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***The Georgian Perspective***

*ნაშრომი წარდგენილია ილიას სახელმწიფო უნივერსიტეტის*

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## Declaration

როგორც წარდგენილი ნაშრომის ავტორი, ვაცხადებ, რომ ნაშრომი წარმოადგენს ჩემს ორიგინალურ ნამუშევარს და არ შეიცავს სხვა ავტორების მიერ აქამდე გამოქვეყნებულ, გამოსაქვეყნებლად მიღებულ ან დასაცავად წარდგენილ მასალებს, რომლებიც ნაშრომში არ არის მოხსენიებული ან ციტირებული სათანადო წესების შესაბამისად.

ირინე გურული  
15 დეკემბერი, 2018

Hereby I declare that this thesis is my own work, based on my personal study, and that to the best of my knowledge and belief, it contains no material which has been accepted or submitted for the award of any degree or diploma.

I also declare that, to the best of my knowledge and belief, this thesis contains no material previously published or written by any other person except where due reference is made in the text of this thesis.

Irine Guruli

December 15<sup>th</sup>, 2018

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## **Abbreviations**

AA – Association Agreement

APMA – Agricultural Program Management Agency

CEEC - Central and Eastern European Countries

DCFTA - Deep and Comprehensive Free Trade Area

EaP – Eastern Partnership

EBRD – European Bank for Reconstruction and Development

EEN – European Enterprise Network

EPRC - Economic Policy Research Center

ETF – Education and Training Foundation

EU – European Union

FDI – Foreign Direct Investment

JSC – Joint Stock Company

LLC – Limited Liability Company

OECD - Organization for Economic Cooperation and Development

GCCI - Georgian Chamber of Commerce and Industry

GDP – Gross Domestic Product

GEOSTAT – National Statistics Office of Georgia

GEA – Georgian Employer’s Association

GEL – Georgian Lari

GEM - Global Entrepreneurship Monitor

GIAC - Georgian International Arbitration Center

GIZ - The Deutsche Gesellschaft für Internationale Zusammenarbeit

GoG - Government of Georgia

GSMEA - Georgian Small and Medium Business Association

ICT – Information Communication and Technology

IFRS – International Financial Reporting Standards

FSU – Former Soviet Union

RIA – Regulatory Impact Assessment

RBC – Responsible Business Conduct

SMEs - Small and Medium Enterprises

UNCTAD - United Nations Conference on Trade and Development

USD – United States Dollar



## Abstract

Entrepreneurship is considered as a backbone of every economy, however its contribution to economic development is dependent on the context in which it operates. The environment of a country shapes dynamics of entrepreneurship, while the environment is shaped by interdependence between economic development and institutions, which affect other characteristics as governance quality, access to resources, and entrepreneurial perceptions. Entrepreneurship is blooming in mature market conditions; however it is increasingly becoming an important source of value added and employment in emerging countries as well.

This study takes a holistic approach in understanding entrepreneurship and SME development in emerging contexts, based on the case of Georgia. Georgia, as a fast reformer, provides an excellent example of an emerging country that accelerated its reform processes towards a market-oriented democratic state. Recent association with the EU and the country's strive towards Euro-Atlantic integration makes it a perfect example to study entrepreneurship and SME development in emerging country context.

The purpose of this research is to identify and analyze external and internal factors impeding and determining entrepreneurship and SME development in Georgia and scrutinize the role of the state in the process through studying the importance of direct and indirect support measures provided by the state. The theoretical framework used for this study is North's Institutional Theory, due to its applicability to the emerging context. In order to answer the research questions at hand a mix of both qualitative and quantitative research methods was used.

Study findings varied according to the business size. The study findings show that notwithstanding the rigorous reforms leading to improved business environment, establishment of a vibrant SME sector in Georgia is still a challenge. The results revealed that apart from the factors that are at the discretion of the government, there are a number of other external factors affecting entrepreneurship and SME development that are not solely dependent on governmental policy. As a result of this thesis one can conclude that the entrepreneurial outcome in Georgia is based on the interplay between the external and internal factors. There are two types of entrepreneurs currently operating the country: the registered enterprises that have a potential of growth and development, which can be labeled as "productive ones", and the unregistered, self-employed or micro enterprises that are engaged in generic business activities and do not have growth and development potential, these can be labeled as "unproductive" entrepreneurs. Entrepreneurial outcome is not a static condition, but rather in itself affects external factors and environment in a country. That is productive or unproductive entrepreneurs feed back into the external environment and shape the economic structure, business environment, macroeconomic and institutional factors in a country.

## მოკლე მონახაზი

მეწარმეობა ეკონომიკის ქვაკუთხედად არის მიჩნეული, თუმცა მისი წვლილი ეკონომიკურ განვითარებაში განსხვავდება იმ კონტექსტის მიხედვით, სადაც ის ოპერირებს. ქვეყანაში არსებული გარემო პირობები დიდწილად განაპირობებს მეწარმეობის დინამიკას, გარემო პირობები თავის მხრივ წარმოადგენს ეკონომიკური განვითარებისა და ინსტიტუციების ერთობლიობას, რომელიც ახდენს გავლენას ისეთ ინდიკატორებზე როგორებიცაა მმართველობის ხარისხი, რესურსებზე წვდომა, სამეწარმეო მოლოდინები და აღქმები. მეწარმეობა უმნიშვნელოვანეს როლს ასრულებს განვითარებული ქვეყნების ეკონომიკაში, თუმცა თანდათანობით, მისი მნიშვნელობა დამატებითი ღირებულების შექმნასა და დასაქმების მიმართულებით ძლიერდება განვითარებად ქვეყნებშიც.

მოცემული კვლევა ჰოლისტიკურად უდგება მეწარმეობის და მცირე და საშუალო ბიზნესის მნიშვნელობას განვითარებადი ქვეყნების კონტექსტში, საქართველოს მაგალითზე. საქართველო, როგორც სწრაფი რეფორმატორი ქვეყანა, ძალიან კარგი მაგალითია განვითარებადი ქვეყნისა, რომელმაც სწრაფად მოახდინა საბაზრო პრინციპებზე დაყრდნობილი დემოკრატიული სახელმწიფოს მშენებლობისკენ გეზის აღება. ევროპასთან ასოცირება და ქვეყნის ევრო-ატლანტიკური გეზი კიდევ უფრო საინტერესოს ხდის საქართველოს მაგალითზე განვითარებადი ქვეყნების კონტექსტში მეწარმეობის კვლევას.

კვლევის მიზანია იმ შიდა და გარე ფაქტორების ანალიზი, რომლებიც განსაზღვრავს და/ან ხელს უშლის მეწარმეობის და მცირე და საშუალო ბიზნესის განვითარებას საქართველოში, ამასთან კვლევაში გაანალიზებულია სახელმწიფოს როლი ამ პროცესში და შესწავლილია სახელმწიფოს მიერ ამ სექტორისთვის შემუშავებული პირდაპირი და არაპირდაპირი მხარდაჭერის მექანიზმები. კვლევის მიზნებისთვის, თეორიულ ჩარჩოდ გამოყენებულია North-ის ინსტიტუციური თეორია, რადგან ის ყველაზე კარგად ერგება გარანტირებადი ქვეყნების კონტექსტს.

საკვლევი კითხვების ანალიზისთვის გამოყენებული იქნა რაოდენობრივი და თვისებრივი კვლევის მეთოდები, ე.წ. შერეული მეთოდი.

კვლევის მიგნებები განსხვავდება ბიზნესის ზომის მიხედვით. კვლევამ აჩვენა, რომ რეფორმების მიუხედავად, საქართველოში მეწარმეობის და მცირე და საშუალო ბიზნესის განვითარება კვლავ გამოწვევად რჩება. შედეგებმა აჩვენა, რომ გარდა იმ ფაქტორებისა, რომლებიც სახელმწიფოს დისკრეციის ქვეშ არის, არსებობს მთელი რიგი გარე და შიდა ფაქტორებისა,

რომლებიც გავლენას ახდენს მეწარმეობის და მცირე და საშუალო ბიზნესის განვითარებაზე და არ არის დამოკიდებული მხოლოდ სახელმწიფო პოლიტიკაზე. ნაშრომის შედეგად შეგვიძლია დავასკვნათ, რომ სამეწარმეო შედეგი საქართველოში დამოკიდებულია შიდა და გარე ფაქტორების ურთიერთქმედებაზე. ორი ტიპის მეწარმეობა არსებობს ქვეყანაში. პირველი ეს არის რეგისტრირებული სამეწარმეო საქმიანობა, რომელსაც აქვს ზრდის და განვითარების პოტენციალი ე.წ. „პროდუქტიული მეწარმეობა“ და მეორე არის დაურეგისტრირებელი სამეწარმეო საქმიანობა, თვითდასაქმებულები და მიკრო მეწარმეები, რომელთა ზრდის და განვითარების პოტენციალი შედარებით შეზღუდულია, ეს ფორმა ე.წ. „არაპროდუქტიულ მეწარმეობას“ სამეწარმეო შედეგი არ არის სტატიკური და თავის მხრივ გავლენას ახდენს ქვეყანაში არსებულ გარემო პირობებზე. კერძოდ, პროდუქტიული და არაპროდუქტიული მეწარმეები მნიშვნელოვანწილად განაპირობებენ ქვეყანაში არსებულ ბიზნეს გარემოს, ეკონომიკურ სტრუქტურას, მაკროეკონომიკურ და ინსტიტუციურ ფაქტორებს.

# 1 Introduction

*This chapter outlines the overall topic of the thesis. It starts with the problem background, where entrepreneurship and its role is introduced. Moreover, the focus is made on the role of entrepreneurship in emerging context, a narrower context is set by providing information on the role of entrepreneurship in Georgian reality. The following section (1.2) outlines the purpose, which is to identify and analyze external and internal factors impeding and determining entrepreneurship and SME development in Georgia and scrutinize the role of the government in the process. Section 1.3 presents research questions.*

## 1.1 Problem Background

Entrepreneurship is found in different forms, however for the purpose of this study, emphasis is made on entrepreneurship that results in small business creation, or as it takes place in small and medium enterprises (SMEs), since the two are often closely related (Aidis & Sauka, 2005).

Entrepreneurship is considered as a backbone of every economy. It has become a global phenomenon; however its contribution to economic development is dependent on the context in which it operates. The environment of a country shapes dynamics of entrepreneurship, the environment is shaped by interdependence between economic development and institutions, which affect other characteristics as governance quality, access to resources, and entrepreneurial perceptions (Acs et al., 2008). Entrepreneurship is blooming in mature market conditions; however it is increasingly becoming an important source of value added and employment in emerging countries as well.

Entrepreneurship plays a far more important role in the development process of the emerging economies, since it contributes to the acceleration of the economic growth and development of these countries. Hence, SMEs are considered to be “*agents of change*” in the emerging economies (Aidis, 2003a; Aidis, 2003b; Smallbone & Welter, 2009a) as well as means for economic and social development (Kirby & Watson, 2003). However, emerging economies tend to have lower rates of entrepreneurship that adds value to the economy as compared to developed market economies; moreover, the difference is even more vivid in the countries of the former Soviet Union (FSU) than those of Central and Eastern Europe (CEE) (Estrin & Mickiewicz, 2010). The reason primarily lies in the soviet legacy and underdeveloped formal and informal institutions.

The majority of the research findings share the opinion that the development of entrepreneurship is very much dependent on the human capital of a country, their abilities and capacities. However, in the case of emerging economies the role of the state is crucial in creating the right “*framework conditions*” (Peng & Heath, 1996; Peng, 2000).

The set of these formal and informal institutions play a major role in the emerging economies for development of entrepreneurship (North, 1990, 1995). In other words, institutions, referred by North as *"the rules of the game in society"* (North, 1990), when stable foster entrepreneurial activity in a country.

Even though entrepreneurship is present everywhere, it develops in the environment where it is strongly supported and fostered. At the same time, emerging economies, unlike market economies, are characterized by institutional weaknesses that hamper development of productive entrepreneurship and SME development (Aidis, 2003a; Welter & Smallbone, 2003). In conditions where institutions are weak, entrepreneurs are reluctant to undertake new activities or restrict their activities to unproductive ones that do not generate much growth or employment (Baumol, 1990). *"If entrepreneurs are defined, simply, to be persons who are ingenious and creative in finding ways that add value to their own wealth, power, and prestige, then it is to be expected that not all of them will be overly concerned with whether an activity that achieves these goals adds much or little to the social product, or, for that matter, even whether it is an actual impediment to production"* (Baumol, 1990, pp. 897-898). Unproductive activities refer mostly to rent-seeking behavior of entrepreneurs that does not generate wealth or value added to the economy.

In emerging economies, for entrepreneurship to take productive paths, two main levels of influence are distinguished: (1) environmental factors (macroeconomic environment and the role of the state) and (2) cultural and personal factors (such as norms and values, personal traits), also referred to as formal and informal institutions. The role of a state is determined as a creation of *"framework"* conditions, as well as direct support measures (Smallbone & Welter, 2001). The combination of these factors play an essential role in an individual's decision-making process to pursue entrepreneurship which is either productive or unproductive. Meanwhile, besides these conditions and overall context, the role and analysis of SME supportive direct measures proposed by the state is also essential. It is believed that government policies and programs play a vital role in shaping and fine-tuning the core factors (Aidis, 2003a). State, as a creator of external environment, plays an important role in SME development. In countries, where entrepreneurship is less supported, private sector development tend to be stagnating. The role of a state and its engagement in supporting entrepreneurs typically changes according to a country's development.

The role of SMEs in emerging countries is increasing in terms of export potential and in the direction of internationalization. Internationalization of SMEs is directly related to their growth and increase of competitiveness, it fosters the development of innovative products and processes. The role of a state is crucial in this direction, it is worthy to mention the EU's Small Business Act and the supportive measures presented in this direction (EC, 2014 *Supporting the Internationalization of SMEs*). State support is directed towards overcoming the hindering barriers, such as financial barriers, access to information, networking and lack of managerial skills (OECD, 2009).

Oftentimes, the role and mode of both formal and informal institutions is not clear-cut, they usually have both - constraining as well as enabling forces in respect to entrepreneurship. However, it can also be argued that in emerging economies, these institu-

tions are more constraining, rather than enabling, since these economies are characterized by high levels of uncertainty, frequently changing external conditions and institutional deficiencies (Smallbone & Welter, 2001b).

Existing literature indicates that entrepreneurship characteristics differ among different emerging economies even though the general trend is characteristic of CEE and FSU countries, not all countries fall into one or the other category (Aidis, 2003b). Governments in different emerging economies have worked on the policies for fostering entrepreneurship and SME development. The main aim of such policies has been overcoming specific constraints encountered by SMEs (Aidis & Sauka, 2005). The policies have worked with different rates of success. Understanding context specific constraints could be a good starting point for shaping efficient supporting policies.

Although there is a wide range of literature that focuses on the issues of entrepreneurship and SME development in emerging markets, not all of it pays enough attention to the contextual, country-specific differences. It is important to understand that entrepreneurship is contextual (Welter, 2011). *“Context can be an asset and a liability for the nature and extent of entrepreneurship, but entrepreneurship can also impact context... context is important to understand when, how and why entrepreneurship happens and who becomes involved”* (Welter, 2011, p. 165). Structure and nature of entrepreneurial activities varies across different countries (Acs et al., 2008). Thus, it is critical to understand the context in which entrepreneurship takes place. In order to achieve efficiency, entrepreneurship policies and other direct or indirect support measures provided by the government need to be specifically tailored to the individual country context, within its political, economic and social conjuncture.

Exploring country-specific institutional characteristics is essential in determining the likely influence on an individual to become an entrepreneur. Studies have found that extensive government spending in the directions of stronger institutions, and development of infrastructure can enhance entrepreneurial activity. However, this relationship is not alike across different economies (Aidis et al., 2010). All around the world, billions of dollars are spent by the government, non-governmental organizations, international donor organizations, that provide business training programs and other types of support measures. Hence, as Campos et al. (2017) puts it this indicates a strong belief by policymakers around the world that entrepreneurship can be taught and that entrepreneurs are not “born.”

As stated, promoting entrepreneurship and SME development is a major challenge for emerging economies; Georgia is no exception in this regard. If in the EU countries SMEs are the major employers and are an important source of value added (comprising 60 percent of the private sector value added), in Georgia this business segment employs 42.7 percent, 20.6 percent of value added, and represents 16 percent of total bank credit as of 2013 (OECD, 2016). These statistics are particularly striking given that 94.1 percent of the business sector is made of SMEs. This compares to Organization for Economic Cooperation and Development (OECD) averages of 99.8 percent (SMEs as part of active enterprises), 70.7 percent of employment, and 66.7 percent of value added (OECD, 2016).

The role of the self-employed as an economically active force of the population, and their level of potential to transform into small businesses, is, however, no less important. As of the latest statistics, 2/3 of the employed are self-employed in Georgia, and constitute 18 percent of the country's Gross Domestic Product (GDP). A large share of the labor force in developing countries is engaged in small-scale entrepreneurship, however companies remain small and it is hard to differentiate them from one another (Campos et al., 2017). Even though the concepts of entrepreneurship and self-employment differ, researchers tend to equate these two notions (Parker, 2004). However, in case of the developing country context, self-employment is quite often informal.

When it comes to governmental policies targeted at entrepreneurship and SME development in Georgia, the policies can be divided in two phases: before and after 2004. The institutional and legal framework formation started after gaining independence in the early 1990s. These included basic transformational reforms including the creation and development of basic market-based, formal institutions, price liberalization, privatization, restructuring of financial sector and appearance of first private business enterprises. The newly created institutions were characterized by deficiencies, widespread corruption, unfavorable tax regime to name just a few. Therefore, starting from 2004, Georgia embarked on implementing radical reforms in the direction of creation a favorable business environment by wide spread liberalization for making entrepreneurial activities easier to pursue.

The prudent reforms undertaken in Georgia in the early 2000s resulted in the World Bank's Top Reformer title. The country made outstanding improvements in many of the areas concerning the creation of formal institutions, reforming business regulations that, at the first glance, created a fostering environment for entrepreneurship. In fact, Georgia's advancement in the ranking was the biggest progress in a single year achieved by any country since the launch of the Doing Business Reports (World Bank, 2006). It is noteworthy that according to the World Bank's Doing Business Rank, Georgia is ahead of France, Germany and the Netherlands; however, this ranking only gives a narrow picture and captures simplification of administrative barriers, whilst it does not say much about the environment necessary for business growth and development. Therefore, one has to be a bit more critical in assessing the actual impact of these reforms on the entrepreneurial endeavors in the country. The methodological limitations of the World Bank Indicators are often questioned since they mostly capture the bureaucracy of starting a business, not saying much about other important aspects, such as running business operations or conditions for potential growth and development.

The reforms implemented for creating a business conducive environment in Georgia have significantly improved external conditions for the private sector. However, there still are a number of factors that hamper business development; these are institutional barriers (e.g. access to finance, taxation, and arbitration court), systematic barriers

(e.g. “growth ceiling”<sup>1</sup>) and social barriers (e.g. managerial skills, human resource) (Rudaz, P., 2012).

In fact, the composition of Georgia’s private sector is rather peculiar. Interestingly, there are 618,492 registered business operators in Georgia, out of which a mere 19 percent are active (Geostat, 2015), all the rest are so-called “empty shells”. Apart from the officially registered private sector representatives, there are slightly above one million self-employed entities in Georgia, which in most of the cases run de-facto micro enterprises and could even be referred to as potential entrepreneurs.

If compared with the region’s advanced reformers, Georgia has a mixed record of entrepreneurship. Despite the relatively conducive business environment, the pool of latent as well as the share of SMEs per 1,000 people is relatively low as compared to the region. In addition, Georgian entrepreneurs are less likely to engage in innovation activities (World Bank, 2015b). There is not much evidence of high-growth entrepreneurship in Georgia, however according to a 2011 nonrepresentative survey Georgians have a strong entrepreneurial spirit. Some 92 percent of surveyed individuals said they would like to be self-employed, and roughly 51 percent believed it would be feasible to become self-employed in the next five years. These numbers indicate that there exists both an interest in entrepreneurship and a confidence in the possibility to become an entrepreneur. Therefore, it might be possible to encourage small business development and growth by tapping into the entrepreneurial potential and mindset prevalent in Georgia (World Bank, 2013a).

According to the Global Entrepreneurship Monitor (GEM), Georgia mainly lags behind in indicators such as: total early-stage entrepreneurial activity (i.e. percentage of total population who are either nascent entrepreneur or owner-manager of a new business) – 7.2 percent, entrepreneurial intention, percentage of population who are latent entrepreneurs and intend to start a business within three years – 16 percent. Motivational reasons for becoming an entrepreneur are mostly necessity driven, with only 30.9 percent being improvement-driven opportunities (GEM Report, 2014). Interestingly, even though the business environment in Armenia is less conducive to entrepreneurship and entry density is not as high, Armenian entrepreneurs are involved in higher level of innovation activities than entrepreneurs in Georgia (World Bank, 2016).

Apart from the measures taken to improve the business environment, the Government of Georgia (GoG) has implemented a number of direct supportive measures, such as soft loan programs, consultation services, and infrastructural support. Notwithstanding these efforts, the establishment of the SME segment, as an economic stimulus is still a challenge in Georgia. Hence, there is still a need to assess overall entrepreneurship framework conditions and main indicators that support entrepreneurial activity. A number of emerging economies were and are facing these issues, therefore considering their experience and studying the measures they have implemented, is very important in correctly identifying the activities to be funded.

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<sup>1</sup> Constraints to growth



Besides, within the framework of the Association Agreement<sup>2</sup>, signed between Georgia and the EU, special emphasis is made on the increasing competitiveness and internationalization of SMEs in Georgia, among other aspects, fostering cross-boarder entrepreneurial activities for creating additional value added is important to pay attention to.

Georgia, as a fast reformer, provides an excellent example of an emerging country that accelerated its reform processes towards a market-oriented democratic state. Recent association with the EU and the country's strive towards Euro-Atlantic integration makes it a perfect example to study entrepreneurship and SME development in emerging country context.

This study takes a holistic approach in understanding entrepreneurship and SME development in emerging contexts, based on the case of Georgia. North's institutional theory (1990) creates the understanding that there is a need of having the "framework conditions" in place for fostering what Baumol calls "productive entrepreneurship" in a country. Several scholars have dedicated substantial research attention to the issues of entrepreneurship and SME development in emerging, and more specifically post-socialist economies, emphasizing on the importance of context, institutional setting, government policy, direct and indirect support measures. However, there is a gap of holistically addressing a specific country context in terms of showing the interplay of both formal and informal institutions, framework conditions that are at the discretion of the government and those that are not solely dependent on the state policy, overall political orientation of a country including assessment of direct and indirect support measures provided by the state.

## 1.2 Purpose

This study highlights the interplay between institutional and legislative setting, and individual characteristics of an entrepreneur that foster entrepreneurial activity. The study also presents key economic indicators and the role of SMEs for the Georgian economy. Explicit attention is paid to motivations and intentions associated with various forms of entrepreneurial activities. However, how a developing economy can create an enabling environment that promotes businesses that are able to compete in the global market and provide benefits to a broader range of people is a pressing policy and theoretical issue.

The purpose of this research is to identify and analyze external and internal factors impeding and determining entrepreneurship and SME development in Georgia and scru-

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<sup>2</sup> In June 2014, the EU and Georgia signed an Association Agreement, which entered into force on July 1 2016. The Agreement is a treaty between the European Union, its Member States and a non-EU country that creates a framework for co-operation between them. Areas frequently covered by such agreements include the development of political, trade, social, cultural and security links.

tinize the role of the state in the process through studying the importance of direct and indirect support measures provided by the state.

### **1.3 Research Questions**

- What are the external and internal barriers to entrepreneurship and SME development in Georgia?
  - What factors determine entrepreneurship and SME development in Georgia?
  - Which barriers remain despite the support measures in place?
- What is the role of the state policy and what type of direct and indirect support measures are in place in Georgia for supporting entrepreneurship?
  - How important is the role of the state in promoting entrepreneurship and SME development in Georgia?
  - How does this role change over time?

## 2 Literature Framework

*This chapter outlines the theoretical lens used in this study. The chapter starts with the definition and determinants of entrepreneurship with a special focus on the emerging economy context. The conceptual framework of this study is based on institutional theory. It is the most widely used theoretical framework for analyzing entrepreneurship in a transition context. The chapter emphasizes on economic aspects of entrepreneurship and scrutinizes the role of the state and the public policy in entrepreneurship and SME development.*

### 2.1 Definition of Entrepreneurship

There is no universally agreed definition upon of entrepreneurship. The definition oftentimes varies based on the research focus (Wennekers et al., 2002). For the purpose of this study, I shall turn to the most widely used theory of entrepreneurship and the entrepreneur introduced by Joseph Schumpeter in his book *The Theory of Economic Development* (1912). Schumpeter argues that an entrepreneur is an individual who introduces new combinations and innovation into an economy, so to say is a main actor in the so-called “creative destruction” process. The Schumpeterian entrepreneur is an innovator and a leader; however, he/she does not necessarily start a new business. For the purpose of this study, I concentrate on entrepreneurs who start their own business, rather than innovate and lead a business owned by someone else. The word “entrepreneurship” in this study is referred to the process of “discovery and exploitation of profitable opportunities” (Shane & Venkataraman, 2000, p. 217).

The OECD – Eurostat Entrepreneurship Indicator Program (2009) established the following definition: “*Entrepreneurs are those persons (business owners) who seek to generate value through the creation or expansion of economic activity by identifying and exploiting new products, processes or markets*” (The World Bank, 2013a, p. 7).

Entrepreneurs may be pushed into self-employment due to lack of other employment options and the need for survival. High levels of unemployment can push people into self-employment, since the opportunity costs of entrepreneurship are relatively low (Audretsch and Thurik, 2002). Alternatively, they may be pulled out of the employment into starting a business if they discover an opportunity and a chance to pursue it.

Therefore, so-called necessity-driven entrepreneurship is more prevalent in less developed and developing economies, while necessity as a motivating factor gradually decreases with economic development, while the opportunity driven entrepreneurship increases (Kelley et al., 2012). Acs et al. (2008) states that opportunity entrepreneurship has a positive impact on economic development, while necessity entrepreneurship has no effect.

When measuring the entrepreneurial activity in a country, one can apply a “static” or “dynamic” perspective. “Static” indicators of entrepreneurship can be self-employment, business ownership rates, and the number of SMEs in a country. “Dynamic” indicators are nascent and startup activity rates, net entry rate and turbulence rate (measuring entry vs. exit) (Audretsch et al., 2007).

Based on the above-mentioned assumptions, the working definition of this thesis is the following:

*Entrepreneurship is a set of activities that based on the context can generate economic value and may take formal or informal forms.*

“Context” refers to the environment in which entrepreneurial activities take place, that is a region, a country or a municipality. “Activities” refers to a diverse set of processes and activities that an entrepreneur engages in during the entrepreneurial cycle. Under “formal and informal forms”, I refer to registered vs. unregistered activities. “Value” means both monetary and non-monetary value, both for personal good as well as for social good.

### **2.1.1 Determinants of Entrepreneurship**

A vast number of studies have been conducted on identifying the determinants of entrepreneurship. The findings indicate that cultural, political, and demographic differences determine entrepreneurial engagements in different countries. Developed and developing countries have different factors determining entrepreneurship. It is argued that in developing countries, government imperfections, financial deficiencies, lack of efficient business support measures, unstable business environment, informal networks, bureaucracy, and individuals’ pessimistic attitudes have a negative impact on entrepreneurship development (Batsakis, 2014).

It is also considered that education, accumulation of human capital, and skilled labor force is a vital determinant of entrepreneurial activity. Furthermore, entrepreneurial engagement can be stronger when educational institutions focus on providing entrepreneurship learning and programs. Education and training also foster intrapreneurship, by leading firms to innovate, identify new technologies and increase competitiveness (World Bank, 2013a).

Dembinski (2006) argues that the availability of resources and opportunities depend to the high extent on a given socio-economic reality characterized by economic, educational and technological development. In other words, the entrepreneurial process can

be viewed as an interplay between “opportunities” and their availability (material mode), “structures and norms” as institutional and cultural structures in which the activities take place (formal mode) and “changers”, as persons who seize the available opportunities and exploit them in a profitable way (efficient mode) (f.1). Alternatively, a mix of internal (personality) and external (social and economic incentives) factors provide the stimulus for entrepreneurship to manifest itself (Aidis, 2003a).

