

**KAUNAS UNIVERSITY OF TECHNOLOGY
SCHOOL OF ECONOMICS AND BUSINESS**

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DEVELOPMENT SMALL AND MEDIUM ENTERPRISES IN GEORGIA

MASTER THESIS

Supervisor

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SUMMARY

The given thesis includes the theoretical and practical considerations about the development of small and medium enterprises in Georgia. Within the frames of the thesis, the basic information about the definitional issues of the SMEs are given; the main problems related to distinguishing the small and medium enterprises are discussed; the current economic situation of Georgia in relation to the SME development is reviewed and the basic considerations about the future implications of the SME development are made.

The second part of the thesis includes the comprehensive review about the current state of the SMEs within the country, as well as the State and the EU programs for supporting its future development. The role of a state in development of the small and medium business is outlined.

The last part of the thesis includes the research conducted to evaluate the efficiency of the State's program "Enterprise in Georgia"; the conclusions are made and the recommendations for the further development of the SMEs in Georgia are formulated.

The Development of Small and Medium Enterprises in Georgia

Introduction and brief history

Almost 25 years have passed after Georgia regained its independency. During this period, its economy went through major changes. The first years of independency were particularly difficult, when the military conflicts in Abkhazia and Samachablo were followed by the absence of any kind of sensible economic policy.

As a result, by 1994, the amount of complete domestic product had decreased three-fold, compared to 1990. The annual inflation was very high by 1994. The monetary reform of 1995 laid the foundation for the macro-economic stability of the country, which resulted in the relative economic growth the years 1996 and 1997¹

Despite this, the corruption in Georgia favored led to the budget crisis. By 2003, the income of population's 52% could not reach a wages.

After the November 2003, the fight with corruption was intensified in Georgia, and the budget and energy crisis were overcome. The new tax code, adopted in 2005, decreased the taxes. The labor legislation, which had been recognized as one of the more liberal legislations worldwide, was also changed. Because of these reforms, Georgia got the status of the country of neo-liberal reforms. At the same time, the private property rights were massively violated. The large business turned out to be under the control of the Government, and the anti-monopoly legislation was virtually abolished, and the corruption had gone up to the highest government circles.

After the Russia-Georgia war in 2008, the European Union offered Georgia the Free Trade regimen, for which it demanded the fulfillment of a number of conditions, including the adoption of the European anti-monopoly legislation and the protection of the consumers' rights.

Within the frames of the Association signed with the European Union in 2014, the Free Trade Agreement was made, which creates the conditions for attracting the private investments towards the Georgian economic sector, as far as the workforce within the country is relatively cheap, registration of a business is relatively cheap and the taxation is relatively low, which will further support the flow of investments and new job creation within the country.

Making small and mid-sized business has its challenges in every country, but the difficulty of maintaining such businesses in developing countries is usually higher than in developed parts of the

¹ <https://matsne.gov.ge/ka/document/view/1293776>

world. Being the country of a relatively new democracy and independent economy, since the fall of the Soviet Union in 1991, Georgia has encountered a number of serious problems considering the economy, as far as becoming an independent state required having an independent economy, which practically did not exist in Georgia since the 1921.

Since Georgia became an independent state in 1991, there have been numerous trails of constructing an economy which would be independent and effective, but so far the country has not succeeded in building a stable economy. The reasons for this might vary, but several leading causes for the ineffectiveness of economy in Georgia include the lack of effective business policy and governance, as well as tendencies of corruption within the government and the monopolies which suppress the development of a new business.

Supporting the development of small medium enterprises (SME) in Georgia has the vital importance, as far as the small and mid-sized business can serve as the foundation for country's economic development and well-being. The development of MSEs within the country can significantly decrease the unemployment rates, which nowadays represent a serious problem for some developing countries, such as Georgia.

The role of the European Union and other major international organizations in supporting the development of small and mid-sized business can be vital as far as Georgia still does not possess the resources enough to promote the growth of the SMEs. It includes the existence of an efficient business-making policy, the constraints that are to be placed on government and existing business monopolies, limiting their interference within the activities of the SMEs, allocation of the international grants for supporting the development of the SMEs in Georgia etc.

Identifying the problematic issues of defining the SMEs is important in specifying their role in development of the economy, and a brief discussion of these issues is given in the 1st chapter of the thesis.

Chapter 1. The problem analysis

1.1 SMEs – basic issues and definitions

The abbreviation SME stands for the small and medium-sized enterprises, and is used by the most major international organizations, such as the European Union, the United Nations, the World Bank and the World Trade Organization².

Defining the small and mid-sized enterprises has been quite problematic, since there is no single definition which could be common for all countries of the world. In fact, in each country there can be an individual definition of the SMEs, as far as different countries have different standards for creation and development of the small and mid-sized businesses.

The first working definition for SMEs for the European Union was adopted by the European Commission, which was updated in 2003 with a new recommendation in 2005, which states that

“Enterprises qualify as micro, small or medium-sized enterprises if they fulfil maximum ceilings for staff headcount and either a turnover ceiling or a balance sheet ceiling (Table 1.). The Commission Recommendation also specifies the method on how to establish and calculate these reference data. Currently, up to 23 million enterprises in the EU fall within the scope of the definition”³

Table 1. SME ceiling

Enterprise category	Head count	Turnover	Or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

According to the European Commission’s report of May 15, 2014, the “assessment of small and mid-sized enterprises is generally carried out by two types of stakeholders: the companies

² https://en.wikipedia.org/wiki/Small_and_medium-sized_enterprises

³ <http://edz.bib.uni-mannheim.de/www-edz/pdf/sek/2009/sek-2009-1350-en.pdf>

themselves in view of a loan or grant application; and European, national, regional and local officials who process these applications. It is crucial that these authorities apply the SME Definition in a consistent way throughout the EU in order to make fair and transparent decisions on the eligibility criteria for support”⁴.

1.2 The problems of identification and support of the small and mid-sized business

As mentioned above, there is no one common standard of defining the “small” and “mid-sized” business. The definitions of the small and mid-sized business vary substantially between various countries and international organizations. The definition of a “small enterprise”, despite the popularity of the subject within various social-economic studies, still does not have a firm ground. The only things on which all researchers agree, is the fragility of the small enterprises, their faulty quantitative and qualitative characteristics, especially in developing countries.

According to Tom Gibson, “Within the community whose work it is to promote economic growth in developing countries, the role of small and medium enterprises remains a topic of debate, which has been badly served by faulty definitions”⁵.

The pioneers in SME finance, Tom Gibson and H. J. van der Vaart argue that “The inadequacies of current conventions in defining SMEs and the inconsistencies among official SME definitions can lead to serious distortions in the allocation of donor spending for private sector development”. They also state that the “volume of turnover of a business is in general a more appropriate measure of its relative size than either of a more conventional measurements by number of employees or values of assets”⁶.

According to the American expert of micro-economy, E. Dolan⁷ argue that the small enterprise is an enterprise which is “characterized with the independent ownership and the independent organization

⁴ The European Commission, Evaluation of the user guide to the SME Definition ENTR/172/PP/2012/FC – LOT 4 Final Report 15th of May, 2014

⁵ *Enterprises in Developing Countries. Defining SMEs: A Less Imperfect Way of Defining Small and Medium Enterprises in Developing Countries.* Tom Gibson Principal, SMEthink Co-Founder, Small Enterprise Assistance Funds H. J. van der Vaart Executive Chairman and Co-Founder Small Enterprise Assistance Funds September 2008. Page 3

⁶ *Enterprises in Developing Countries. Defining SMEs: A Less Imperfect Way of Defining Small and Medium Enterprises in Developing Countries.* Tom Gibson Principal, SMEthink Co-Founder, Small Enterprise Assistance Funds H. J. van der Vaart Executive Chairman and Co-Founder Small Enterprise Assistance Funds September 2008. Page 10.

⁷ Edwig G. Dolan “Basic Microeconomics: Principles and Reality” p. 15

of the economic activities. The small business is an enterprise, which includes at least the two of the listed below: independent management; one's own capital; a local region of activities; relatively minor size in terms of the branches"⁸.

The international *Organization for Economic Co-operation and Development* (OECD), which includes the developed countries, defines an enterprise which has up to 19 employees as "quite small", an enterprise with up to 99 employees as "small", and an enterprise with employees from 100 to 499 – as "big"⁹. According to the World Bank, the total number of the employees which make an enterprise the entity of "small business" is more than 50.

In addition, the concept and category of small business might have different criteria in various countries, such as the amount of capital and the sales in volume is the main criteria in Great Britain, Italy, Japan, the form of ownership – in Hungary, the non-monopoly state on the market – in the USA, having a dependent condition within the large enterprise – in Japan etc. Hence, in our consideration, the most common criteria for defining a "small enterprise" are the following: the number of employees, the volume of turnover, the amount of the authorized capital, and the status (level) of independency of an enterprise.

It has to be mentioned that there is a "combined approach" towards defining an enterprise, the best example for which is the definition of a small firm, as presented by the Bolton (UK) committee report of 1971. The committee was trying to overcome the disadvantages of the quantitative approach and offered the "economic" and "statistical" definitions of a small firm (enterprise, business). According to the economic definition, the small firm is a firm which: has a minor share within the market space according to its activities; cannot influence the prices; the management is executed by the head (or co-owner) instead of the formalized management structure and the enterprise is independent in terms of not being a part of any major company¹⁰.

⁸ E. Bragina, "Small enterprises in transitional economies", Journal "The world economy and international relations" № 1, 2001, p. 88.

⁹ M. Lapusta, "The small enterprises", 2007. P. 51.

¹⁰ ბოლტონის (დიდი ბრიტანეთი) კომიტეტის მოხსენება, 1971 (Bolton Committee Report (England) in 1971). www.isbe.org.uk

The criteria and definitions of the small enterprises are also presented by the UN Economic Commission. One of the criteria is linked with the number of the employees within an enterprise: In African countries, the number is below 100, in Latin-American countries – from 5 to 50 employees. Different criteria have been offered for the countries of Asia and the Pacific, where a small enterprise should not employ more than 50 people in case the manual labor is used, and up to 20 people in case the working process is mechanized. There are even bigger differences on the national level, but the number of employees is the basic criteria for defining a small enterprise. An exception in this regard is India, where because of the excess workforce the numbers of employees are not regulated and the size of an enterprise is defined by the amount of the start-up capital.

In developed countries, an important part of the “healthy market economy” is the support of the SMEs by the commercial NGOs, which represent the companies busy with micro-financing and investments. Nowadays, there are more than 5000 such organizations in the European Union. The organizations supporting the small business have grown by 30% from 2004 to 2008. The following countries share the leadership in terms of the number of such organizations: Germany (17%), France (15%) and Netherlands (12%). In USA and Canada, the number of the organizations mentioned above are getting close to 24 000.

According to the “Report on Support to SMEs in Developing Countries through Financial Intermediaries” (November 2011), **“The SME sector is the backbone of the economy in high-income countries, but is less developed in low-income countries”**. According to the Organization for Economic Co-operation and Development (OECD), “more than 95% of enterprises in the OECD area are SMEs”. These enterprises represent up to 60% of the employment within the private sector and contribute greatly to the innovation, together with supporting the regional development and social cohesion¹¹. It is also important that the contribution of the SME sector to the GDP and employment in low-income countries is critical¹².

The term SMEs, as mentioned above, can include a wide range of businesses, but their dynamism is usually different from each other, as well as the technical advancement and their attitude towards taking risks. As the report mentioned above states, “Many are relatively stable in their technology, market and scale, while others are more technically advanced, filling crucial product or service

¹¹ OECD SME and Entrepreneurship Outlook 2005 Edition

¹² Ayyagari, Demirguc-Kunt and Maksimovic, 2011. “Small vs. young firms across the world”, World Bank

niches. Others can be dynamic but high-risk, high-tech “start-ups”¹³. There is a common agreement between the researchers and practitioners that the SMEs make the crucial contribution to creating new jobs and the economic growth in high-income and especially – in low-income countries¹⁴.

1.3 General characteristics and specifications of small and medium-sized business

The small and medium business, which usually comprises the small and medium enterprises, differs from a large business-enterprise in a number of ways. Some of the basic differences, except for the size and scale, include the functions and goals of the business. The small and medium business represent the “corner-stone” of the economy of developed countries, as far as it accounts for almost half of the private sector. The role of the small business in economy is conditioned by its importance in country’s economic development. The small business creates jobs, and in developed countries it accounts for 2/3-3/4rth of the new jobs. It is important to consider that such an increase in the number of jobs is conditioned by the activities of such small businesses which aim to be transformed into medium or large enterprises, but there might be many small businesses which dont have any employees at all.

In addition, the small business creates the new products. Ability to implement the innovations freely, which is characteristic for many small enterprises, still gives them the advantage in field of technological development, as well as in terms of diversifying the service or the goods to be sold at market. In some cases, the innovation comes from the renewal of the views towards the marketing abilities, and other times the implementer of the innovation creates a new technology himself, and based on it he expands the activities of his own company, or sells his business to a larger company which requires the implementation of this technology on its production line.

The small business satisfies the needs of larger organizations. Numerous small businesses represent the distributors, providers of goods or services to the large corporations. At the same time, the government agencies make a certain part of their trade agreements with the small businesses.

¹³ David de Ferranti and Anthony J. Ody, “Beyond Microfinance: Getting Capital to Small and Medium Enterprises to Fuel Faster Development”. Policy Brief 159, The Brooking Institute, March 2007

¹⁴ SEAF, 2007. “From Poverty to Prosperity: Understanding the Impact of Investing in Small and Medium Enterprises Data Survey and Case Study Analysis of SEAF Investments”

The small business brings an important part of the money into the budget. For instance, if we imagine the USA's business as the one economic aggregate, its economy would take the 3rd place in world's economy.

The next quality of small business is that it takes the risks which larger companies usually don't go for. The entrepreneurs which are risky and yet inexperienced people, play an important role in economy. Besides this, the small business offers us the exceptional types of goods and services. Often the small business is the one which takes the niche which is usually ignored by the large companies. In addition, the small and medium enterprises are flexible and they adapt to the changes to the market, as well as their own production.

On the other hand, they can operatively create and implement the new techniques and technologies, which is difficult for larger firms, as far as production of completely new technologies is the factor which violates the stability of large-scale serial production. Another important factor is that the small firms are characterized with strong initiatives and dynamism, which makes an important distinction between the large and small firms. This difference finds the expression in interpersonal relations and the social-psychological climate of a given firm, and this also differs between the large and small firms in terms of group coherence and other social factors. In this regard, the employees of a small firm might be strongly united with the goal to survive as an independent entity and to gain more independence as a group¹⁵.

A small enterprise can support the solution of the problem of transition to the market economy, as far as it forms a large part of the market infrastructure. It takes the responsibility to realize the important functions of the national economy, which are difficult for large enterprises to realize. Such functions of the small firms might include the informational-counselling services, auditing, employee, employee selection and assessment, currency and stock exchange, technical service etc.

The small and medium-sized enterprises have particular socio-economic functions; the most important of these functions is that they can hire a large number of employees who have been fired from the large-scale enterprises, together with decreasing the social tension created by the economic crisis within the country. Hence, the refreshment of the economic activities has to be the part of any

¹⁵ The strategic management, F. Analoui, A. Karami, 2005, p. 17.

reform or change within the economic policy, the major part of which is presented by the development of the small and mid-sized business.

The Georgian legislation does not define the concept of “business”, and the “entrepreneurship” is defined by the law “about the entrepreneurial activities”. The entrepreneurship is linked with the material production process, which creates the material goods with the goal of gaining income, while the concept of “business” can include any kind of activity which gains the profit, including buying the production with the goal of its realization.

According to the UNIDO and the world summit for sustainable development report¹⁶, “For developing countries, integration into the global economy through economic liberalization, deregulation, and democratization is seen as the best way to overcome poverty and inequality”. First and foremost, this requires the development of the SMEs, which constitute the major part of the private sector. As already mentioned above, the SMEs constitute approximately 90% of the business worldwide and the jobs they make account for 50-60% of the total number of the existing jobs. The SMEs can have a big role in economic development of the developing countries, as far as, according to the same report, “SMEs are the key to the transition of agriculture-led to industrial economies as they provide simple opportunities for processing activities which can generate sustainable livelihoods. In this context, the predominant role of women is of particular importance”. This can be really important for developing countries such as Georgia, as far as Georgia has always been the country with major agricultural opportunities, and creating and activating SMEs in this sector could contribute greatly to the Georgian economy which currently suffers certain setbacks.

1.4 The SME development in developed countries and Georgia

The subject of SMEs development is of a great importance under the conditions of the economic modernization in Georgia. The small and mid-sized business has an important role in any country –

¹⁶ UNIDO and the World Summit on Sustainable Development. CORPORATE SOCIAL RESPONSIBILITY. *Implications for Small and Medium Enterprises.*

it ensures the employment, supports the formation of healthy competition, provides the market with new goods and service and satisfies the requirements of large enterprises.

In last years, a number of studies have been published by Georgian scientists and researchers on the issues of SMEs development within the country, which offer various measures for improving their functioning.

It has to be mentioned that the level of development of the SMEs in Georgia is significantly lower than it is in developed countries. The state aid to the small and mid-sized enterprises is also weak. We think that it would be beneficial to pay the attention to the conditions of the SMEs of foreign countries and conduct their analysis. Studying and analyzing the foreign experience of supporting the SMEs will help the Georgian state and municipal bodies in developing the efficient programs for supporting the entrepreneurship¹⁷.

