizations are of particular importance. With their help, consulting centers, business incubators and so on were established.

Small business support projects, jointly implemented by the Government of Georgia and international donor organizations, contribute to resolving some issues. However, in major cases, these activities are of fragmentary nature and along with expiration of the project, they complete their life cycle. Another issue is the impossibility to assess the sustainability of technical assistances and other similar supports, as the existing database does not allow assessment of the activities carried out in this direction.

In order to support the establishment and development of small and medium enterprises and increase their competitiveness, since 2014 there are two agencies operating in the system of the Ministry of Economy and Sustainable Development of Georgia - the Entrepreneurship Development Agency and Georgia's Innovation and Technology Agency.

There are several organizations in Georgia that support small and medium entrepreneurship, among them: Georgian

<sup>1</sup> Social-economic Development Strategy of Georgia - GEORGIA 2020 <https://napr.gov.ge/source/%E1%83%A1%E1%83%A2%E1%83%A0%E1%83%90%E1%83%A2%E1%83%94%E1%83%92%E1%83%98%E1%83%90/ViewFile.pdf>

Chamber of Commerce and Industry, Georgian Employers' Association, Georgian Small and Medium Enterprises Association.

In order to develop small and medium enterprises, new competitive industries and the existing ones, in 2014 the Government of Georgia launched the state program "Produce in Georgia".

**ESTIMATES OF GEORGIAN ENTREPRENEURS**

Entrepreneurs answered the question: "How has the business environment changed over the past two years, in your estimation?" (**diagram N1**).

Based on the answers, we can assume that for entrepreneurs the state policy is either completely unsatisfactory, or they lack knowledge of the reforms undertaken, which is caused by the lack of PR about their own activities from the state. Answers to the following question are also supported by arguments: (**diagram N2**).

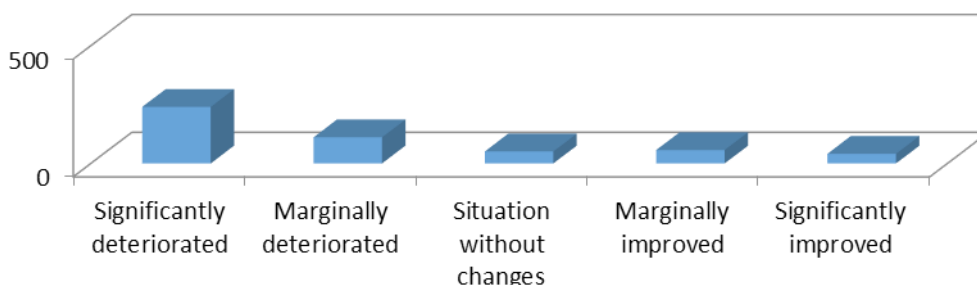
**CONCLUSION**

The inability of small and medium enterprises to give an effective impulse to the economy, a low level of generation of new jobs and a small share of services and products created by them in GDP can be considered a weak part of the Georgian economy. The economy of Georgia mainly stands at large enterprises, which have a weak correlation with small and medium-sized enterprises.

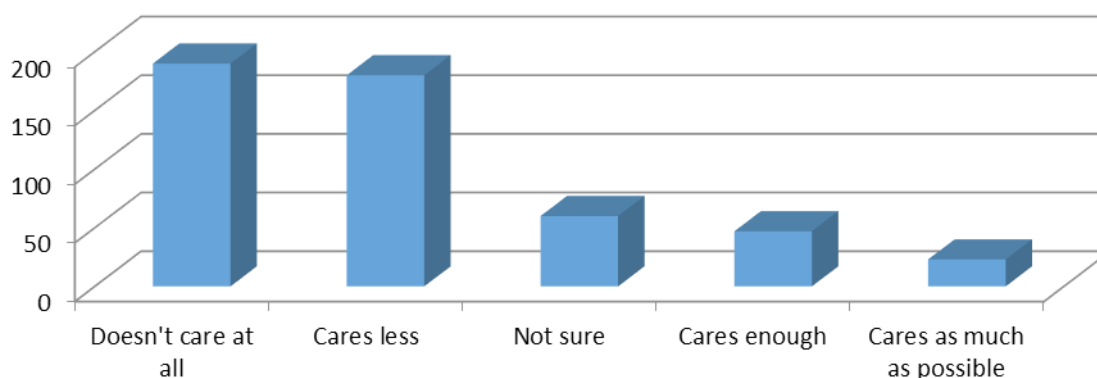
From an economic and organizational point of view, poor mobilization of small and medium-sized enterprises and the failure to use their collective efforts impeded investment growth, the logistics of enterprises and current cost policies required a significant transformation of their management, and the strengthening of global trends and the lack of human resources in the country compounded problems of entrepreneurship, and the chain of development of small business values remained undeveloped.

The study, analysis and our research of the current state

**Diagram 1. Grouping of respondents according to the perception of changes in the business environment in Georgia over the past two years**



**Diagram 2. Grouping of respondents according to the attitude to state care**





of SME gave us the opportunity to draw conclusions and make the following recommendations:

1. Institutions supporting small and medium enterprises play a crucial role in the growth and development of this sector. Despite the fact that support institutions for SME already exist in Georgia, they need to be strengthened.

2. Supporting innovation and research and development is one of the most important factors in improving the competitiveness and productivity of companies. The value added of companies, especially small and medium enterprises, is low, one of the reasons for which is the insufficient level of technology development and the lack of innovation. In order to support innovation and R&D development in small and medium enterprises, it is necessary to raise awareness of the importance of innovative entrepreneurship.

3. Knowledge of small and medium entrepreneurs is low regarding the demand for export markets, not only on the demand for goods and services, but also their related specific requirements, which, in turn, negatively affect the development of export potential. In order to support the competitiveness of small and medium enterprises, export support is crucial.

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