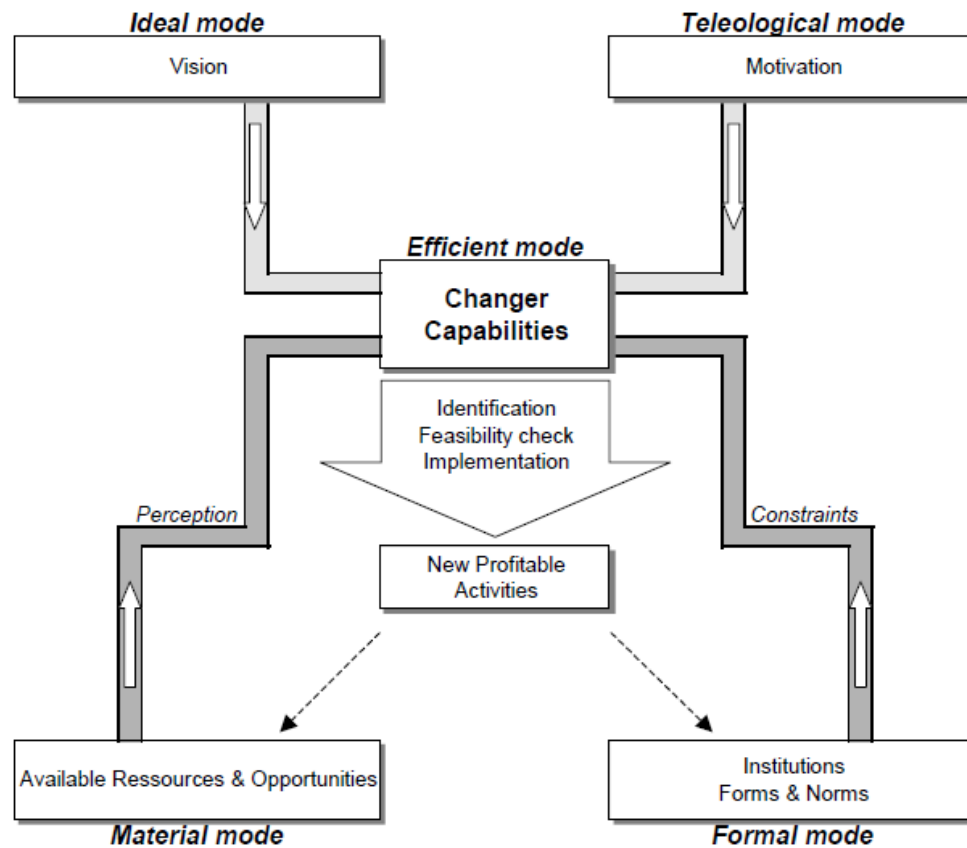


Figure 1. Multi-modal causation grid applied to entrepreneurship (Dembinski, 2006).

*“Rather than an inborn skill, entrepreneurship is largely a product of environment. It involves a complex of economic and social behaviors. Entrepreneurship can flourish only in the right environment”* (World Bank, 2013a, p. 11). Entrepreneurship is influenced by social values, culture, government policies, the political system, technology, economic conditions, customs, and laws.

Audretsch et al. (2007) examine entrepreneurship determinants on three different levels – the micro, industry and macro levels. The micro level focuses on individual’s decision-making processes, individual motives for becoming self-employed, such as background, skills, experience, traits, etc. On the industry level, the focus is on the market-specific determinants, such as opportunities for entry. The macro level determinants focus on range of environmental factors, technological, economic, cultural, as well as government regulation. As a matter of fact, the macro as well as industry determinants could also be taken advantage of by already existing firms and not necessarily by new ventures. In the latter case, it might be the influence of the governmental intervention that pushes the creation of new ventures, rather than the incumbent

firms to take on the emerged opportunities. Examples of such interventions are competition policy and protection of intellectual property rights. In order to take on the opportunities the individuals also have to possess the right resources and have personal characteristics to pursue the risk.

The determinants are wide in scope, however this study focuses mainly on the macro determinants for entrepreneurship development in a country, and in particular in the emerging country context.

### **2.1.2 Entrepreneurship as defined in emerging country context**

After more than two decades of transition from centrally planned to market economies, there is a considerable difference among the countries in the extent to which they developed and to which an environment facilitating entrepreneurship and SME development was created. Therefore, it is not appropriate to refer to transition economies as a homogeneous group. Georgia is included in the group, that saw advancement towards the market economies relatively quickly. This group of countries that quickly move towards the market economy, are described as “emerging market economies” (Smallbone and Welter, 2009).

It is important to clarify what is meant by entrepreneurship in developing country context. Oftentimes, entrepreneurship and SMEs are used interchangeably, in some definitions entrepreneurial activities also include the informal sector and petty capitalism. Petty capitalism refers to small businesses that employ few employees or rely on their owner's and owner's family labor, while informal sector refers to unregistered entrepreneurial activities. The World Bank in its methodology includes both SMEs and informal sector as a form of entrepreneurship in developing countries. As a matter of fact, the informal sector as an important source of economic activity in the developing world (Acs and Virgill, 2009). Since the largest share of firms in developing countries are small, both in terms of number of employees and the assets they own, and many operate in the informal economy and use family labor, for the purpose of this study the widest possible definition of entrepreneurship will be adopted. Therefore, for this study, entrepreneurship refers to SMEs, micro enterprises, self-employed and the informal sector.

Scase (2000) asserts the difference between “entrepreneurship” and “proprietorship” for business activities that take place in post-soviet space and Central Europe. According to him, entrepreneurs are committed to wealth creation, capital accumulation and business growth, while proprietors are committed to consume and utilize wealth to maintain certain standards of living and do not reinvest the gained funds back into their businesses. However, Scase also asserts that these two categories can be dynamic and it is possible for an individual to switch in between these two categories.

The above stated definition can also be enriched by Baumol's definition of productive and unproductive entrepreneurship which is mainly shaped by the so-called “*rules of the game*” or the set of formal and informal institutions that to a great extent create the incentives for making a choice between these two types of entrepreneurial activities. Dallago (1997) also agrees with Baumol's concept and adds that “*it is more the set*

*of “rules of the game” than the supply of entrepreneurs that determines the performance of an economy and the efficiency of an economic system via allocation of entrepreneurship to productive or unproductive uses” (Dallago 1997, p. 106).*

Sobel (2008) provides empirical evidence supporting Baumol’s concepts, finding that there is a highly significant relationship between having good institutions and the index of net entrepreneurial productivity. In other words, states that have the worst institutions have unproductive types of entrepreneurship, while better institutions lead to higher venture capital investments, higher rates of patents, faster rates of growth, etc.

Aidis (2003a) states that entrepreneurship in transition context cannot be taken for granted. Entrepreneurial outcome in these countries can be either productive or unproductive and the two main levels of influence are environmental factors (macro and micro environment and the role of the state) and cultural and personal factors (norms and values, personal characteristics). These factors in combination influence individual’s decision to purpose either productive or unproductive forms of entrepreneurship.

Schoar (2010) argues that subsistence entrepreneurs make up the majority of the entrepreneurs in developing countries. These entrepreneurs run micro operations that do not have the potential to grow into large firms and only provide an alternative employment opportunity to the entrepreneurs. Therefore, these types of entrepreneurs have very limited potential to serve as a value added to the economy or create employment. On the contrary, transformational entrepreneurs are much rarer in the economy and more difficult to identify. The author also states that these two types of entrepreneurs are very distinct from one another and rarely transition from one type to the other. For the purpose of this study, the self-employed who might be considered as subsistence entrepreneurs, as Schoar puts it, are considered to be a “reservoir” for entrepreneurship. This study will address the question whether entrepreneurs in Georgia are necessary or opportunity driven, however it will not attempt to clearly label and distinguish between the two.

## **2.2 Entrepreneurship in Economics**

The importance of SMEs for job creation served as a catalyst for renewed economic interest in entrepreneurship and SMEs. Studies conducted by various authors have found and proved that small firms play an important economic role as agents of change through entrepreneurial and innovative activity (Acs & Audretsch, 1990; Audretsch, 1995), stimulating industrial evolution (Audretsch, 1995), creating an important share of new jobs (Acs, 1992 in Wennekers & Thurik 1999:28) and reducing unemployment levels (Audretsch & Thurik, 2004). In short, small firms are usually viewed as *“vehicles in which entrepreneurship thrives”* (Wennekers & Thurik, 1999, p. 29). Small business sector can be viewed as *“vehicles both for Schumpeterian entrepreneurs introducing new products .... and for people who simply run and own a business for a living.”* (Thurik & Wennekers, 2004, p. 140).

Alternatively, Baumol (1993) incorporates two functions of the entrepreneur: as a Schumpeterian innovator and as a manager. Baumol argues that the entrepreneurs do not come and go, but rather, number of productive and unproductive entrepreneurs changes as the external environment develops and changes. Productive entrepreneurship does not necessarily yield tangible products. However, a productive activity should yield a positive marginal product no matter how indirect the route the activity takes in achieving this. Ultimately, the value of productive entrepreneurship should translate into a positive impact of economic growth, including such objectives as increasing employment, decreasing inequality, reducing poverty (World Bank, 2013a).

On the contrary, an unproductive entrepreneur engages in innovative activity but makes no contribution to the real output of the economy, and only thrives to increase one's own wealth and value-added. In some cases, the activity can also serve to reduce output or restrain its growth. Finally, a destructive or rent-seeking entrepreneur engages in innovative activity that leads to the misallocation of valuable resources into pursuits that from the viewpoint of the economy are useless and are carried out for the self-serving purposes of the entrepreneur.

At first sight, the definition is quite clear cut, however, a number of researchers highlight that in the transition context, it is hard to distinguish between the two types of entrepreneurs, since most of the small firms are involved both in productive and rent seeking activities (Sauka & Welter, 2010). Alternatively, Davidsson (2004) suggests that some rent seeking activities could also have a significant economic impact. In other words, tax evasion at the early stages of development could help an enterprise grow and later on contribute to the growth of the economy.

Acs et al. (2008), view economic effects of entrepreneurship through the lens of Porter's stages of development. They argue that during the *"efficiency-driven stage"* (second stage of development, when countries are in the need to increase their efficiency and educate their workforce to be able to compete on the global market), there is a decrease in entrepreneurial activity and the number of self-employed, since people strive to become wage employed. Hence, entrepreneurship on efficiency driven stage might not lead to economic development. On the third stage of development, which is the innovation driven stage, it is expected that the entrepreneurial activities are on the rise, since people shift from wage work to entrepreneurship, and contribute to economic growth and development.

In this study a particular attention will be paid to the economic role of entrepreneurs in Georgia analyzed through the lens of stages of development and external environment conditions.

### **2.3 Contextualizing Entrepreneurship**

In management literature the term context refers to *"circumstances, conditions, situations, or environments that are external to the respective phenomenon and enable or constrain it"* (Welter, 2011). One cannot disengage entrepreneurship from the context, because the interactions between the context and entrepreneurship helps the inter-



pretation of entrepreneurship from phenomenological and theoretical perspectives (Basco, 2017). Contextual influences affect the role of entrepreneurship and as well as their structure and performance (Karlsson & Dahlberg, 2003). Ramirez-Pasilla et al. (2017) discuss three types of driving forces for entrepreneurial practices. These are top down, bottom up and a combination of the two, the hybrid. For the top-down driving force, the institutional framework defines the context for entrepreneurship. For the bottom up type of driving force, entrepreneurial practices are the result of actions of individual and collective needs, the entrepreneurs find ways to adjust to the institutional framework. The hybrid type of driving force is when entrepreneurs make use of and benefit from an institutional framework.

Welter, (2011) identifies different dimensions of contexts – organizational, institutional, social and spatial. These can be classified into two broader levels: macro context and meso context. The macro context represents broader external elements that form the environment in which entrepreneurship occurs – these are economic, political, societal, legal and cultural elements. The meso-context is comprised of an environment that is closer to the phenomenon of entrepreneurship, these are social networks, industrial sector and family. Meso and macro levels are affected by time and spatial geography. Context is particularly important in the emerging economy environment, since the historic, economic and social evolutions may determine the nature of entrepreneurship (Basco, 2017).

Figure 2, clarifies the interplay between entrepreneurship and context.

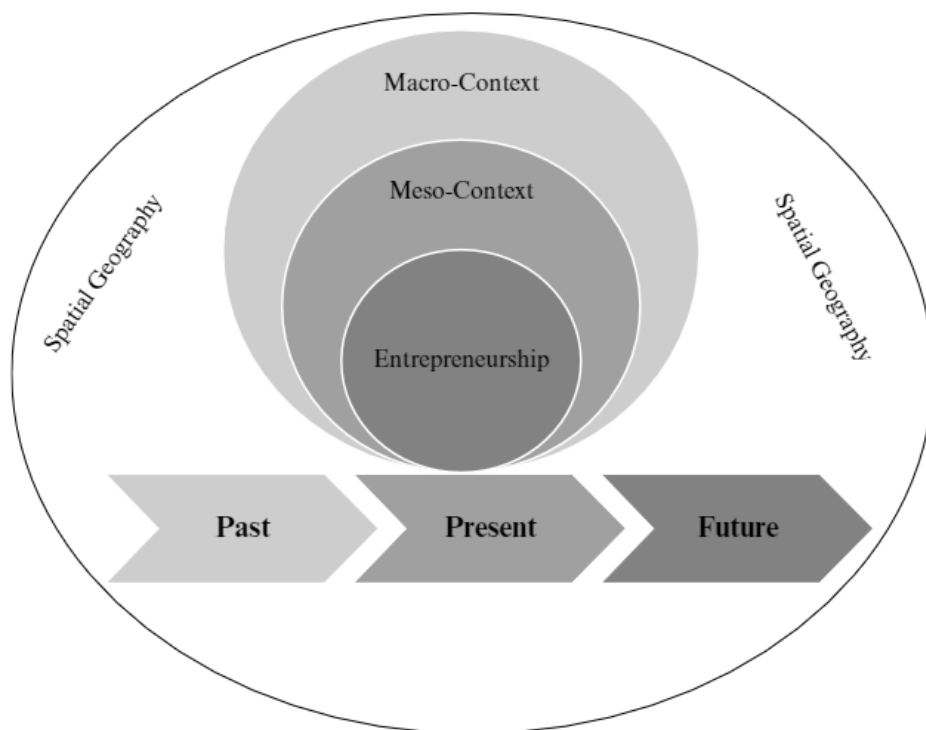


Figure 2 Multiple Embeddedness context (Basco, 2017)

The macro context, as North (1990) puts can also be further subcategorized into formal and informal institutions. Institutions form the “rules of the game in a society” (North, 1990), these institutions, when working efficiently reduce uncertainty and risk for entrepreneurs, create an enabling environment to conduct entrepreneurial activities. These rules are the so-called “formal” institutions: legal and organizational frameworks existing in a society. North (1990) acknowledges the importance of what he calls the “informal” institutions, which refer to the code of conduct, values, norms, and attitudes of a society. It is noteworthy that societal attitudes are perceived to be harder to change. *“Although formal rules may change overnight as the result of political and judicial decisions, informal constraints are much more impervious and deliberate policies”* (North, 1990, p.6). If the changes made are radical and are inconsistent with the existing informal constraints, *“there is an unresolved tension between them that will lead to long-run political instability”* (North, 1994, p.140). *“In all countries, the development of entrepreneurship and the behavior of entrepreneurs are influenced by the appropriateness and operation of formal institutions”* (Welter & Smallbone, 2011, p. 109).

According to Aidis (2003b), institutional theory is particularly important for explaining the roles of institutions and their effect on economic performance in emerging economies; since in an advanced market economy, these institutions are present and functioning, impact of institutions deserve less attention. Inadequate performance of formal institutions may lead to institutional distrust given the fact that informal institutions change slowly. The conceptual framework of this study is based on institutional theory. Institutional theory is the most widely used theoretical framework for analyzing entrepreneurship in a transition context. This particular study makes contributions to the macro context of entrepreneurship and in particular to formal institutions.

## 2.4 Institutional Theory

North (1990) asserts that institutions diminish uncertainty, define and limit the variety of choices existing for individuals. *“Institutions reduce uncertainty by providing a structure to everyday life”* (North, 1990, p.3). In order to better understand North’s institutional theory, one needs to distinguish between organizations and institutions. North classifies organizations as political, economic, social and educational bodies, whereas institutions as formal institutions (political and judicial rules, economic rules and contracts) and informal institutions (customs, traditions, codes of behavior). Emergence and evolvement of organizations are shaped by the institutional framework, which in turn is influenced by organizations and their entrepreneurs. Therefore, North considers organizations as *“agents of institutional change”* (North, 1990, p.5).

Institutions include forms of constraints of human behavior and are formal and informal. Formal constraints are rules that “humans devise” and informal constraints are conventions and codes of behavior. Institutions can either be created or they can

evolve over time. North asserts that institutions can be regarded as a “framework” in which humans interact. They are the “rules of the game” consisting of written and unwritten rules. Institutions affect the economic performance, due to their effect on the “costs of exchange and production”. North argues that it is the interaction of these two institutions that shapes the economy and create a constraining or enabling environment for entrepreneurs.

Sauka (2008) summarizes as follows: *“The behavior of the involved actors (e.g. what they can and must do and what is advantageous) is formed by the existing institutions and plays a critical role in reducing overall transaction costs by reducing the level of uncertainty and risk involved in individual exchanges. Moreover, these institutions, important for facilitating market exchanges and for shaping entrepreneurial activity, are comprised of two distinct categories: formal and informal institutions.”* (Sauka, 2008. P.57).

#### **2.4.1 Formal Constraints**

The formal rules as described by North (1990) include political, judicial and economic rules and contracts. These rules can range from constitution to individual contracts. In their turn, political rules define the structure of policymaking, decision-making, characteristics of agenda control. Economic rules define property rights, while contracts are specific based on the particular agreement. The function of the rules is to facilitate exchange, both political and economic. Political rules lead to economic rules, but the causality takes place in both directions. North states that the degree to which rules have an impact on economic performance is also dependent on informal norms. Hence, looking at the formal rules alone will not give an adequate picture of the relationship between formal institutional constraints and economic performance.

#### **2.4.2 Informal Constraints**

Informal constraints, codes of conduct, norms of behavior and conventions also affect choices that humans make. Unlike formal rules, informal constraints are less obvious. The importance of informal constraints can be observed when by imposing the same formal rules on different societies we get different results. Informal constraints come from information transmitted by the society and is a part of the cultural heritage. Cultural processing of information shapes the way institutions evolve. Since informal constraints are culturally derived, they do not change immediately as a result of changes in formal rules. There is a tension between the changed formal rules and the persisting informal institutions that has important implications on the way economies change. There is a phenomenon of institutional clash, when formal rules change quickly, while informal rules still persist. At North (1997, p.16) notes: *“the performance of an economy is an admixture of the formal rules, the informal norms, and their enforcement characteristics. Changing merely the formal rules will produce the desired results only when the informal norms are complementary to the rule change, and enforcement is either perfect or at least consistent with the expectations of those altering the rules.”*

### 2.4.3 Institutional Constraints

North compares transaction costs in an advanced industrial economy and in a third world country and concludes that transaction costs in the latter are much greater, in some cases the costs are so high that no transactions occur. North characterizes the institutional structure of such economies as lacking formality and enforcement. He argues that in the conditions of insecure property rights, poorly enforced laws, barriers to entry, and monopolistic restrictions, firms will have short time horizons and will tend to be small in size. The most profitable businesses in such environments tend to be trade, redistributive activities and black market. Unlike small firms, large firms will exist only under the governmental umbrella and protection. North concludes that the institutional framework is an important determinant of performance of an economy. *"The market overall is a mixed bag of institutions; some increase efficiency and some decrease efficiency"* (North, 1990, p.69).

North states that the institutional environment affects activities and economic outcomes: *"If the institutional framework rewards piracy then piratical organizations will come into existence, and if the institutional framework rewards productive activities then organizations and firms will come into existence to engage in productive activities"* (North, 1994, p. 361). Aidis and Sauka (2005) extended North's institutional theory and added two more factors that influence entrepreneurship development in a particular setting, these factors are economic (supply and demand, market competition, labor force, etc) and other (SME policies, procurement tendencies, consulting advice accessibility, etc).

### 2.4.4 Agents of Change

*"The agent of change is the individual entrepreneur responding to the incentives embodied in the institutional framework"* (North, 1990, p. 83). Market discovery, evaluation and management does not occur in a vacuum. The institutional context determines the kinds of information and knowledge required by an entrepreneur. North states that competition, decentralized decision-making practices, well-protected contracts and private property rights as well as bankruptcy laws are crucial for effective organizations. He believes that rules need to be in place that not only promote successful efforts but also dissolve unsuccessful efforts.

North states that institutions reduce uncertainty and highlights the importance of stability as an important but not *a sufficient condition for efficiency*. Institutions change, and even more so, they change incrementally. Changes in relative prices are major sources of institutional change; this change creates a need for more efficient institutions. This need for change comes from entrepreneurs in political and economic organizations who perceive that they can do better by changing existing institutional framework. However, the perceptions are heavily dependent on the way entrepreneurs receive and perceive information.

## 2.5 Institutional conditions in emerging economies

Literature reveals that the key feature of early stage transition was massive privatization of government owned enterprises. After the collapse of the socialist states, there was a high rate of startups. Businesses formed quickly, while the formal institutions to support them were not in place. Creation of conditions to assist the development of entrepreneurship was not on the initial agenda of the reforming countries. The lack of these formal institutions and existing barriers slowed subsequently down entrepreneurial activities and growth of businesses (Acs & Virgill, 2009). Since then, the existence of private enterprises has become a norm; however, there are a number of barriers and imperfections in the developing countries which persist.

Some of the most common institutional barriers and general characteristics that entrepreneurs and SMEs face in transition economies are listed below in table 1.

<b><u>Factor</u></b>	<b><u>General Characteristics</u></b>
<b>Environment</b>	Macro: Dramatic Changes in socio-economic and political conditions
	Micro: newly created private sector and lack of recent “productive” entrepreneurship tradition
	Hostile economic environment
	Absence of business infrastructure and support services
	Lack of external financing
<b>The role of the state</b>	Non-liberal governmental stance; hesitant to intervene in market processes
	No previous experience with business tax systems or legislation
	Negative attitude towards entrepreneurs
	Over-regulation, interference, corruption
<b>Business owner characteristics</b>	New business, new career
	Diverse social origins
	Primitive business methods
	Dependence on assistance through private networks
	More progressive and market oriented, than the general population

Table 1 Entrepreneurship in transition countries: General Characteristics (adopted from Aidis, 2003).

As the table shows, the most common environmental barriers include unpredictable and uncertain socio-economic environment, as well as the low access to finance and

absence of necessary business infrastructure and support services. On the state policy side, due to the lack of experience, examples of over-regulation and hostile tax and legislative environment is commonplace. If we look at the business owner characteristics, again due to the lack of previous experience, businesses in transition economies are characterized by relatively primitive business methods and usually depend on assistance through private networks.

## **2.6 Business Owner Characteristics in Emerging Economies**

Entrepreneurs in transition countries tend to have lower entrepreneurial skills than in mature market economies, and they usually lack special knowledge and techniques to manage enterprises in the conditions of market economy (Smallbone & Welter, 2006a; Welter, 1997). This is due to the socialist legacy when the system neglected management and business education. Nevertheless, entrepreneurs are reluctant to admit this fact and instead blame external barriers as causes of their problems (Welter, 1997).

The second way in which business owner characteristics affect entrepreneurship in emerging and especially post socialist states is their risk taking behavior. Again, due to the lack of tradition of private entrepreneurship, there is an underdeveloped risk taking culture (Warner & Daugherty, 2004). Informal institutions, such as norms and behaviors are harder to change, therefore due to this institutional inertia, cognitive institutions in post socialist economies are less supportive of entrepreneurship than in matured market economies (Kshetri, 2009).

## **2.7 The role of the state and public policy in relation to entrepreneurship**

Empirical evidence shows strong links between entrepreneurship and economic growth. Recognition of this importance has led many countries to eliminate barriers to entrepreneurship and other market failures. Policymakers also ensure positive externalities to assist growth of entrepreneurship and economic development, such as knowledge and networks.

Government policies can restrict or foster entrepreneurship. There are different perspectives on the role of the government in the economic process; some theories consider the intervention in the economy harmful, while the “antitrust” schools of thought argue that the government is an important player in determining the direction of economic processes. When it comes to entrepreneurship, there is no automatic justification of government intervention; it is connected to the existence of market failures and distorting externalities. Examples of such externalities could be knowledge, “level playing field”, access to finance, etc. (Audretsch et al, 2007). Parker (2007) argues that it is not always justified by the government to interfere in fixing the externalities for the following reasons: it might be too costly to do so, the government might not inter-

fere wisely, subsidies might be directed to benefit politicians and interest groups, rather than increasing social welfare, many government programs have unclear and multiple objectives, and these multiple objectives make it hard to evaluate government entrepreneurship programs.

Aidis (2003a) argues that in the emerging country context, government policy and programs can play an instrumental role in entrepreneur's decision to pursue productive or unproductive entrepreneurship (f.3). The author argues that some factors are easier to change than others. For example, personal characteristics are least likely to change, but well designed training programs can actually change cultural norms and values to have a positive influence on individuals' beliefs and values.

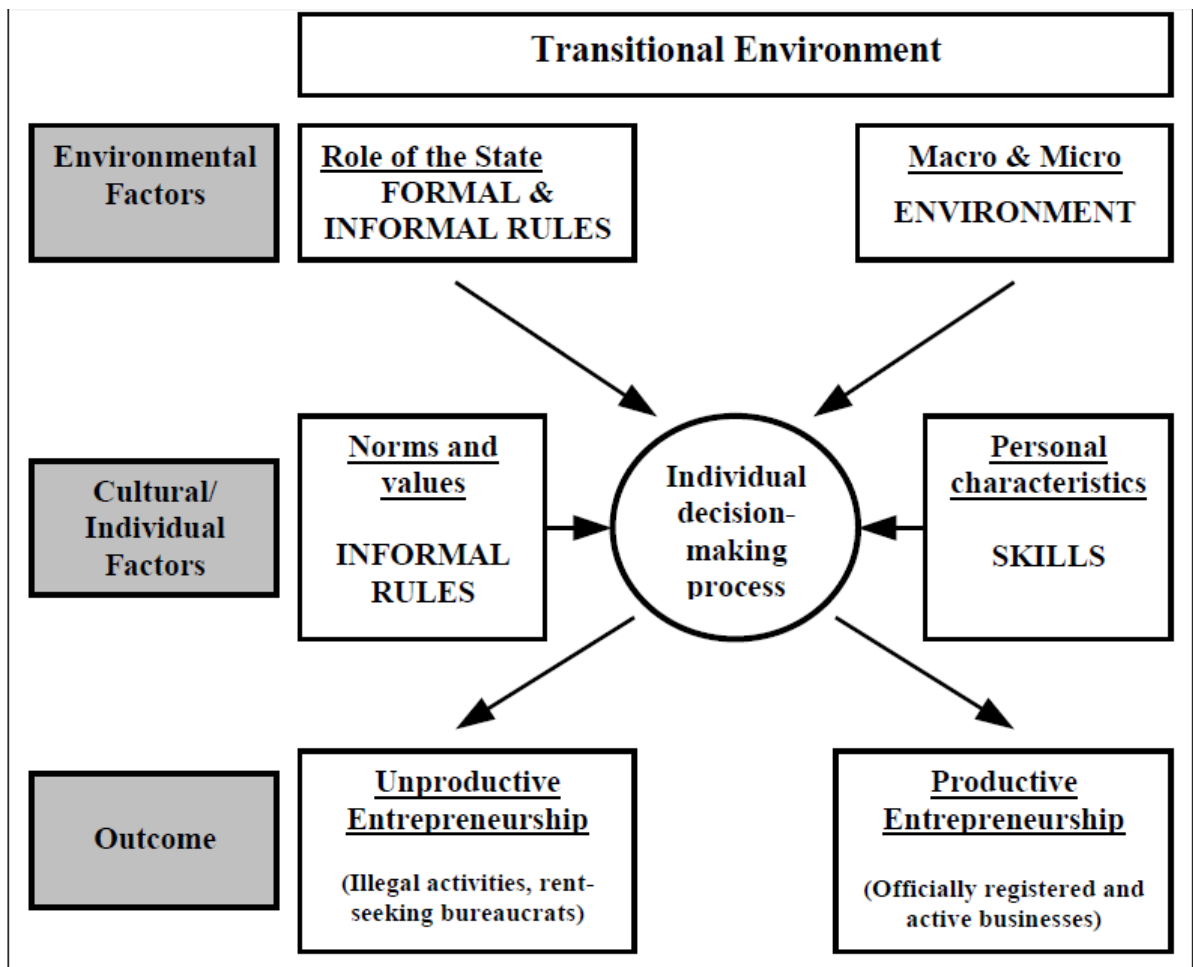


Figure 3. A model for entrepreneurship in economic transition (Source: Aidis, 2003a)

Quite often, notwithstanding the government interference and hostile business environment, entrepreneurial activities are still undertaken, in extreme market imperfections, entrepreneurs are even pushed into the informal sector (Acs & Virgill, 2009). Even more so, entrepreneurs operating in such turbulent environments are not able to endure. It is important to "correctly" analyze entrepreneurship, so that the support

measures taken can contribute to further economic growth and development (Aidis & Welter, 2006).

Entrepreneurship in transition environments can be regarded as a two way process: the role of the state as an agent of institutional change and the role of entrepreneurship as a fostering factor in institutional change.

The government contributes to the understanding of entrepreneurship as an acceptable form of behavior in society by the way it deals with entrepreneurs. In environments where formal and informal institutions are coherent, the rule of law positively shapes individual behavior. In contrast, in fragile settings, the rule of law is nonexistent and non-compliance to the rules becomes a norm. It is common that in conditions where formal institutions do not function properly, entrepreneurs use network-based strategies to overcome institutional uncertainties and have path-dependent behaviors. However, in order to foster transition and sustainable development, it is important to move from relation-based to rule-based business environment. *“Entrepreneurship is ultimately dependent on the drive and commitment of individuals, which government can facilitate through an appropriate and effective functioning institutional frame, although the state cannot substitute for individual entrepreneurial endeavor”* (Smallbone & Welter, 2011, p.19).