In developed countries, the development of SMEs is taking place rapidly, as far as the national governments pay great attention to such enterprises and provide the support for them – they establish and realize the programs for supporting the small and mid-sized and impose significant discounts for them. In economically developed countries, the small and mid-sized business serves as the basis for middle class formation, which is the basis for the stable development of economy and employs the major part of the population. In these countries, the 50-70% of the GPD is produced by the small and average companies.

After the industrial revolution in European countries, the importance of the SMEs would grow because of the increasing economic and social importance of the given sector – in the beginning of the 20th century, the number of SMEs accounted for 98.7% of the whole number of enterprises, 99.3% - in Switzerland and 99.7% - in Austria, but it has to be mentioned that the share of employment in this sector was relatively modest.

The small and mid-sized enterprises display the efficiency not only in consumer sector, but also in the processing industry sector, as the industries of those particular minor mechanisms, details and semi-finished goods, the production of which is not rentable for large enterprises. All these serve as the basis for defining the small enterprises in economies of western countries and the systemic approach towards the role of small enterprises.

¹⁷ A. Ageeva, “The Entrepreneurship: the problems of the ownership”. 2004. P. 7.

The level of the development of SMEs is largely determined by the sectoral specifics of a given country and its economic mechanisms. This is why when we use the numbers to compare the SMEs of the developed countries with the Georgian reality, it is really important to consider the institutional and infrastructural differences between Georgia and western countries, as well as the sectoral structure of the economy.

The national features are the factors which play an important role within the formation of possibilities of including the SMEs within the industrial processes of the real economic sector.

The Entrepreneurship contributions are important within the development of the science and mastering the new products – in USA, the main part of the inventions come on development of the small and mid-sized specialized firms. It has to be mentioned that the production of airplanes, helicopters, conditioners, personal computers and other modern productions first were started in SMEs.

In USA, the small and mid-sized enterprises function in various fields - Material production, trade, financial sector, the social services sector and in the field of innovation. The number of SMEs constantly increases in the USA, so that from 1983 to 2006 their number has increased from 13 million to 26 million. Nowadays, the two thirds of the jobs in USA are created by the SMEs¹⁸.

The government's support towards the SMEs has the critical importance. The philosophy and principles of supporting the small and mid-sized business within the country which is usually considered as the “foundations for capitalism” – the USA, is not new. It was created much earlier, during the Second World War.

In the USA, the law “about the small business” was adopted in 1942. In 1953, the federal agency was created in the USA, which still protects the interests of the small business on the governmental level. Nowadays the Small Business Administration includes approximately 3700 employees, in each state of the USA there is its regional department with 30-40 employees. The administration has its departments in 90 major cities of the country. This organization provides the financial and counselling support towards the entrepreneurs, helps them in getting the State orders and arranging contracts with large entrepreneurs.

¹⁸ A. Calinin, “Analysis of the development and the conditions of the SMEs in the world”. Journal “Economics, entrepreneurship and the law” №4, 2011. P. 5

The main goals of the agency mentioned above include the following: providing direct subsidies and credit from their own funds at the expense of the budget; assistance in obtaining a loan and submission of guarantees for business loans; the technical and informational support of the business etc.; and at last, maintaining and developing the competitive environment, which will serve as the basis for the efficiency of enterprises.

In our opinion, this could serve as an effective model for the development of SMEs in Georgia, as far as without the sufficient support, developing the economy rapidly by means of the small and medium-sized business development is almost impossible. Taking into the consideration the model of the Small Business Administration which operates efficiently in USA, the Georgian business environment, which currently is not highly effective, could be imposing fewer constraints to the development of SMEs within the country in turn would contribute to the country's stable economic development.

As for Georgia as the former country of the USSR, the final period of the 1980s was marked by the attempts to revitalize the activities based on the economic sector of the USSR and the creation of the private business sector. During the years of transformation, the new laws "about the cooperation" and "about an individual labor activities" were adopted, which actually legalized the private initiative and the basics of entrepreneurship. This period was marked with the emergence of small enterprises in forms of cooperatives, condominiums, private enterprises, individual farmers and some other types of microstructures.

The economic reform placed the new practical and scientific tasks in front of the society. This was an unprecedented attempt of the rapid and radical transformation of the complex and multi-national system. It had to satisfy the "needs of the population" under the conditions of the market economy. It is natural that such transformation implied the deep structural transformation of the public economy.

During the decades, the soviet economy was based on the "scale effect", which gave some positive results, but the flexibility of economic subjects and the adaptation to changes was moved to the background, which was decreasing the economic, social and technological efficiency.

As already mentioned above, within the enterprise relationship network, the SMEs sector has an important role within the formation of the competitive environment, reduction of the social inequality and increasing of the employment rates. The small businesses play a meaningful role in

poverty reduction. They are flexible and respond quickly to the market changes, are easily susceptible to new products and are mainly focused on local markets.

The stable and combined relationships between the small and mid-sized businesses and their competitiveness with the global enterprises are the preconditions for the growing viability and profitability of the enterprises, and this is known with the name of “value increase”.

The chain of value increase unifies the whole process of creation and consumption of a product by the suppliers, manufacturers and consumers. Within this system, the increase in value of each unit depends on another one and their rational and effective unions are directed towards the joint efforts to reduce costs and risks of the production and to increase the production and its consumption. This is the network of vertical and horizontal connections, where the benefits from each level increases by means of the partnership, and their activities become more stable.

An individual enterprise cannot be successful if it is not united within the whole chain of the well-coordinated value increase, beginning from the date of purchase of raw materials all through the realization of the finished goods and the services.

Nowadays the economic development of Georgia is oriented towards deepening the integration within the world economy. This is why the formation of the environment for the liberalization of the economy and the business environment it taking place, which directly influences the development of competition between the businesses and the process of development of the interrelated enterprises.

As the empiric observations reveal, nowadays the business-units in Georgia does not have the problems of entering the market. In spite of this, the share of the SMEs in the chain of creating the values is still minor because of the various factors limiting the business, which did not support the development of production and services.

1.5 Business Development Reforms in Georgia

Since 2005, the government radically improved the investment climate in Georgia, and by means of introducing the new business laws simplified the regulation of business. The reforms mainly affected the simplification of enterprise registration. The accent was made on decreasing the extra

costs of economic and administrative regulation. The costs needed for starting a business and its registration have been significantly decreased. The demand towards the minimum statutory capital was decreased 10 times. The registration of a business was delegated to the tax department (previously it was the task of the courts and the notary) and the registration conditions with the principle of “one window” for the trade, taxes and employment have been created.

In 2005, the new licensing law was brought into action, which left only 150 licenses and permission, instead of the pre-existing 950 ones, which has been one more important step towards the improvement of business-environment. The licensing procedure and the term of its issuance have been significantly decreased.

These reforms, together with some other institutional reforms have limited the interference of the government within the business, the bureaucracy and corruption. This has limited the transactional costs and made Georgia one of the successful countries within the field of business reforms.

According to the “Doing Business” report of 2008, Georgia went to the 15th position from the former 115th¹⁹.

The institutional conditions for entering the market were simplified for the entrepreneurs. As the result, in 2005-2008, the quantity of the SMEs sharply increased, as far as starting a business became easier and the costs needed for it – decreased.

One of the most successful reforms is considered to be the adoption of the new tax code, which has significantly altered and simplified the taxes. As the result, the fiscal burden on the entrepreneurs has been reduced. Nowadays, from the previous 21 taxes for entrepreneurs, only 6 have been left. The profit tax has been reduced from 20% to 15% since the 2009, the individual income tax – from 25% to 20%, and the estate tax represents the 1% of the cost of the property.

From 2009 to 2012, the taxes were gradually decreased, which supported both the development of business and the growth of economy. One of the important steps forward was the adoption of the new customs legislation, which considered the reduction of the previous customs rates from 1 to 25 percent to the new rates – from 0.5 to percent.

¹⁹ www.doingbusiness.org/documents/DoingBusiness2009-Overview.pdf fizikuri

In 2006, as the result of the tariff reductions, the trade in Georgia on non-agricultural products became fully liberalized, together with its important liberalization on agricultural products as well. The bureaucracy on the customs was abolished, together with the phytosanitary, health and veterinary services.

The relative simplicity of the export procedures, being the member of the World Trade Organization, together with the European Neighborhood policy, have created the appropriate conditions for the SMEs to participate within the export activities. The wine and nuts production could serve as one good example for this, as long as these products are/were the main export production which is brought as the raw material from the farmers by more than twenty small and mid-sized business owners. And the EU preferential trade regime contributes to the growth of its value. The main advantages of these products are the increase in demand, low costs etc.

The simplification of the visa regimen and the liberalization of the taxes for the tour operators, together with improving the infrastructure, have contributed to the tourism development in Georgia, which mainly includes the family households and the small and mid-sized hotels and tour-operators.

Herewith, the projects of reconstructing the cities of Georgia (such as Batumi and Signagi) have ensured the growth of the value of SMEs within the field of tourism infrastructure. The value growth process has been based on the projects initiated by the government, which have horizontally lengthened the value growth chain, although in the period until now, the configuration of this chain has not taken place.

1.6 The initial considerations about the SME development in Georgia

As already mentioned in the beginning, Georgia is the country of transitional economy and although a few decades have passed after the fall of the Soviet Union, Georgia still does not belong to the list of the developed countries, which first of all has to do with its economy, which is not yet strong and stable enough to satisfy the demands of the European Union and other major international organizations to become their official member country.

Despite the fact that Georgia has taken a number of steps forward towards creating a more stable economy, much more has to be done in order to achieve the economic stability and overcome the

poverty and unemployment. As mentioned above, the development of the small and medium-sized business contributes to the creation of stable economy and sustainable development of country's economy, but as far as there are some major monopolies (large enterprises and firms), the unemployment rates are high and the development of SMEs is hampered.

As far as Georgia has historically been an agricultural country, rich of natural resources, the main accent has to be placed on the development of SMEs within this field, and this requires the special attention and the creation of supportive policies by the government, which would support the development of small and medium-sized businesses within this field and hire many of the residents of Georgia who currently live in rural areas.

Being the developing country, Georgia needs the support from the European Union and other major international organizations in order to achieve the economic stability and decrease the unemployment rates by means of developing the SMEs.

The economic interactions between Georgia and the countries of the EU could promote the rapid development of the small and medium businesses in Georgia, as far as it would serve as the motivator for many small and medium business owners to start trading with new countries, and support the start-up businesses to develop into efficient firms and enterprises. This could contribute greatly to the economic development of Georgia, as far as throughout the world, many of the existing large businesses and business networks many of which are now international have started as the small or medium firms or enterprises.

It is important not to underestimate the role of major international organizations such as the European Union within the creation of effective policies for SME development in Georgia, together with opening up and providing the opportunities for funding for the small and mid-sized businesses, which still have many financial barriers in Georgia. Some of these barriers include the burdens which banks place on small entrepreneurs, while others can include the excessively high taxes for SME owners which are too difficult to afford because of the difficult economic conditions within the country.

In the following chapter we will discuss the present and future possible role of the European Union within the development of the SMEs in Georgia, its attempts to create the policy which would reduce the present financial and economic burden on the owners of the SMEs in Georgia and provide an opportunity to decrease the unemployment rates in Georgia, which are quite high and

require a special attention in order to avoid the escalation of the existing difficult economic situation within the country.

1.7 The general implications of interaction between the state and the small business within the world's economic practice

The market economy, despite the number of its positive qualities, cannot always automatically regulate the social and economic conditions. This is true for its role within the field of SMEs. Because of this, the fundamental role in entrepreneurial activities is played by the State.

In developed countries, the creation of favorable conditions for development of SMEs is viewed as one of the most important fields of State's activities.

It has to be mentioned that, there are certain conditions which the State and the SMEs pose towards each other. From the perspective of SMEs, the State has to create the condition necessary for efficient realization of their goals. On the other hand, from the State's perspective, the SMEs have to ensure the realization of goals such as decreasing the unemployment rates, developing the competition, increasing the level of public welfare etc. In case of the mutual assent between the goals of the State and SMEs, it is possible to implement an effective state policy within the given field. This is the factor which determines the State strategy towards the SMEs. As the world-wide practice confirms, the perfect small entrepreneurship is formed by means of using the sophisticated mechanisms of its regulation by the State. Several authors²⁰ think that after overcoming the crisis and achieving the development of SMEs, the intensity of the State regulation decreases, but its quality increases. The conditions of sustainable economic development enable achieving the high quality entrepreneurship, which implies the interaction between the state and the SMEs on the basis of their partnership.

Understanding the role of the SMEs in country's economic development is really important by the state (or country), as far as in order to achieve the development, SMEs need to be supported by State business legislation and regulations. This is especially important for the developing countries, as far as in some developing countries such as Georgia, the state regulations do not really support the development of SMEs within the country, and this hampers country's economic development. And

²⁰ Высоков 1999: 37; Экономика предпринимательства. Курс лекций 1999:63; Ярин 2002: 70

formation of an effective business-legislation and regulatory system sometimes requires the cancelation of previous views about having a business.

For instance, in western countries, the entrepreneurial boom during the 1970s and 1980s forced the western politicians to cancel their previous views of the small business. During the years 1969-1978, 3351 thousand small enterprises were formed in Western Europe, and during the years 1979-1988 – additional 6175 small enterprises²¹. Nowadays there are approximately 3 million small enterprises in France, and each year approximately 250 thousand new small enterprises are formed. Herewith, 40-50% of the new workplaces (jobs) created in France comes on the small enterprises²².

Small enterprises have started to play the leading role in such progressive fields of economy, such as electronics, biotechnologies, informational services, shopping retail etc. All of these clearly indicate that the small business has acquired a qualitatively new role, as far as it has become one of the forms of the modern stage of the scientific-technical revolution²³.

The common and important principle of the State regulations is the realization of **rational protectionism** towards the SMEs. In general, the protectionism implies the protection of national markets from the foreign competition and the State policy directed towards the direct and indirect restriction of the importers²⁴.

The protectionism principle used within the State regulation of the SMEs, which still is often the subject of debate both in Georgian and the foreign literature, is still being realized within the practice of the countries with developed market economy. This principle might enable the SMEs to gain the equal conditions towards the large enterprises, and this will be the precondition for achieving the equal competition between them.

The primary element for formation of the State regulatory system is its legal support. The formation of the legal support of the regulation of small entrepreneurship started in different periods in various developed countries. For instance, in 1953 the US adopted a federal law “about the small business in the USA”, according to which, the small enterprise was the firm which had one or

²¹ Афанасьев 1993: 63

²² Калинин 2011: 4

²³ Блинов, ... 2003: 96

²⁴ Ahmed Silemet Jean-Marie Albertini 2002: 552

several owners and the number of its employees did not exceed 500 people, and the volume of its actives – 5 million USD²⁵.

In France, the state regulations of small business were founded in 1960s. In 1965, according to the Sabatin law N. 1329, the small enterprises which would buy or sell machine tools and devices worth 3 or 4 thousand French Franks, after signing the agreement, had right to benefit from the discounts worth 15 300 Franks annually²⁶.

1.8 The characteristics of the development of small business in Georgia

For the improvement of the difficult socio-economic situation in Georgia, and for overcoming the poverty and unemployment, the development of small and medium business is undoubtedly of the crucial importance.

The international experience of the small business makes it clear that the SMEs function efficiently and take the leading place in re-production only in case there is the effective economic policy for supporting the small entrepreneurs. Facilitating the small business development policies is one of the main demands the European Union has towards its partner countries.

Thus, Georgia, as the country associated with the European Union (the Association Agreement was signed on 27 June 2014), is required to follow the European standards precisely. Here we have to mention that in Georgia, despite the annual increase in the scales of economy, the SMEs sector still reveals unsatisfactory trends of development. According to the World Bank research of 2013 – “Supporting the Entrepreneurship in Georgia”, the small and medium business is less than 20% of the gross domestic product, and this index is significantly lower than in many of Georgia’s neighbor countries (for instance, the percentage is 42% in Armenia), and in Europe and the Central Asia regions, the small and medium enterprises on average create 60% of the gross domestic production²⁷.

For the evaluation of efficiency of the business sector, analyzing numerous structural characteristics is required.

²⁵ Анимица, ... 2002: 36

²⁶ Baleyolier 2001: 13

²⁷ <http://press.mediamall.ge/?id=7954>

According to the Georgian National Statistics Department data of 2012, there were 366 229 enterprises in Georgia, 46% of them – in Tbilisi, 12% - in Imereti, 8% - in Lower Kartli, 6% - in Kakheti, 6% - in Adjara, and the remaining 14% - in Racha-Lechkhumi, Lower Svanetia and Mtskheta-Mtianeti regions. The picture is same for the more recently registered enterprises – in particular, 42% of the newly registered enterprises fall on Tbilisi, 16% - on Imereti region, 8% - on lower Kartli, 7% - on Samegrelo and upper Svaneti, 9% - on Adjara etc²⁸.

The data above clearly speaks of the inequality which is characteristic for the regional distribution of the enterprises in Georgia, as far as almost half of the enterprises have been registered in Tbilisi, and the city is unconditional leader and it indicates to the dominant role, which the city of Georgia has within the country's economic system. Such centralization of the economic activities usually leads to the problems in correct development of country's economy. As far as Georgia has always been an agricultural country, more attention has to be given to the regions where the agricultural and farming conditions are quite favorable and could contribute greatly to the development of the SME sector in Georgia.