In post-soviet republics in the conditions of institutional embeddedness, entrepreneurship behavior is heavily dependent on the external environment (Peng, 2000; Peng & Heath, 1996). However, it is not quite clear cut whether the institutional deficiencies represent a major reason for unregistered entrepreneurial activities in these countries.

Welter and Smallbone (2011) identify six main types of management behavior in former soviet countries that represent responses to the external environment in which entrepreneurs were operating: (1) “prospecting” firms that are innovative and flexible in their organizational structure; (2) “evasion” when in the conditions of inadequate legal environment, entrepreneurs are engaged in arbitrariness and corruption (working informally, avoiding taxes, etc.); (3) “financial bootstrapping” – in the conditions of low access to finance, entrepreneurs operate without getting external sources of funding. In these cases, entrepreneurial activities oftentimes are very simple; (4) “diversification and portfolio entrepreneurship” diversification of business activities rather than expanding core activities to make the business look less successful and less visible to government officials; (5) “networking” as using personal contacts and relations to gain access to commodities and services that are in short supply, such as the soviet period “blat”; and (6) the forms of adaptability to the external environment, administrative or other burdens.

The governments of Central and Eastern European Countries (CEEC) that are now members of the EU served as positive agents of institutional change in terms of entrepreneurship development. Given the fact that entrepreneurs played an important role in the first years of transition, they also contributed and created a demand for this institutional change. The process of EU accession also played an important role in the re-



forming process, due to the requirements and conditions presented by the EU, to the aspirant countries (Smallbone & Welter, 2011).

Smallbone and Welter (2010) distinguish between three levels of policy-making – (1) macro-SME and entrepreneurship policy, (2) meso – Financial Institutions, and (3) business development centers, regulatory bodies, and national agencies (f.4).

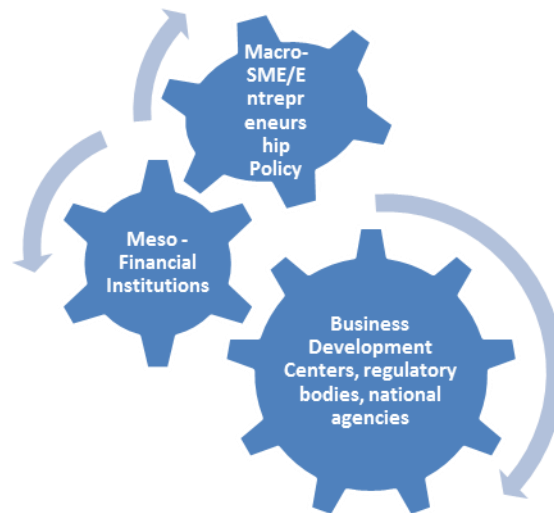


Figure 4 Three levels of Policymaking (Smallbone and Welter (2010)).

The effectiveness of the overall institutional frame and policy depends on the relationship between these different levels and the behavior of individual organizations that operate within these levels.

At the beginning of transition, in most CEECs the attention of policymakers was focused on establishing framework conditions for the private sector with no intervention in proposing business support programs. In later stages of transition, an introduction of direct support measures took place. In order to decrease “implementation gaps”, a clear link was required between the strategic policy objectives and action plans which are tied to the budgetary processes.

Smallbone and Welter (2001) identify five main policy types through which governments influence entrepreneurship:

1. Influence on the macroeconomic and business environment;
2. Impact of government regulations and legislations which have different effect on firms of different sizes, thus increasing compliance costs for new and small firms;
3. Development of market institutions that are essential part of market economy, banks, other financial intermediaries, business courts, etc.
4. Direct support measures for assisting small businesses and start-ups

5. The value government and society places on entrepreneurship in the society.

Verheul et al (2001) apply a different perspective in describing government interventions, focusing on entrepreneurship as an individual phenomenon. They distinguish five types of state interventions:

1. On the demand side – influencing the number, type and accessibility of entrepreneurial opportunities;
2. On the supply side – influencing the number of potential entrepreneurs;
3. Policies that aim at availability of resources, skills, knowledge for entering entrepreneurship and developing business, input factors – labor, capital, information;
4. Policies that aim at influencing individual preferences of entrepreneurship;
5. Policies aimed at individual decision-making.

Acs et al. (2008) state that institutional and environmental conditions are easier to target through public policy planning, as compared to the individual-level factors that are harder to affect.

Alternatively, Lundstrom and Stevenson (2005) assert that state policies should be concentrated on increasing motivation, opportunities and skills of entrepreneurs, while at the same time developing an entrepreneurial climate and culture in the country, encouraging and favoring entrepreneurship. This attitude would change the mindset in society and naturally increase business startup rates and market dynamics. Entrepreneurs are motivated by wealth accumulation as well as the need of achievement; they do not pursue an opportunity unless they are successful to make a profit (Shane, Locke, and Collins, 2003). Prior to pursuing an opportunity, entrepreneurs assess the level of risk. A number of external factors determine the level of risk such as regulations, political attitudes, market size, availability of resources, skilled labor (Hayter, 2011).

Lundstrom and Stevenson (2005) also introduce a distinction between entrepreneurship and SME support measures. In their definition, SME support is aimed at individual firm support for them to expand, modernize, and develop. These measures are usually of “traditional” type and include facilitating access to domestic and individual markets, access to finance, training, and counseling. On the other hand, entrepreneurship measures are directed towards increasing the number of businesses and entrepreneurs, encouraging individuals to startup businesses. Support is concentrated on the nascent years, leaving out the obstacles in the later years of development. Authors believe that entrepreneurship policies are concentrated on the longer-term horizon, changing societal attitudes and values. The Lundstrom and Stevenson (2005) consider that the “genuine” entrepreneurship policies reduce barriers to entry, early stage growth and exit (f.5).

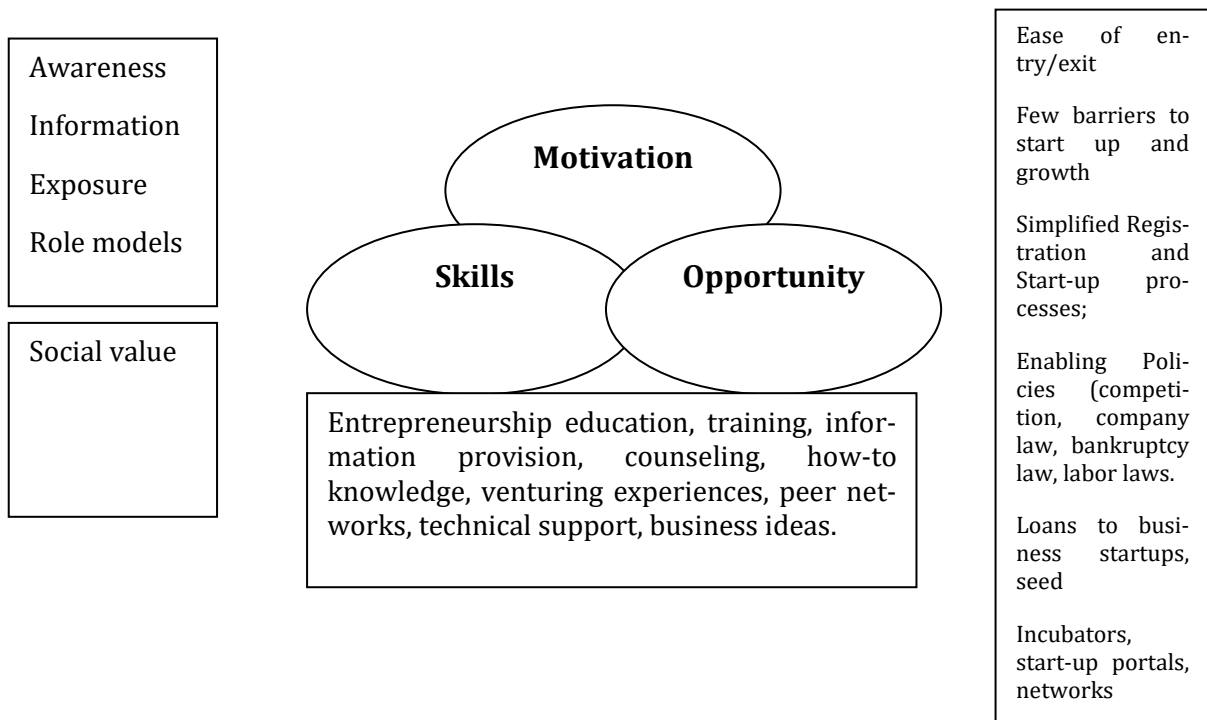


Figure 5. Entrepreneurship Policy Foundations (Adopted from Lundstrom & Stevenson, 2005).

Hoffman (2007), used correlation analysis to determine the relative importance of 24 possible policy areas of government intervention. The policy areas chosen were divided in 5 main directions each having a sub-area:

- (1) opportunities – entry barrier deregulation; access to foreign markets; technology transfer; private demand conditions; procurement regulation;
- (2) capital – loans; wealth and bequest tax; business angels; venture capital; capital taxes; stock markets;
- (3) ability – business education, entrepreneurship education, restart possibilities, entrepreneurship infrastructure both private and public;
- (4) incentives – personal income tax, business tax and fiscal initiative, social security discrimination, administrative burdens, labor market regulation, bankruptcy legislation.
- (5) motivation/culture – entrepreneurship motivation, initiatives towards specific groups; Communication about heroes.

Four areas that were significantly correlated with performance and that were of high priority in the top performing countries were: *restart possibilities*, *personal income tax*, *labor market regulation* and *entrepreneurship education*. Additional two areas that were also identified as significant were *venture capital* and *bankruptcy legislation*. According to the author, these findings can be used by other countries to compare their

business environments to those of the top performing countries and also measure relative importance of the proposed policy areas in their respective countries.

In contrast, Audretsch et al. (2007) argue, that entrepreneurship policy is considerably more than specific government institutions mandated to assist SMEs with specific types of enterprises, but rather is a “*broad spectrum of institutions, agencies and different constituency groups*” (Audretsch et al. 2007, p. 2). This is what the authors call a shift from a managed to an entrepreneurial economy, when the policy approach goes beyond economic policy and also embraces all aspects of society. This understanding envisages that entrepreneurship policy goes beyond specific support measures and instruments, agencies and state institutions and takes a new orientation towards entrepreneurial economy. Given the fact that entrepreneurship is an interdisciplinary subject, when shaping a public policy for fostering entrepreneurship, a broad range of fields have to be taken into account, including management, finance, psychology, sociology, economics, political science and geography (Audretsch, et al. 2007).

Audretsch, Keilbach and Lehmann identify network, knowledge, failure and demonstration externalities as reasons for government intervention into entrepreneurship. They find that entrepreneurial networks are beneficial to entrepreneurial activity. Regional clusters and networks are also viewed as means for fast learning and positive spillovers (Acs, 2002). Knowledge and education can be problematic in developing countries and is an important means for productivity improvement within the firm and thus promotes economic growth. In the developing world, with high levels of information asymmetry, knowledge is particularly important for discovering and exploiting opportunities. “*Innovative entrepreneurship requires a strong educational foundation*” (Acs & Virgill, 2009, p. 62). Education both at the primary and tertiary levels is important for entrepreneurship in developing countries.

Failure and demonstration is important, since entrepreneurs learn from examples. Therefore, examples of new firm creation and even failure are beneficial for other entrepreneurs. For policymaking purposes, it is important to study how markets function, and how they fail. This will help policymakers to discover what are the factors that expand entrepreneurial activities in a country (Acs & Virgill, 2009).

Aidis et al. (2010) explored country specific institutional characteristics that are likely to influence an individual’s decision to become an entrepreneur. The study was conducted for 47 countries and found that two aspects of business environment were important for an individual’s choice to become an entrepreneur: the size of the state sector and freedom from corruption. The study found that at all levels of economic development, the larger the size of the state the less the incentives to be entrepreneurial. Therefore, a tradeoff needs to be made when making policy choices. The larger the fiscal role of the state, the less the aspirations to create a more entrepreneurial society.

Entrepreneurship policy can be viewed through the lens of Porter’s stages of economic development. The theory argue that for the developed countries in the innovation-driven stage, the policies fostering entrepreneurship should be focused on training and education, stimulating investments and international trade, facilitating export spillovers and supporting role models. On the other hand, countries in the factor driven or

efficiency driven stage have to work on achieving institutional and macro-economic environments, by increasing entrepreneurial capacity, enabling individuals and businesses to absorb knowledge.

## 2.8 Transition Stages and the State Policy for Entrepreneurship Promotion

There is no consensus on defining the so-called “transition stages”. Aidis and Sauka (2005) assert that transition indicators of EBRD that present progression of economic transition according to both macroeconomic and institutional variables is the most suitable one. These indicators have been compiled for the transition countries systematically since 1989.

EBRD’s classification indicators are divided into two main phases – initial and next phase, the indicators are based on four main categories, each containing at least one subcategory (t.2). The initial phase is characterized by privatization of assets, market liberalization and macroeconomic stability, while the next phase implies the development of policies, institutions and behavior that accelerates growth.

<u>Enterprises</u>	<u>Markets and Trade</u>	<u>Financial Institutions</u>	<u>Infrastructure</u>
Large-scale privatization	Price Liberalization	Banking Reform and interest rate liberalization	Infrastructure reform
Small-scale privatization	Trade and foreign exchange system	Securities market and non-banking financial institutions	
Governance and enterprise restructuring	Competition Policy		

Table 2 EBRD Transition Indicator Classification. Source: EBRD.

EBRD indicators lack informal factors and solely concentrate on the so-called formal institutional indicators. A theoretical transition classification model presented by Mortel (2002) addresses both institutions based on the institutional theory developed by North. According to Mortel (2002), based on the institutional theory developed by D. North, there are three stages of transition process. The First Stage of transition starts when a country has the freedom or desire to transform, or when it is forced to do so. This is the stage when the future transition strategy needs to be formed, when the decision making on new laws and regulations begins. The Second Stage of transition, is characterized by formal institution reforms, including introduction of legislation and rules. Privatization and decentralization takes place, a legal framework is shaped, and laws on private property, competition, and bankruptcy are introduced. In line with the formal institution reform, informal institutions also change during stage two. There can be a disharmony between formal and informal institutions at this stage, since the framework uncertainty still persists. The Third Stage of transition starts when the legal

framework formation is complete, but marginal changes are taking place, when implemented institutions are being refined. The third stage of transformation is focused on the change of economic behavior of agents. Economic agents experiment with decision making practices in the new context and reality. The third stage lasts longer than the previous ones. This stage ends when formal and informal institutions are at harmony. This harmony is dependent on the experience brought about during the previous stages, if during the new economic and political order there are social and economic hardships, such as poverty, unemployment, etc. people tend to be less likely to accept new order and adapt to it.

A study conducted by Aidis and Sauka (2005) looked at the barriers for SME owners throughout different stages of transition. They found that as transition moves to stage three and beyond, SME owners become more concerned with the human resources, skills and development, internal business capabilities, and business growth. That is during the more advanced stages of transition, there is a need for business training programs for SME owners. At the same time, three formal constraints taxes, policy instability and legal regulations represent a barrier for business development in all stages of transition. The same is true for access to finance. Below, is the table identifying major barriers facing SMEs in different stages of transition (t.3).

Stage I	Stage II	Stage II and III	Stage III
<u>Formal: Taxes, Policy instability/uncertainty, legal regulations</u>			
<ul style="list-style-type: none"> <li>• Customs and Trade regulations</li> </ul>	<ul style="list-style-type: none"> <li>• Frequent changes to laws and government</li> <li>• Business registration</li> </ul>	<ul style="list-style-type: none"> <li>• Governments non-transparency</li> <li>• Commercial law</li> <li>• Social security payments</li> </ul>	<ul style="list-style-type: none"> <li>• Too many licenses;</li> <li>• Accounting standards;</li> <li>• Information;</li> <li>• Needs for specific consulting advice;</li> </ul>
<u>Informal</u>			
	<ul style="list-style-type: none"> <li>• Governments Attitude;</li> <li>• Organized crime and mafia;</li> <li>• Anti-corruption measures;</li> <li>• Business security;</li> <li>• Lack of positive attitude</li> </ul>	<ul style="list-style-type: none"> <li>• Corruption;</li> <li>• Bureaucracy;</li> <li>• Payment behavior of clients;</li> </ul>	<ul style="list-style-type: none"> <li>• Too many tax inspections;</li> <li>• Implementation of regulations;</li> <li>• Motivation/quality ethics of workforce</li> </ul>
<u>Economic: Financing: access and cost</u>			
<ul style="list-style-type: none"> <li>• Macroeconomic stability</li> <li>• Inflation</li> </ul>	<ul style="list-style-type: none"> <li>• Physical infrastructure;</li> <li>• Low product demand;</li> <li>• High input prices;</li> <li>• Suppliers;</li> <li>• High interest</li> </ul>	<ul style="list-style-type: none"> <li>• Infrastructure;</li> <li>• Unfair competition;</li> <li>• Premises rental costs;</li> <li>• Wage costs;</li> <li>• Business training</li> </ul>	<ul style="list-style-type: none"> <li>• Shortage of qualified workers;</li> <li>• Strong competition;</li> <li>• Lack of investment/finance</li> </ul>

Table 3 Main Barriers Facing SMEs in Different Transition Stages (Aidis & Sauka 2005).

## 2.9 Chapter Summary

This chapter has outlined the theoretical lens used for this study. It started out by defining entrepreneurship, with a particular emphasis on entrepreneurship as defined in the emerging country context, and presented the definition used for the purpose of this study. The study will use the widest possible definition of entrepreneurship that unites micro firms, self-employed and SMEs operating in both formal and informal economies. Later on the chapter highlighted importance of entrepreneurship in economics and in particular in emerging economies. Assertion was made that context is particularly important in an emerging country environment, since the historic, economic and social evolutions may determine the nature of the entrepreneurship (Basco, 2017).

The theoretical framework used for this study is North's Institutional Theory, due to its applicability to the emerging context (Aidis, 2003b). Notions of formal and informal institutions, as well as institutional conditions and constraints most frequently observed in emerging economies were presented. The final subchapter of the literature review was dedicated to the role of the state in entrepreneurship and SME development in emerging economies as viewed by various scholars and researchers. Subsequent amount of literature suggests that government policies can restrict or foster entrepreneurship. A decision to purpose an entrepreneurial activity is made by an individual, however, the government can facilitate the process through creating an effectively functioning institutional frame (Smallbone, & Welter, 2011). Aidis (2003) argues that in an emerging economy context, government policy and programs can play an instrumental role in entrepreneurs' decisions to pursue productive or unproductive entrepreneurship.

Emphasis was made on the changing role of the state depending on different phases of economic development and transition of a country. The chapter presented various public policy initiatives affecting entrepreneurship and SME development in emerging contexts. Based on the previous work outlined above, these concepts were interpreted as being connected in the following way (f.6):



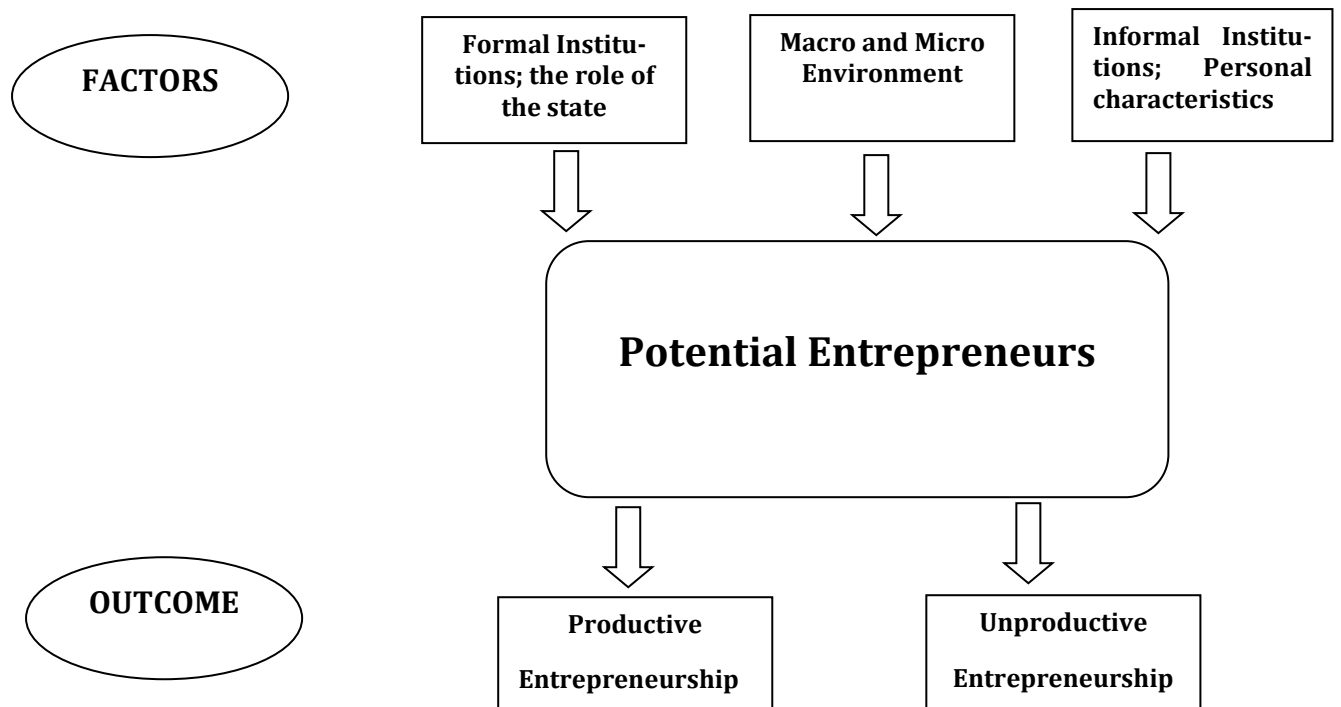


Figure 6 Theoretical View of this Study

The theoretical view of this study is that in the emerging environment, an interplay between formal institutions, such as the role of the state (direct and indirect support measures), the macro and microenvironment (economic and business environment, banking and financial institutions) and informal institutions (individual characteristics) of an entrepreneur that results in either a productive or unproductive entrepreneurial activity. Productive entrepreneurial activity fosters economic development, while unproductive entrepreneurial activity has either negative or no effect at all. The above given framework will be used to assess entrepreneurship and SME development in an advanced transition setting based on the example of Georgia.

### 3 Methodology

Research methods are important in any research; however, the entrepreneurship field has a characteristic that makes it even more important to be able to conduct quality research. Entrepreneurship is multidisciplinary (Carsrud & Brännback (eds.), 2014). Entrepreneurship researchers use both quantitative and qualitative approaches, however the use of large samples and quantitative research designs dominates (Molina-Azorin et al., 2012). Gartner and Birley (2002) and Hindle (2004) highlight the need for greater use of qualitative methods, since many important questions in entrepreneurship cannot be addressed only through quantitative approaches. A combination of both methods in entrepreneurship is not very common; however, given the fact that entrepreneurship is a multi-faceted area of research, the application of a narrow methodological approach will not make it possible to grasp the whole phenomenon (Molina-Azorin et al. 2012).

In order to answer the research questions at hand I used a mix of both qualitative and quantitative research methods. First, I conducted desk research to understand the overall situation in entrepreneurship and SME development in Georgia. Second, I analyzed survey data of a previously conducted longitudinal study with micro and small entrepreneurs. Lastly, I conducted in-depth interviews with policy-makers, entrepreneurs and international and local experts to shed light and gain insights into the topic. This chapter describes each research stage in detail, including data collection and analysis.

Mixed analysis involves the use of both quantitative and qualitative analytical techniques within the same framework. Mixed analyses involve the analysis of one or both data types, the analysis process can occur either concurrently or sequentially in two phases, or more than two phases (Johnson & Onwuegbuzie, 2004). In this research, the quantitative data was collected prior to the qualitative, the analysis is done sequentially. The analysis components might not interact until the data interpretation stage resulting in a basic parallel mixed analysis, although the research aims to use a more complex forms of parallel mixed analysis, in which interaction takes place in a limited way before the data interpretation phase. Furthermore, the questions formed for the qualitative data collection were based on the preliminary analysis of the quantitative data. The data was collected in such a way to provide more data about results gathered in the earlier phase of data collection. Therefore, quantitative methods to some point determined the questions of the qualitative study and filled in the missing gaps. The process is presented in figure 7 below.

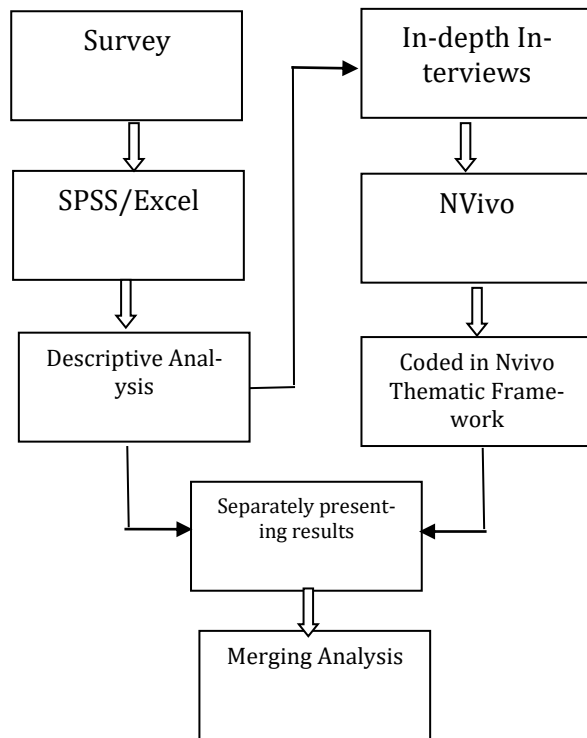


Figure 7 Sequential Design (adopted from Driscoll et al, 2007).

Johnson and Onwuegbuzie (2004) state that in mixed analyses, either the qualitative or quantitative analysis component might be given priority or approximately equal at the research conceptualization phase, or decision might emerge during the course of the study. For the purpose of this study, notwithstanding the fact that quantitative data collection method covered a wider pool of stakeholders, none of the data collection or analysis methods were prioritized, both were given equal importance.

The mixed analysis could represent “case-oriented, variable-oriented, and process/experience oriented analyses”. The mixed analysis is led by an effort to analyze data in such a way to at least result in one of the five types of generalizations: (1) external statistical generalizations; (2) internal statistical generalizations; (3) analytical generalizations; (4) case-to-case transfer; (5) naturalistic generalization (Onwuegbuzie & Combs, 2011). The study aims at yielding to analytical generalization, which does not aim to generalize statistically to the defined population that has been sampled, but rather tries to generalize to a theory being studied, that has a much wider applicability than the particular sample studied.

Each type of data was analyzed separately; afterwards the data correlation process took place, when the quantitative data was correlated with the qualitized data. At the following, data consolidation phase, both quantitative and qualitative data were combined to consolidate data around the preset theoretical framework. The next stage, data comparison involved comparing data received from the qualitative and quantita-

tive data sources. At the data integration, the final stage of data analysis, all the data collected through different techniques was coherently presented as one whole.

### **3.1 Desk Research**

The desk research comprised of conducting literature review, analysis of government documentation and studying international experience. The previous studies conducted on the topic were important for understanding the overall situation in Georgia and for investigating some general historical facts that were useful for the following research questions – identification of barriers, effectiveness of the government policy for shaping enabling business environment. Strategic documents of the Government and existing legislation assisted in identifying the existing programs directed towards supporting entrepreneurship and SME development in Georgia.

As part of the desk research, the country's key economic indicators and the role of the SMEs in the economic processes were reviewed. The previous studies conducted on the topic were important for understanding the overall situation in Georgia and for investigating some general historical facts useful for the research purpose. Another form of secondary research included investigation of the web-pages of the governmental and non-governmental organizations, bodies in charge of fostering entrepreneurial activities and improving business climate in the country. In this manner a knowledge base was formed regarding the activities undertaken in the direction of fostering entrepreneurship; the knowledge base was used for forming the questions for in-depth interviews. The literature review helped me explain and understand the research problem. It was even possible to answer some of the research questions based on the secondary data. At the same time, this type of research broadens horizons of the researchers and gives them a possibility to bring up scientific conclusions from the research. In case of reports, the international organizations and studies done by them, were compared and contrasted against the empirical findings of my own study. Furthermore, the literature study provided suggestions about a suitable research method for the research problem at hand, it also provided me with an instrument for interpreting and understanding the primary data.

### **3.2 Survey**

The database of the longitudinal research undertaken every 6 months, in total 4 times and interviewing 350 micro and small and 250 self-employed was used for this research. The survey results helped in identifying the major external and internal barriers in entrepreneurship and SME development in Georgia. The longitudinal study made it possible to monitor the dynamics and development of entrepreneurship over a period of time. This is especially interesting to observe the reaction and response of entrepreneurs towards different governmental initiatives during that period of time, thus assessing their effectiveness.

The database was created within the framework of "Emergence of Entrepreneurship in Georgia" project (joint initiative of the Economic Policy Research Center (EPRC) Georgia and Fribourg University, Switzerland). The first round of interviews was conducted

in July 2013, altogether 600 - self-employed (350), micro and small enterprises (250) were questioned, in three different regions of Georgia (Kakheti, Adjara and Tbilisi). The second round of interviews took place in March 2014, the third in October 2014, and the fourth in May 2015.

Longitudinal study made it possible to monitor the dynamics and development of entrepreneurship over a period of time. Thus, the study can be regarded as some form of an observational study when the observation is conducted on the same subject over a period of time. This type of a study tries to establish the sequences of a process: *“the term “longitudinal data” denotes repeated measurements of the same individuals over a time span long enough to encompass a detectable change in their developmental status”* (Rajulton, 2001, p.170).

A cohort study as a form of longitudinal observational study was made of three cohorts – self-employed, micro enterprises and small enterprises. Household statistics of the National Statistics Office of Georgia (Geostat) recognizes a self-employed as a person who *“worked 7 days prior to the interview process (for at least one hour) to generate income (salary, profit or other compensation in kind), or helped other household members for free.”* The Ministry of Finance of Georgia (according to the Tax Code of Georgia) defines micro-businesses as those with an annual turnover below GEL 30’000. Micro business status can be given to an individual pursuing economic activity alone. These individuals do not pay income tax and are exempt from having a cash register. An individual cannot be engaged in activities requiring special permits and licenses, as well as trade (except for those cases when producing/processing goods themselves). Small firms are, for Geostat, those that employ less than 20 persons with an annual turnover of less than GEL 500’000.

Even though the prospective cohort study looks at the groups in the coming years, questions on the past experiences were included to analyze the way they went from intention to action. The cohort was closed, meaning that the study followed the same groups of people from the start, without adding new participants.

The purpose of using this specific research method is to examine relationship between factors and outcome, thus the sample population does not need to be representative of the whole Georgian population or of each category’s population (Mann, 2003).

Advantages of longitudinal cohort studies:

- As mentioned, the study can be used to track processes unfolding over time. For the purpose of this study, usage of this method can track changes in behavior of entrepreneurs against consecutive changes taking place in the SME policy-making in the country; the latter makes this methodology rather useful. Furthermore, the environment in which potential and active entrepreneurs evolve in Georgia is rather uncertain and many reforms are planned or ongoing.
- They produce information on the same people from different rounds of observation making it possible to distinguish between sequences of events. Differ-

ence between cause and effect is clearer in longitudinal studies (Grimes and Schulz, 2002).

- It allows studying the effect of many different variables. It makes it possible to see outcome with the same or with a different environment (Mann, 2003).

That being said, it is important to identify some of the disadvantages of the chosen research method:

- The main one is the length of the study. The time span of observational methods needs to be *"long enough to encompass a detectable change in their development status"* (Rajulton, 2001, p. 171). One cannot say what the optimal length of research is. However, socio-economic change (and entrepreneurship is part of it) is quite complex and changes in behavior as part of its diffusion can take many years. Four waves of interviews might not prove a causal relationship between policy-making decisions and emergence and evolvement of entrepreneurship. But there is always a chance to reproduce the data and use it as a platform for further research and analysis.
- The rate of exit might be another disadvantage of the study. However, experience showed that the rate of exit was quite low, below 1 percent.
- A problem of bias exists because the sample population is not representative of the population at large.

The surveying process was conducted once in every 6 months during a 2 year period. The surveying method used was stratified random sampling. The survey was administered by the representatives of Geostat and was conducted face to face.

The questionnaire was separately tailored for self-employed and micro and small enterprise cohorts. The questionnaire mostly included close-ended questions with a mix of ranking, rating and multiple choice questions and was divided into several blocks: (a) general information and history; (b) future projects, expectations and intentions; (c) motivations for pursuing entrepreneurial activities; (e) legal framework (f) informal institutions; (g) non-material and material resources and opportunities. Detailed questionnaires for both cohorts are given in the appendices.

The survey method is used for the exploratory type of research; it will suggest possible reasons for relationships between variables and to produce models of these relationships (Saunders, et al. 2007, p. 138).

### **3.2.1 Survey Data Analysis**

Since this study relies on a descriptive analysis, no hypotheses were developed. Hypotheses for descriptive analyses poses a potential disadvantage to divert attention from other interesting facets in the data (Bryman & Cramer, 2011). The survey was analyzed twofold: firstly, I conducted a quantitative analysis of the fourth round of interview results. Since the aim of the research is of exploratory character and seeks to explore, describe and evaluate, "what" and "how" questions are used. Therefore, hy-

potheses were not used, since they are not required to answer descriptive and exploratory questions (Blaikie, 2003).

I analyzed the quantitative data using descriptive statistics. To understand, explain and predict patterns of entrepreneurial behavior and relationships between entrepreneurship and business environment, univariate and bivariate descriptive analysis was conducted. As Blaikie (2003) puts it univariate descriptive analysis is summarizing the characteristics, in terms of variable distribution; while bivariate descriptive analysis describes the form and strength of association between variables, as well as compares the same variables in different populations, and other variables in the same population. Namely, characteristics of entrepreneurs and the context they operate in was presented, as well as similarities and differences between the characteristics of self-employed and micro and small enterprises was observed by describing patterns or connections between them.

At the second stage, the change between the first and fourth rounds was analyzed based on event history analysis (EHA): *“EHA, also known as survival or duration analysis, is a set of techniques to address questions concerning whether and when events occur, the extent to which individuals vary in the timing of events occurrence, and how variation in the timing of event occurrence is related to specific individual and contextual factors”* (Barkaoui, 2014, p.90). An event consists of some type of qualitative change that happens over time. We can use events to describe changes in quantitative variables. Therefore, we can use longitudinal record of events to a sample of individuals (Allison, 2014). I have been observing the events taking place in Georgia that have affected the business environment and analyzed the change in perceptions among the respondents that took place in between the rounds based on the changing business and economics context.

### **3.3 In-depth Interviews**

Semi-structured face-to-face interviews were conducted with policy-makers (government sector), business associations, financial institutions, local and international experts (non-government sector), and entrepreneurs (private sector). In total 30 interviews were conducted, ten interviews with each group.

Using semi-structured interviews for the exploratory study is a reasonable choice. This type of interviews is used when a researcher is not only interested in “what” and “how”, but also in “why” questions (Saunders et al., 2007). Semi-structured interviews are especially useful in the following circumstances:

- When the order and logic of the questions needs to be varied (Saunders et al. 2007);
- When the questions are open-ended and complex in nature (Hussey & Hussey, 1997; Saunders et al., 2007);
- When the researcher wants the respondents to share as much information as possible regarding a phenomenon to develop the understanding of the interviewees’ “world” (Hussey & Hussey 1997; Cooper & Schindler, 2001).

Semi-structured interviews give the flexibility to ask interviewees to further explain their points, give examples, therefore this method gives the researcher an opportunity to get more in-depth and significant data, while probing on the meanings and ideas presented by interviewees. This might lead to some points that have not been considered beforehand, and that will further contribute to successfully fulfilling the research purpose.

Interviews with policymakers were used to identify the type of direct and indirect support measures that are used for supporting entrepreneurship in Georgia. Interviews with experts and representatives of sectoral associations were useful for answering the questions on the barriers to entrepreneurship and the how questions on the effectiveness of the government policy and the extent to which the government can influence existing external and internal barriers to entrepreneurship. Interviews with entrepreneurs shed light on the context in which SMEs operate and enabled practice-based conclusions and presenting concrete recommendations based on cross-case comparison. The sampling technique used for the in-depth interviews with the representatives of the government and experts was non-probability snowball sampling.

In case of entrepreneurs, targeted (purposeful) selection method was used, namely, entrepreneurs operating in different spheres, on different levels of development, successful as well as unsuccessful ones. This sampling technique uses the researcher's judgement to select cases that will make it possible to answer the research questions at hand. This sampling technique is particularly useful when choosing a particularly informative case (Neuman, 2000). In particular, the extreme case or deviant sampling were used to focus on unusual or special cases, so that the outcomes enabled me to learn the most and answer the research questions and meet research objectives in the most effective way (Saunders et al., 2007). The extreme cases were also relevant in understanding and explaining more typical cases as well. The names of the entrepreneurs are not revealed to ensure confidentiality. With this approach, entrepreneurs were more frank and open in their evaluations and discussion.

### **3.3.1 Data Collection and Analysis**

A major feature of the in-depth interview is the combination of structure and flexibility. An interview guide was used to set out the key topics and issues to be addressed during the interview. However, the structure was flexible and the interview was interactive. I was using a wide range of probes and techniques for achieving the depth of answers for exploration and explanation (Legard et al., 2003).

Qualitative interviews are mostly built up from three types of questions: (1) main questions – to guide the conversation and might change as the research progresses; (2) probing questions for bringing the clarity and evidence in responses; (3) follow-up questions to pursue implications of answers and elaborate on main concepts (Rubin et al. 1995).



For the purpose of the study, the interview guide was prepared divided into three main topics: (1) Barriers to Entrepreneurship and SME Development; (2) Drivers of Entrepreneurship and SMEs; (4) the Role of the Government. Each block in its turn was subdivided into narrower themes and assigned main, probing and follow-up questions. In total 13 main and 24 probing questions were prepared.

I conducted one pilot interview using the interview guide, which gave the possibility to readjust the guide by taking into account the loopholes discovered during the pilot interview. This included reducing time spent on introductory remarks, reformulating and reducing a number of questions, rethinking probing and follow-up questions.

The interview process went as follows: before the start of the interview, I presented myself and briefly described the purpose of the thesis and outline of the topics to be discussed. Permission to audio record the interview was taken from each respondent, respondents were informed that the gathered data was aggregated and analyzed without showing separate answers of the respondents; additionally I informed the respondents that additional consent would be taken from them in case of quoting. Each respondent briefly presented himself/herself and the work they did, as well as the relevant experience. After the end of the interview, respondents were asked to provide recommendations that they found important for improving entrepreneurship and SME climate in the country.

Once the interviews were audio recorded, they were fully transcribed. Due to the large volume of the interviews, data management was conducted through making sense of information by creating descriptive and explanatory nodes in the Nvivo software. The usage of computer software increased the effectiveness and efficiency of data learning. The computer increases rigor in the analysis and ensures a more complete set of data for interpretation. As Bazeley puts it *“the computer’s capacity for recording, sorting, matching, and linking can be harnessed by the researcher to assist in answering their research questions from the data, without losing access to the source data or context from which the data have come”* (Bazeley, 2007, p.2).

At the beginning, I familiarized myself with the data. The data was then indexed and coded by means of the preliminary theoretic framework; information was classified and organized according to key themes, concepts and emergent categories. The four main themes were subdivided by related subtopics. The main themes were: (1) External Environment; (2) Internal Environment; (3) The role of the Government; (4) EU’s Association Agreement.

The transcripts for each respondent were then “coded” in the matrix where every respondent was quoted for each subtopic. In this way data from each case was automatically synthesized within the appropriate parts of the thematic framework. Specific data contained references to more than one theme and was multi-coded. As a next step in the analysis process, the categories were refined and data was further classified to help me understand the main happenings and patterns in a single subtopic. Ultimately, the summary of each theme and subtopic was written up, which helped identify differences and similarities across the cases.

The cases were also divided into subgroups – state sector representatives, private sector (entrepreneurs) and expert circles. This division made it possible to identify possible opinion-sharing patterns across similar groups.

### **Nvivo Thematic Framework**

1. External Environment
  - 1.1 Access to Finance
  - 1.2 Business Environment
    - 1.2.1 Positive Aspect
  - 1.3 Business Formalization
  - 1.4 Legislation
    - 1.4.1 Dispute Settlement
    - 1.4.2 Insolvency
    - 1.4.3 Taxation
    - 1.4.4 Positive Aspects
  - 1.5 Public Private Dialogue
  - 1.6 Recommendations
2. EU's Association Agreement
  - 2.1 Positive Aspects
  - 2.2 Possible Challenges
  - 2.3 Recommendations
3. Internal Environment
  - 3.1 Drivers of Entrepreneurship
4. The role of the Government
  - 4.1 Decision Making
  - 4.2 Direct Support Measures
  - 4.3 Indirect Support Measures

## **3.4 Mixed Method Data Analysis**

### **3.5 Trustworthiness of the Thesis**

Mixed methods were chosen for complementarity and completeness purposes. An important obstacle in mixed method analysis is to assess the quality of inferences. A researcher needs to separately evaluate the findings derived from the quantitative data, from the qualitative data and assess the credibility of the conclusion made based on the two sets of inferences (Bergman, 2011).

Abbas Tashakkori and Charles Teddlie (1998) introduce an 'integrative framework,' which, addressing quality issues in mixed methods designs, is composed of two forms of quality: design quality and interpretive rigor. They introduce nine specific criteria for assessing the quality of mixed methods research. 1. Design suitability; 2. Design ade-

quacy; 3. Within design consistency; 4. Analytical accuracy; 5. Interpretive consistency; 6. Theoretical consistency; 7. Interpretive agreement; 8. Interpretive distinctiveness; 9. Integrative efficacy. There still is a need to develop a set of standards of quality in mixed methods research (Bergman, 2011). Therefore, when talking about the quality of the research I have assessed three components of mixed method studies: qualitative, quantitative and integrated.

In the analysis process, computer software was applied. *"It can be claimed that usage of computer for qualitative analysis can contribute to more rigorous analysis"* (Bazeley, 2007, p.3). We can imply that the same goes true for the quantitative analysis.

### **3.5.1 Reliability**

Reliability refers to the question whether the research process if repeated by another researcher would generate the same result. Thus, there is the aim to ensure transparency and replication of the research procedures. The following actions were taken to ensure reliability.

The surveys were administered by the Geostat employees and fully filed electronically. The interviews were fully transcribed and coded in Nvivo based on the predetermined framework. The secondary data was systematically collected throughout the research period and relevant data was added. When choosing the secondary data, only reliable and trustworthy sources were used, such as international organizations and other renowned research institutions and authors.

### **3.5.2 Validity**

Validity refers to presenting a phenomenon in a logical and credible way. Mixed method analysis made it possible to use data triangulation and comparison of one set of results with another, thus increasing and enhancing validity of the findings. Additionally, mixed method analysis ensures complementarity in terms of elaboration, illustration, enhancement and clarification of the results from one method with the findings from the other method (Greene et al., 1989).

### **3.5.3 Generalizability**

In the mixed analysis method, quantitative and qualitative data generalizability, or as also referred to external validity, is assessed separately. Generalizability refers to the notion of to what extent are the findings of the research representative enough to generalize for the population as a whole. Since, the quantitative data collected in the study were obtained through random sampling; one can assume that the results obtained are more likely to be generalizable. There is a direct link between sampling and the external/internal validity of the study (Henry, 1990). From the qualitative perspective of the study, *"generalizations to other individuals, settings, and times are not desired"* (Tashakkori & Teddlie, 1998, p. 65). However, Tashakkori and Teddlie, also argue that some degree of generalizability of conclusions is desirable. As Yin, (2003) puts it

in my research I aim to “*generalize a particular set of results to some broader theory rather than a population*” (Yin, 2003, p.37).

## 4 Results and Analysis

*This chapter outlines the results and analysis of this study and highlights how the findings from the study answer the research questions. The purpose of the research is to identify and analyze external and internal factors impeding and determining entrepreneurship and SME development in emerging economies based on the case of Georgia and scrutinize the role of the state in the process through studying importance of direct and indirect support measures provided by the state. The study aims to answer the following two questions and relevant sub questions:*

- *What are the external and internal barriers to entrepreneurship and SME development in Georgia?*
  - *What factors determine entrepreneurship and SME development in Georgia?*
- *What is the role of the state policy and what type of direct and indirect support measures are in place in Georgia for supporting entrepreneurship?*
  - *How important is the role of the state in promoting entrepreneurship and SME development in Georgia?*
  - *How does this role change over time?*

Even though it is argued that entrepreneurship and SME development is particularly important in the early stages of transition (Smallbone & Welter, 2001), the results show that it is, also important and challenging in the advanced stages of transition.

It is not a lack of entrepreneurship talents that are problematic in post socialist economies, but rather the fact that significant proportion of entrepreneurial ventures lack the characteristics of what Baumol calls “productive” entrepreneurship. Therefore, the aim of the thesis was to identify external and internal barriers to entrepreneurship to add value to the question of how can North’s “rules of the game” be transformed to convert unproductive entrepreneurial activities into productive forms that generate value-added to the wider economy.

### 4.1 Snapshot of Georgian Economy

According to the World Bank classification, Georgia is a lower middle income country in Eastern Europe. The country embarked on a road to transition to democratization and market liberalization after regaining independence in 1991. A larger scale reforms and transformation started after the rose revolution in 2003, resulting in the World Bank’s *Top Reformer in the Region* title.

By looking at the GDP composition, one can assume that Georgia lacks activities in high value added sectors which translates into a narrow export base. As of 2016, largest shares in the GDP were made up of manufacturing and trade sectors. Traditional sectors of agriculture and industries such as metal, are not enough to support Georgia’s integration in the highly competitive global economy. In the recent years, new sectors such as tourism and transportation started to emerge. Recent free trade agreements

with the EU and China are particularly important for boosting diversification of economic activities. The country mainly struggles to mobilize both domestic and foreign investments for supporting growth. Various studies concluded that job market also represents a challenge with high levels of unemployment and underemployment. Almost half of the country's labor force is engaged in the agricultural sector which produces only 8 percent of GDP. Many people are counted among the long-term unemployed. A number of international organizations and research conducted proves that skill mismatch on the job market is a major cause for persistently high levels of unemployment. Inequality is also high and further reforms are recommended by the international organizations to achieve inclusive growth. Table 4 gives a snapshot of key economic indicators for Georgia.

<b>Key Economic Indicators for Georgia</b>	
Population in thousands (2017)	3 718.2 (Urban 57%; Rural 43%)
Gross Domestic Product (GDP) at current prices, mil. USD (2016)	14332.8
GDP per capita (at current prices) USD (2016)	3852.5
Share of population under absolute Poverty line (2016)	21.3%
Unemployment rate (2016)	11.8%
Self-employed as percentage of employed (2016)	57%
FDI inflows as percent of GDP (2016)	9%
Remittance inflow as percent of GDP (2016)	8%

Table 4 Key Economic Indicators. Geostat.

## 4.2 The role of entrepreneurship in the Georgian Economy

As of 2017, the National Statistics Office of Georgia has changed the methodology for determining the size of an enterprise. In order to align the methodology with the European one, employment rates and annual turnover volume thresholds were increased.

<u>New Methodology</u>	<u>Old Methodology</u>
<u>Large Enterprise</u>	
Number of employed >249  And/or  Average annual turnover >60 million GEL	Number of employed >100  And/or  Average annual turnover > 1.5million GEL
<u>Medium Enterprise</u>	
Number of employed 50 to 250 persons  Average annual turnover 12 to 60 million GEL	Number of employed 20 to 100  Average annual turnover 0.5 million to 1.5 million
<u>Small Enterprise</u>	
Number of employed <50  Average annual turnover <12 million GEL	Number of employed <20  Average annual turnover <0.5 million GEL

Table 5 Definition for Enterprise Size (Geostat, 2017).

As it can be seen from table 5, the changes are quite drastic and are directed towards upscaling the definition of SMEs. As a result of this change, the number of large and medium sized enterprises fell, while the small sized enterprises increased by almost 11 percent (figure 8). According to the new methodology, SMEs represent the largest share of the Georgian enterprise sector: 99.7 percent of all registered firms (out of 90,403 enterprises) out of which 62.2 are individual enterprises. SMEs represent 64 percent of business sector employment, 60 percent of business sector value added.

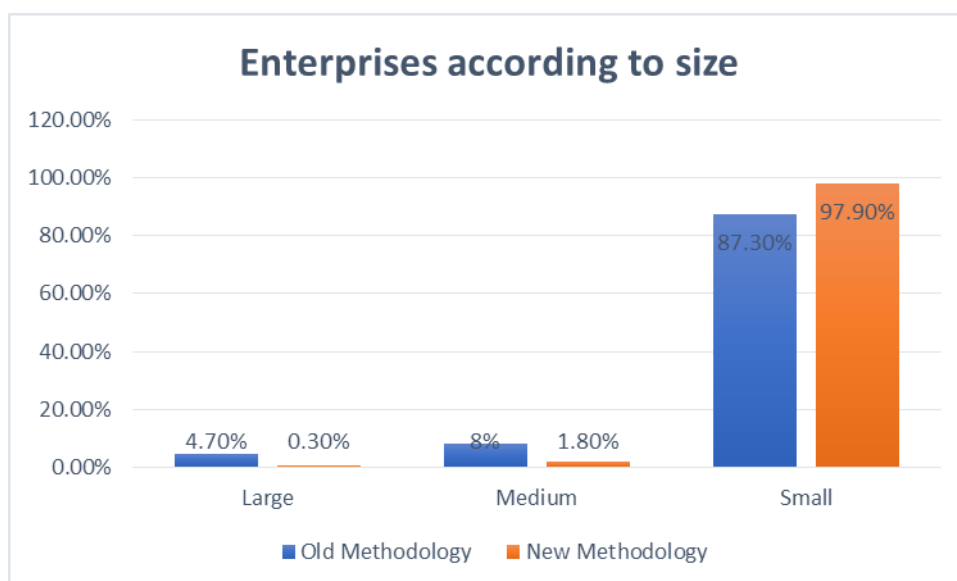


Figure 8 Share of SMEs according to old and new calculation methodologies. Source: Geostat, 2017.

It is noteworthy that for taxation purposes the revenue service of Georgia also distinguishes between micro and small businesses. In order to become exempt from income tax and receive a status of a micro business, one has to pursue business activities independently and have a total annual income of up to 30 thousand GEL. For receiving a status of a small business, an individual's total annual income must not exceed 100 thousand GEL; small business is taxed with 5-3 percent income tax<sup>3</sup>, instead of 20. One does not have to be registered with the national registry office in order to receive these preferable taxation regime statuses. The Ministry introduced this initiative in 2012. As of 2015, 40,821 entities are small business status holders, while 37,137 hold the micro business status. The number of beneficiaries has doubled since the initiation of these preferential regimes.

SMEs contributions to the economy have been on the rise, as of 2017 they contribute to 58 percent of private sector value added, and 56 percent of total production value, however only 17 percent of total business sector turnover (figure 9).

<sup>3</sup> As of 2018, modifications were made to the tax code that further decreased turnover taxes for small businesses to 1 percent.



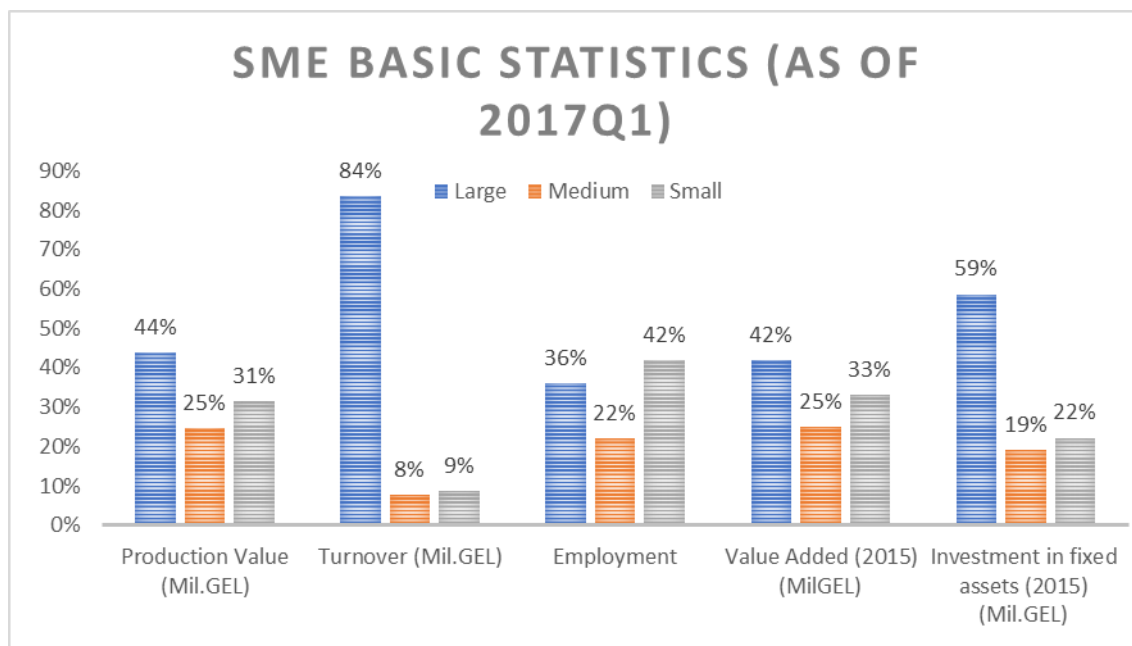


Figure 9 SME Basic Statistics. National Statistics Office of Georgia [www.geostat.ge](http://www.geostat.ge)

Regional disparity is an important drawback: 71 percent (Geostat, 2016) of all business sector turnover is registered in Tbilisi, and 61 percent of all business sector employed are located in Tbilisi. These statistics indicate a severe underdevelopment of the regions. Likewise, in the regions, the largest business sector turnover is in the regional centers, while the rural areas are particularly stagnating.

A large share of Georgia's employed population is self-employed. Out of employed, 57 percent are self-employed and 42 percent hired. Over the last decade, self-employment has remained high, even reaching 65 percent of total employed. However, self-employment skews largely to older populations and to the rural sector, as of 2016, 63 percent of self-employed reside in rural areas and 56 percent of self-employed are ages 50 and above. This is due to the fact that self-employment are mainly engaged in subsistence farming or unregistered/informal activities. The methodology of employment statistics states that self-employment can be referred to own-account workers, including producers of goods for own final use, performing some work for at least one hour during the reference period for profit or family gain, in cash or in kind. The fact that employment is a major issue in Georgia is proven by the public opinion polls that have not changed much over the course of the past years. On the question: do you consider yourself employed, a high 63 percent of surveyed answers NO (NDI, 2017).

Over the course of the past ten years, the number of registered limited liability companies and performance of SMEs has been on the rise, both in terms of the overall turnover, as well as the output produced (figures 10 and 11).

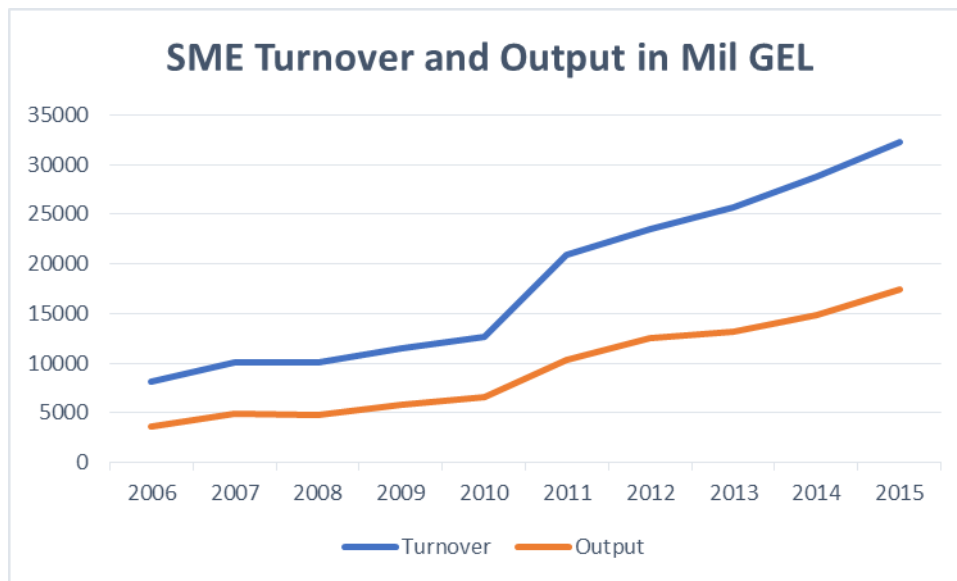


Figure 10 SME Turnover and Output in Mil GEL (2006-2015) Source: Geostat

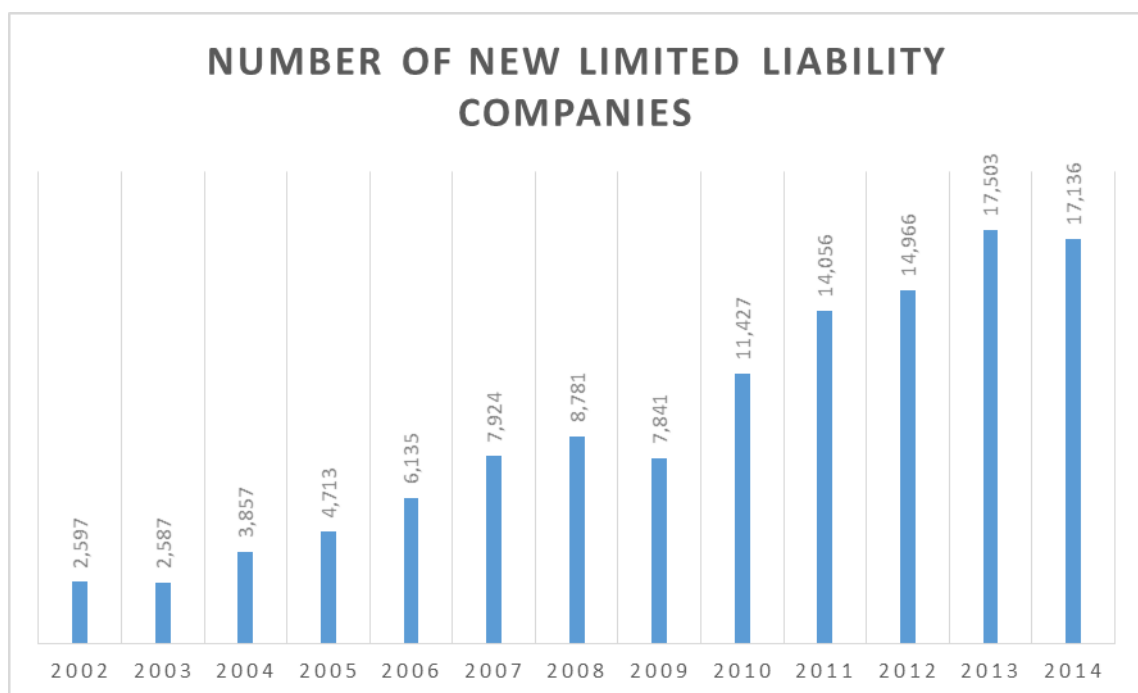


Figure 11 Number of New limited Liability Companies (World Bank, Entrepreneurship Database)

When it comes to new firm entry, Georgia stands out with a mostly increasing trend over time since the 2000s. The country also has a high entry density as compared to the region, however firm ownership levels still remain low. The entry density stands at 5.65 as of 2014, which refers to the number of newly registered corporations per 1 thousand working age people (World Bank, 2013). A positive business environment for SMEs clearly is not enough for rapid business growth and fostering entrepreneurship.