Although there are a number of programs aiming to support the SME development within the field of agriculture, the government should give more attention to those who are trying to collaborate with the farmers and other representatives of the agricultural field to create the basic forms of the SMEs.

1.9 The brief description of the current situation of SMEs in Georgia

According to the results presented by the Georgian National Department of Statistics (for the 1st quarter of 2014), the total turnover by the sizes of enterprises is as follows :

1. Large business – 83.8 percent;
2. Medium business – 6.9 percent;
3. Small business – 9.3%.

The situation is slightly different in case of the total production of goods:

1. Large business – 83.4 percent;

²⁸ <http://www.geostat.ge/>

2. Medium business – 6.8 percent;
3. Small business – 9.8 percent.

As one can see, the percentage of the enterprises of small, medium and large businesses and the percentage of their total production – are closely related. This once again stresses importance of development of the SMEs within the country, as far as their production constitutes less than 16% in sum, which can be supporting the monopoly of the large enterprises within the country.

The total amount of goods and services procurements realized by the enterprises, constituted 8.1 billion GEL during the first quarter of 2014, and the purchases of the goods and services for the resale – constituted 5.3 billion GEL.

The total number of employees in enterprises amounted to 495.7 thousand people – with 40.5% females and 59.5% males among them.

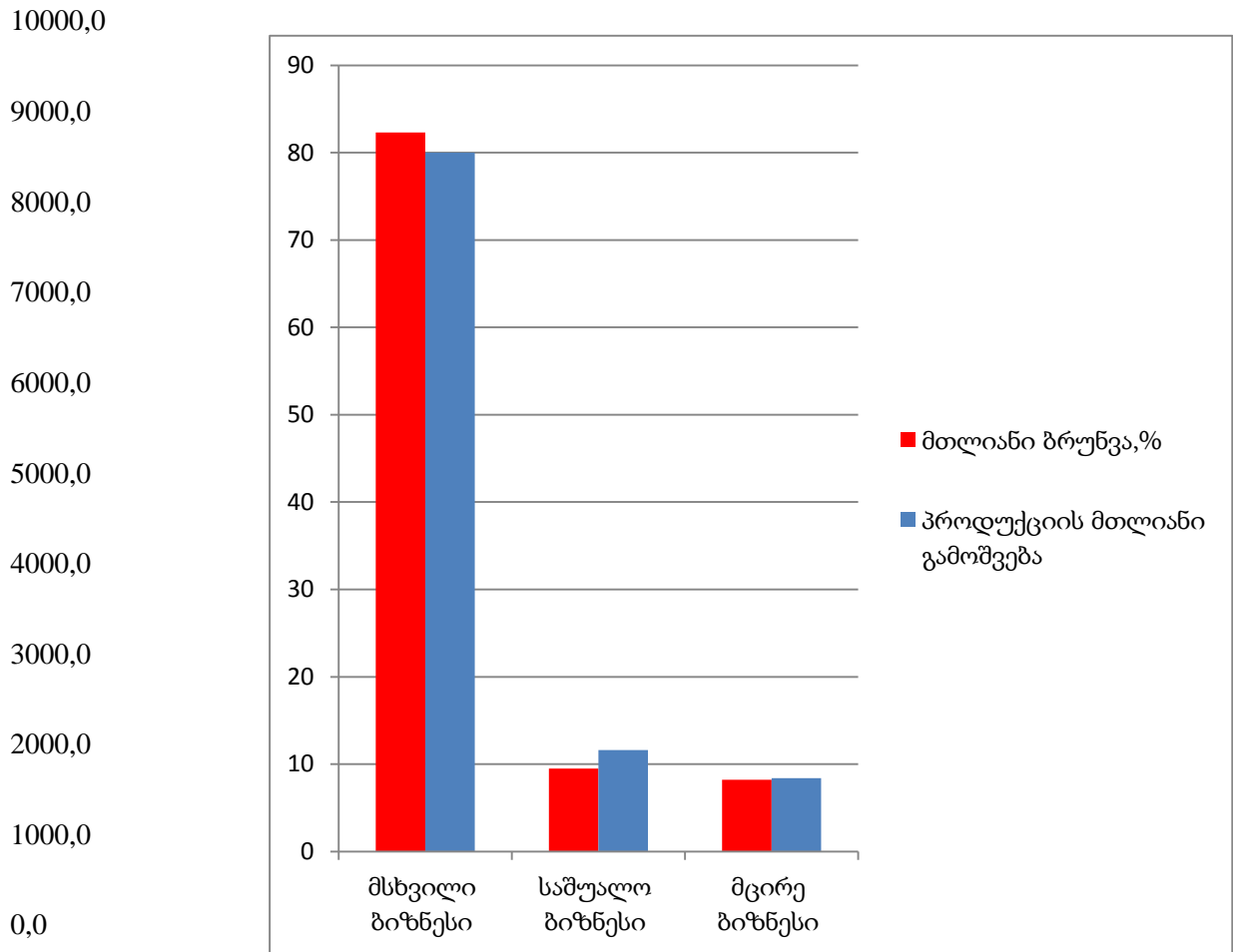
The total number of the employees according to the size of enterprises is distributed as follows:

1. Large business – 62.0 percent;
2. Medium business – 15.2 percent;
3. Small business – 22.8 percent.

The diagram bellow (Figure 1.) is taken from the website of the National Statistics Office of Georgia and it shows the main trends for the first quarter of 2014:

საწარმოთა საქმიანობის შედეგები

(2014 წლის III კვარტალი)



მილიონი ლარი

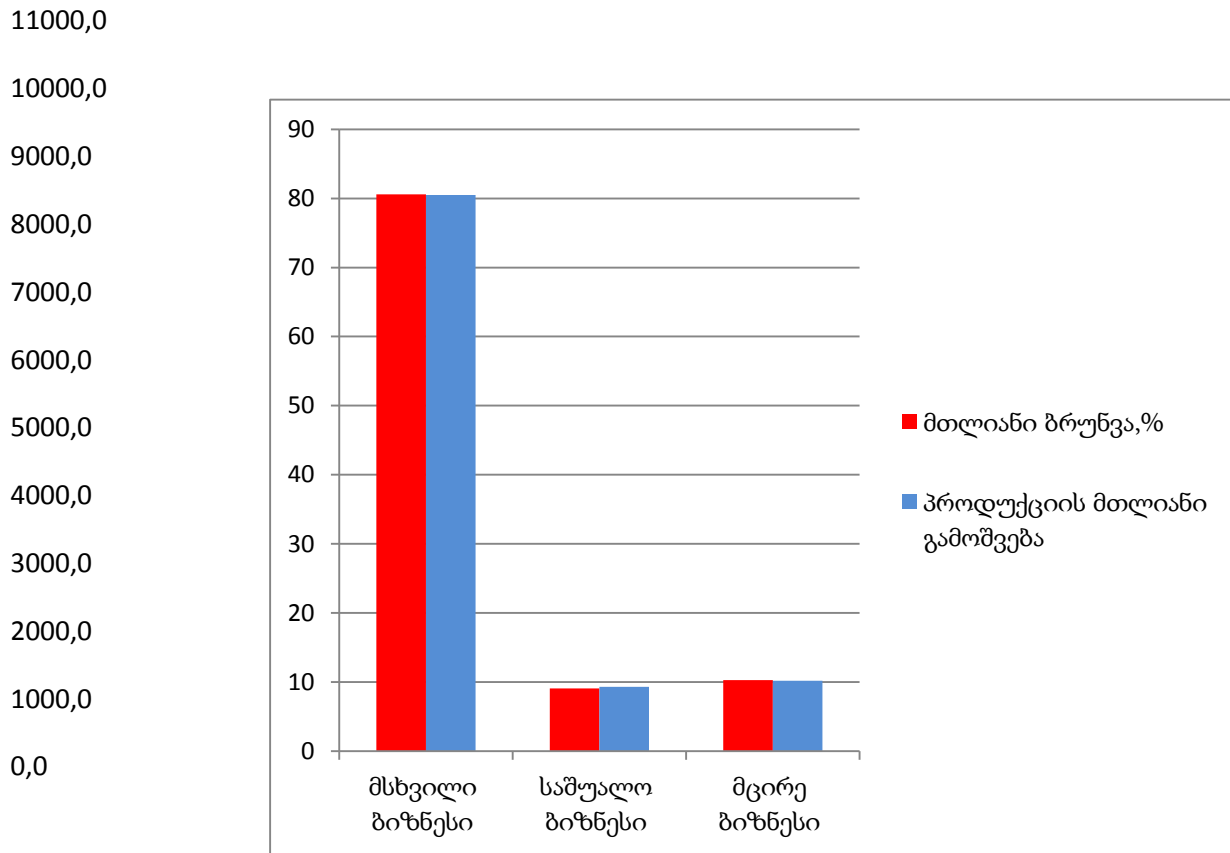
Figure1. The main trends for the first quarter of 2014

As for the data for the second quarter of 2015, the total turnover of the enterprises in Georgia constituted 12.8 billion GEL, and the overall output of the production – 7.0 billion GEL. The total turnover by the sizes of enterprises is as follows:

1. Large business – 80.6 percent;
2. Medium business - 9.1 percent;
3. Small business – 10.3 percent.

Below is the diagram (Figure 2) for the main trends of the second quarter of 2015 (taken from the website of the National Statistics Office of Georgia):

საწარმოთა საქმიანობის შედეგები (2015 წლის II კვარტალი)



მილიონი ლარი

Figure 2. The main trends for the second quarter of 2015

As one can see, the turnover of the SMEs within the country have been increased by 6% approximately, which indicates that the field of SMEs is slowly developing within the country. This can be the result of the policies of the European Union and its support programs towards the country, as well as the State policy of supporting the SMEs development.

The situation is slightly different in case of the total production:

1. Large business – 80.5 percent;

2. Medium business – 9.3 percent;
3. Small business – 10.2 percent.

The total number of employees in enterprises amounted to 568.5 thousand people – with 40.5% females and 59.5% males among them. This speaks of the increase in workplaces, which could be caused by the increasing number of SMEs in Georgia, although the male-female ratio has remained unchanged.

The total number of the employees by the size of enterprises is distributed as follows:

1. Large business – 60.0 percent;
2. Medium business – 16.9 percent;
3. Small business – 23.1 percent.

From the numbers given above, one can see that, in terms of the total turnover, the SMEs in Georgia do not even account for the 20%. This number is really low, considering the importance of the development of the small and medium enterprises. The fact that Georgia runs almost exclusively on large business, underlines the fact that there might be really bad problems linked with the monopoly of the business within the country, which have to be eradicated in order to enable the SMEs develop and create a firm basis for the development of country's economy.

To sum up, in the chapter given above, we have discussed the main problems considering the identification issues of the SMEs, we have talked about the general characteristics of the SMEs and have discussed the initial considerations about the SMEs in Georgia and their future development.

In the following chapter, we are going to talk about the main theoretical solutions to the problem of SME development in Georgia, considering the international experience within the given field and the EU programs aiming to support the development of the SME field within the country.

2.Theoretical Solutions

2.1 The main tendencies of the State support towards the small business within the Georgian economy

The small enterprises have traditionally conditioned the stability of country's economic system and they are the major source for overcoming the unemployment and new job creation. Hence, they have a huge role in formation of country's middle-class.

N. Chitanava views the small business as the basic element of the future social orientation economy. According to Chitanava, such role of small business is determined by the natural-productional characteristics, the existing traditions and practice, the objective preconditions for formation of the SMEs, the need of new jobs creation, the need of forming the consumer market based on the national basis etc.²⁹

As for the importance of the small entrepreneurship, E. Mekvabishvili's analysis is quite comprehensive. He considers that the basic role in formation of the middle-class within a country belongs to the development of SMEs, which requires the development and implementation of an effective system of supportive measures by the State³⁰.

The transition to the market economy during the economic reforms realized during the transitional period gave rise to the development of small entrepreneurship, and its further development has been largely based on the economic conditions of the country.

According to the results of the joint study by the World Bank and the International Financial Cooperation – “Doing Business” – Georgia holds the 15th place from 189 countries³¹

Although, it has to be mentioned that the study mentioned above is based on studying 11 different indicators, which in fact measure the quality of business regulation and do not include such important indicators as the macro-economic stability of the country, the quality of infrastructure, the level of corruption etc.

According to the Index of Economic Freedom by the Heritage Foundation and The Wall Street Journal, in 2012, Georgia, scoring 69.4 points, took the 34th place from 179 countries, which was the

²⁹ ჭითანავა 2000: 273

³⁰ <http://social-democrats-georgia.Blospot.Com/2010/07/blog-post.html> (2.07.2010).

³¹ <http://www.doingbusiness.org/data/exploreeconomies/georgia/>

worsened index in relation with the index of 2011, when the score was 70.4 and the rating – 29th. Correspondingly, Georgia was demoted into the category of “countries with moderate economic freedom”.

The trend of worsening the rating position mainly occurred because of the increase in government spending, corruption and the monetary freedom. Although, it has to be mentioned that, within the given rating, Georgia was the leader within the Caucasus region (where Armenia was the 39th and Azerbaijan – the 91th), - along with being the leader among the neighbor countries, such as Russia (144th position in 2012) and Turkey (73rd position in 2012). Hong-Kong, Singapore and Australia (correspondingly with 89.9, 87.5 and 83.1 points) were named as the world’s most economically free countries³².

2.2 The basic directions and priorities of strengthening and supporting the small business in Georgia

The European integration strategy has been clearly defined recently, which has been confirmed by the Agreement on Association and Free Trade made with the European Union in June 2014. The agreement mentioned above deepens the process of convergence of Georgian legislation with the EU model, which obviously includes the support for accelerated development of the small business within the country. Supporting the small business is recognized as the main factor for the economic policy in the European Union, and during the last ten years there have been notable actions towards this direction, which necessarily have to be considered in Georgian reality in relation to the small business.

During the first decade of the 21st century, important steps were taken towards the development of the small business in Georgia. According to the 30th article of Georgian constitution, “the labor is free, and the State is obliged to support the development of free entrepreneurship and the competition”³³.

During the last three years, the procedures of registering an enterprise and starting a business have been significantly simplified. As the result, Georgia has shown the best results in indicators such as

³² <http://www.heritage.org/index/ranking>

³³ საქართველოს კონსტიტუცია 2011: 14

“procedures linked with the starting a business” and “the number of days required for starting a business”. Correspondingly, the country took the 8th and 3th positions in these indicators (The Global Innovation Index 2011). These reforms have been important, as far as by simplifying the registration procedures, the number of the newly registered enterprises has significantly increased in Georgia.

But still, little has been done in terms of adopting the favorable changes within the legislation for the small business, except the articles adopted within the Tax Code about the taxation of micro and small enterprises and the simplification of the customs procedures. Hence, adopting the laws about the small and medium enterprises, together with creating a business administration body which would ensure the realization of the strategic business tasks and ensure the SMEs policy creation and implementation would contribute largely to the rapid development of the SMEs in Georgia.

In this regard, the Georgian Ministry of Economy and Sustainable Development have developed a project which considers the creation of Small Business Support Agency and allocation of 150 million GEL in this direction during the years 2015-2017. During these 3 years, the realization of 5 000 projects and creating 3 000 new jobs have been planned by the Ministry of Economy and Sustainable Development³⁴.

For increasing the internationalization index of the national small business, studying the hampering factors of the operation of Georgian SMEs at international markets is necessary. Realization of the supportive actions by the government has a special role in improving the internationalization of the SMEs. With this goal, the government has to implement an efficient policy, which implies increasing the awareness of the rapidly increasing SMEs in the need of internationalization. Herewith, the government should develop a special plan for simplifying the internationalization of the SMEs.

Nowadays there is practically no collaboration between the business, universities and the research institutions in Georgia, and exactly this situation conditions the vacuum for technology development within the country, which itself hampers the development of SMEs and country’s economic growth. The clear of this fact is the index of Georgia in The Global Innovation Index of 2011, when the country took the 75th position.

³⁴ <http://www.economy.ge/en/home>

Although, there are some efforts towards improving the situation mentioned above. In 2012, on the basis of collaboration between the National Center of Intellectual Property – “Geo-patent-stat”, the German International Cooperation, Business Associations and Universities, the National Technology Transfer Center was founded, which gives special attention to the issues of technological improvement of the SMEs.

In the given field, Georgia must take into account the American experience of organizing the business-incubators. Creating the business-incubators with state and private universities in Georgia would contribute greatly to the acceleration of development of the small and medium enterprises. The business-incubators which are supported by the State, usually ensure the implementation of the innovative ideas within the small enterprises, which increases their competitiveness and supports the creation of new jobs, and Georgia should adopt such model which would greatly contribute to creation and development of SMEs within the country.

With aim of improving the export opportunities for the small enterprises, the European Union financed the 3-year project named “East-Invest” in 2011, which aimed to support the economic collaboration between Georgia and the Eastern Partnership countries. Within the frames of the project, strengthening of the small entrepreneurship was realized, together with supporting the business strategies and participation in international trade exhibitions and symposiums.