Distribution according to activities of registered 1,585 Medium and 95,670 Small enterprises is presented in Table 6.

<b>SME Activities 2017</b>		
	Medium	Small
Agriculture	1,77%	1,28%
Fishery	0,00%	0,10%
Mining	0,76%	0,63%
Manufacturing	15,39%	9,61%
Electricity, gas, water production and distribution	1,26%	0,09%
Construction	14,13%	6,32%
Trade; Repair works	<b>23,15%</b>	<b>47,28%</b>
Hotels and Restaurants	5,24%	5,28%
Transport and Communication	6,12%	6,78%
Real Estate	9,46%	11,19%
Education	5,55%	1,17%
Health and Social care	11,55%	1,83%
Communal, social assistance	4,98%	2,40%
Unknown	0,57%	6,04%

Table 6 SME Activities 2017. Source: National Statistics Office of Georgia.

A major challenge in economic development of Georgia lays in ensuring long-term economic growth through private sector development. The private sector as seen in the chart above is dominated by retail trade and household repair works that does not generate opportunities for increased value added to the economy. The sectoral distribution of SMEs has not changed over the course of the past years. There is a clear lack of productivity and diversification of the sectors. Therefore, one can say that there is lack of high growth entrepreneurship in the country, notwithstanding the high levels of self-employment, which can be referred to entrepreneurs by “default”.

### 4.3 The Institutional Environment for Entrepreneurship and SME Development in Georgia

Starting from the early 2000s, the GoG has implemented a number of significant reforms directed towards reducing state intervention, simplifying business regulation and making Georgia an attractive place for investing and doing business. In fact, the country became the region’s best performer according to the World Bank. According to the latest Doing Business Report, Georgia ranks 8<sup>th</sup> in starting up a business indicator, 3<sup>rd</sup> in property registration, with an overall rank of 16<sup>th</sup> out of 190 economies (table 7). It takes only three procedures and three days to start a business, and no minimum capital is required.

Significant efforts were made in lowering corruption, Georgia made it to the lowest levels of the 19 countries of Eastern Europe and Central Asia. The country currently ranks 44<sup>th</sup> in the Corruption Perception Index (Transparency International, 2016). The country ranks as “mostly free” according to the Heritage Foundation of Economic freedom. With an overall score of 76, Georgia ranks above both regional and world averages. The country scores relatively low on property rights (55.1), judicial effectiveness (66.5), government integrity (65) and financial freedom (60). The report states that protection of property rights has improved, and the government has made enforcement of contracts easier. It is highlighted that little progress has been made in the direction of judicial reforms, and that the government does not fully respect independence of judiciary. On the regulatory environment side, the overall procedures are efficient. Hiring and firing practices are flexible and not burdensome, however the labor market lacks dynamisms and unemployment rates remain high.

According to EBRD’s Judicial Decisions Assessment, 2011 the quality of court judgments in commercial law matters in Georgia are among the best in the former Soviet space. Factors that adversely affect court decisions are gaps in commercial areas and judges’ high caseloads. However, the report states that ensuring full judicial independence takes time.










<b><u>Topics</u></b>	<b><u>DB2017 Rank</u></b>	<b><u>DB2016 Rank</u></b>
Overall	16 	23
Starting a Business	8 	10
Dealing with construction permits	8 	9
Getting Electricity	39 	65
Registering Property	3	3
Getting Credit	7	7
Protecting Minority Investors	7 	22
Paying Taxes	22 	35
Trading Across Borders	54 	62
Enforcing Contracts	16 	17
Resolving Insolvency	106 	101

Table 7 Doing Business Rankings. World Bank 2016.

According to the Global Competitiveness Report (2016-2017), Georgia ranks 59<sup>th</sup> out of 138 countries and lags behind in such indicators as innovation (116<sup>th</sup>) and business

sophistication (102<sup>nd</sup>), education and skills (49<sup>th</sup>), skills of current workforce 37<sup>th</sup> place, skills of future workforce 63<sup>rd</sup>, business dynamism 57<sup>th</sup>, innovation capacity 100<sup>th</sup>. A detailed country profile is presented below; it shows major loopholes in the directions that are in many cases determinants of entrepreneurship and SME development in a country. Critical factors for improvement are highlighted in red (table 8). According to the report, Georgia is in the second stage of development as an efficiency driven economy, however according to the GDP per capita, it is in a transition stage as moving from the second to the third development stage.

<b><u>1<sup>st</sup> Pillar Institutions</u></b> Property Rights 43 Favoritism in decisions of government officials 45 Wastefulness of government spending 69 Burden of Government regulation 8 Efficiency of legal framework in settling disputes 53 Transparency of government policymaking 43 Ethical behavior of firms 68	<b><u>43</u></b>
<b><u>2<sup>nd</sup> Pillar Infrastructure</u></b> Quality of overall infrastructure 75	<b><u>65</u></b>
<b><u>3<sup>rd</sup> Pillar: Macroeconomic Environment</u></b> Inflation annual % change 80	<b><u>40</u></b>
<b><u>5<sup>th</sup> Pillar: Higher education and training</u></b> Quality of education system 95 Quality of math and science education 100 Quality of management schools 97 Local availability of specialized training services 125	<b><u>89</u></b>
<b><u>6<sup>th</sup> Pillar: Good Market Efficiency</u></b> Intensity of local competition 78 Extent of market dominance 76 Effectiveness of anti-monopoly policy 114	<b><u>46</u></b>
<b><u>7<sup>th</sup> Pillar: Labor Market Efficiency</u></b>	<b><u>43</u></b>
<b><u>8<sup>th</sup> Pillar: Financial Market Development</u></b> Financial services meeting business needs 79 Affordability of financial services 82 Financing through local equity market 130 Ease of access to loans 52 Venture capital availability 94 Soundness of Banks 54	<b><u>58</u></b>
<b><u>9<sup>th</sup> Pillar: Technological readiness</u></b> Availability of latest technologies 111 Firm-level technology absorption 111 FDI and technology transfer 97	<b><u>65</u></b>
<b><u>10<sup>th</sup> Pillar: Market size</u></b> Domestic market size index 99 Foreign market size index 104	<b><u>101</u></b>

<b><u>11<sup>th</sup> Pillar: Business Sophistication</u></b> Local supplier quantity 132 Local supplier quality 116 State of cluster development 122	<b><u>102</u></b>
<b><u>12<sup>th</sup> Pillar: Innovation</u></b> Capacity for innovation 105 Quality of scientific research institutions 118 Company spending on R&D 123 University-industry collaboration in R&D 119 Availability of scientists and engineers 115	<b><u>116</u></b>

Table 8 Global Competitiveness Report (2016-2017) Major Findings

In 2016, the OECD provided a list of recommendations to the GoG while listing challenges for the development of SMEs. According to the report, notwithstanding the progress achieved, Georgian SMEs still face a number of institutional barriers and market failures that represent obstacles to business development in the country. OECD conducted the analysis together with the public-private working group. The five major challenges identified were the following: 1) incomplete institutional framework for SME policy; 2) limited access to finance for SMEs; 3) skills mismatch in the labor market and low job creation; 4) limited export activity by Georgian SMEs; 5) limited innovation activities and R&D expenditure. Major findings of OECD are presented below in table 9.

<b><u>Incomplete Institutional Framework for SME policy</u></b> <ul style="list-style-type: none"> <li>✓ Lack of SME participation in public-private consultations;</li> <li>✓ Ad hoc coordination of SME policy;</li> <li>✓ Lack of Regulatory Impact Assessment (RIA) mechanisms for business-related legislation;</li> <li>✓ Weak bankruptcy and insolvency procedures;</li> <li>✓ Limited statistics, hinders evaluation of SME support policies;</li> <li>✓ No uniform definition of SMEs.</li> </ul>	<b><u>Limited access to finance for SMEs</u></b> <ul style="list-style-type: none"> <li>✓ High collateral requirements (up to 220% of the loan value); high interest rate (around 16%);</li> <li>✓ Low financial literacy among entrepreneurs;</li> <li>✓ Regional disparity, limited capacity to assess SME risks outside the capital;</li> <li>✓ Limited availability of non-banking sources of finance;</li> <li>✓ No public grants to commercial entities.</li> </ul>
<b><u>Skills mismatch in the labor market and low job creation</u></b> <ul style="list-style-type: none"> <li>✓ Lack of analysis of skills demand for designing educational policies;</li> <li>✓ Shortcomings in vocational education and training;</li> <li>✓ Low uptake of lifelong-learning, lack of trust;</li> <li>✓ Lack of entrepreneurial culture.</li> </ul>	<b><u>Limited export activity by Georgian SMEs</u></b> <ul style="list-style-type: none"> <li>✓ Limited information on foreign markets;</li> <li>✓ Limited availability of financial and insurance products;</li> <li>✓ Lack of structured support to help SMEs integrate into global value chains.</li> </ul>
<b><u>Limited innovation activities and R&amp;D expenditure</u></b> <ul style="list-style-type: none"> <li>✓ Limited collaboration between industry and academia;</li> <li>✓ Lack of financial instruments to facilitate innovation in SMEs;</li> </ul>	

Table 9 Summary of Barriers to SME Development in Georgia. OECD 2016.

Efforts were made in the direction of formalizing economic transactions and including the self-employed population into the formal economy. The major step taken towards this direction was the introduction of special tax regimes for micro and small enterprises and exempting them from income taxes in 2012. Another initiative was connected with the introduction of a tax receipts lottery. The incentive for a consumer was that at no extra cost, just by asking for a receipt one could win a prize. The latter was designed to increase the issuance of receipts in business to consumer transactions. This way, transactions were more likely to become part of the official economy and collection of the value added tax was guaranteed. For the tax authority, the extra revenue from VAT collection outweighed the costs of paying for prizes. The lottery was introduced in 2012 in line with the GPRS based cash registers throughout the country (Fookien et al., 2014). The initiative lasted only for some months and was dropped in line with the change in government through 2012 parliamentary elections.

Steps were taken for ensuring certainty and predictability of taxation prognosis. In 2010, the Parliament of Georgia passed Article 94 of the Georgian Constitution, which requires a referendum for increasing taxes (excluding excise taxes) or introducing new

tax laws. As a result, the organic law, the Economic Liberty Act, was created. This legislative act serves as a guarantee that the government will not raise taxes without the consent of the population. The law additionally sets certain limits to the size of the government as well, such as a debt to GDP ratio below 60 percent and government to GDP expenditures ratio below 30 percent, as well as a budget deficit to GDP ratio of maximum 3 percent. On June 5<sup>th</sup>, 2017 in line with the constitutional amendments, the Chairman of the Georgian Parliament Irakli Kobakhidze announced that discussions would be held on the possible abolishment of the Economic Liberty Act in the reformed constitution. The initiative was followed by a negative outcry from the opposition parties and non-governmental organizations. According to the reformed constitution, the Economic Liberty Act will be valid for the next 12 years and might be abolished after that period.

It can be stated that the progress made towards improving the institutional environment was impressive. However, it did not translate equally into private sector development and stronger economic indicators, such as decrease in unemployment. There still are a number of bottlenecks in terms of legislation, institutional framework and overall economic policy formation that hamper private sector development in Georgia.

#### **4.4 Towards a high-value added entrepreneurship and SME sector in Georgia**

The evidence presented in the research shows the importance and development paths of entrepreneurship and SME sector emergence in Georgia. Reforms undertaken during the course of the past years and steps taken towards EU integration, involved significant changes for entrepreneurs and SMEs operating in Georgia. These changes brought about a simplification and improvement of the business environment and presented opportunities by opening of new markets and new possibilities. However, further reforms and steps need to be taken towards achieving an increased capacity of Georgian entrepreneurs and SMEs to become sources of innovation, job creation and sustainable economic development.

Notwithstanding the fact that, in parallel to the reform process, the number and turnover of SMEs in Georgia have substantially increased, it is still arguable whether these firms play an important economic role as agents of change through entrepreneurial and innovative activities (Acs & Audretsch, 1990; Audretsch, 1995), or if these small firms are important sources of new job creation (Acs, 1992 in Wennekers & Thurik 1999:28), thus contributing to reducing unemployment levels (Audretsch & Thurik, 2004). One needs to acknowledge the achievements in the direction of private sector development so far. However, the aim of this research is to identify further constraining factors and limitations for SMEs and entrepreneurship development in Georgia.

From this study, I can conclude that entrepreneurs in Georgia operate in both formal and informal economies. Apart from the officially registered private sector representatives, there are slightly above one million self-employed entities in Georgia, which in most of the cases run de-facto micro enterprises and could be even referred to as po-



tential entrepreneurs or “reservoir” for entrepreneurship (Schoar, 2010), since “*informal economic activity is inherently entrepreneurial*” (Amoros et al., 2016, p.10) . However, one needs to be careful not to misinterpret the definition, since most of them are “subsistence entrepreneurs” that merely seek alternative employment opportunities in the environment of high unemployment and economic distress. Therefore, these type of entrepreneurial activities are most frequently unproductive for wider economic growth. Smallbone and Welter (2009) state that SMEs have a distinctive role of absorbing surplus labor in transition economies and not in creating economic welfare and value-added.

The size of the informal sector has been on the decrease in Georgia. This can be attributed to two major factors: institutional reforms and overall modernization and development processes of the economy that contribute to decreasing the size of the informal economy, as stipulated by “modernization” and “neo-liberal” theses (Williams, 2016).

Scase (2003) asserts that even though small businesses are numerically significant, they are concentrated in such sectors as services and trade, thus they are not capable of meaningfully contributing to economic development. The composition of SMEs in Georgia, as well as characteristics of the self-employed, show high concentration of their activities in what Baumol (1993) calls “unproductive” entrepreneurship. These “unproductivity” characteristics are low income generation, low growth potential, low innovation and value added, and low job creation potential.

Petty traders, craftsmen, shuttle merchants and owners of illegal taxis are an important part of contemporary entrepreneurial activity in former soviet republics (Smallbone and Welter, 2009). Following this trend, about 71 percent of the SMEs in Georgia are concentrated in the trade and repair works sector, while 71 percent of the surveyed self-employed are engaged in the agricultural sector, which, if compared to the amount of labor resources, contributes insignificantly to the country’s GDP. Profits and value-added generated through these activities are negligible. Low sophistication of business activities is demonstrated through some findings: according to the survey results, more than 70 percent describe their activity as stagnating or decreasing. Absolute majority is not able to save any money. Up to 35 percent of the surveyed have an interest in growing their business, however, 26 percent refuse to do so if this is also associated with risk-taking. For almost 60 percent of the respondents their business activity has not grown since its foundation.

The survey findings demonstrate that characteristics of Georgian self-employed and micro business representatives can be referred to what Scase (2003) calls “proprietors” rather than entrepreneurs. These characteristics are a lack of long-term orientation, with an emphasis on consumption rather than reinvestment. However, Smallbone and Welter (2009) argue that this type of behavior is also found in mature market economies, where only few small firms grow due to the stated reasons. In other words, only a few business owners can be clearly labeled as pure Schumpeterian entrepreneurs or pure shopkeepers. However, what Scase calls proprietorship is a more common condition in developing economies. The reason might be peculiarities of the economic structure and policymaking practices. A lack of long-term orientation is

mainly due to unpredictable and unstable socio-economic environments, while the low reinvestment rate is due to low levels of disposable income among entrepreneurs and SME representatives.

The Schumpeterian entrepreneur brings innovation into an economy. When it comes to SMEs in a transition context, they are innovative in local terms, such as introduction of products and services on a domestic market, however they are not innovative in an international sense and on an international scale (Smallbone & Welter, 2009). The surveyed respondents are skeptical about the introduction of new products and services, and they have limited capacity to innovate and develop. Likewise, international studies assert that notwithstanding a strong entrepreneurial spirit, Georgian entrepreneurs are less likely to innovate (World Bank, 2015b). A number of international ratings show a similar tendency, Georgia ranks relatively low in such indicators as innovation capacity, business sophistication, and introduction of new products and services.

The innovation capacity of SMEs in transition markets is heavily dependent on such developments as institutional support and nature of the market, poor protection of intellectual property rights, could act as a disincentive to innovation as well as to certain types of foreign investments (Smallbone & Welter, 2009). This study shows that progress has been achieved in the direction of creating innovation infrastructure and institutional base, such as establishment of the Techno Park and provision of funds for innovative startups. However, such factors as actual capacity to innovate, financial instruments for facilitating innovative activities, as well as understanding the need and importance of research and development is underestimated on both company as well as university and even state levels. The reason partially lays in soviet legacy and obsolete educational system that does not foster creative thinking, critical and analytic reasoning, and individual self-realization. A study on the economic return on education and labor market (Amashukeli et al., 2017) came up with interesting findings on the relation of economic growth and education of the labor market participants. The study concluded that the low-productive labor market in Georgia is caused by the misbalance between the types of credentials required by the contemporary labor market and the professions young people pursue at higher education institutions. The two most important skills of labor productivity were identified as English language proficiency and computer literacy. The study concluded that these two skills develop at very slow pace in Georgia. These problems were identified as a major cause for underdevelopment of innovative industries in the country.

This brings this study to the following question: is the creation of the so-called framework conditions sufficient for entrepreneurship development in a country? *“it is arguable whether achievement of these framework conditions represents a sufficient condition for entrepreneurship to become established, because of the influence of the years under central planning on the attitudes towards entrepreneurship and the wider culture of enterprise in the population”* (Smallbone & Welter, 2009, p. 23). This statement refers to the difficulty of changing what North calls informal institutions (North, 1990). Both formal and informal institutions need to be reformed to foster promotion of productive entrepreneurship (Smallbone & Welter, 2009).

The mindset, behavior, norms and values of the individuals, which are an important determinants of how entrepreneurial activities unfold, take time to change and readjust. At the same time, inadequate performance of formal institutions lead to institutional distrust given the fact that informal institutions change slowly (Aidis, 2003b). Georgia underwent that path of development, which involved deficiencies in the functioning of formal institutions, until the country embarked on the reform path and overcame problems of the corrupt state. One example of institutional distrust is the introduction of tax exemptions for micro enterprises, notwithstanding these favorable conditions for formalizing business activities, not many self-employed actually used it. Therefore, due to this institutional inertia, cognitive institutions in post socialist economies are less supportive of entrepreneurship than in matured market economies (Kshetri, 2009).

The study results revealed that apart from the factors that are at the discretion of the government, there are a number of other external factors affecting entrepreneurship and SME development that are not solely dependent on governmental policy. Georgia, being a small open, import dependent economy is heavily reliant on the global market developments, changes in prices, levels of demand etc. These factors affect the predictability of the macroeconomic context through such channels as high inflation rates, national currency fluctuation, or demand and supply factors. Such factors of predictability often discourages entrepreneurs to invest in projects that aim at long-term returns and they rather concentrate on the activities that offer rapid returns, for example trade. In practice, the ability of the government to independently create a stable macro-economic environment is rather limited and is dependent on other external factors. However, to exploit the potential of SMEs in the transition context, “laissez-faire” response from the side of the government is not enough (Smallbone & Welter, 2009).

The potential of SMEs in Georgia is yet to be exploited in the following directions: diversification of the economic structure, identification and emergence of new sectors and new markets, internationalization and integration into the global economy, establishing SMEs as sources of innovation, strengthening research and development components, contributing to economic development through linkages with other businesses, through inter-firm level cooperation, acting as suppliers to larger firms, and increased collaboration with academia. The country’s western orientation and EU aspirations will play a positive role in the development process. The process of EU accession also played an important role in the reforming process of CEEC, due to the requirements and conditions presented by the EU, to the aspirant countries (Smallbone & Welter, 2010). The latter is expected to be the case in Georgian reality as well, that is on the path towards EU integration and is currently implementing the reforms in line with the EU’s Association Agreement and Deep and Comprehensive Free Trade Area (DCFTA) agreement.

We can argue that economic effects of entrepreneurship vary at different stages of transition. As Acs et al. (2008) put it, it is expected that entrepreneurial activities contribute to economic growth and development on the final stage of transition, which is Porter’s innovation driven stage. Alternatively, if we look at the EBRD transition stages, the first type of reforms are easier to implement, since they are concerned with reduc-

tion of the state activity, while the second stage of reforms are harder to achieve, since they involve creation of market institutions. Currently, Georgia is in its final stage of development moving from efficiency driven to innovation driven stage. This means that entrepreneurial activities are yet to be fully exploited to serve wider economic goals.

When analyzing the transition context, one needs to differentiate between emerging economies and emerging economies that are former socialist states. The latter have a worse legacy in all contexts. It is important to understand that business activity in those countries was illegal, therefore both formal and informal institutions are immature, while the importance of entrepreneurship has been acknowledged only recently. Both formal and informal institutions need to be reformed to foster the promotion of productive entrepreneurship. As North (1997) notes, the reason of relative success of policy measures in eastern European countries, as compared to the countries of FSU is that the latter did not have a heritage of market economy and democracy, therefore informal rules could not provide grounds for the establishment of new formal rules.

## **4.5 Formal, Institutional and Informal Constraints to Entrepreneurship Development in Georgia**

The study findings vary according to business size. In the case of self-employed and micro business owners, internal constraints related to business owner characteristics prevail, while in case of small and medium-sized enterprises that have larger growth and development potential, external barriers represent a major constraint. The study revealed that the self-employed and micro group is similar in characteristics and constraints they face, while small and medium size enterprise representatives tend to also perceive similar constraints and have alike characteristics.

### **4.5.1 External Environment**

The surveyed respondents highlighted the importance of the external environment, 40 percent of them stated that the outcome and success of their business activities was dependent on other factors rather than themselves. Constraints were identified in terms of formal rules including political, judicial and economic rules and contracts (North, 1990).

Most of the interviewed experts and entrepreneurs also started their evaluation of the external environment by concentrating on the macroeconomic environment in Georgia. They stated that external environment is specifically important when talking about the SME sector. Since, SMEs are more vulnerable towards the drastic macroeconomic changes; larger companies find it easier to insure such risks. When it comes to currency exchange risk and inflation, SMEs are not in equal conditions as larger counterparts<sup>4</sup>.

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<sup>4</sup> Expert 1, (personal communication on June 28<sup>th</sup>, 2017).

The interviewed experts and entrepreneurs stressed the small size of the market and low demand, as well as the overall economic stagnation and access to capital as a major challenge. Economic stance was named as a constraint for business growth and development. There is stagnation and even decrease in demand, economic growth is mainly stimulated through fiscal and monetary channels<sup>5</sup>. Market size, demand and purchasing power of the population are among the most frequently cited problems by private sector representatives<sup>6</sup>. Demand is what drives the economy and private sector forward. Services and products offered by SMEs are mainly targeting the middle-income population, and this segment is very small in Georgia<sup>7</sup>. When the economy is growing, every sector is better off; there are more tourist inflows, more construction projects, etc.<sup>8</sup>.

In these conditions, experts see the role of the foreign direct investments (FDI). FDI makes countries like Georgia richer<sup>9</sup>. A number of respondents agree that domestic savings and investment rates are not enough for boosting economic performance. Lack of investments both domestic and foreign can be regarded as determinants of low access to capital and finance. FDI represents an important source of capital, especially in countries where financial constraints are a barrier to private sector development. In the conditions where domestic market size is limited, inflowing investments can increase market opportunities for domestic SMEs. FDI can also be an important source of knowledge and technology transfer. In case of Georgia, one can state that domestic SMEs cannot take full advantage of the inward investment due to their poor quality standards. In such a case, the role of policy is important in ensuring that potential spillovers for domestic SMEs are fully exploited (Smallbone & Welter, 2009).

In line with the reforms undertaken by the government of Georgia over the course of the past years, some of the expert respondents and all of the interviewed government representatives believe that the overall business environment is gradually improving. The government has recently adopted the SME strategy 2016-2020, which aims to further overcome the currently existing loopholes in many different directions. Firstly, it is the tax legislation and insolvency law. The second direction is entrepreneurial education and knowledge dissemination. The third one is increasing the overall entrepreneurial spirit. The Strategy was a prerequisite for receiving a wider spectrum of assistance from the EU<sup>10</sup>. OECD and EU were engaged in drafting the strategy. It complies with the European Small Business Act. Activities envisaged for 2016 were all implemented in a timely manner. In fact, 70 percent of the two-year timeline is already accomplished<sup>11</sup>.

Several expert and entrepreneur respondents mention the problem of a predictable business environment as an issue. During the previous government administration, the

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<sup>5</sup> Ibid.

<sup>6</sup> Expert 2, (Personal Communication on May 25<sup>th</sup>, 2017).

<sup>7</sup> Entrepreneur K.V. (Personal Communication on May 15<sup>th</sup>, 2017). Financial Sector

<sup>8</sup> Entrepreneur G.K (Personal Communication on July 27<sup>th</sup>, 2017). Various Sectors

<sup>9</sup> Expert 10, (Personal Communication on June 28<sup>th</sup>, 2017).

<sup>10</sup> Policymaker 1 (Personal Communication on August 20<sup>th</sup>, 2017).

<sup>11</sup> Policymaker 2 (Personal Communication on April 19<sup>th</sup>, 2017).

legislative environment was more stable and predictable. As one of the entrepreneurs puts it, the policy was towards simplification, however there were some other shortcomings, such as governmental pressure on businesses. There was a risk of expropriation for large businesses. However, currently, business might go bankrupt through legal ways, with the radical changes that took place in regulatory requirements<sup>12</sup>. The deputy head of one of the largest business associations in Georgia speaks on behalf of the 65 members they interviewed and states that the companies highlight that the business environment has changed for the better and they have positive outlooks for the future. When asked about the predictability of governmental decisions, the same expert stated that making all type of governmental decisions known well in advance, might cause adverse effects. For example, stating that excise tax is expected to increase in the near future, will cause excess import of excise products and might create a pressure on the national currency. Therefore, not all type of legislative or taxation changes can be known in advance due to the risk that business response to this expectations might not be favorable for overall macroeconomic environment. Frequent changes to existing laws and regulations that are characteristics to the transition period, requires constant readjustment of knowledge by small business managers (Smallbone & Welter, 2009). The lack of predictability and stability of economic and political environment was named as a major constraint for doing business in Georgia.

As discussed in Chapter 2 Constraints and challenges faced by entrepreneurs and business owners in developing countries change according to the phase of transition (Aidis & Sauka, 2005). This study shows that the pattern of constraints for business development reported by entrepreneurs shifts in emphasis they had before the reform period, when institutional constraints predominated. Currently, micro and small enterprises do not name state administration, along with tax administration, licenses and permits, and labor code, as obstacles for their activities. The majority of the self-employed are not registered formally and do not have any relations with state administration, hence they do not see institutions as constraining factors for their activities. Three formal constraints: taxes, policy instability and legal regulations have been found in previous research to represent a barrier to business development through all stages of transition (Aidis & Sauka, 2005). While some of the constraints such as tax rates, protection of property rights, access to finance, decision-making practices of the government are still present, this study shows that issues of competition and markets have grown in importance. This reflects the progress that has been achieved in the process towards transformation to the market oriented economy.