Nowadays in Georgia the small and medium enterprises are experiencing an acute deficit of financial resources. In order to increase their own production, they need the increase of the turnover capital, which is mainly contributed by the owners.

By the 2014, there were 67 microfinance organizations in Georgia³⁵.

They give out loans to small enterprises, mostly on small farms. Despite the developed infrastructure, they also experience the lack of financial resources and aren't able to satisfy the demands of the SMEs.

During the last decade, significant results have been achieved towards the implementation of the electronic governance (e-governance). As the result, the small entrepreneurs were enabled to implement the electronic forms of communication within their business, such as interacting with the Revenue Department of the Ministry of finances in electronic format. Within the frames of the e-

³⁵ (საქართველოს ეროვნული ბანკის 2013 წლიური ანგარიში 2014: 97).

governance program, income tax payments can be made online, and the blanks for paying the taxes can be directly downloaded from the website of the Revenues Agency.

The Georgian government has to solve several basic problems with goal of supporting the development of small and medium business within the country. It should encourage the small entrepreneurship in order to support the unemployed or partially employed people to start their own businesses (and take the initial steps towards this direction).

Teaching the representatives of small business in order to support them in making the efficient decisions in terms of governance and professional development is another important issue which has to be given special attention by the government. And, supporting the SMEs in selling their production in order to attain their first income is an important task to be realized by the government, which will help them in finding the additional funds, purchasing and improving the production facilities.

Supporting the export has gained an important meaning for increasing the competitiveness of the SMEs. As far as the Georgian companies and especially – the representatives of the SMEs are finding difficulties in terms of competitiveness, the Georgian government should support increase in competitiveness and produce the competitive production and services both for local, as well as the European and the international markets.

The DCFTA (The Deep and Comprehensive Free Trade Area), which represents a free trade area between the EU and its member states, as well as the selected states. It entered the force in September 2014 for Georgia. Despite this, the knowledge of solely the perspectives offered by this agreement is not enough for the representatives of the SMEs to achieve the high international; efficiency of their enterprises. The situation is same for the demands considered by the agreement, and their fulfillment is necessary not only for realization of the export in the European Union, but also – for placing the production at the local market.

Adapting to the requirements of the DCFTA represents a challenge for the business. On one hand, the insufficient knowledge of the demands, and on the other hand, meeting these demands requires additional financial resources. The government permanently conducts the informational campaigns for the business sector and the interested parties. The DCFTA Action Plan for 2014-2017 includes

the actions linked with increasing the awareness about the agreement, where special accents are placed on the small and medium business.

The small and medium business is experiencing the lack of information about the export market and the specific requirements which limits their export opportunities. Analyzing these issues requires the additional human and financial resources, which represent the problem for the SMEs in terms of their limited financial possibilities.

Within the frames of the DCFTA, creating the infrastructure for removing the technical barriers is required. But the lack of knowledge of the realization of the marketing actions abroad and the absence still remain a problem. The SMEs in Georgia still are not integrated within the international trade relations, which are essential for their successful internationalization.

At the request of the EU Association Agreement, the strategy for small and medium business is being developed. A number of agencies and banks (such as EIB, EBRD etc.) are helping the local entrepreneurs for in implementing the European standards, as the result of the negotiations with the European Union. Among those international financial institutions, which are currently realizing the projects for supporting the SMEs, we could name the following: IBDR – within the frames of the strategy program “Georgia 2020”, and financing of the municipal infrastructure development program. Here we can also mention the EBRD (European Bank for Reconstruction and Development) with 155 projects signed until the end of 2012, with the Cumulative investment value - 1, 802 billion Euros.

Among the projects being realized by the Georgian Government, we could name the following – “Produce in Georgia”, “Plant the Future”, as well as the law about the high-mountain regions of Georgia, which is currently under development.

2.3 The innovative instruments for supporting the SMEs – the European experience³⁶

The small and medium businesses constitute 99% of the business within the European countries³⁷. This impressive number undoubtedly speaks of the significance of the SME segment of the business in Europe. The same can be said about the economies of the USA and the developed countries of Asia.

- 3 Although, the fact is that the small business is small exactly because it does not possess the adequate resources, skills and finances to cope with those big challenges which the development of society places in front of them. Numerous studies have confirmed that the main problem regarding the activities of the SMEs is the limited accessibility of finances, which prevents them from mobilizing and developing other resources.
- 4 Despite the importance of the issue, the statistics of financing the business, as well as the innovation statistics – do not belong to the priorities of Georgia’s Department of Statistics. Although, the fact is that such statistics are necessary for the small business in order to be able to determine the priorities in their own business. This statistical information would also be beneficial for the policy makers, as it would enable them to better see the flaws, which hamper the development of small business, in particular – the innovative small business within the country.
- 5 In order to become more attractive in competition with the USA and Japan for the best researchers and inventors, the European Union has planned its 2014-2020 budget period with various remarkable programs and funding. The EU has considered the funding of 450 billion Euros for the National structures and other private investments³⁸.
- 6 In order to better analyze the problem and make the decision, since 2008 the the European Commission and the European Central Bank annually conduct the research of the availability of finances, which gives quite detailed information about the situation of the enterprises in this regard. The research conducted in 2014, which included the countries of the EU has shown that the enterprises name the limited availability of finances as the 5th most disturbing factor for the development of their business (13%) Although, equally important problems include finding the

³⁶ http://www.nbg.gov.ge/bankjournal/uploads/journal/2015_2/statia4.pdf

³⁷ http://ec.europa.eu/growth/access-to-finance/index_en.htm.

³⁸ http://ec.europa.eu/regional_policy/en/funding/available-budget/.

consumers, the lack of qualification of the employees and managers, problematic regulations, high competition etc.

2.4 The action plans and financial instruments of the European Union (2014-2020)

One of the main activities of the European Union could be considered supporting the development of small and medium business, which is realized by means of a number of programs. The number of businesses financed by the EU annually exceeds 200 thousand³⁹

Currently the most ambitious programs of the EU include the following: Horizon 2020, The European Structural Funds and Investment (ESIF), and the Competitiveness of enterprises and small and medium enterprises (COSME).

It has to be mentioned that the 2014-2020 budget period is distinguished with offering the new-generation financial instruments to the governments and SMEs. These new financial instruments are mainly focused on innovation, sustainable development and job creation. Compared to the previous budget period, the current financial instruments have been simplified and improved and become more accessible and flexible in terms of additional fundraising from both private and State sectors.

Usually the EU practice does not include the direct financing of a business. This takes place by means of collaboration with local, regional and national bodies, as well as through the financial intermediates, which realize financing a business by using various financial instruments. Although, in case there is a special program to be implemented, such projects might be funded directly by the EU.

Thus, the EU finance access mechanism is clearly identified and it includes the institutional aspects in forms of the European Investment Bank (EIB) and the European Investment Fund (EIF); and the collaboration, implying the realization of enterprise financing by means of close collaboration of the EIB and EIF with national bodies.

The largest 2014-2020 budget period project is “Horizon 2020” (H2020), which came into force in December 2013. It represents the framework program for supporting the research and innovations. Its budget for years 2014-2020 is 80 billion Euros⁴⁰. This program has a strong political support

³⁹ https://www.nbg.gov.ge/uploads/journal/2015/2015_2/statia4.pdf

⁴⁰ <http://ec.europa.eu/programmes/horizon2020/en/what-horizon-2020>;

<https://eu-smartcities.eu/sites/all/files/Guideline-Using%20EU%20fundings%20mechanism%20for%20smart%20cities.pdf>

from European leaders and the members of European Parliament, as far as they admit that there is no alternative to innovation in Europe's future development.

The H2020 is a simple program and it is open for everyone in terms of accessibility. It includes 18 thematic sections, among which the small and medium business tool (SME tool) is notable. SME tool is specially designed for the financial support of the small and medium enterprises with high innovative potential, which have international ambitions and market-oriented innovative ideas.

The goal of the SME tool is fill a shortfall in funding, which is characteristic for implementation of high-risky innovative ideas and includes the complete innovative cycle until the distribution of a new product, service or process to a market. The SME tool is realized in 3 stages – with the first stage being drawing out the business-idea and its planning, the second stage – realization of a business plan and the third stage – commercialization.

As we have already mentioned above, one more instrument for financing the small and medium business within the frames of H2020 is the accessibility to venture financing, which is characterized by high probability of failure to regain the return. Its goal is to help the enterprises and other organization to develop their skills in research and innovation, by means of loans, guarantees and equity financing. In receiving the latter, the European Investment Bank and the European Investment Fund are involved, which correspondingly allocate funds and announces funding conditions and selection criteria.

One more ambitious project of the European Union for 2014-2020 is COSME - EU program for the Competitiveness of Enterprises and Small and Medium-sized Enterprises. This program is designed to simplify the access for the SMEs to the loans and equity financing, and includes the funding of 4 billion Euros annually.

Hence, from everything listed above, it is clear that the European Union spends more and more each year on development and innovations, improves the quality of the financial instruments and continuously simplifies the mechanisms for accessing the finances. Using the experience gained in this field in Europe should be the best way for our country on its way towards the development and the innovation support.

2.5 SME financing statistics: new statistical activities of the National Bank of Georgia⁴¹

As we have already mentioned above, despite the importance of the issue, the SME problems still aren't included within the priority directions of the statistics. Although, the National Bank of Georgia, within the frames of its reforms, has given the proper attention to this field in terms of creating the instrument for monitoring the access to finance and financial health indicators. In particular, the issues mentioned above are the important part of the new statistical-informational system of the National Bank of Georgia, which is expressed in studying the financing of the SMEs by types of activities, by denomination currencies, by types of loan security etc.

Within the frames of the novelty mentioned above, reviewing the first results empirically is already possible. In particular, according to the preliminary data, the loans on the SMEs have reached 900 million GEL by June 1, 2015; 42% among them- in national currency and 58% - in foreign currency. The statistics shows that 16 percent of the loans issued to the small and medium businesses are short-term and 84 percent – long-term. SMEs in Georgia rarely use variable-interest-bearing loans and the share of such loans issued to the small and medium business is only 5 percent totally.

Developing a more active approach towards the statistical activities of the National Bank of Georgia in field of SMEs could contribute to the creation of the basic information for guiding the financial institutions, as well as the policy-makers in correct identification of funding sources and directions. It would also really help the researchers interested in studying the SME problems.

Hence, the right priorities and the right tools and mechanisms for achieving them – represent the key for the innovation and success within the countries of the EU; and the practical knowledge and experience are the way which would undoubtedly help Georgia in achieving the similar success.

2.6 The State trends for impacting the business

For successful functioning and development of a business, developing an appropriate environment is necessary, and the State and government have the leading role in formation of such environment. We could define the business environment as the complex of those subjective conditions and factors, which influence the implementation opportunities of the business, its direction, tempo and scales.

⁴¹ https://www.nbg.gov.ge/uploads/journal/2015/2015_2/statia4.pdf

There are micro and macro environments for business⁴², as well as the economic, political, socio-cultural, natural geographic, demographic environment etc.⁴³ A business environment is being formed by various activities of the state towards the business as an object of impact. Because of the content and character of such an impact, they can be divided into direct and indirect measures.

The direct measures include those measures, which are linked with the literal functions of the government, such as increasing the political stability, the public order and protection of the physical safety and the property of an entrepreneur etc. Realization of such measures would ensure the creation of a favorable business-environment, which in turn is the necessary condition for the successful operation of small and medium business, as well as any other types of business.

Together with the State, the society can largely contribute to creating the favorable environment for development of a business. This could be expressed in formation of positive attitudes towards the entrepreneurs and finally in formation of the market mentality among the members of society.

Thus, the preconditions for the development of business and entrepreneurship could be united into three groups:

1. The state policy in relation with business;
2. The culture and the value system of society;
3. Entrepreneurial skills and abilities of people (the citizens).

For formation of a favorable business environment, the governmental measures directly oriented on small and medium business are of a crucial importance, and these measures include the efficient utilization of financial, organizational-institutional, informative-educational and some other kinds of mechanisms and levers.

2.7 About the realization of the State anti-corruption program 2015-2016

With goal of supporting the effective and coordinated fight against corruption and increasing the accountability of the government, the National Anti-corruption Strategy has been approved on April

⁴² ერქომაიშვილი გ. ბიზნესი: ფირმის ფუნქციონირების ძირითადი ასპექტები. თბ., 2007, გვ.63.

⁴³ სამადაშვილი უ. ბიზნესის საფუძვლები. თბ., 2007. გვ.118; 121–122.

20, 2015, according to the Government decree 170th, together with the action plan 2015-2016 for the realization of the Georgian National Anti-corruption Strategy⁴⁴.

One of the leading priorities of the strategy is the prevention of corruption in relation to the private sector. The result of the measures towards this issue has been the implementation of the anti-corruption and integrity programs within the enterprises created with state equity participation. Additionally, the new reporting forms have been developed, which include the financial information, as well as the information about the business. A more sophisticated form of the developed business-plan enables to collect the important financial and other kinds of information about the business.

With aim of efficient spreading of the information about the privatization of various services and facilities, the agency has developed the communication channels with the consumers according to the relevant target audience. This kind of communication helps to raise the public awareness. The information about the activities of the agency is available nationwide and is transparent for all groups of the society.

The goal of efficient distribution of the information related with the ongoing auctions of land leasing transfers, the National Agency of State Property distributed 161 380 leaflets up to 1000 villages. The agency also provided the members of Georgian Farmers Association with the current auctions.

During the reporting period, the agency provided the information about 108 current auctions on the website and informational portal – bpn.ge. At the same time, the information about the auctions was distributed in social media and the website of the agency.

With goal of diminishing the risks of corruption, the digitalization of the administrative process still continues.

⁴⁴ 2015 წლის 20 თებერვლის საქართველოს მთავრობის N170 დადგენილება „საქართველოს ეროვნული ანტიკორუფციული სტრატეგიისა და საქართველოს ეროვნული ანტიკორუფციული სტრატეგიის განხორციელების 2015-2016 წლების სამოქმედო გეგმის დამტკიცების შესახებ“

2.8 The financial assistance from the European Union (2013-2015 report)⁴⁵

During the process of implementation of the Association Agreement, an important role is given to the financial aid from the European Union, which is realized by means of various aid programs and projects of the European Union and supports the successful realization of the European integration reforms. It has to be mentioned that, in relation with Georgia's successful democratic reforms, the amount of the aid issued by the European Union increases annually, and more extensive and wide-ranging assistance initiatives are becoming accessible for Georgia.

During the reporting period, the Single Support Framework (SSF) was signed between the Georgian government and the European Commission, which considers issuing up to 410 million Euros to Georgia in following priority areas:

1. The development of agriculture;
2. Strengthening of the justice sector;
3. Supporting the civil service reform;
4. Institutional strengthening of the state institutions.

Active measures have been taken for providing the support within the frames of the given program - in particular, the financial covenants were signed, with the total budget of 223 million Euros. The aid mentioned above will be used on the development of private sector, the support of SMEs, justice sector reforms, human rights protection, supporting the increase in employment etc.

Georgia actively participates in regional initiatives within the frames of the EU Eastern Partnership. Among such activities, the Territorial Cooperation Program is notable, which considers providing 12 million Euros as the aid for supporting the development of tourism, agriculture and the small business within the border regions of Georgia-Armenia and Georgia-Azerbaijan.

In this regard, the 14 rounds of negotiations have been successfully conducted between the delegations of Georgia-Armenia and Georgia-Azerbaijan, and all procedures needed for the realization of the specific region-oriented projects have been prepared.

It has to be mentioned that, within the frames of the mutual Georgia-Armenia program, 8 projects within the fields of tourism, environmental protection and small business development, which will be used for supporting the development of the bordering regions of Georgia-Armenia, as well as the

⁴⁵ ევროკავშირის ფინანსური დახმარება (2013-2015 წლების ანგარიში)

employment of the local population, increasing the tourist potential and strengthening the ties between the people of different nations.

2.9 “Enterprise in Georgia”

On October 20, 2014, the new component of the Government initiative, “Enterprise in Georgia” - was presented to the society, which is the program named “Supporting the SMEs development in Georgia”. It is being realized by the Entrepreneur Development Agency, and the budget of the program is 20 million GEL. It was announced that the duration of the program will be 26 months. The program considers issuing the participatory financing on the startup and existing entrepreneurs, or to an entrepreneurial group composed with maximum of 3 beneficiaries. The maximum amount of the funding for an entrepreneur is limited with 5 000 GEL, which is 15 000 GEL for a group of entrepreneurs. The share of the participation from the beneficiaries must not be less than 20% of the total sum of the funding⁴⁶

As for the technical support, the program considers two components. These are the trainings, which were to be realized during the first four months from the start of the program and conducting the technical-professional consultations for the beneficiaries during the first 12 months from the start of the program.

Various programs for supporting the SMEs are widely proven in Eastern European countries and they are also successfully realized in Georgia by the company BP. The Entrepreneurship Development Agency of Georgia has based the regional project mentioned above, which aims supporting the SMEs, on the experience of eastern European countries.

Within the frames of the project, the interested parties will be able to obtain the financial resources that will enable them to develop their own business. Herewith, the directions for production and services are not limited and the entrepreneur is free in his choice. Except for obtaining the financial resources, within the frames of the project the micro and small entrepreneurs will be able to receive

⁴⁶ <http://www.economy.ge/ge/media/news/saqartvelosi-mikro-da-mcire-mewarmeobis-xelsewyobis-samtavrobo-programa-amoqmedda>

the professional counselling services and develop the skills needed for an entrepreneur, which will additionally support the success of their business.

The budget of the program “Enterprise in Georgia” is 52 million GEL, and its realization will take place for 26 months.

The small and medium business development strategy for 2016-2020, together with the action plan, is being drawn out under the coordination of the Georgian Ministry of Economy and Sustainable Development, with the close collaboration with the Organization for Economic Cooperation and Development (OECD) and with the support from GIZ⁴⁷

The strategy includes several priority directions and the measures for their realization: the creation of the institutional framework, developing the competitive human resources, internationalization of the small and medium enterprises, accessibility on finances, supporting the research and innovation etc.

The strategy will consider the basic principles of the best practice of the EU countries in terms of the SMEs policy. Strategy and action plan will be completed by the end of 2015. The strategy is being developed by the group which includes the representatives of various State agencies, as well as the representatives of the business sector.

The representatives of the Ministry of Economy and Sustainable Development state that “the effective realization of the SMEs development strategy will support the development of small and medium business within the country and the increase of its competitiveness, which is important both for decreasing the unemployment rates and for establishing their position at international markets”.

The importance of the program “Produce in Georgia” is magnified by the fact that, aside from the urgent need for creating something efficient for supporting the representatives of agriculture (the farmers), the program is relatively easily accessible and can serve as the foundation for the free and unconstrained development of the SMEs within the county.

⁴⁷ <http://www.ipress.ge/new/8503-mcire-da-sashualo-biznesis-strategiis-shemushaveba-tslis-bolos-dasruldeba>

2.10 About the Action document for support to EU-Georgia DCFTA and SMEs⁴⁸

According to the document, “The overall objective of the proposed Sector Reform Contract is to assist the Georgian Government in the implementation process of the Deep and Comprehensive Free Trade Area (DCFTA), facilitating Georgia's economic integration into the EU market”. The main objectives of the program, according to the document, are “(1) to further strengthen the DCFTA policy framework for trade and SME development; (2) to improve the overall functioning of priority trade and private sector related institutions; (3) to strengthen economic actors and SMEs along the DCFTA process; (4) to ensure economic integration of targeted groups, such as internally displaced persons (IDPs), returned migrants, women in business and young entrepreneurs”.

The DCFTA program includes the support towards the strategy of socio-economic development of the country, called “Georgia 2020”, which underlines the general strategic view for Georgia. According to the document, the program “Georgia 2020” will guarantee the reinforcement of continuous trade reforms and facilitate the new economic opportunities for those people who currently don't have much chances for starting their own business.

According to the document, Georgia, despite being a small developing country with quite low GDP (USD 3,605 in 2013), “Over the past 10 years, undertook significant economic, social and governance reforms resulting in sound fiscal and monetary policies”. According to the same report, “The GDP growth according to Geo-Stat was 3.2% in 2013, against originally projected 6%. Although significantly decreasing from the year before, current account deficit remained high at 6.1% in 2013, and the medium-term outlook may represent a challenge to fiscal stability”. But, the document also states that the problems of poverty and unemployment still remain actual (22% and 15% respectively), and there is a large gap between the economic situation of the residents of cities and rural areas. Despite the fact that, the primary source of employment in rural regions is agriculture, it accounts only for small percentage of the GDP – just 8 percent.

The document also states that “SMEs still shows weak performance in terms of business turnover and value added”. Main problems of the SMEs in Georgia, according to the document, include the “lack of adequate entrepreneurial and institutional preconditions for developing foreign trade-oriented sectors for inclusive growth”.

⁴⁸[http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/comitologie/ros/2014/D033950-02/COM-AC_DR\(2014\)D033950-02\(ANN2\)_EN.pdf](http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/comitologie/ros/2014/D033950-02/COM-AC_DR(2014)D033950-02(ANN2)_EN.pdf)

According to the report, there is enough additional potential to increase the employment rates through the development of SMEs within the country. It also states that “Georgia recognized the need to promote SME development (SME competitiveness, entrepreneurship skills, ease of access to finance) as a way to overcome poverty and reach sustainable and inclusive economic growth”.

The report states that Georgia still hasn’t developed the sufficiently effective strategies and the legal framework for adequately supporting the development of the SMEs within the country. But, it also states that “for some specific economic sectors strategies are in place (e.g. agriculture) or under preparation (e.g. tourism)”. According to the report, such strategy, after being developed “enhance the business enabling policy and legal environment, conducive to SMEs development”.

The report states that the donors assisting Georgia in the development of private sector include “World Bank, IFC, EBRD, GIZ, UNDP, USAID, ADB (Asian Development Bank), the EU and its Member States, Millennium Challenge Corporation (MCC)”.

The donors’ programs target specific projects (such as agriculture), as well as more general business. The program named “SME Flagship Initiative”, which in Georgia includes the support of the agriculture sector. According to the document, “The EU-funded European Neighbourhood Programme for Agriculture and Rural Development (ENPARD) includes a EUR 18 million grants' programme, implemented via 16 non state actors, in support to the establishment of at least 160 small farmers' cooperatives (which are a specific form of SMEs)”.

One more important strategy towards the SME development in Georgia is the “The World Bank Country Partnership Strategy for FY2014-17”, which has been anchored to the Georgian Government Strategy 2020. The aim of this strategy is to support the competitiveness of Georgian SMEs in three following fronts: “through improvement of business enabling environment, provision of infrastructure and services, and improving the framework for matching labour code and demand”. According to the document, The World Bank will manifest its support towards Georgia through three main fields of assistance: “i) technical assistance to EDA and GITA under the MoESD, ii) technical assistance to MoESD on a manufacturing study/assessment of competitive industries, cluster policies, R&D and innovation, and iii) technical assistance to the Government on institutional and policy development (pension reforms, creation of insurance deposit funds, business environment reforms)”.

The document above also includes the EBRD strategy, which aims supporting the development of SMEs in Georgia, as well as the energy and the logistics infrastructure. “EBRD supports Georgian SMEs through the Small Business Support regional programme (EU funded), which provides direct tailored technical assistance to individual SMEs, helping them adapting to the demands of a market economy”.

In general, the expected results of the programs listed above, are to support the growth and development of the SME sector in Georgia. In particular, each program has its own specific objectives and the expected results, which are listed below in forms of direct quotation:

1. “Strengthened DCFTA and SME policy frameworks - Trade-related policy areas implemented following an agreed timeframe and sequencing (such as SPS Legislative Approximation Program Market Surveillance Action Plan, competition, public procurement)”;
2. “Regulatory and institutional framework for SMEs developed, aligned with DCFTA policy orientations and SBA policy recommendations; - Cooperation mechanisms between state institutions and stakeholders involved in trade and SME policy-making ensured”.
3. Improved institutional capacities of central administrations to design and implement specific measures within the SMEs context;
4. Strengthened capacities of SMEs bodies/agencies (EDA/GITA) to meet DCFTA requirements and to channel business support to SMEs;
5. - Strengthened public-private policy dialogue: improved cooperation between line ministries, SMEs bodies/agencies and stakeholders (including business and sectoral associations) involved in SMEs/DCFTA related areas;
6. - Facilitating the integration of Georgian SMEs bodies/agencies into EU, regional and/or international platforms;
7. - Awareness raising activities to promote DCFTA/business in accordance to market needs are improved⁴⁹”.

According to the Action plan of 2015 of the Georgian Government and the EU,⁵⁰ in 2015 the program for supporting the small and micro enterprises has started, which aims to support the micro

⁴⁹[http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/comitologie/ros/2014/D033950-02/COM-AC_DR\(2014\)D033950-02\(ANN2\)_EN.pdf](http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/comitologie/ros/2014/D033950-02/COM-AC_DR(2014)D033950-02(ANN2)_EN.pdf) page 14.

and small enterprises in regions of Georgia by means of technical and financial mechanisms (such as consulting, trainings and the further support).

The entrepreneurship development agency realizes various counselling services for the small and medium business, the goal of which is to implement the international European standards within the enterprises, increasing the competitiveness of the production and promoting the export.

In 2015, Georgia was included within the “Enterprise Europe Network” – EEN. This network represents the electronic portal, which aims to support the internationalization of small and medium business sector of the EU countries, as well as other countries, by means of spreading and interchanging specific business-offers.

As one can see, currently there are quite a large number of the State and International programs for promoting the development of the SME field in Georgia. Of course, this is going to take time and efforts, as far as turning a developing country which was a member of the former Soviet Union, with its own economy being practically fully destroyed – into a country with fully developed economy – is a difficult task.

To sum up, in our opinion, there are several important steps which the country has to take in order the support the development of SMEs. The first step, which has already been taken towards it, is drawing out the supportive policy for the development of small and medium enterprises within the country, but still much has to be done in this direction, as far as under the conditions of State corruption and the unfavorable tax and labor codes, the development of medium and especially – small businesses is seriously hampered.

⁵⁰[http://www.eunato.gov.ge/sites/default/files/%E1%83%90%E1%83%A1%E1%83%9D%E1%83%AA%E1%83%98%E1%83%A0%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%90%E1%83%A1%E1%83%9D%E1%83%AA%E1%83%98%E1%83%A0%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%93%E1%83%A6%E1%83%98%E1%83%A1%20%E1%83%AC%E1%83%94%E1%83%A1%E1%83%A0%E1%83%98%E1%83%92%E1%83%98%E1%83%A1%202015%20%E1%83%AC.%20%E1%83%92%E1%83%94%E1%83%92%E1%83%9B%E1%83%98%E1%83%A1%20%E1%83%A8%E1%83%94%E1%83%A1%E1%83%A0%E1%83%A3%E1%83%9A%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%9B%E1%83%9D%E1%83%99%E1%83%9A%E1%83%94%20%E1%83%90%E1%83%9C%E1%83%92%E1%83%90%E1%83%A0%E1%83%98%E1%83%A8%E1%83%98%20\(9%20%E1%83%97%E1%83%95%E1%83%94\).pdf](http://www.eunato.gov.ge/sites/default/files/%E1%83%90%E1%83%A1%E1%83%9D%E1%83%AA%E1%83%98%E1%83%A0%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%90%E1%83%A1%E1%83%9D%E1%83%AA%E1%83%98%E1%83%A0%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%93%E1%83%A6%E1%83%98%E1%83%A1%20%E1%83%AC%E1%83%94%E1%83%A1%E1%83%A0%E1%83%98%E1%83%92%E1%83%98%E1%83%A1%202015%20%E1%83%AC.%20%E1%83%92%E1%83%94%E1%83%92%E1%83%9B%E1%83%98%E1%83%A1%20%E1%83%A8%E1%83%94%E1%83%A1%E1%83%A0%E1%83%A3%E1%83%9A%E1%83%94%E1%83%91%E1%83%98%E1%83%A1%20%E1%83%9B%E1%83%9D%E1%83%99%E1%83%9A%E1%83%94%20%E1%83%90%E1%83%9C%E1%83%92%E1%83%90%E1%83%A0%E1%83%98%E1%83%A8%E1%83%98%20(9%20%E1%83%97%E1%83%95%E1%83%94).pdf)

The second step, which is becoming the members of major international organizations, has been taken as well, but this process includes much more than just signing the association agreements, free trade agreements etc. The key to the foreign and international support towards the small and medium business development in Georgia is taking the responsibility (by the State) to fulfill the requirements posed by these international organizations (such as the European Union) towards the creation of the basis of further economic development of the country. And this inevitably includes the development of SMEs, as far as no country can be developed economically without them.

The third and the last step, which is often missed out in most papers and researches related to the field of SMEs, in our opinion, is the necessity to introduce some changes to the general socio-cultural environment which might be hampering the development of small and medium businesses within a given country. Such social factors, in case of Georgia, include the tendency towards corruption and restricted social capital, which in turn influences the major representatives of business in Georgia, mainly – the large entrepreneurs – to support the businesses of their close friends and relatives (which are the closest part of their social capital), and to try to monopolize the small and even medium businesses by trying to buy them. This is an important problem to be overcome, because restricted social capital can serve as the factor which hampers the development of the small and medium businesses within the country.

3. RESEARCH METHODOLOGY

3.1 Review

There are many programs supporting business in Georgia and their main purpose is to develop small and medium business in Georgia. The programs are mostly funded by the state, though there are also programs funded by European Union, which mainly aim at improving infrastructure and raising the level of education.

The purpose of my research was to define the situation of doing business in Georgia, in detail, what kind of supporting programs are there and also which programs do they have to set up a new business. The most important issue, is how the companies funded by this project assess the

business environment in Georgia and what do they consider as hindering factors for business. All of abovementioned will be reviewed in my research.

3.2 Research methodology

The main purpose of studying the small and medium business was obtaining detailed information about small and medium businesses registered in Georgia and assessment of business environment existing in Georgia.

I carried the research in two stages: At the first stage I searched for the information about the companies participating in the program of “Produce in Georgia” and at the second stage, I contacted the selected companies and tried to get the information through internet and telephone.

The first stage was from November 4 to November 11 and in this period I searched the necessary companies according to their type of activities. The information included: Title of the company, address, contact information (telephone number, web site, facebook page, skype etc), 20 companies were selected in total according to different spheres of activities.

At the second stage I tried to get necessary information directly from the companies with the help of telephone and internet. This process lasted from November 13 to November 25.

The aim of the research was to find out how the participating companies assess business environment in Georgia, what problems do they face when doing business in real life, how does the state and other bodies interfere in their activities and if the business environment in Georgia requires improvement or not.

The selection was carried out in accordance with location and activities of the companies. It is also to be admitted, that the majority of companies I contacted refused to take part in testing and to give information. Finally I selected the following companies (Table 2.): 1) Tetri Kudi LTD; 2) Itong Caucasus LTD, Iberia euro pro LTD, 4) Inventi LTD, 5) Abashis rdzis karkhana LTD, 6) Ailama LTD, 7) Kseniia LTD, 8) Tsalka Agro LTD, 9) Kartuli daphna LTD, 10) Royal Georgia LTD, 11) Geoplant LTD, 12) Geo product company LTD, 13) Continent LTD, 14) Damako LTD, 15) GSK Kula LTD, 16) Vam Group LTD, 17) Aisbergi 2 LTD, 18) „Dar capital” LTD, 19) Khevi Ltd, 20) Sakeletroidi LTD.

Table 2. The selected companies

Company	Region	Address	productive	Area	Buildings	Contact
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			activity	(land)		
1) Tetri Kudi LTD	Kvemo Kartli	Gori region	Mushroom producing			https://www.facebook.com/%E1%83%A8%E1%83%9E%E1%83%A1-%E1%83%97%E1%83%94%E1%83%97%E1%83%A0%E1%83%98-%E1%83%A5%E1%83%A3%E1%83%93%E1%83%98-615819231830494/
2) Itong Caucasus LTD	Tbilisi	Kipshidze 15	Producing of buildings materials	12,829		ტელ: 2 602 602
3) Iberia euro pro LTD	Kvemo Kartli	Gardabani, Martkophi	Producing of furniture	1) 10728 2. 9269	2211 N2 - 60.	მობ: 598 45 22 00
4) Inventi LTD	Mtskheta-mtianeti	Mtketa purkonbinat	Producing of animals feeding	4500 კვ.მ	- 1558.82	ტელ: 2 35 72 20
5) Abashis rdzis karkhana LTD	Samegrelo	Abasha, Norio	Milk producing	126,481 კვ.მ		+995 32 2470074;
6) Ailama LTD	Imereti	Wkaltubo, Gumro	Fish producing	8225 კვ.მ	N1 480 – 2-446	+995 599 77 90 06
7) Kseniia LTD	Shida-Kartli	Kashuri, Bekauri ave	Polymers materials producing	4,350	952.3 კვ.მ	+995599714421
8) Tsalka Agro LTD	Kakheti	53 SarajishviliGurjaani	Agriculture producing	32 595		walkagurjaani@gmail.com
9) Kartuli daphna LTD	Imereti	Bzvani, Vani	Producing of laurel	12,351 კვ.მ		tinatin.gelashvili@dapna.com.ge
10) Royal Georgia LTD	Tbilisi	5 chirnakhauli	Textile industry	5363	2534	+995 32 2382527
11) Geoplant LTD	Guria	55 chavchavadze	Producing of tea			geoplant@geoplant.ge
12) Geo product company LTD	Kvemo kartli	Rustavi	Greenhouse products	3000		Office
13) Continent LTD	Mtsketa-Mtianeti	Gldani	Hard wood producing	2748.00	2 Buildings	Office
14) Damako LTD	Imereti	Gumbra, ts kaltumo	Chemistry mass industry	2128	N1 - 1021.34	Oficce
15) GSK Kula LTD	Shida Kartli	Karbi, Gori	Fruits	6773	10006, N2,	office@kula.ge

			producing		N3, N4 - 57	
16) Vam Group LTD	Shida Kartli	Kvemo Khandaki	Dye producing	14714	N1, N2, N3-304.58	Mirian.gvelesiani@vam.ge
17) Aisbergi 2 LTD	Samegrelo	7 Kratasiuki, Poti	Fish producing			aisbergi2@gmail.com
18) „Dar capital” LTD	Adjara	Khelvachauri, industrial Zone	Producing of Building materials	7695	461.70	info@darcapital.ge
19) Khevi Ltd	Mtsketa-Mtianeti	Fanteshi, Kazbegi	Producing of non alcohol drinks	40 000		https://www.facebook.com/pages/%E1%83%A8%E1%83%9E%E1%83%A1-%E1%83%AE%E1%83%94%E1%83%95%E1%83%98/961140980696748
20) Sakeletroidi LTD	Tbilisi	N12 Ipolit Ivanov	Non pricier metal producing	1985.00		gglonti@meatana.ge

I carried out the research in two parts, I personally participated in the first part and the second part was surveying the companies and collecting-processing data from them.