Georgia is currently in the final stage of transition, or the third stage when the legal framework is complete and marginal changes are taking place for refining the institutions that are in place (Van de Mortel, 2002). This study results partially revealed what was asserted by Aidis and Suka (2005), that in the final stages of transition, SME owners are more concerned with human resources, skills and development, internal business capabilities and business growth. The surveyed respondents named a number of "size-related" disadvantages, almost a quarter of them believe that competition

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<sup>12</sup> Entrepreneur K.V. (Personal Communication on May 15<sup>th</sup>, 2017). Financial Sector

grounds are not fair and favor large businesses over small ones. This study also reveals unequal opportunities for SMEs when it comes to public procurement procedures.

The above-mentioned factors contribute to a negative attitude from the side of SME representatives towards the formal institutions, including the government bodies. In such situations, entrepreneurship remains restricted, the number of firms is small and their contribution to the economy in terms of job creation and innovation is rather limited. This hindrance in external environment also contributes to the development of high levels of informal economy. The study results identified three main types of managerial responses of entrepreneurs to the external environment as described by Welter and Smallbone (2011). (1) "Evasion", when notwithstanding tax benefits, we find quite a number of individuals working in the informal sector without registering their activities; (2) "financial bootstrapping", when entrepreneurs do not get external sources of funding mainly due to low access to finance, thus limiting their business activities in size and scope; (3) "networking", relations and personal contacts play an important part in gaining access to information, capital and advice.

In the subsequent subchapters, I will focus on the specific constraints in external and internal environments. The below presented directions are believed by the surveyed and interviewed respondents represent an obstacle to entrepreneurship and SME development in Georgia.

#### **4.5.2 Access to finance**

This study reveals challenges related to access to finance due to the high cost of capital, rigidity and risk assessment practices of the banks and other financial institutions. The survey results show that managerial behavior is what Welter and Smallbone (2011) call "financial bootstrapping." Due to the low access to finance, entrepreneurs operate without external sources of funding, which limits their activities. In such cases, informal institutions and practices substitute deficiencies of the formal markets. Most start-ups are financed through the combination of own savings and loans from family and friends (Smallbone & Welter, 2009). Majority of the surveyed respondents either solely rely on their own savings or turn to friends and families in search of additional funding.

Access to finance a major bottleneck in a number of emerging economies, Georgia is no exception. At the moment, the only alternatives for gaining access to capital are banks and non-banking institutions. Banks have rigorous risk management systems and usually do not provide funding to startups, and even if they do, the interest rates are quite high (roughly 15 percent annual rate) and the duration of the credit is low with only 5 years. Microfinance institutions are an even more expensive alternative. The government is currently working on development of alternative sources of funding,

such as through capital markets, venture capital, crowdfunding, etc.<sup>13</sup>. However, these are relatively new initiatives and will take time to develop.

The institutional framework on the meso level includes banking and non-banking sources of finance as well as establishment of associations and chambers that would represent private sector interests and support them in the process of exploiting foreign markets. Smallbone and Welter (2009) assert that the most difficult in the reform process is creation of market institutions. These includes banks and financial institutions, business and training support services. These institutions also include state agencies that potentially impact the private sector. Capital markets are virtually non-existent in the most of the former soviet republics. While banks have a conservative approach with respect to financing private enterprises and especially small ones, that are viewed as high risk loans. In most banks we see lack of willingness from the side of the banks to finance small enterprises, and lack of collateral from the side of the enterprises (Smallbone and Welter, 2009).

The study reveals similar dynamics in Georgia, almost 65 percent of self-employed and up to 44 percent of the surveyed micro and small business representatives do not have a bank account, while 61 percent of self-employed turn to family and friends when they need money. In case of the micro and small enterprise group, when having money problems, up to 30 percent turns to the bank/microfinance institution, while more than 46 percent would talk to family and friends. Trade credit from a supplier is a common way to gain access to material resources without having a bank credit line; it is the case for one third of the micro and small firm representatives. Interestingly, the most frequent reason for not having a credit or loan is no need for it. In both groups, more than one third of the respondents mention that they do not need a loan, since they have sufficient capital. On the other hand, lack of finance was named as the main obstacle that prevents business growth. In 22 percent of the cases, asking family and friends is due to the high interest rates that the microfinance/banking institutions are offering. Lack of finance is seen as a larger obstacle in conducting business for micro and small enterprises (for 76 percent), as compared with the self-employed group (for 34 percent).

These findings highlight that the perceived constraint of lack of finance is not the only problem. Most of the entrepreneurs do not see the need to apply for loans. Therefore, the problem does not solely lie in the supply of capital but also actual demand for it. EBRD in the transition report identifies SME finance and development gaps in 2016. For Georgia, the report labels non-banking financing and business skills and standards as a large development gap. Bank financing and the overall business environment represents a medium gap, while the legal framework for bank lending is seen the least problematic. According to the same report, the quality of institutions, access to services and labor markets is identified as a medium gap.

Access to finance is perceived as an obstacle according to various reports drafted by international organizations. Figure 12 shows trends in issuing loans by the commercial

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<sup>13</sup> Policymaker 2 (Personal Communication on April 19<sup>th</sup>, 2017).



banks in Georgia. As can be seen, loans issued to SMEs have been on the rise, as of August 2016, 41 percent of all loans issued by commercial banks were issued to SMEs.

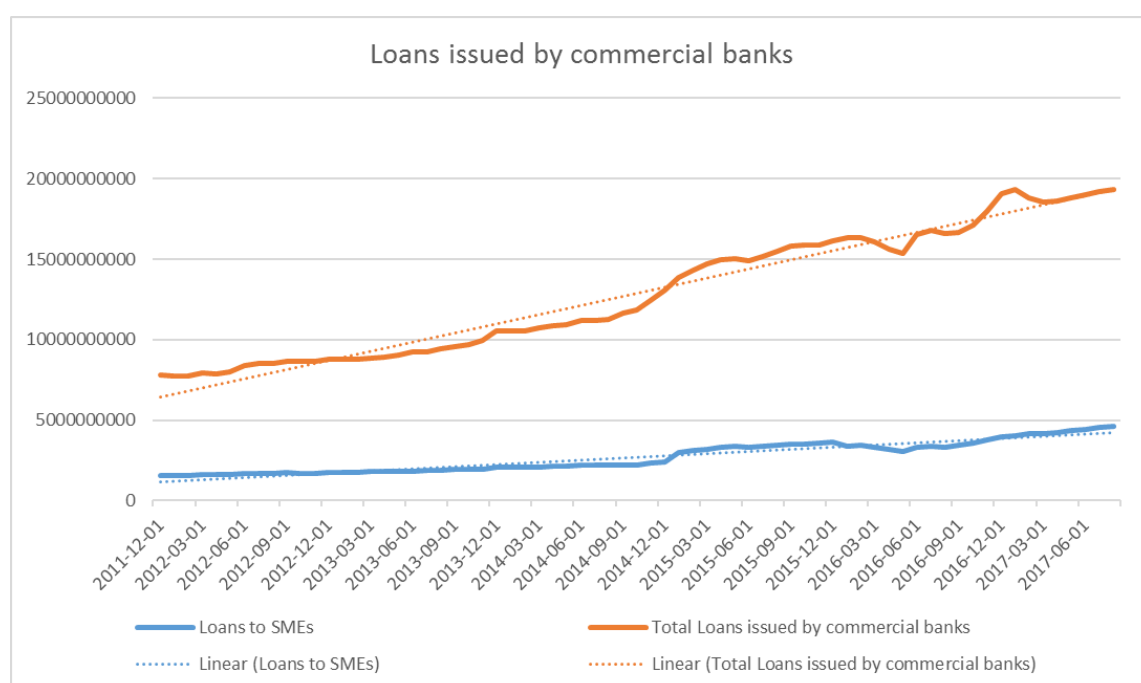


Figure 12 Loans Issued by Commercial Banks (National Bank of Georgia)

As one of the interviewed experts puts it, access to finance is far more troublesome for SMEs as compared to large companies. The high interest rates are due to the credit rating of the country, the price of capital for the banks is high. Those banks that are listed have access to cheaper capital, but not in the national currency. Therefore, dollarization is high on corporate as well as individual levels. Georgia is characterized by high interest rate “spread” which means that there is a big gap between the interest rates you get on a loan and a deposit. The expert believes that a major reason for this is low engagement of the population in the banking sector. Only 40 percent of the

population has some type of bank product. Administrative overhead of banks is quite high; with a risky creditor, lending risk is higher, thus the higher interest rate. Introduction of new regulations for microfinance companies are expected to increase the interest rates even further<sup>14</sup>.

In the globalized world, gaining access to finance is also possible outside a country. However, this study showed that the market is small, start-ups are not of the right size and sophistication to attract foreign venture capital firms. Thus, there is a problem from the supply side. *"We do not have gazelle firms on the market"*, otherwise attraction of foreign venture capital funds is quite realistic<sup>15</sup>. A head of the sectoral association stated that *"idea generation and its implementation is far more problematic than access to finance"*<sup>16</sup>.

A number of interviewed entrepreneurs believe that in gaining access to finance, personal history and personal contacts at the banks<sup>17</sup> or the size of the collateral<sup>18</sup> are far more important than a well-written business plan. Startups have little chances of getting funding, as entrepreneur G.K puts it *"I have a successful business, but also wanted to start an agricultural activity, the bank considered my new activity as a start-up and refused to give me a credit"*. When characterizing the state run programs, most of the respondents mention that since the final decision regarding granting of a credit is up to the banks, it is quite problematic for inexperienced entrepreneurs to take advantage of these programs.

As entrepreneur, G.I. says: *"starting up business is easy, that is the legal registration, however the actual start-up, beyond registration is way harder"*<sup>19</sup>. This mainly concerns access to finance, which is quite hard for a startup without any experience to gain. At the initial stage, there is a high chance to receive funding from the state, as well as from international donor organizations. There is quite a lot of funding available for start-ups, mainly in the regions. However, not many concentrate on helping existing businesses to grow<sup>20</sup>. Financial institutions emphasize company experience when deciding on issuing a credit. Even if the founders of a new company are running a successful business, financial institutions are still hesitant to issue a credit line for an inexperienced company.

Notwithstanding these perceptions of entrepreneurs, according to international ratings, such as The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) Private Sector Development Report, and the World Bank's Doing Business indicator, access to finance has improved over the course of the past years<sup>21</sup>.

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<sup>14</sup> Expert 2, (Personal Communication on May 25<sup>th</sup>, 2017).

<sup>15</sup> Expert 8 (Personal communication on May 19<sup>th</sup>, 2017).

<sup>16</sup> Expert 5 (Personal communication on April 21<sup>st</sup>, 2017).

<sup>17</sup> Entrepreneur G.K (Personal Communication on July 27<sup>th</sup>, 2017) various Sectors; Entrepreneur I.N. (Personal Communication on July 21<sup>st</sup>, 2017) textile sector.

<sup>18</sup> Entrepreneur N.P. (Personal Communication on July 6<sup>th</sup>, 2017) tea production.

<sup>19</sup> Entrepreneur G.I., (Personal Communication on November 11<sup>th</sup>, 2016. Sector: Construction)

<sup>20</sup> Expert 5 (Personal Communication on April 21<sup>st</sup>, 2017).

<sup>21</sup> Expert 3 (Personal Communication on May 25<sup>th</sup>, 2017).

### 4.5.3 Insolvency

In many transition countries, the legal framework is still the main barrier to small business and entrepreneurship development. These includes laws relating to private property, bankruptcy, contracts, commercial activities and taxes (Smallbone & Welter, 2009). This study reveals insolvency law to be a drawback in entrepreneurship and SME development, not giving entrepreneurs a “second chance”, due to the lengthy procedures and heavy concentration on the survival of the debtor.

Many of the registered enterprises are inactive. As of June 2017, according to the Geostat, only 26.3 percent of all registered enterprises in Georgia were active. Inactive enterprises make no or limited contributions to the economy. There could be two reasons for this, one is a stigma attached to insolvency, another reason may be the Law on Insolvency Proceedings, which does not meet the needs of either debtors or creditors, and does not provide framework for “rehabilitation” (Gourley, 2015). The legislative constraints are present in terms of complicated liquidation procedure. Georgia ranks 106<sup>th</sup> out of 190 economies when it comes to resolving insolvency, according to the World Bank 2017 Doing Business Report. According to the same report, it takes approximately 2 years to complete liquidation proceedings in Georgia, because statutory deadlines are not always complied with. In particular, it may even take one year for the first meeting of the creditors to take place. Filing for insolvency takes place relatively infrequently as a tool to resolve financial distress in Georgia. In the period of January 2009 to March 31, 2015 there were 315 applications to the Tbilisi City Court to open an insolvency proceeding. Out of these applications, 74 percent were rejected or suspended<sup>22</sup>.

Insolvency law is named to be a major drawback in entrepreneurship and SME development according to the interviewed respondents, as well as a number of international organizations. During personal communication, one of the experts states that business closeout is a lengthy process and does not give a second chance to an entrepreneur. The legislation is not tailored to help businesses overcome their problems. Due to the prolonged bankruptcy procedures, business representatives do not have an incentive to finalize the closeout procedure, it is a lot easier just to go ahead and register a new company instead. The Law clearly departs from “best practices” and focuses strongly on the survival of the debtor, therefore not protecting rights of creditors. Procedures are the same for all types of businesses, there was a case when it took one year and 7 months to liquidate a company that has not conducted any operations<sup>23</sup>.

The GoG received recommendations from a number of international organizations to amend the Law on Insolvency Proceedings. The Ministry of Justice has created an in-

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<sup>22</sup> Tbilisi City Court (2017)

<sup>23</sup> Expert 2 (Personal Communication on May 25<sup>th</sup>, 2017).

ternal working group to prepare draft amendments in response to a widespread recognition regarding the existing bottlenecks. The process is under way for several years now, a number of public private discussions were held. As of now, the project/draft of the law has been developed; currently it is still work in progress<sup>24</sup>.

#### 4.5.4 Property Rights

In line with international ratings, there is still a room for improvement in various directions. Protection of property rights is among them. Almost 30 percent of the surveyed micro and small enterprises believe that property rights are not well protected in Georgia. Among other factors, this is an outcry of recent complications related to the purchase of agricultural land for foreigners in the country. In particular, in 2013, the Georgian Parliament imposed a moratorium on selling agricultural land to foreigners. The Constitutional Court of Georgia ruled the adopted law unconstitutional the same year. In June 2017, Parliamentary Chairman Irakli Kobakhidze announced that the Cabinet of Ministers and the Parliamentary majority struck a deal on introducing a new provision in the constitution prohibiting agricultural land sale for foreign citizens, stating that the decision was based on *“strategic interests of Georgian citizens and the country.”* The opposition and non-governmental organizations negatively assess this initiative, stating that the government decision is unclear and does not have a substantiated financial and economic reasoning behind it.

Entrepreneur V.I. who owns a winery complains about the complications related to the purchase of agricultural land in Georgia – *“protection of private property rights is still problematic in Georgia”*<sup>25</sup>. Entrepreneur states that after the moratorium on sale of agricultural land to foreigners, enacted in 2013, purchase of arable land is also restricted for the citizens of Georgia. Procedures for long-term rent of arable land are no less complicated. The procedures are quite vague, involve central and local governments and ultimately the land is rented out on the basis of an auction. *“If you want to rent state owned agricultural land, you need to have good contacts, access to information, insider knowledge on how to proceed, the procedures are not transparent and they take several months to finalize”*<sup>26</sup>.

Other interviewed respondents also reflected their views on the restrictions on the agricultural land sale. Restriction on the sale of land to foreign citizens will result in the decrease of the price on land, it will be hard to capitalize and use it as a collateral for getting a credit from bank<sup>27</sup>. Introduced restrictions on the sale of land to the foreigners is also viewed negatively by the economic adviser to the President of Georgia, she believes that attraction of FDI is highly important for Georgia, therefore the government needs to strive to ensure having a favorable business environment<sup>28</sup>.

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<sup>24</sup> Policymaker 2 (Personal Communication on April 19<sup>th</sup>, 2017).

<sup>25</sup> Expert 10 (Personal Communication on June 28<sup>th</sup>, 2017).

<sup>26</sup> Entrepreneur V.I. (Personal communication on June 30<sup>th</sup>, 2017). Wine making/Chateau

<sup>27</sup> Expert 6 (Personal Communication on May 15<sup>th</sup>, 2017).

<sup>28</sup> Policymaker 3 (Personal Communication on June 29<sup>th</sup>, 2017).

#### 4.5.5 Dispute Settlement

One new aspect that has not emerged in similar studies before, is the role of the judiciary and accessibility of independent and timely dispute settlement mechanisms. While, this particular concern can be attributed mostly to medium and large companies, it greatly affects ability of a country to attract foreign investments and hence, indirectly affects overall business climate and entrepreneurial opportunities in the country.

Business disputes take a long time to be solved, there are several reasons for this: the legislation, qualification of judges, and availability of judges. Courts should be substituted by an alternative dispute settlement mechanism to efficiently manage the large number of business disputes. One might say that the court system is less politicized as before, but the real reform was never conducted.

There are three overarching issues named by experts and mentioned in the reports of international organizations: (1) overwhelming number of business cases and lack of judges prolongs the process; (2) judges are in many cases not qualified to pursue a business case (3) commercial law is underdeveloped and decisions are often based on precedent (common law) principle. Inefficient court system is one of obstacles for foreign investors as well. This view is shared among a number of respondents as well as international organizations.

It is believed that existence of an alternative mechanism could fasten the resolutions processes and improve the quality of business dispute settlements. The issue is being negotiated in the government and it is still not known if the alternative arbitration court will be state or private. However, an issue of trust is also important; experts believe that it will be hard to bring trust in the arbitration court <sup>29 30 31</sup>. In 2013, GCCI founded Georgian International Arbitration Center (GIAC), the first non-profit arbitration institution in Georgia. The Center based on the best international arbitration practice, aims at establishing neutral, efficient and flexible dispute settlement mechanism in the region. Since its establishment, the Center has dealt with only several cases and is working on popularizing and building trust towards this arbitration mechanism.

#### 4.5.6 Taxation and Tax Administration

During the interviews, taxation and tax administration was not highlighted as an issue; however, tax rates were mentioned by some respondents as being too high for the region. Tax rates are quite high if compared to other countries. It might be so that taxes

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<sup>29</sup> Expert 2, (Personal Communication on May 25<sup>th</sup>, 2017).

<sup>30</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

<sup>31</sup> Expert 9 (Personal communication on June 2<sup>nd</sup>, 2017).

to be paid by individuals are comparably low, but if we take company paid taxes such as VAT or profit tax, 18 and 15 percent respectively, they are considerably high<sup>32 33</sup>.

Significant improvements to tax legislation over the course of the past years, has been mentioned as an achievement by most of the interviewed respondents. The latest improvement was the introduction of the so-called Estonian profit taxation model, which envisages tax exemption of the reinvested profit. Therefore there is an expectation that reinvestment rate will increase and short-term budget deficit will bring positive results in the long-term<sup>34</sup>.

When it comes to tax administration, documenting expenses for tax purposes is quite troublesome, for example to declare expenditures when purchasing supplies from a physical entity (from an individual who is not registered)<sup>35</sup> is not possible. This bottleneck in the legislation has been widely debated among business associations, however with any clear action plans from the side of the government so far.

Another bottleneck in tax administration related to tax exemptions, which as of now only applies to the primary production. This represents an obstacle in promoting processing enterprises in the agricultural sector<sup>36</sup>. Entrepreneur G.I. highlights the issue of favoritism when it comes to tax exemptions or tax benefits. He states, *“Oftentimes decisions on tax exemptions are made based on personal sympathies. If a business has financial problems, the state is not determined to assist an entrepreneur in overcoming these problems, but rather the entire assets are seized, until the tax liabilities are covered; the state does not help a business to self-rehabilitate, by for example creating an individual payment schemes, etc.”* He believes that by a more individual approach and assistance, the government will be able to do better in tax collection as compared to the current approach, which is mainly directed towards penalties, fines and asset seizures for late tax payments. Even though the declaration procedure is quite easy, if one fails to declare on time, all assets are frozen in 24 hours’ time.

A positive aspect is the abolishment of the so-called “timekeeping” system. Prior to the abolishment of this system, the revenue service had a doubt that a company’s sales were lower than expected, tax officers had the right to tax sales according to the previous sales indicator. This was particularly troublesome for seasonal businesses, for example tourism sales which vary greatly on seasonal basis<sup>37</sup>.

The overall environment in terms of taxation has been improving, a good indicator for this is the statistics of dispute settlement body of the Ministry of Finance, more disputes are solved in favor of businesses. However, abolishment of an alternative audit institute can be regarded as a step backwards. For large companies with complicated financial operations it was a very good mechanisms, since tax authority does not have a sampling approach, their inspections usually take long and create a heavy adminis-

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<sup>32</sup> Expert 1, (personal communication on June 28<sup>th</sup>, 2017).

<sup>33</sup> Entrepreneur I.N. (Personal Communication on July 21<sup>st</sup>, 2017) textile sector.

<sup>34</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

<sup>35</sup> Expert 8 (Personal communication on May 19<sup>th</sup>, 2017).

<sup>36</sup> Entrepreneur N.P. (Personal Communication on July 6<sup>th</sup>, 2017) tea production.

<sup>37</sup> Expert 3 (Personal Communication on May 25<sup>th</sup>, 2017).

trative burden for a company<sup>38</sup>. However, tax legislation is quite unforeseeable, with frequent amendments, which is usually characteristic to developing countries<sup>39</sup>.

#### **4.5.7 Business Process Characteristics**

Relatively large size of the informal sector in Georgia is linked to institutional constraints. Existence of the informal sector is connected with weak institutions. Decision to operate in the informal sector is due to the misalignment of individual and public incentives (Webb et al. 2009), while good institutions lead to efficient resource allocation and create the right incentives for innovation and productive entrepreneurship (Baumol, 1990). Empirical findings show that among some of the determinants of the informal sector are tax burdens, labor market regulations, poor government institutions, financial credit constraints, rule of law, regulation of entry (Amoros, et al. 2016). This study findings highlight most of the mentioned determinants. However, one need to understand that informality goes beyond the pure registration procedures and also concerns the informal nature of entrepreneurial activities, be it operation via written contracts, hiring practices, formal transactions, etc. Below sections on business process and business owner characteristics show the highly informal nature of entrepreneurial activities in Georgia that goes beyond the pure registration process.

Private sector in Georgia is still under development and is characterized by a number of inefficiencies. Immaturity of business processes also has its impact on small firms in terms of their standards and sophistication. The findings suggest that business processes are characterized by various deficiencies. To name just a few: underdevelopment of value chains is an important constraint especially on the stages of finding suppliers and sales. Depending on the sector and specifics of business activities, finding a trustworthy, reliable supplier is a challenge for some of the interviewed respondents. Due to heavy regional disparity, supply in the regions is practically non-existent. Capital is the main source of supplying raw materials to the regions, which increases logistics and ultimately final product costs. Lack of collaboration between large and small firms represents a constraint. Small firms need large firms as suppliers and customers (Smallbone & Welter, 2009). Without this collaboration, it will be hard to foresee development of SME sector in Georgia.

In a number of cases being small is a constraint in itself, large companies have many advantages, they gain easier access to finance, as well as public procurement tenders, etc. At the same time, large businesses are more engaged in public and private dialogue with the government and have the voice to lobby their interests. SMEs started to join sectoral and other business associations which enable them to get heard easier. Experience shows that establishing effective membership organizations for entrepre-

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<sup>38</sup> Ibid

<sup>39</sup> Entrepreneur G.K (Personal Communication on July 27<sup>th</sup>, 2017) various Sectors

neurs is not an easy task; therefore, their influence on the institutional change is sometimes quite weak.

The challenge of sales points and distribution channels is equally shared among the interviewed respondents; the issue has been advocated on the state level as well. The latter concerns late repayment (reimbursement) of sales to entrepreneurs, which results in serious cash-flow problems. Realization of production is an issue in terms of reimbursement. It is not hard to sell the product, but rather to receive payment from the store<sup>40 41</sup>. Payback time is between 4-5 months. The payback time is usually longer for larger supermarkets that also ask for a specific volume of products, which is an additional obstacle for SMEs. According to one of the interviewed policymaker, there is an initiative to regulate the issue of late payments on a legislative level. The reason for that is the following: even if the payment's due date is negotiated through a contract, in case of violation of contract terms and filing a lawsuit, the process might last for up to 4 years, which makes it rather troublesome especially for smaller scale SMEs<sup>42</sup>. The initiative is at a nascent stage and has not been finally decided upon.

#### *SME Participation in Public Procurement and Competition issues*

Procedural issues related to public procurement still need to be improved. The public procurement legislation is currently being developed; a step forward is that only price quotations are no longer taken into account during the tendering procedures, quality also came into play. However, there still are quite some loopholes in the legislation. For example, specifically in the construction sector it is related to technical regulations and construction norms<sup>43</sup>. Entrepreneur G.K believes that there are some discrepancies in the law that prolong the entire procurement process. There are constraining mechanisms in the law, most probably for anticorruption purposes that hinder the implementation process. Catching the right balance of regulation is hard.

SMEs and large businesses are not competing on equal grounds, it is quite hard to comply with procurement procedures for a small business. The public procurement agency has taken steps towards fostering participation of SMEs in the public procurement process. For example, according to the Law on State Procurement, it is possible to divide a large tender into separate lots according to quality, quantity or geographical area factors. As of 2016, it is also possible for one or more SMEs to unite and jointly participate in the public procurement tenders. This increases their chances to comply with tendering requirements. Additional methodological guidelines were prepared for procurer organizations to take into account several aspects when drafting their terms of reference to foster opportunities of SME involvement. Quite often it is the case that a prerequisite for participation in a tender is a bank guarantee, in some cases even surcharge, which is a significant obstacle for SMEs.

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<sup>40</sup> Entrepreneur V.I. (Personal communication on June 30<sup>th</sup>, 2017). Wine making/Chateau; Entrepreneur N.P. (Personal Communication on July 6<sup>th</sup>, 2017) tea production.

<sup>41</sup> Entrepreneur N.P. (Personal Communication on July 6<sup>th</sup>, 2017) tea production.

<sup>42</sup> Policymaker 3 (Personal Communication on June 29<sup>th</sup>, 2017).

<sup>43</sup> Expert 4 (Personal Communication on July 3<sup>rd</sup>, 2017) .



According to the interviewed entrepreneur G.K. who is more experienced in participating in public procurement tenders says that competition, especially from foreign companies is on the rise. Quality control of foreign companies (mostly from the region) is harder and this affects the quality of the products they deliver. Oftentimes, the foreign companies operate with dumping prices; competition agency does not have strong mechanisms of control. To some extent the Ministry of Economy and Sustainable Development tries to control the situation to avoid unfair competition. At the same time, Georgian banks favor Georgian based companies, for example when issuing bank guarantee<sup>44</sup>. The increased competition is especially acute in public procurement tenders. Some interviewed respondents believe that this is mainly due to the economic crisis in the neighboring countries.

#### *The Company Law*

One of the interviewed experts raised the issue of the company law and its implications on doing business and business procedures in Georgia. The company law is currently being amended, one can say that this will be a completely new law. In the early 2000s, the law was simplified and a lot of provisions were taken out. For example, partner relationships and dispute settlement mechanisms were completely delegated to the company statute to decide. As a result of these simplifications, the following problems arose: many founders would use the template statute provided by the national registry agency for registration, thus neither the law nor the statute would regulate partner relations. Ultimately, this has increased problems related to dispute settlement and is one of the reasons for prolonged court cases. The new law will regulate many of the issues, partner rights and liabilities, Limited Liability Company (LLC) and Joint Stock Company (JSC) rights and liabilities, etc. There will be quite some changes in regards to registering a joint stock company. In the past we could see an increased number of registrations of this company type, mainly for the confidentiality purposes, since identity of shareholders was kept confidential<sup>45</sup>.

Another aspect that was named as one of the determinants of business process characteristics in Georgia is the availability of human resources. For a qualified human resource, SMEs compete with large businesses that in most cases can offer higher salaries, oftentimes there are headhunting and staff retention problems<sup>46</sup>. The interviewed entrepreneurs and experts highlighted the availability and search for qualified human resource was identified as a major obstacle on all levels and all sectors.

## **4.6 Business Owner Characteristics – Internal Environment**

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<sup>44</sup> Entrepreneur G.K (Personal Communication on July 27<sup>th</sup>, 2017). Various Sectors

<sup>45</sup> Expert 2 (Personal Communication on May 25<sup>th</sup>, 2017).

<sup>46</sup> Entrepreneur G.K (Personal Communication on July 27<sup>th</sup>, 2017). Various Sectors

The reforms implemented have created conducive business environment in Georgia, however among a number of factors that still persist, social barriers need to be identified. These include managerial skills and human resource constraints (Rudaz, 2012). This represents a constrain in a number of ways: access to finance, potential expansion and successful operation among others. Given this constraint, horizon of Georgian entrepreneurs seems to be limited.

Entrepreneurs also lack business sophistication and competitive capacity in Georgia. This leads us to discussing business owner characteristics in further details.

#### **4.6.1 Profile of the Surveyed Respondents (activities and motivations)**

Out of 250 micro and small business representatives, 73 percent were men and 27 percent women, while out of 350 self-employed, 51 percent were men and 49 women. 51 percent of the micro and small business sample are 51 years and younger. About one-third of the self-employed respondents are above 60 years old. 24 percent of them are less than 39 years old and 44 percent are between 40 and 59 years old. As noted above, the self-employed are more skewed towards the rural areas and older generations.