4. RESEARCH FINDINGS AND DISCUSSION

4.1 “Start your business with Fab Lab”.

In order to provide a perfect and thorough research, I decided to travel to Georgia in October and study the business environment existing in Georgia personally.

Very soon after I arrived in Georgia, GITA (Georgian Innovations and Technologies Agency), which belongs to the Ministry of Economics, announced the project: “Start your business with Fab Lab”.

Fab Lab It is a modern laboratory equipped with digital and computer technics with the latest mountings (3D printers, 3D scanners, laser cutters, programmable machine tools and other

equipment), computer technics and program software. All interested person have access to it, who wants to do business. Laboratory gives opportunity to create a desirable technological product in a digital format- e.g. equipment based on smart technologies, to be used for educational purposes. FabLab aims at generating ideas, creating a platform for invention and education, which will encourage the process of developing innovative infrastructure in Georgia. Fab Lab organizes Make-a-thon events and exhibitions of the inventors.

I decided it would be interesting to conduct a survey about this project, as according to the organizers, participants would be able to start their business quite easily and create start-up. The duration of the project was 1 month and I decided to personally take part in the project in order to conduct a perfect survey and find out whether the idea of the Ministry of Economic was serious and truthful or not.

16 teams were selected at the first stage of the project, selection was carried out on the basis of an idea and a motivation letter, after the initial selection we had to present our ideas in front of the jury and we were among 5 teams moved to the next stage after the first attempt, 6 teams were given the chance, they took this chance and gained the right to stay in contest till the end.

After the selection, 2 weeks trainings started for the selected 11 teams, where the managers of well-known companies used to visit (finances, legal, PR and marketing, sales etc) and conduct lectures how to do our business and gave useful advices. After 2 weeks of training courses, 1 week practical training started in Fab Lab, where the principles of working of the equipment and other technical details were explained to us. During this period, we also had to seek the sponsor who would finance us with 200Gel, it was a good experience in respect with the relationship with investors.

After 3 weeks of trainings, each team was given 6 hours' time to implement our ideas. All this ended up with the exhibition-sale of our products held in the largest Shopping Mall of Tbilisi on December 6, where 1 winner was revealed, who sold the biggest number of products. The winner company was "Woody glasses" which produced wooden glasses and managed to sell products of 1710 GEL during 1 day exhibition, which comprises approximately 650 EURO.

After winning the project, this team obtained 1 year free subscription to Fab Lan for an indefinite period, also their production was showed by all leading TV companies of Georgia and

their productions has become very popular. As for the other teams, we were given the chance to use Fab Lab for 3 months for free and with 50% discount after 3 months.

It is to be admitted that after the exhibition-sale we received lots of orders for the product presented by us, which gave us the opportunity to enhance our activity and within 1 month our start-up managed to sell the production of 1500GEL without any advertisement and PR actions. We are free from taxes at this stage as we were participating in a state program.

All in all, we can assess “Start your business with Fab Lab” positively, because we managed to sell the products of 1500Gel during 1 month. The most important thing is that, we had many trainings and we met successful managers in Georgia. I think, this project is quite good for people, who want to start their own business, gain experience in small business, develop their skills in this job and study the relationship with partners, sponsors and be competitive.

4.2 Enterprise in Georgia

“Enterprise in Georgia” is the largest supporting program for small and medium business in Georgia, where the state funded 90 companies during 2 years and the investment comprises 250 million Gel. Within the limits of this project, 5186 people were employed and the credit given to the project is approximately 2.2 million Gel.

“Enterprise in Georgia”

Is a state program implemented with the initiation of the government of Georgia which aims at supporting the development of industry in the country, creating new enterprises and increasing the export potential.

The program is coordinated by the Ministry of Economy and sustainable development of Georgia and it involves the following LEPLs belonging to the system of this Ministry: “Entrepreneurship Development Agency”, “National Agency for State Property” and “Georgian Technologies and innovations Agency”.

The project provides the following type of support:

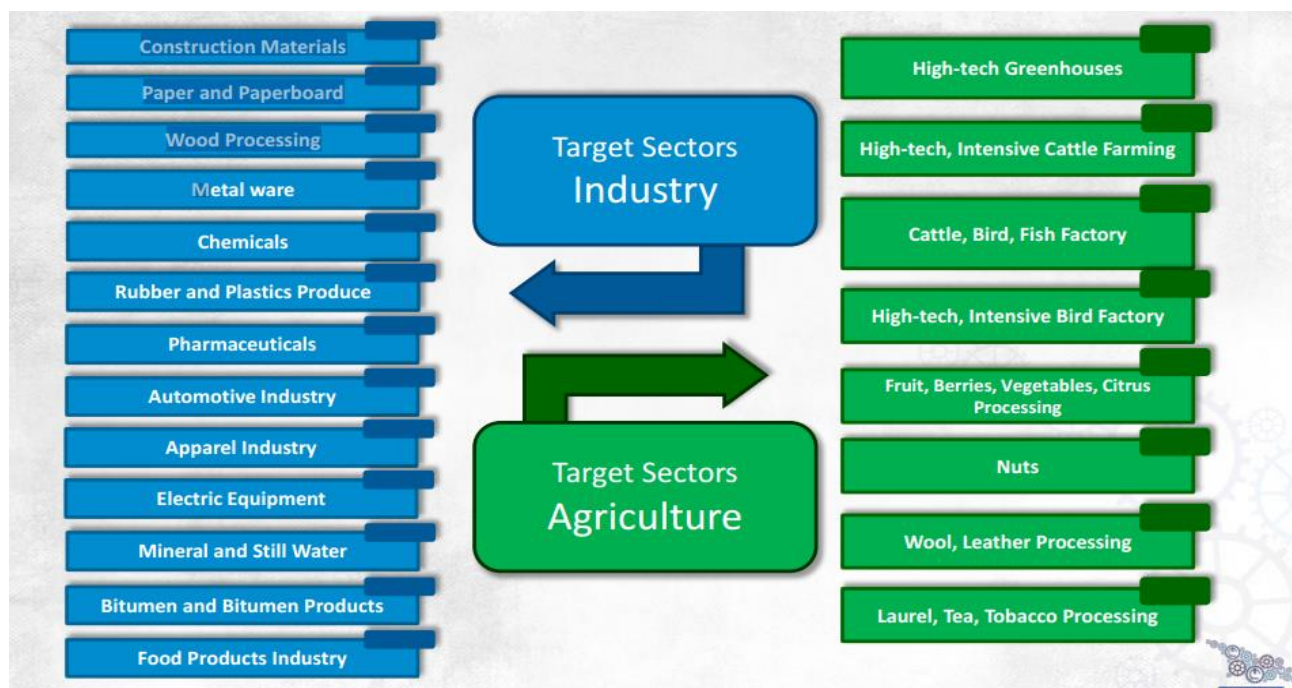
1. Access to finances
2. Access to the real estate
3. Technical support

Within the limits of the said program, LEPL National Agency for State Property is responsible for the components of delivering physical infrastructure, which implies transferring the state property to the entrepreneur free of charge with certain investment obligations. We offer non-agricultural land plot together with building-constructions on it or without it existing in state property to the interested persons by symbolic fee-1 Gel.

The main purpose of studying the small and medium business was obtaining detailed information about small and medium businesses registered in Georgia and assessment of business environment existing in Georgia.

Priority sectors are industry and agriculture (Table 3)

Table 3. Priority sectors



Within the limits of the program, the development of industries oriented to manufacturing will be supported, which is selected in accordance with the following criteria: the capacity of import and local potential of manufacturing.

4.3 Results

1) 1. How would you assess the specific program offered by the State?

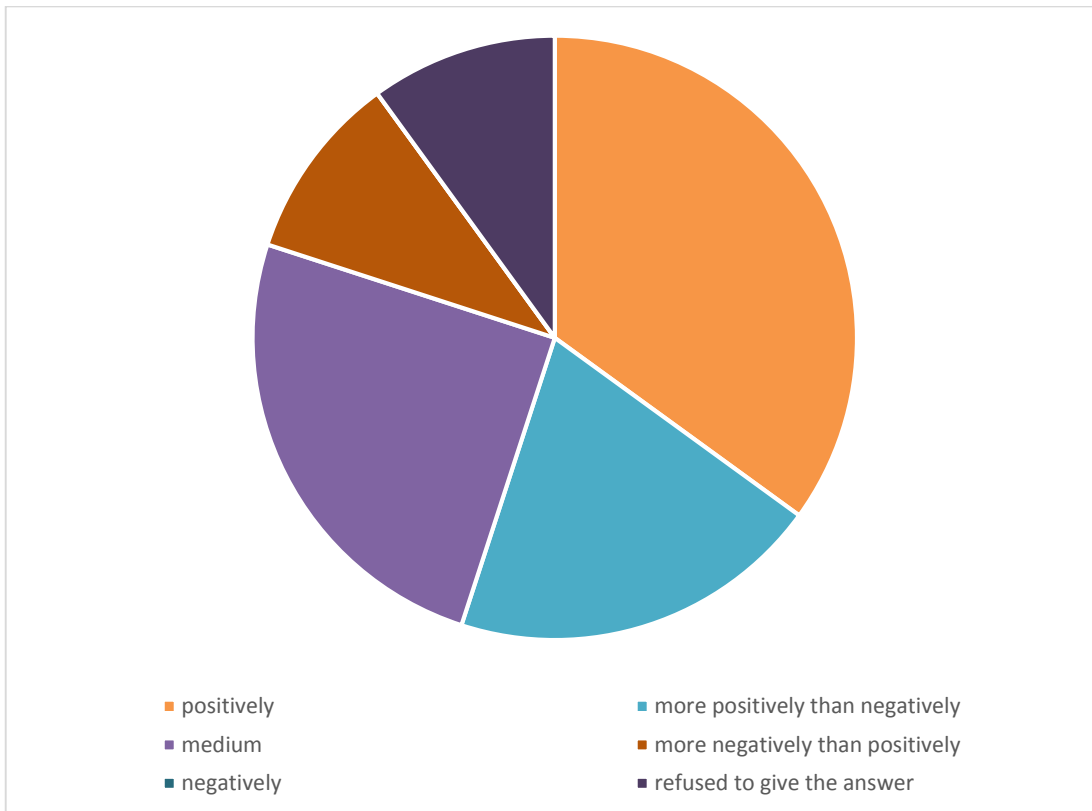


Figure 3. Research results About „Enterprise of Georgia” programme

Figure 3 shows research result About „Enterprise of Georgia” programme. 35% characterizes it positively and 20% more positively than negatively. 25% of questioned people have medium attitude towards this issue. 10% characterizes more negatively than positively. 10% refused to give the answer.

2) How would you assess business environment in Georgia?

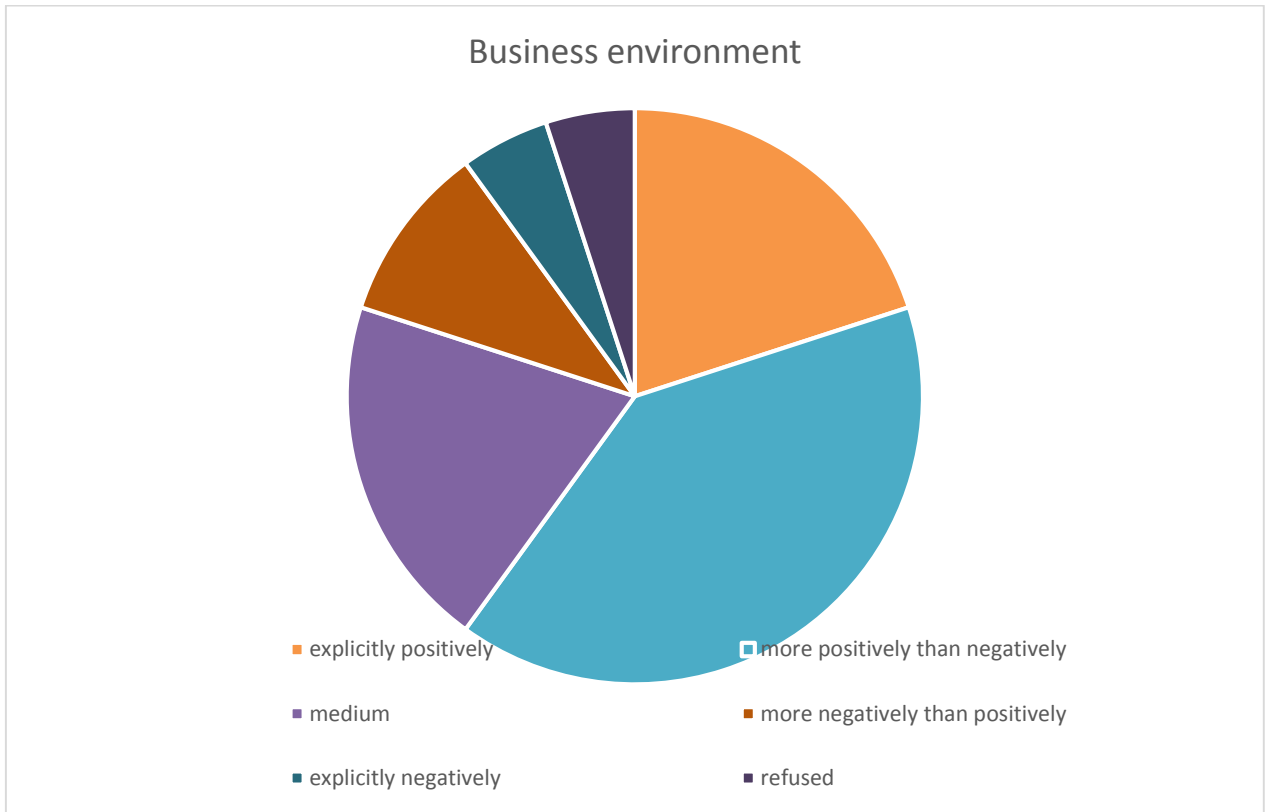


Figure 4. Research results about business environment

Figure 4 shows research results about business environment. 20% of questioned people characterizes the business environment in Georgia explicitly positively and 40% more positively than negatively. 20% of questioned people consider the business environment as medium and it means that only 15% of questioned people characterizes the business environment in Georgia negatively, among them 10% assess more negatively than positively and 5% explicitly negatively. 5% of questioned people refused to assess the business environment. It was stated, that companies working in agricultural sector mostly assess the business environment negatively, it may be explained by the fact, that it is difficult to compete with the imported products in Georgia. The companies working mostly in construction sphere assess the business environment positively.

3) How would you assess tax Legislation in Georgia?

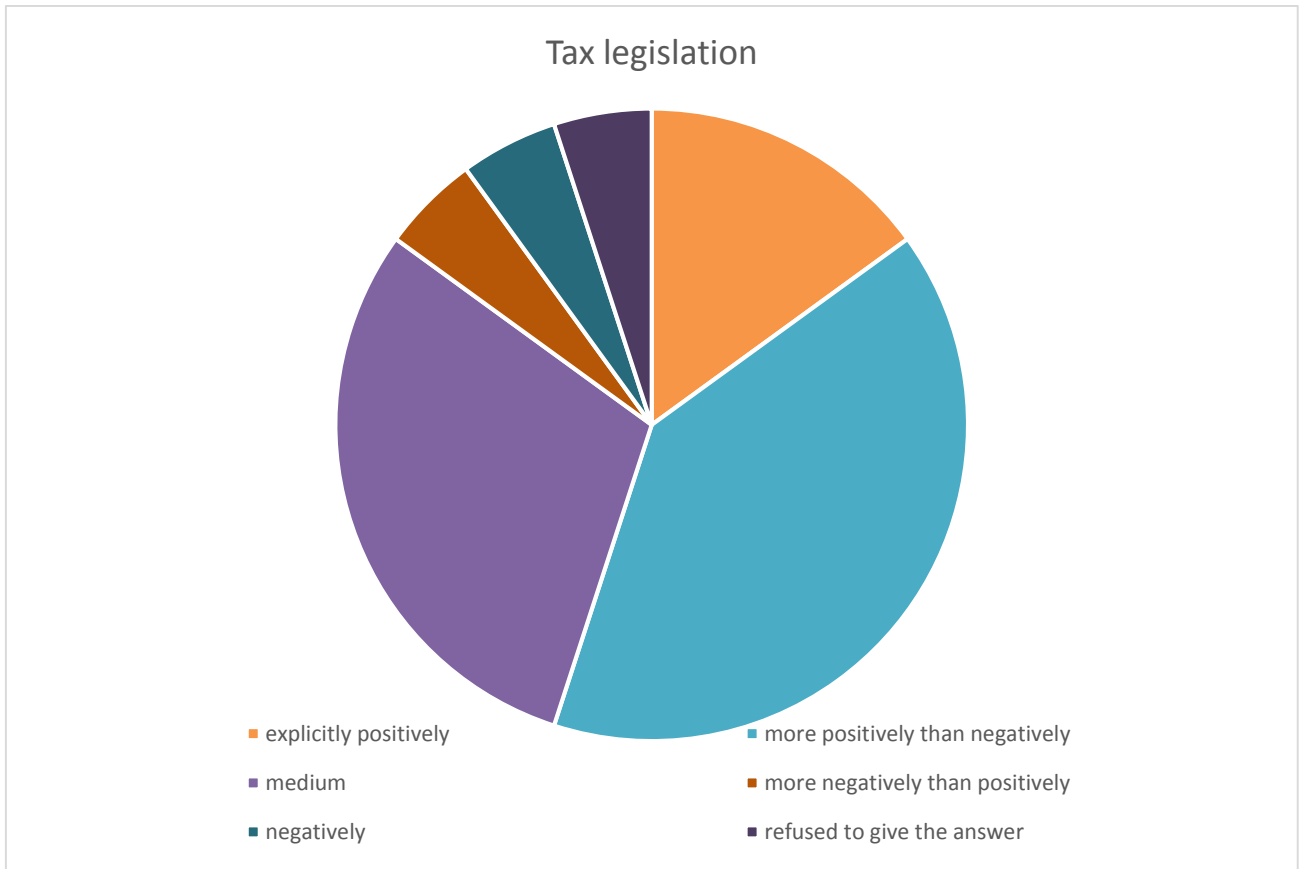


Figure 5. Research results about tax legislation

Figure 5 shows research results about tax legislation. According to the researches, Most of the companies, 40% assess Georgian tax Legislation more positively than negatively and 15%-explicitly positively, 30%-medium. Such kind of attitude may be explained by the fact that companies working in agricultural industries are free from taxes in most cases or have some kind of preferences. It explains the positive assessment of tax environment. 5% of questioned people characterizes the legislation negatively, also 5% more negatively than positively and 5% refused to give the answer.

4. Are you satisfied with the credit conditions offered by the banks?

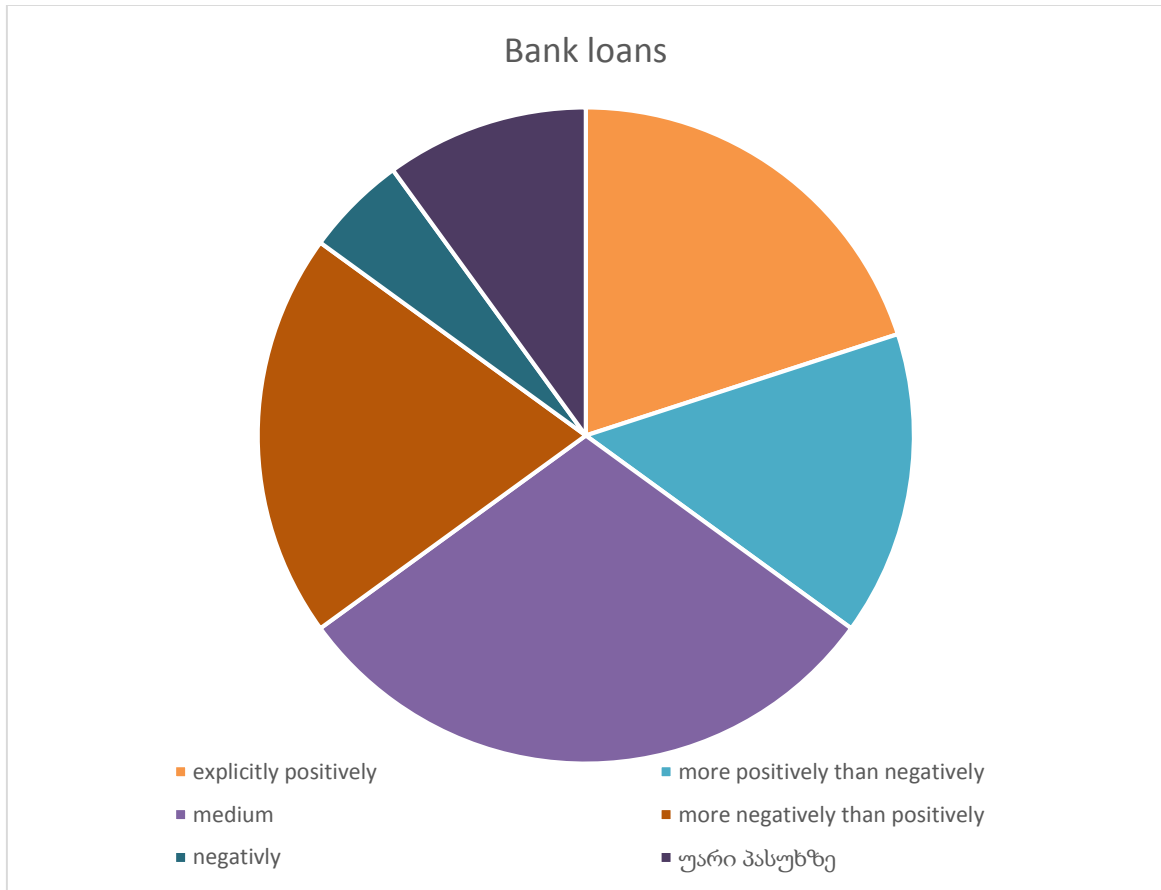


Figure 6. Research results about bank loans

Figure 6 shows research results about bank loans. Despite the fact that companies have cheap credit loans within the limits of this program, only 20% characterizes it positively and 15% more positively than negatively. 30% of questioned people have medium attitude towards this issue. 20% characterizes more negatively than positively, it means that the state has to work more with banking sector to offer the desirable bank loan to the participating companies. 5% characterizes the credits explicitly negatively and 10% refused to give the answer.

5) Do you use the Georgian raw goods in your production? If yes, how many percent of your production do they account?

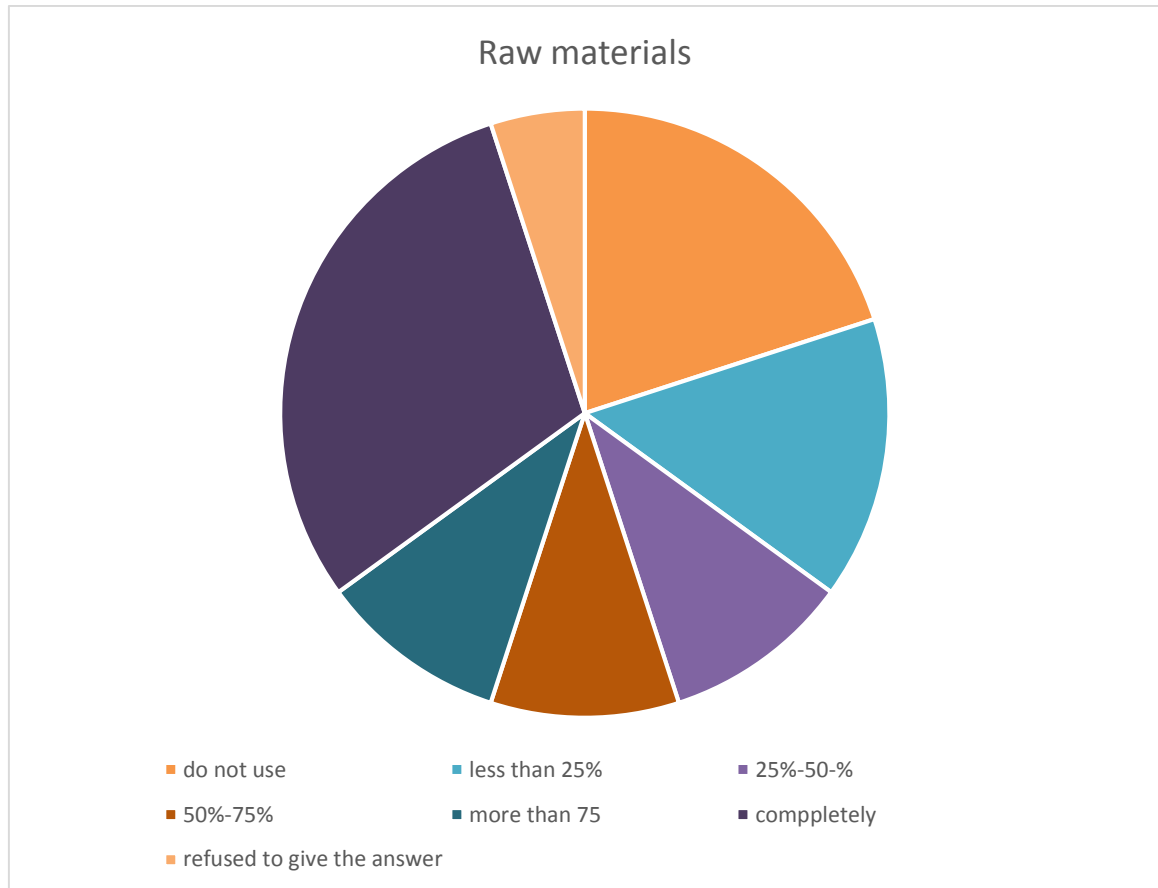


Figure 7. Research results about raw materials

Figure 7 shows research result about raw materials. With the help of this question I intended to find out what number of entrepreneurs use local resources as in many cases exported resources are cheaper.

According to the research, 30% of questioned people use local resources completely and 20% do not use local resources at all. 25-50, 50-75, 75 and more-each of them is used by 10% of questioned people. 15% use less than 25% of local; resources and 5% refused to give the answer. Despite the fact that it is cheaper to export resources, most of the companies use local resources which indicates the low quality of foreign resources, also it is more expensive to deliver and transport resources, so Georgian companies prefer to purchase local resources.

6) Does your technology correspond to the international standards?

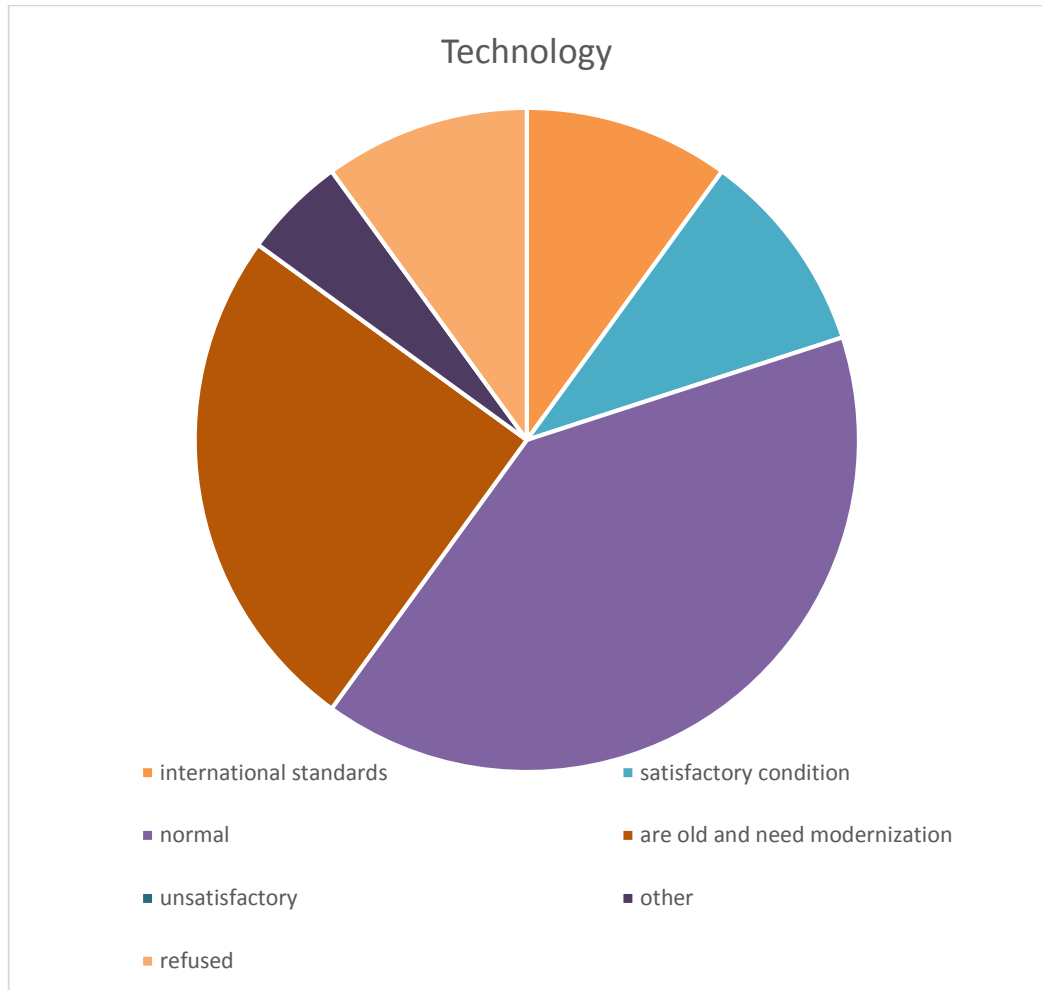


Figure 8. Research results about international standards

One of the purposes of this project is to help companies get closer to international standards and produce high quality production.

Despite it, only 10% of questioned people consider that technologies meet the international standards, it is too little. Majority, 40% consider that their technologies are in normal, satisfactory condition, 10% think, that they are in pretty good state. 25% think, that their technologies are old and need modernization and none of the companies consider their technologies as unsatisfactory. Only 5% stated other condition of their technologies and 10% refused to answer.

7) Where do you sell your production? (the markets)



Figure 9. Research results about markets

Figure 9 shows research results about markets where companies sell their products. Since 2014 European Union Market is open to Georgia, so without any extra regulations it can export its product like the country member of the European Union. Though the research has showed that 60% of the companies still operate in local market and only 20% export their product abroad completely. 10% uses mainly local market and 5% uses mainly foreign market. 5% refused to answer.

8) Are you planning to continue your current business in future? If not, why?

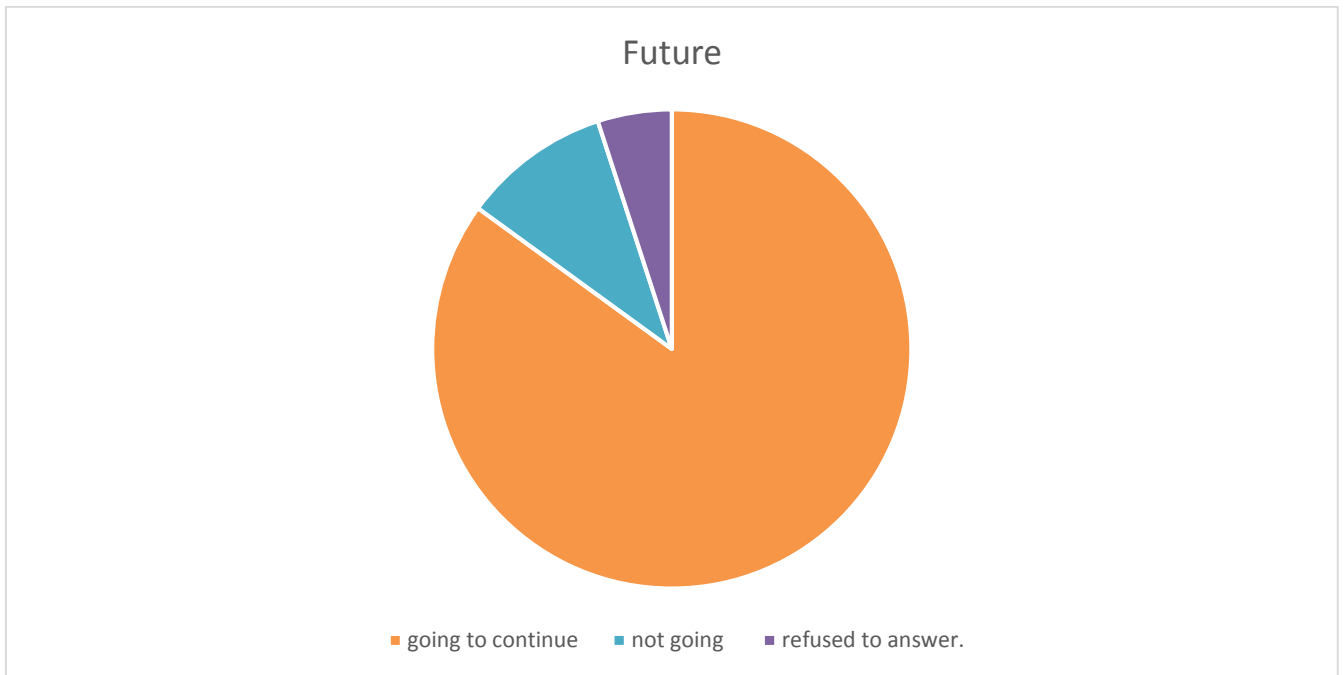


Figure 10. Research results about future activity

Figure 10 shows research results about future activity. Successful business conditions the future activity of the business. 85% of the questioned people admitted that they are going to continue their business, 10% is not going and 5% refused to answer.

Only 2 companies admitted that they were not going to continue their activities, 50% considered their activity as non-prospective and non-profitable, and 50% said that they are going to change the type of activities. One of them was greenhouse thrift, where they mainly grow vegetables, they say that they could not compete with cheaper products exported from Turkey and that's why they consider this activity as non-prospective and non-profitable.