The major activity for self-employed, 71 percent of the respondents are engaged in agriculture sector (mainly primary production), this trend reflects the structure of Georgian economy (f.13). The business activities of the micro and small enterprises are quite diverse, they comprise repair works of vehicles, running a hair salon, repair of jewelry, watches, clothes and shoes, activities related to construction, translation and web design. There is a difference in activities between rural and urban population, if absolute majority of rural population is employed in agriculture, 90 percent of self-employed interviewed in Tbilisi are active in services and trading. 27 percent of micro and small business representatives, can be regarded as entrepreneurs by “default”, while another 28 percent state that they chose the sector of business since that is what they were doing in the past as an employee working for someone else. Another 20 percent heard that this was something that others were also doing. Other common answers were that this was their profession, they liked what they did, it was interesting for them, etc.

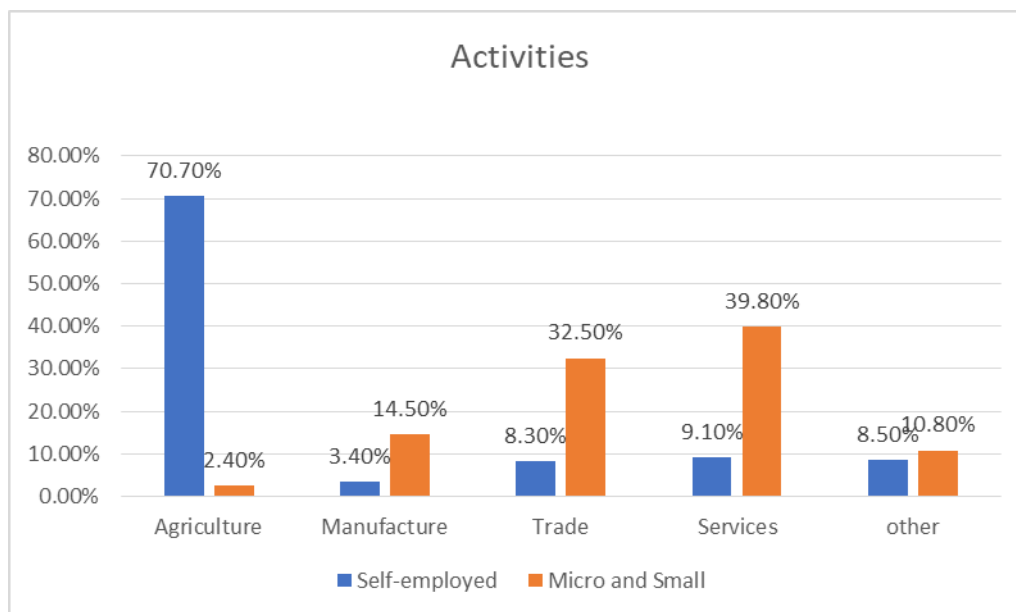


Figure 13 Survey Results. Activities of Self-Employed and Micro and Small Enterprises

For 73 percent of micro and small enterprises the activity that they are currently pursuing is the first one, while 16 percent of the respondents had another business activity in the past that in case of 18 respondents has failed due to insufficient sales, or lack of finance. Three respondents named government intervention and taxes as the major cause for business failure. Micro and small business representatives are quite experienced, majority of them have been engaged in business activities for more than 5 years.

The age variable in this study is independent from entrepreneurial activity. One finds self-employed younger than 39 and older than 60 years old who are also involved in non-agricultural activities. For majority of respondents in both groups, the activity that they are pursuing is the main source of income, namely almost 80 percent for self-employed and for almost 84 percent of micro and small representatives. For 60 percent of the self-employed, the activity that they pursue is “necessity driven”, since there is no other job opportunity, and the majority of them have been self-employed for more than 5 years. Moreover, 51 percent would not even describe what they do as a “business”. This is also due to the low monthly turnover of the self-employed, for 30 percent of the respondents revenue is below 200 GEL, which is barely enough to survive. The revenue of self-employed reflects the fact that their activities is by default. “Entrepreneurship for survival” is the appropriate term in the light of the self-employeds’ earnings.

In more than 70 percent of the cases, the respondents are sole managers and owners of the business, while in 15 percent of the cases they are partners and managers. In 60 percent of the sample, they work alone, while the others employ 1-3 people, occasionally they also have paid helpers from time to time. Self-employed receive family members’ help on a regular basis, due to the specifics of their activity, namely in the agricultural production mostly the entire household is engaged. When it comes to the micro and small businesses, they do not get family members’ help so frequently.

More than 70 percent describe their activity as stagnating or decreasing. Absolute majority is not able to save any money. However, 25 percent express readiness to reinvest if there were any savings available. Up to 35 percent of the surveyed have an interest in growing their business, however, 26 percent refuse to do so if this also means more risks. The age factor is an important variable in this case, the oldest segment of this study clearly differentiates itself from the youngest one when it comes to motivation, confidence and attitude towards risks. There is a higher percentage of younger self-employed who plan to sell more of their products and services during the next 6 months to 2 years. Similarly, 57 percent of those below 39 are willing to take more financial risk for a chance to produce more.

Another way in which business owner characteristics affect entrepreneurship in emerging and especially post socialist states is their risk taking behavior. Again, due to the lack of tradition of private entrepreneurship, there is an underdeveloped risk taking culture (Warner & Daugherty, 2004). Up to 60 percent of the surveyed respondents in both groups refuse to take any financial risks to develop their businesses. It goes true for the desire to pay for gaining access to new technology, equipment, as well as other type of improvements that needs additional financial resource. Only 14 percent of those above 60 would take that risk. This can be both related to risk aversion, as well as lack of belief that additional financial investment will improve their business and translate into higher income. As one of the interviewed experts puts it, the reason for being risk averse is the lack of the long-term vision - *"They [Georgian entrepreneurs] are risk averse, there is lack of trust, and they do not have long-term vision, and are concentrated on today"*<sup>47</sup>.

Half of the self-employed below 39 feel confident to start another activity with the skills they have, against 32 percent of those above 60. Similarly, a fear of failure would prevent 39 percent of the young self-employed to start another entrepreneurial activity, while it would prevent 60 percent of the older ones.

It is difficult to identify one single category of motivations of micro and small firms for doing what they do. The "entrepreneurship by default" is still a prevalent answer, but, contrary to self-employed, it is equally mixed with the desire to make more money. Taking advantage of possible opportunities is still not a very common response (f.14).

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<sup>47</sup> Expert 5 (Personal Communication on April 21<sup>st</sup>, 2017).



Figure 14 Survey Results. Motivations of Self-Employed and Micro and Small Enterprises

Majority in both categories believes that a major reason for starting a business is to increase personal income (f.15).

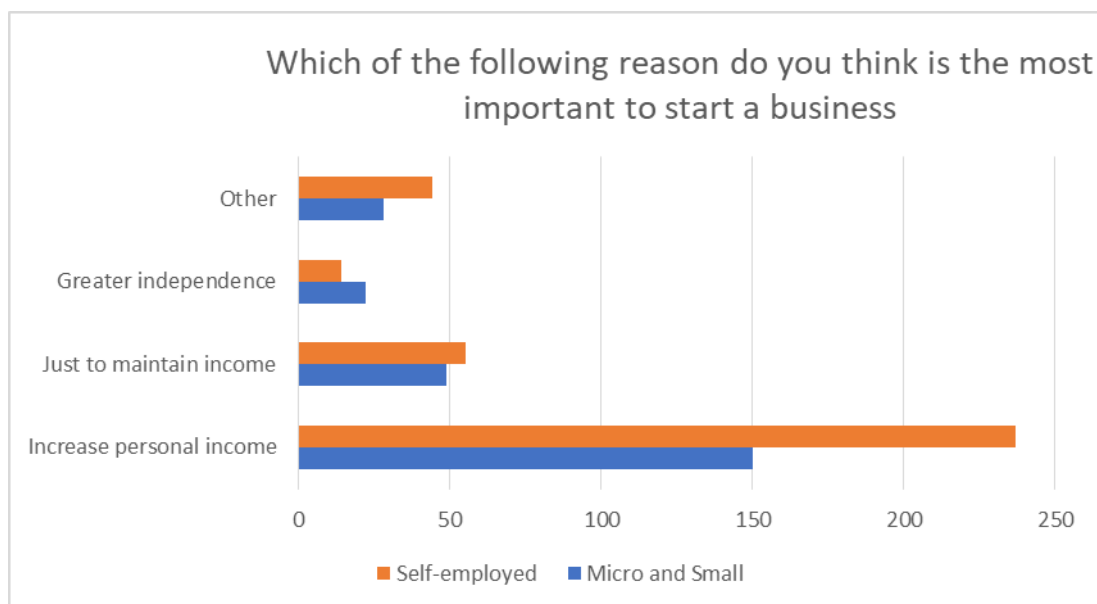


Figure 15 Survey Results. Motivations (2) of Self-Employed and Micro and Small Enterprises

Even though this can be called entrepreneurship by default, when asked if they would quit what they were doing for the same revenue as an employee, 56 percent of self-employed said no, while 74 percent of micro and small would refuse to quit their activity for the same income employed for someone else. We can say that micro and small

enterprises value what they do more and can be regarded as “reservoirs” of entrepreneurship. This means that “greater independence” has a higher value in both groups.

#### **4.6.2 Growth perspectives**

Unlike self-employed, one third of micro and small business representatives characterize their activity and revenue from that activity as “more or less stable.” Average annual turnover for more than half of the respondents is up to 15,000 GEL. 61 percent do not reinvest their profits, while 26 percent do so. When asked what they would do with extra financial resources for their business, the most frequent answer was buying material resources for the business and buying real estate. For almost 60 percent of the respondents, their business activity has not grown since its foundation. 23 percent of the micro and small firms interviewed declared that their businesses were growing, without knowing by how much and 5 percent who can specify in percentage the growth of their firm. The growth rate ranged mainly from 20 to 50 percent. The majority of the respondents are skeptical about growing their business or introduce new products/services in the coming months, they are also quite skeptical in their expectations for the future. 30 percent believe that the situation for small businesses will get worse in the near future, 22 percent think that it will not change and another 13 percent thinks that it will get better. One of the interviewed entrepreneurs says that *“Georgian entrepreneurs have this position that searching for new markets, exploring foreign markets, is not interesting for them, it is not on their agenda, most of the entrepreneurs are content with the domestic market and they do not want to take risks. Entrepreneurs develop to a certain extent and then they lose interest, they tend to rely only on one market, there is lack of long-term vision”*<sup>48</sup>.

This position well describes the characteristics of Georgian entrepreneurs, their concentration on the short-term goals could be linked to the unforeseeable and uncertain business environment that they operate in.

#### **4.6.3 Education and skills of the self-employed and micro enterprises**

Entrepreneurs in the transition countries tend to have lower entrepreneurial skills than in mature market economies, they usually lack special knowledge and techniques to manage enterprises in the conditions of market economy (Smallbone & Welter, 2006a; Welter, 1997). 16 percent of the self-employed hold the Soviet equivalent of a bachelor or master degree, and almost 50 percent have primary education. 78 percent of the self-employed with a university degree are above 40 years old. The level of education of micro and small firms is higher than for their self-employed counterparts. 55 percent of micro and small enterprise representatives hold a university degree, and 23 percent have primary education (f.16). Almost half of the surveyed micro and small business representatives believe that they do not have the right skills and knowledge

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<sup>48</sup> Entrepreneur G.I., (Personal Communication on November 11<sup>th</sup>, 2016. Sector: Construction)

to start a business that is different from the one that they are running now. This is due to the socialist legacy when the system contributed to no management and business education.

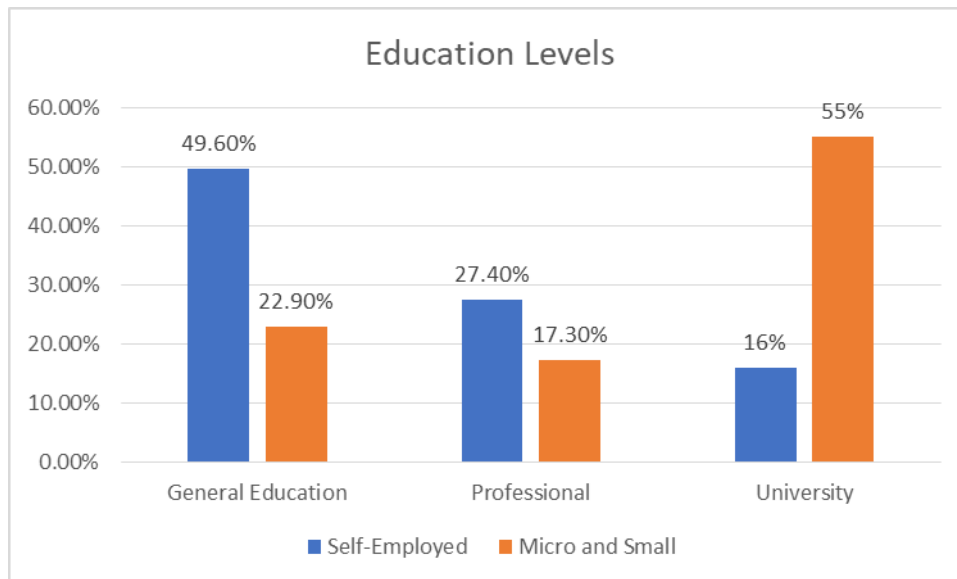


Figure 16 Survey Results. Education Levels

Most of the time entrepreneurs are reluctant to admit this fact and blame external barriers as causes of all their problems (Welter, 1997). Furthermore, due to this reluctance to admit the need of obtaining “modern” knowledge, there is a lack of readiness from the respondents to participate in trainings or other courses, even if this would help their business to improve. According to the survey, half of the self-employed are hesitant to do so, while micro and small business representatives are more motivated, with 47 percent stating that they will be interested in taking courses. Capacity building programs and consultation schemes offered by the government are barely used. Apart from education and experience, there are other factors that dominate in Georgia and sometimes are more important than the latter, these are personal networks and acquaintances. These relationships quite often help entrepreneurs in many different aspects. Participation in the trainings among the respondents is very low (f. 17)

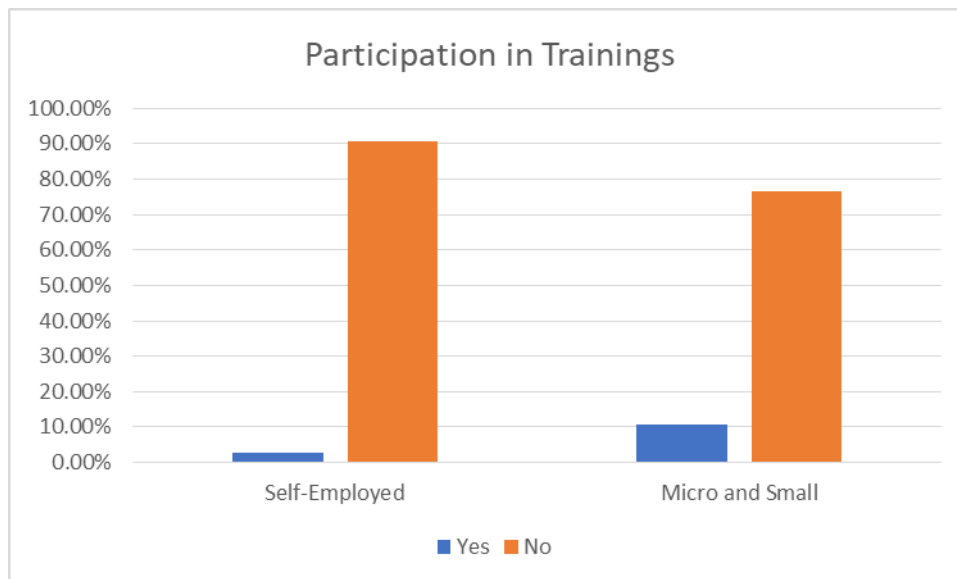


Figure 17 Survey Results. Participation in Trainings

By the same token, 74 percent of the self-employed that are younger than 39 would be ready to follow training courses to improve their business, while only 20 percent of those above 60 would agree to do so. This is a quite interesting tendency, since almost half of the micro and small business representatives believe that they do not have the right skills and knowledge to start a business that is different from the one that they are running now. When asked if they would be willing to participate to improve their business, half of the self-employed are hesitant to do so, while micro and small business representatives are more motivated, with 47 percent stating that they will be interested in taking courses. The diversity of answers in these two groups also has to do with age of the respondents. Government initiatives that promote training are likely to disappoint if established for a population older than 50 years old. Old ways are harder to unlearn, new skills more difficult to acquire above a certain age.



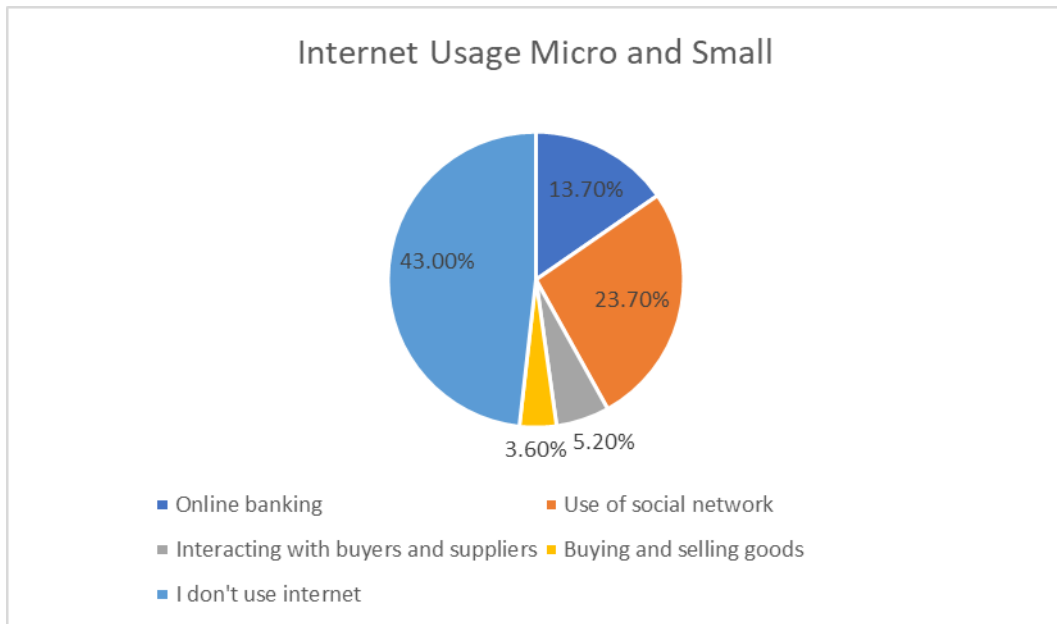


Figure 18 Survey Results. Internet Usage Micro and Small

A very small number of self-employed uses the internet. Among the micro and small enterprise representatives, 43 percent do not use the internet, and 24 percent use it for social networks. It is unknown if the social networks are used for personal or professional purposes (f.18).

#### 4.6.4 Formality indicators

One can assert that the soviet legacy is also responsible for ignoring other “formality indicators” such as holding accounting records, or operating with contracts. Absolute majority of the surveyed self-employed do not do any accounting, while 60 percent of micro and small keeps accounting records. Up to 60 percent of the surveyed respondents operate mainly without a formal contract (f.19).

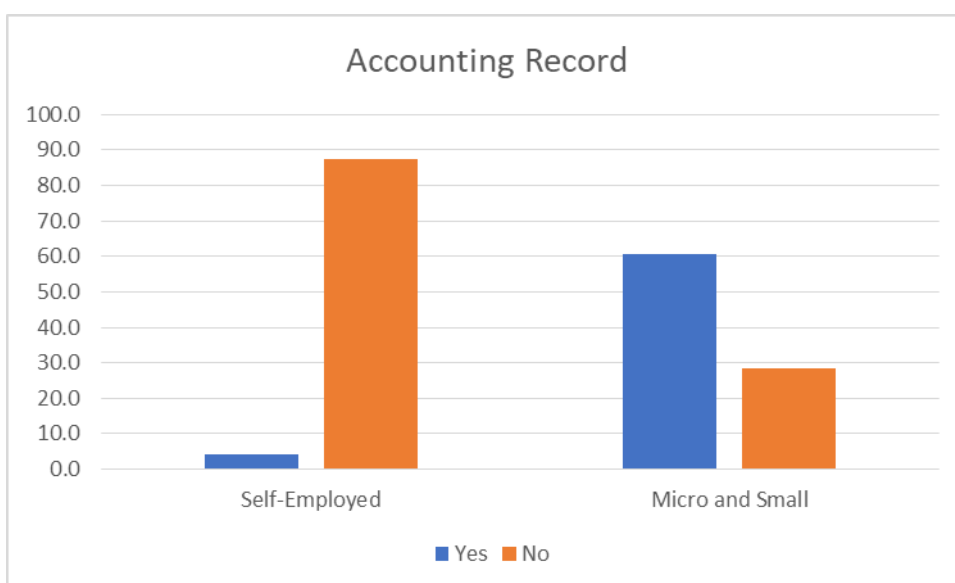


Figure 19 Survey Results. Accounting Record

21 percent of micro and small enterprise representatives do the accounting themselves, around 40 percent use the help from an accountant. When it comes to operating contracts and written terms of transaction, up to 60 percent of the respondents operate mainly on oral terms. Interestingly, when asked if they thought that a contract was a strong guarantee, the majority of the respondents think that it is a strong guarantee. Notwithstanding the trust in contracts, they are used quite infrequently.

Networks and networking can gain particular importance in fragile environment of the former Soviet republics, where formal institutions for entrepreneurship do not function properly. This is also due to the lack of trust towards institutions or fragile informal institutions. As one of the interviewed policymakers puts it: *“there might be a cultural problem, Georgians are individualistic, and they do not have interest to collaborate with one another, or even search for alternative suppliers and diversify their network<sup>49</sup>”*.

External advice and consultancy can be used for overcoming internal constraints of entrepreneurs (Smallbone & Welter, 2009). This study shows low levels of usage of external advice and consultancy. The role of the family is clearly strong, especially for the self-employed. Majority of self-employed turn to their spouses and family members for advice. Someone with business experience is the second source of advice, while some state that they do not need advice (f. 20).

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<sup>49</sup> Policymaker 3 (Personal Communication on June 29<sup>th</sup>, 2017).

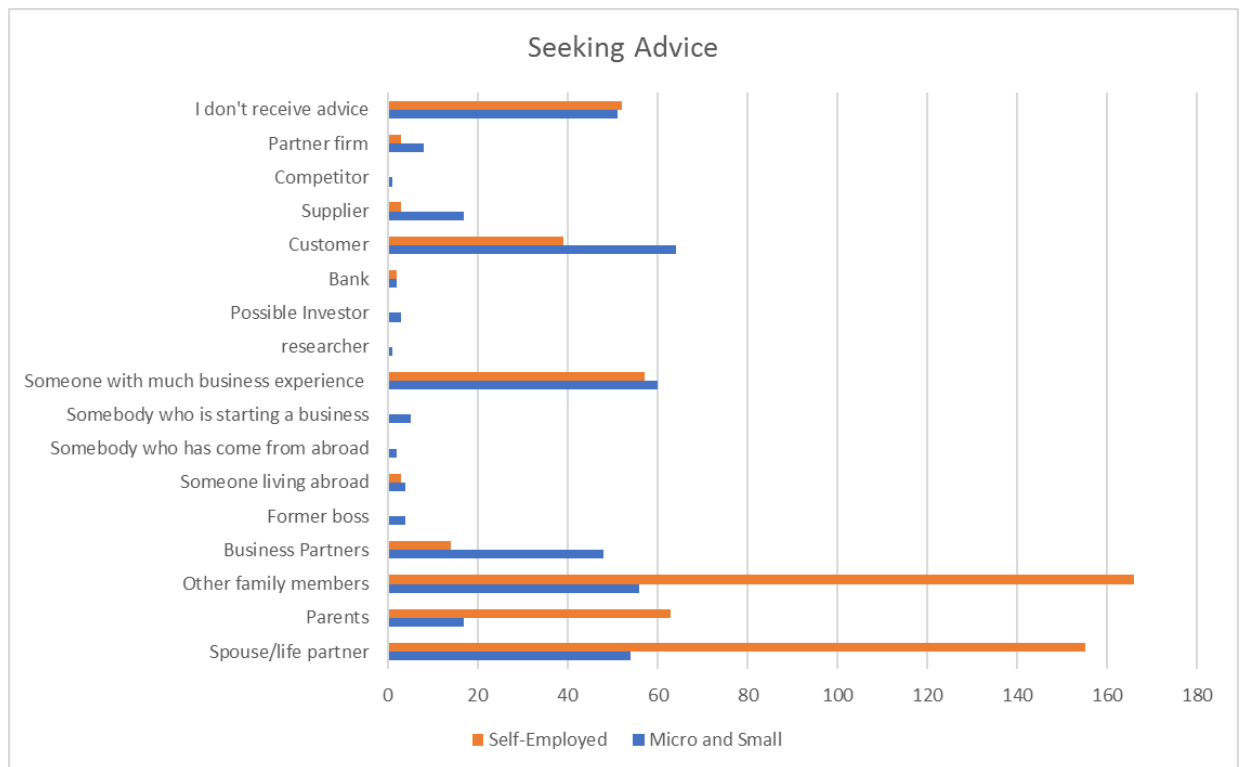


Figure 20 Survey Results. Seeking Advice

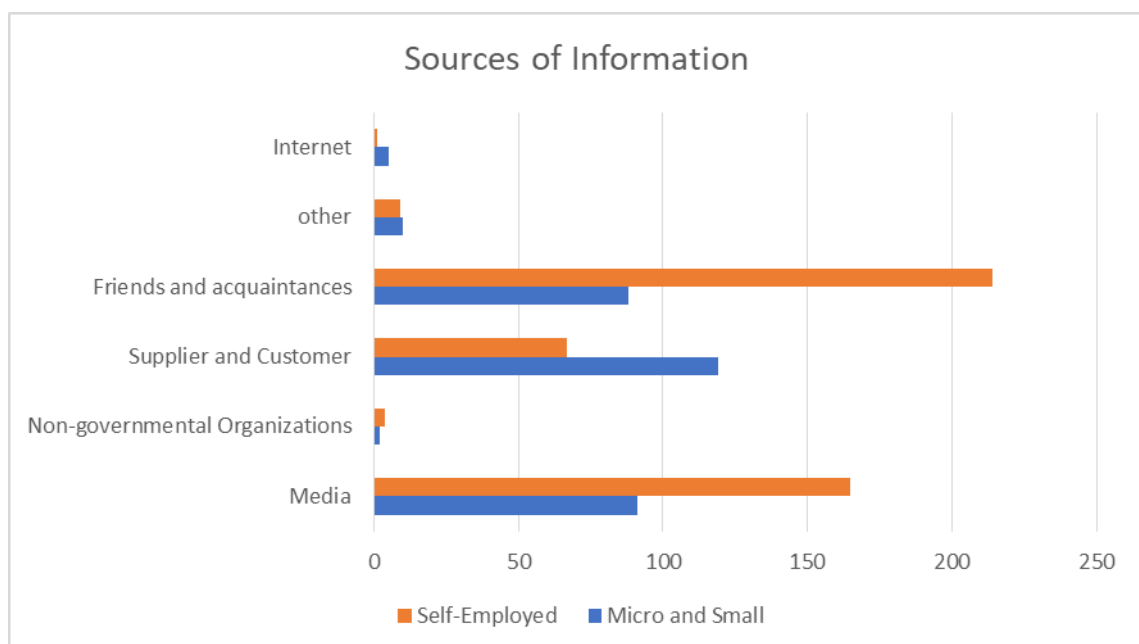


Figure 21 Survey Results. Sources of Information

For self-employed informal networks are more important also in case of receiving information (f.21). Media plays an important role for receiving information for both the self-employed and the micro and small groups.

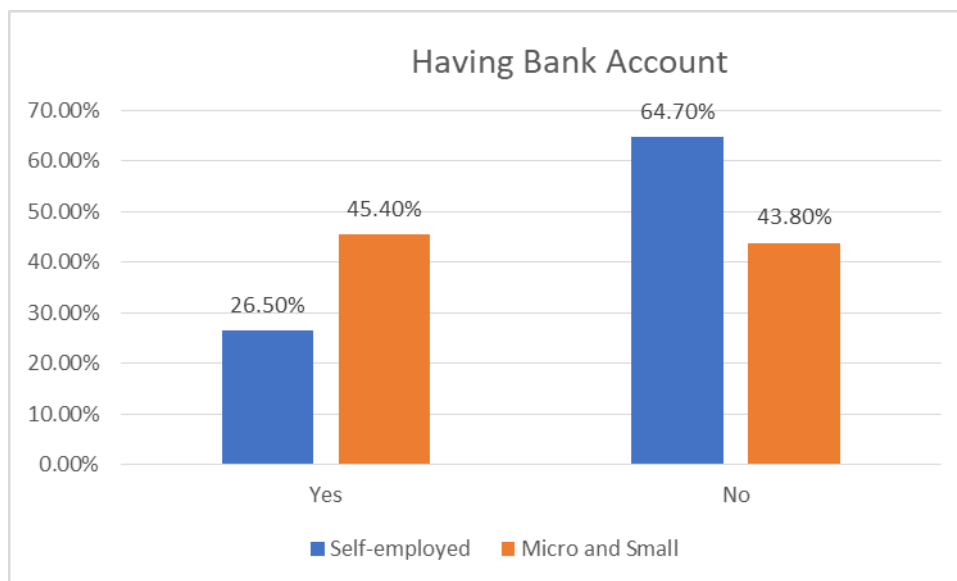


Figure 22 Survey Results. Having a Bank Account

Up to 65 percent of the surveyed self-employed and 44 percent of the micro enterprise representatives do not have a bank account. Data shows that having received university education seems to be related with having a bank account, with holding a record and operating with written terms of transaction. Holders of University degree (107 out of 237) Yes No Having a bank account 68.2% 31.8% Holding accounting record 84.1% 15.9% Operating with written terms of transaction 59.8% 40.2%.