9) Are you planning to expand your business?

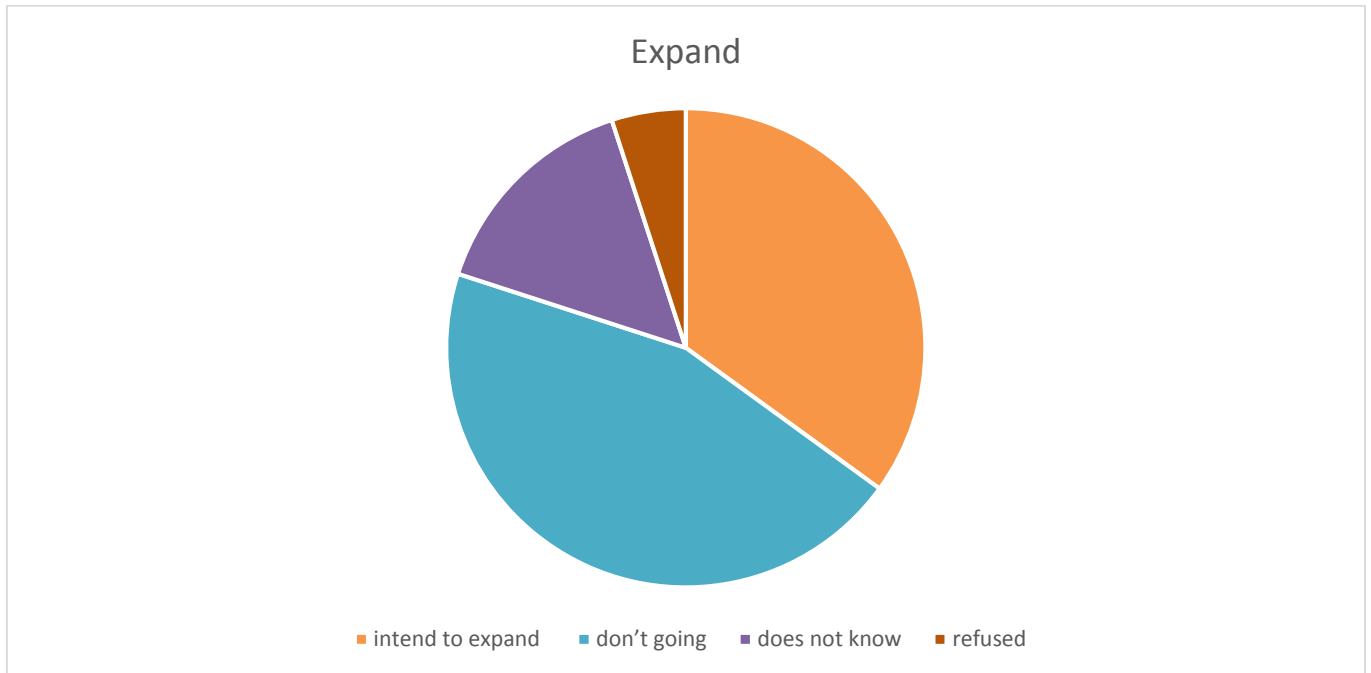


Figure 11. Research results about opportunity of expanding

Figure 11 shows research results about opportunity of expanding for companies. Successful business implies the opportunity of expanding. Despite the fact that this project has existed only for 2 years, 30% of questioned people intend to expand their business and 50% consider that it is early to think about expanding and they have lack of funds. 15% does not know whether they will expand their business next year or not and 5% refused to answer.

10) Are you satisfied with the operation of the State supervisory bodies?

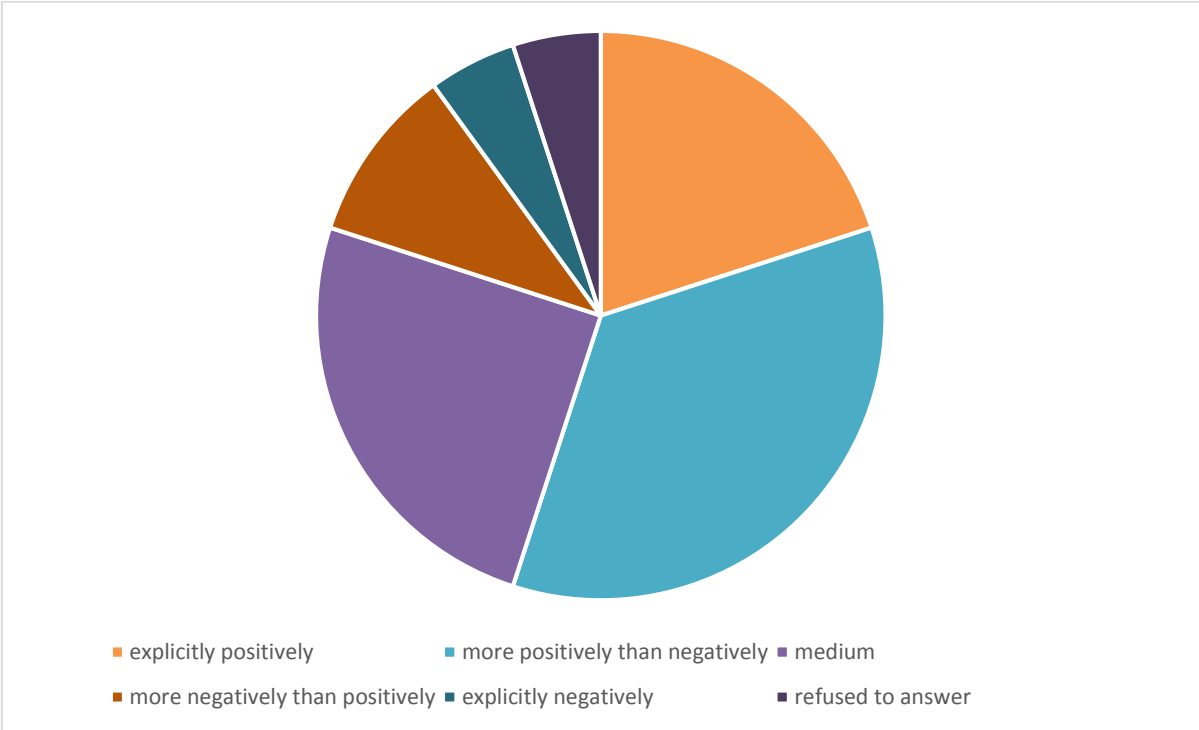


Figure 12. Research results about supervisory bodies

Figure 12 shows research results about supervisor bodies. 20% characterizes the work of controllers explicitly positively and 35% more positively than negatively. 5% characterizes their work explicitly negatively and 10% more negatively than positively. 5% refused to answer.

11) How often do you have to pay the extra fees?

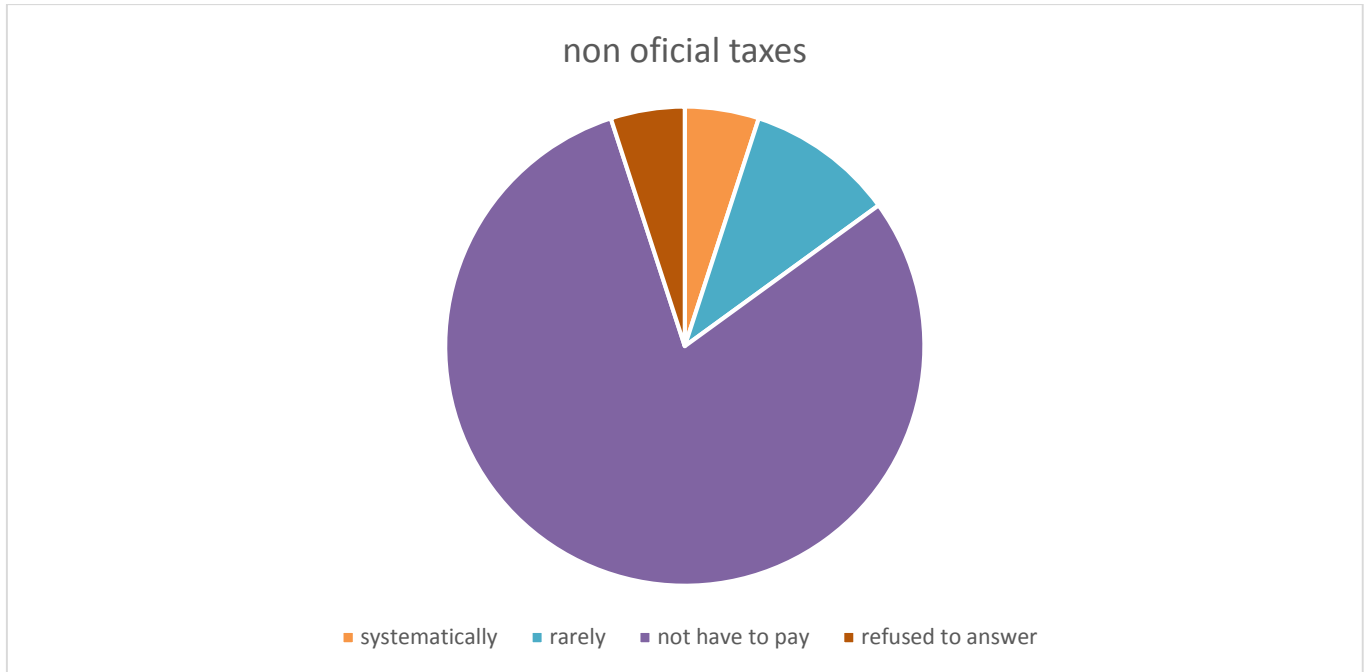


Figure 13. Research results about non-official taxes

Figure 13 shows research results about non-official taxes. In many cases, non-official taxes raise doubts, some of them see the signs of corruption too. In this case, 80% of questioned people do not have to pay non-official taxes at all, 5% has to pay them systematically, 10% has to pay them rarely and 5% refused to answer.

It indicates that the country has good tax system and low level of corruption.

4.4 Main Business hindering factors

In order to estimate what do the companies consider as the main hindering factor for business I decided to offer different type of questionnaire and give multiple choice questions.

Questionnaire:

Define the factor, factors which hinder the development of business

1. Non-protection of business interests by the government
2. Undeveloped financial market and low liquidity of entrepreneurial assets
3. Difficulty access to the bank credit
4. High interest rate accrued on the bank credit
5. Disorder in tax system
6. High tax rates
7. Corruption
8. Non-protection of the local market from smuggling
9. Non-protection of the market from counterfeit production
10. Increasing prices on product and services
11. Extra interference in business by management and controlling bodies
12. Low competitiveness of the produced goods/services
13. Other
14. Nothing hinders the development of business
15. I don't know
16. Refusal

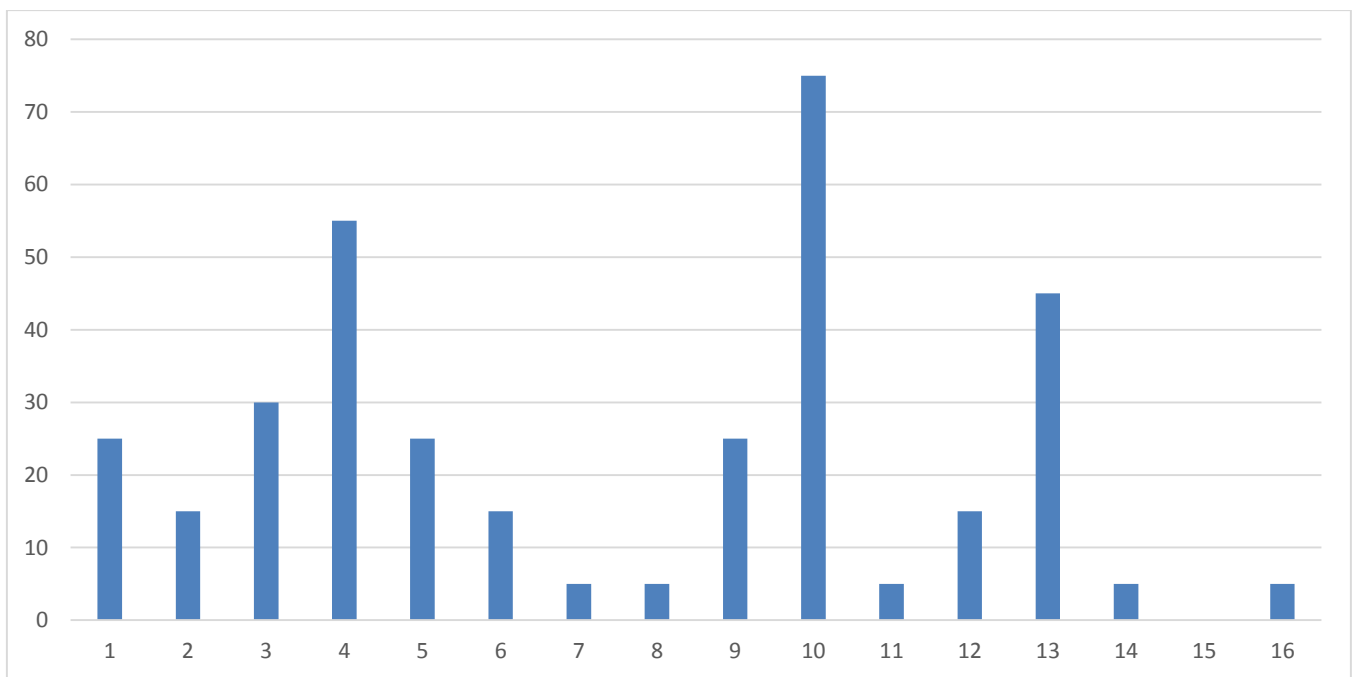


Figure 14. Factors which hinder the development of business

Figure 14 shows which factors hinder the development of business in Georgia. The main problem was revealed increasing the price on goods/services which is directly linked with devaluation of Gel against the Dollar, when the prices were increased on everything, the price of resources required for manufacturing was also increased which had its reflection on

companies. That's why the majority of companies 75% consider it as the main, biggest problem. It is to be admitted that 55% consider high interest rate as the main hindering factor, when the state offers low interest rate to all the participants of this program and is proud with it. Also difficult access to bank credits was named as an important problem, by 30% of questioned people. As for the corruption, extra interference by management and controlling bodies in the business and non-protection of local market from the smuggling, they are acknowledged as problems by only 5%. Again 5% consider that nothing hinders the development of business in Georgia. 25% consider non-protection of business interests by the state, disorder in tax system and non-protection of market from counterfeit as problems which to my mind is quite a big number and needs attention. Undeveloped financial market and low liquidity of entrepreneurial assets and high tax rates are considered as problems by 15%, again 15% does not know the main hindering factor for business development in Georgia. And 20% name other problems.

CONCLUSIONS AND RECOMMENDATIONS

The thesis given above, which included the review of the main issues, directions and problems linked with the SME development in various countries and Georgia, as well as the theoretical considerations and the empirical research about the current condition of the SMEs development in Georgia, helped to draw out specific conclusions about the general state and the possible directions of the development of small and medium business in Georgia.

The thesis has revealed that the current state of the development of small and medium business isn't very favorable currently in Georgia, but it has also shown that the development of SMEs in Georgia is slowly speeding up its pace. There are a number of State programs in Georgia, as well as the international programs which include supporting the SMEs development in Georgia, which really contribute to the issue of small and medium business development within the country. Such programs, as mentioned above, include the active participation of the European Union within the development of the field of SMEs in Georgia.

Despite some progress, the thesis has emphasized the fact that still much has to be done in order to achieve the full-scale development of country's economy, which obviously relies on the development of the small and medium business within the country. For this purpose, the Georgian government has initiated the program "Enterprise in Georgia", which was the subject of our research. The aim of the program has been to support the development of small and medium entrepreneurship in Georgia.

The study which we have conducted on "Enterprise in Georgia", has identified several important trends that possibly hamper the development of SMEs in Georgia.

Within the frames of our study, it was revealed that the problems of the increasing prices of the raw materials directly affect the development possibilities of the small and medium businesses. Another important problem, hampering the development of the small business within the country, is the high interest rate on the loans given to the small and medium entrepreneurs, which in fact distracts the accumulation of the finances needed for the further development of a particular business. Within the frames of the study, another important problem was identified, which is expressed in the unwillingness of the small and medium entrepreneurs to expand their own businesses. This, of course, is the negative factor caused by the unstable economic conditions within the country, which contribute to the low development level of the SMEs.

After identifying the basic problems linked with the development of SMEs in Georgia, the following recommendations for the development of the small and medium business within the country can be made:

1. Increasing the efficiency of the State support towards the development of SMEs could contribute greatly in rapid growth of the field; this could be achieved by lowering the percentage of the loans given to the small and medium entrepreneurs;
2. Drawing out the precise plan for the development of SMEs in Georgia during the following years could help the State in creating the conditions for the SMEs to develop effectively and in a limited amount of time;
3. The effective implementation of the EU policies related with the prevention of the State corruption and other kinds of problems which hamper the development of SMEs within the country, could contribute greatly into the efficient development of the small and medium businesses in Georgia.

In the end, it is important to notice the future studies are required to identify the other possible ways of supporting the SMEs development in Georgia. As far as Georgia is a developing country, its economy needs to be supported externally as well as internally, and for this purpose, the collaboration between the Georgian government and the European Union is essential for creating the firm basis for the stable development of the small and medium business within the country.

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