Most of those with primary education do not have a bank account, do not hold accounting records and tend to operate without formal contracts. Primary education (63 out of 237) Yes No Having a bank account 17.5% 82.5% Holding accounting record 33.3% 66.7% Operating with written terms of transaction 7.9% 92.1%.

In their assessment of the educational levels and managerial skills of SME representatives, the interviewed experts agree that education and managerial skills of entrepreneurs tend to be quite low. They believe that this represents a constraint in a number of ways, among others, access to finance, expansion potential and successful operation. Given this constraint, the horizon of Georgian entrepreneurs seems to be limited, according to the respondents, they put major emphasis on the domestic market, but have little interest in entering foreign markets, and long-term development is not on their agenda. They have a perception that the domestic market is more or less guaranteed, while the foreign market will not be accessible for them. *“Entrepreneurs do not work on themselves, do not try to develop and catch up with the market. I see more problems internally than in the external environment.”<sup>50</sup>;* *“Market research is a problem, when you ask them [entrepreneurs] what is the market that you try to target, who did you talk to, what are you planning to do? They do not have an answer to these type of questions”<sup>51</sup>.*

<sup>50</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

<sup>51</sup> Expert 5 (Personal Communication on April 21<sup>st</sup>, 2017).

However, the interviewed entrepreneurs mention that apart from education and experience, there are other factors that dominate in Georgia and sometimes are more important than the latter, these are personal networks and acquaintances. These relationships quite often help entrepreneurs in many different aspects.

Several respondents mentioned the problem of lack of ideas. Therefore, they find that the introduction of entrepreneurial learning components in the state funded programs is seen as important. The interviewed Enterprise development agency representative says that capacity building programs and consultation schemes that they are offering are not popular among entrepreneurs. There is a lack of interest to develop and learn. This position is also shared among experts as well as entrepreneurs themselves. As seen above, the survey results lead to similar conclusions.

In parallel, the Ministry of Education is undertaking a program on lifelong entrepreneurial learning. This program funded by international donors works currently in a pilot regime. It runs in several high schools, and comprises the creation of virtual enterprises, preparation of a business plan, filing for bankruptcy, etc. It is expected that with the support of the EU a new program will start in this direction from 2018.

#### **4.6.5 Drivers of Entrepreneurship in Georgia**

New venture creation is a process, it is a combination of individual circumstances, individual opportunity recognition and a specific set of external conditions. The latter plays a larger role in the conditions of transition, as compared to the mature market economies, where individual factors are dominant. On the side of motivation, it is difficult to differentiate between the necessity vs. opportunity driven entrepreneurs (Smallbone & Welter, 2009). The study results proved that it is difficult to identify one single category of motivations of micro and small firms for doing what they do. The “entrepreneurship by default” is still a prevalent answer, but, contrary to self-employed, it is equally mixed with the desire to make more money. Taking advantage of possible opportunities is still not a very common response.

Substantial research is dedicated to the topics of increased number of necessity driven entrepreneurs operating in the conditions with high unemployment rates and uncertain environments. However, Smallbone and Welter (2009) state that these type of categorization in the transition context may be an oversimplification of the reality of business behavior, particularly so in the environment with rapidly changing conditions. Evidence from different transition countries shows that entrepreneurs usually have a wide range of business motivations. Even though this can be called entrepreneurship by default, when asked if they would quit what they were doing for the same revenue as an employee, 56 percent of surveyed self-employed said no, while 74 percent of micro and small refuse to quit their activity for the same income employed for someone else.

The interview with one of the entrepreneur found out yet another reason to pursue an entrepreneurial path. Namely, the respondent said that given his experience of work-

ing at high-level positions during the previous government administration, there was either a choice of working at the managerial position at a private company or to do something on his own. Given the fact that at a private company he would have to deal with the company founders (which according to him is not an easy task); he took the other path and started his own company instead. This example strengthens the theory that it is quite hard to categorize entrepreneurs operating in transition context. Necessity driven entrepreneurs can also be found among politically affiliated individuals who, with the change of government, do not have opportunities for applying for formal positions.

Another important factor that can be regarded as a motivator or driver for entrepreneurial activities is a peer example. Several interviewed respondents stressed the importance of inspiration by a success story as a strong motivating factor in Georgia. As a matter of fact, the governmental and non-governmental institutions use the so-called demonstration method, when entrepreneurship popularization is done through showcasing and promoting successful stories.

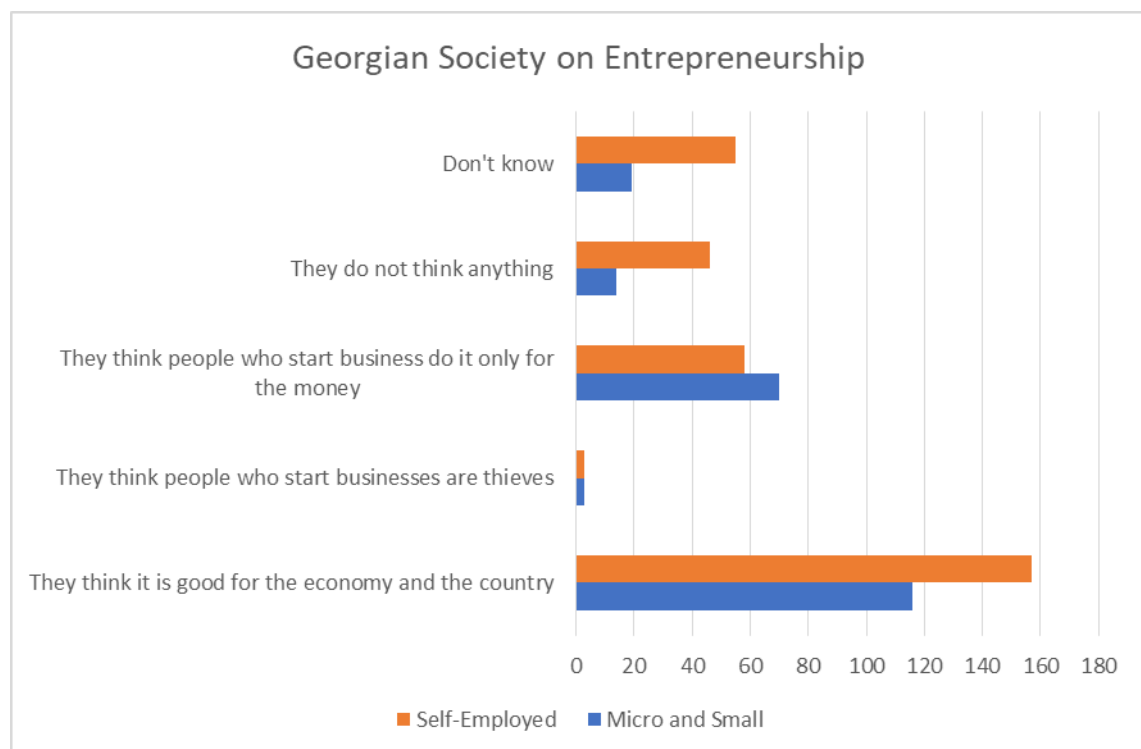


Figure 23 Survey Results. Georgian Society on Entrepreneurship

External environment not only is viewed as an interplay of institutional and legislative setting, but also a wider social context. When it comes to the position of the society on entrepreneurship and entrepreneurial activities in Georgia, the surveyed self-employed and micro entrepreneurs, believe that Georgian society values entrepreneurship and thinks that it is good for the economy as a whole. The majority believes that Georgian culture favors entrepreneurship and looks positively at those who take risks to develop a business. Quite a large number of respondents believes that society

thinks that people who start a business do it only for the money and personal wellbeing. However, there is quite a large number of respondents who do not know what the attitudes of Georgian society towards entrepreneurial activities and risk taking are (f.24).

## **4.7 Public policy and development of entrepreneurship in Georgia**

The state cannot substitute for individual entrepreneurial endeavor (Smallbone & Welter, 2010), however, government policy and programs play an instrumental role in entrepreneur's decision to pursue productive or unproductive entrepreneurship (Aidis, 2003a; Baumol, 1991). Evidence from a number of transition economies and especially the countries of FSU shows that enterprises are set up and survive despite the role of the government, however the problem is that they usually remain small and their contribution to the economy is limited (Smallbone & Welter, 2001b). In advanced transition settings, governments play a key role in creating the conditions necessary for productive entrepreneurial activities (Sauka, 2008).

Since gaining independence, the government of Georgia has been employing various public policy tools for fostering entrepreneurial activities in the country. However, one can argue the economic impact of these policies, especially when it comes to the so-called direct support measures. It is important to "correctly" analyze entrepreneurship so that the support measures actually contribute to economic growth and development (Aidis & Welter, 2006). By "correct" analysis the authors mean assessment of constraining and conducive factors and determinants of entrepreneurial activities in a specific context. Georgian policymakers aim both entrepreneurs and SMEs in their policies, as described by Lundstrom and Stevenson (2005).

Three main type of institutional changes can be identified in the transition context: first is the legal infrastructure characteristics to the market economy; second is creation of legal framework to facilitate entrepreneurship development; third is creation of commodity, capital and labor markets. Although, the state does not have to deliver business services directly to the firms, it does have an important role in the type of support infrastructure it develops. The aim should be to avoid proliferation and fragmentation of agencies so that it creates confusion among SMEs not knowing where to turn to for assistance (Smallbone and Welter, 2009).

Evidence from Georgia shows that governmental policies targeted at entrepreneurship and SME development can be divided into three phases: 1990s till 2004; 2004-2012; 2012 till now.

### **1990s till 2004**

The institutional and legal framework formation started after gaining independence in the early 1990s. These included basic transformational reforms including creation and development of basic market-based, formal institutions, price liberalization, privatization, restructuring of financial sector and appearance of first private business enter-

prises. The newly created institutions were characterized by deficiencies, widespread corruption, unfavorable tax regime to name just a few.

#### 2004-2012

Georgia embarked on implementing radical reforms in the direction of creation a favorable business environment by wide spread liberalization for making entrepreneurial activities easier to pursue. The country made outstanding improvements in many of the areas concerning creation of formal institutions, reforming business regulations that, at one glance, created a fostering environment for entrepreneurship.

Prior to the reform process, which aimed at radical simplification of the barriers to business start-up and operation, enterprises were still set up. This study has shown that in light with the reforms, there was an increase in both the number of registered enterprises as well as their turnover. During the later years of the reforms, more emphasis was placed on differentiating government regulations (mainly taxes) according to the size of an enterprise. During the same period, the first attempts of introducing direct support measure programs was made on both central and local government levels. However, sectoral structure, contributions to GDP and to overall economy has not changed substantially.

Policies implemented during the first and second stages can be referred to as those that Smallbone and Welter (2001) call “influence on the macroeconomic and business environment”, differentiating government regulations according to the size of an enterprise and development of market institutions. Alternatively, these policies were determined to affect what Hoffman (2007) refers to “opportunities” – through entry barrier deregulation, and “incentives” – through tax initiatives, reduction of administrative burdens.

#### 2012-till now

Starting from 2012 we see stronger involvement of the GoG in the private sector development process. This decision was also stipulated in the national socio-economic development strategy. Two new agencies were established during the process, directly mandated to develop entrepreneurship and innovation in the country. A number of what Smallbone and Welter (2001) refer to “direct support measures” in the form of soft loans, grants, consultation and educational programs were introduced at a larger scale. Additional works took place in the direction of placing value and promoting entrepreneurship as an endeavor for increasing social welfare. Increased availability of funds were directed towards what Hoffman refers to working on the supply side, i.e. influencing the number of potential entrepreneurs. Even though most of the programs do not have sectoral preferences, increased funding opportunities and designated programs in the agricultural field, can be regarded as policies that aim at influencing individual preferences of entrepreneurship (Hoffman, 2007).

Government priorities vary based on the transition phase and reform phase (Smallbone and Welter, 2001b). Georgia passed through different stages of policy making processes. While at the earlier stages of development, the Government was busy with building legislative base, building functioning institutions and readjusting the society



onto the new track, at the later stages of development there is a stronger need to facilitate well functioning meso institutions – such as bank systems. Bank system needs to recognize SME sector as a potential market for a range of financial products, facilitate the development of the venture capital funds, establish effective support infrastructure (Smallbone and Welter, 2001b). Findings demonstrate that the governmental role is more important in creation of external environment, rather than provision of direct support measures.

Studies dedicated to identifying most crucial public policy involvement areas, detected four areas that were significantly correlated with performance and that were of high priority in the top performing countries were: *restart possibilities, personal income tax, labor market regulation and entrepreneurship education*. Additional two areas that were also identified as significant were *venture capital and bankruptcy legislation* (Hoffman, 2007). According to the author, these findings can be used by other countries to compare their business environments to those of the top performing countries and also measure relative importance of the proposed policy areas in their respective countries. This study found that out of the identified key areas, Georgia has not made reforms in the directions of restart possibilities and bankruptcy legislation. Personal income tax exemptions introduced for registered micro and small business representatives, and labor market can be assessed as liberal and deregulated. Additionally, entrepreneurship education and venture capital creation are a recent direction for Georgian policymakers, reforms in this direction are still under development and in the pilot phase, therefore it is hard to assess their impact. Following, Hoffman's findings, we can assert that the latter two directions should be paid further attention in terms of policy formation.

Following the argument of the need to work on the “ability” side, including business and entrepreneurial education – specific steps have been taken, however they lack clear coordination and consistency in the process. Willingness and interest to participate from the side of the entrepreneurs is also a major challenge.

As described in the previous chapters, prudent reforms took place in Georgia in the early 2000s for improving the business climate in the country. However, the new course of economic policy can be described as one influenced by neoliberalism that envisaged the elimination of government interference in the economic sphere to the most possible extent. The policies were shifted towards improving the overall business climate, without supporting or favoring one group against the other. That is to say, support for SMEs in particular was not considered as an important element of economic policymaking and framework (Rudaz, 2012).

The government under the coalition Georgian Dream<sup>52</sup> has somewhat changed the focus of the previous government. In the socio-economic development strategy of Georgia adopted in 2014, the government states that free market relations should be combined with an optimal model of state regulations. A new approach is taken for the upcoming years of 2016-2020 aiming at introducing the state's involvement in entrepre-

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<sup>52</sup> A ruling party in Georgia since 2012.

neurial activities at minimum levels. The government's policy considers the private sector's competitiveness to be a very significant driver of economic development and aims at participating in economic activities, in particular in those sectors where the private sector remains weak and inefficient, while this involvement will not seek to compete with the private sector.

The socio-economic development strategy reads<sup>53</sup>: *"The government must stimulate private sector, facilitate investments and create fair and protected business environment. Its goal is also to stimulate development of business through developing innovations and entrepreneurial skills and raising access to finances, which leads to economic growth."*

As part of the new approach, the government of Georgia established two new agencies in 2014 – the Entrepreneurship Development Agency (Enterprise Georgia) and Georgia's Innovation and Technology Agency (GITA). Both new agencies operate as legal entities of public law (LEPLs) under the Ministry of Economy and Sustainable Development of Georgia. Specific strategies dedicated to SME promotion and innovation development were drafted.

Since 2012, public spending in the direction of entrepreneurship, innovating, tourism and agricultural development has been on the rise. From figure 25, we can see a shift from heavy spending on the agricultural programs towards a larger focus in the direction of entrepreneurship and innovation development. This is particularly true for the year 2017. In total, since 2012 over 1.2 billion GEL was spent on what the literature calls "direct support" measures stimulating a specific economic sector.

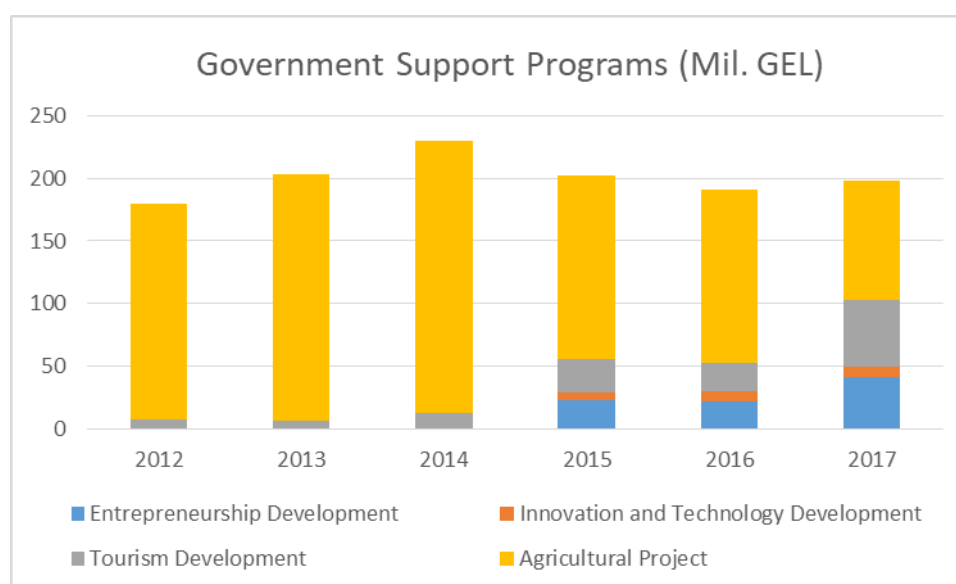


Figure 24 Government Support Programs (2012-2017). Source: Ministry of Finance of Georgia

<sup>53</sup> <https://www.adb.org/sites/default/files/linked-documents/cps-geo-2014-2018-sd-01.pdf>

In line with the reforms undertaken by the government of Georgia over the course of the past years, respondents believe that the overall business environment is gradually improving. Acs, et al (2008) state that institutional and environmental conditions are easier to target through public policy planning, as compared to the individual-level factors that are harder to affect through a public policy. In contrast, Audretsch, et al (2007) argue, that entrepreneurship policy is considerably more than specific government institutions mandated to assist SMEs with specific types of enterprises, but rather is a "*broad spectrum of institutions, agencies and different constituency groups*" (Audretsch, et al 2007, p. 2). This is what the authors call a shift from the managed to entrepreneurial economy, when the policy approach goes beyond the economic policy and also embraces all aspects of the society. This understanding envisages that the entrepreneurship policy goes beyond specific support measures and instruments, agencies and state institutions and takes a new orientation what they call the entrepreneurial economy. The authors also argue that entrepreneurial incentives in a country and the size of the state are inversely related. This means that increased budgetary spending in the direction of entrepreneurship support does not always lead to increased entrepreneurship and SME activates.

#### **4.7.1 State Administration**

Since micro and small enterprises are the ones that have a stronger contact with the state administration, it is noteworthy to emphasize on their responses when it comes to assessing the quality of state administration. Quite a large number of surveyed respondents does not know how to assess predictability, pace or impartiality of state administration (f.26). The undisputed answer from the category of "tend to disagree" is the one that concerns the pace of state administration, the majority believe that the pace of state administration is rather slow. Similarly, the majority agrees that the state administration is fair, impartial and not corrupt. State administration, along with tax rates, licenses and permits, and labor code, are not named as an obstacle for micro and small enterprises. The self-employed group does not have any relations with state administration, since they are not registered and operate informally.

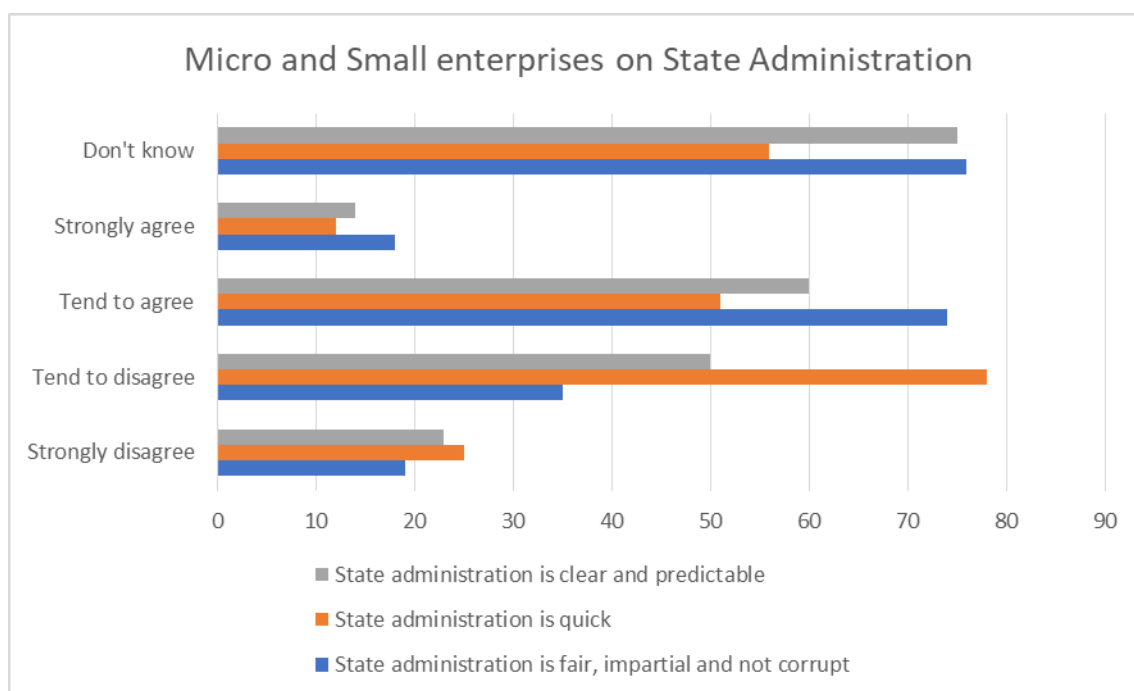


Figure 25 Survey Results. Micro and Small Enterprises on State Administration.

### *Decision Making Practices*

During the interviews, several respondents highlighted the top down approach in decision-making as an important drawback in policymaking practice of the Georgian government. According to the respondents, the public private dialogue mechanisms are not formalized and take place on an *ad hoc* basis. One such platform for public private dialogue is a council under the Ministry of Economy and Sustainable Development, which comprises line ministers and business associations and aims to negotiate all on-going issues with the private sector representatives<sup>54</sup>. The council was created by the decree of the Minister of Economy and Sustainable Development. It unites various business support organizations, associations, non-governmental sector representatives, and department heads from other line ministries. Up until 2017, two meetings were held; the first one was dedicated to the pension reform and the second one to the Open Government issue. Identification of thematic topics to be discussed is usually bottom up and comes from the private sector representatives; the subsequent follow-up on the discussed issues is an important part of the council work<sup>55</sup>.

A different position was observed among the interviewed experts and entrepreneurs. According to them, even though communication has improved during the past few years between the private sector and the government, the recommendations presented during such meetings are rarely implemented in reality. In the majority of cases, the processes of holding such dialogues are fostered and administered by international donor organizations. A lack of follow-up decreases motivation among private sector

<sup>54</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

<sup>55</sup> Policymaker 2 (Personal Communication on April 19<sup>th</sup>, 2017).

representatives to participate in such meetings and dedicate their time and energy to prepare recommendations for improvement. The process is not institutionalized and largely is dependent on the incumbent individuals and teams, in other words on their personal good will. Slow decision-making practice was mentioned by a number of interviewed entrepreneurs and experts along with the problem of taking initiative and responsibility for an action from the side of the policymakers. Several experts believe that the current government is far more open towards dialogue, even more so, they are quite proactive and prone to such a dialogue, and recommendations are consolidated during meetings and later acted upon. This view is not equally shared among the interviewed respondents. Business association representatives highlight the importance of membership in associations, since this gives an important avenue for participating in the dialogue process with the government. Membership in associations is not very common, therefore individual involvement of SMEs in the decision making process is quite hard. Tendencies are positive, sectoral associations are getting more active and popular. Respondents believe that associations should be more active in communicating and popularizing themselves. Currently, SMEs do not have enough information about the associations and their benefits<sup>56</sup>.

Interviewed experts have identified another issue related with decision-making practices, namely, they highlighted that decision-making is not based on rigorous analysis, or any type of regulatory impact assessment. As one experts puts it, *policy making should not only be a political act, but also have economic reasoning and rationale behind it*<sup>57</sup>. Several entrepreneur and expert respondents identified a lack of long-term vision and strategic goals as an important problem in the decision-making process. Policies seem to be quite chaotic in nature and are often tied to the electoral cycle. When there is a strategy, it is easier to make sure that each activity is directed towards contributing to one or more strategic goals. However, Once a promise is made during the preselection period, it is hard to change, since the expectations are already created. Having an overarching strategy that is clearly communicated to the public, will bring predictability to the overall business environment.

The policymaker respondents identify the SME development strategy as an important step towards fostering the entrepreneurship and SME environment in Georgia. A number of respondents from the group of experts and business association representatives agree that the SME strategy is a positive development, however they state that the major coordinating body is the Ministry of Economy and Sustainable Development that lacks adequate staff and it is therefore believed that enforcement and implementation of the strategy will be quite problematic. Another challenge is coordinating the issues among various ministries in solving problems that are cutting across different entities.

A challenge of enforcing a particular decision has also been named among the most problematic issues in the policymaking process by the expert respondents and entrepreneurs. Several initiatives have been announced and later on called back. This creates further uncertainty and positions the government as rather weak. *“There is a*

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<sup>56</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

<sup>57</sup> Expert 10 (Personal Communication on June 28<sup>th</sup>, 2017).

*problem of decision-making, implementation and enforcement of the initiatives, increased red tape can be observed. The government is open for a dialogue, but the ideas generated do not go to the implementation phase. Decision-making is slower than before*<sup>58</sup>. One such initiative was “Business Houses”, announced by the Prime Minister of Georgia in September 2016. The idea behind this initiative was integration of front offices of all relevant ministries into one common space, where businesses would have access to all business-related state services, namely up to 600 of them. It was also envisaged to add consulting services for business representatives. The interviewed respondents find this initiative particularly useful, since it will increase access to information for entrepreneurs. The idea of bringing everything in one space, all business services and front offices of all business support organizations “would increase access to information”, will be a good “networking opportunity for entrepreneurs”<sup>59</sup>. However, as of now, the initiative has not been developed further.

From their side, the interviewed policymakers stated that private sector representatives are rather passive and in some cases lack qualification to participate in the discussion formats.

Lack of decentralization and centralized decision-making was also named as a challenge. *“Everything is centralized. Not much decision making is taking place locally. The region does not stimulate any private sector development and does not foster it in any way”*<sup>60</sup>. This is especially problematic, when underdeveloped social and economic infrastructure in the country is particularly acute in the regions. These concerns basic physical infrastructure such as roads and power and water supplies, as well as organizational structure and facilities, such as buildings and warehouses. Entrepreneur V.I. says that he had to take care of everything, including such basic infrastructure as bringing communications to the place: gas, electricity and water supply<sup>61</sup>. These constraints vary according to sectors and business specifics. What is the role of the state in the process? How important is it? Notwithstanding all the barriers as one respondent entrepreneur puts it: *“if you work and try, everything will work out even in Georgia.”*

#### **4.7.2 Direct Support Measures to Entrepreneurship Development**

Apart from reforming the overall business environment, the government of Georgia has been engaged in a number of direct support mechanisms for improving entrepreneurship in the country. These measures include subsidized loans, grants for start-ups, tax exemptions, technical assistance programs, training and learning possibilities. Overall, almost all of the respondents were in favor of providing some sort of direct

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<sup>58</sup> Expert 9 (Personal communication on June 2<sup>nd</sup>, 2017).

<sup>59</sup> *ibid*

<sup>60</sup> Entrepreneur V.I. (Personal communication on June 30<sup>th</sup>, 2017). Wine making/Chateau

<sup>61</sup> Entrepreneur V.I. (Personal communication on June 30<sup>th</sup>, 2017). Wine making/Chateau

support measures. However, the question of efficiency and actual economic impact of such measures was actively examined.

Currently, several agencies are mandated to develop entrepreneurship. They can be differentiated according to the size of funding they provide. To start with, the largest one, the co-investment fund is a private fund working in the direction of equity finance, with a budget of 5 million and above. Then comes the partnership fund which is a state fund also working on the equity finance direction with a budget of one million GEL and up. Enterprise Georgia works in the direction of SMEs along with the APMA. The latter works in the direction of agriculture, while enterprise Georgia is concentrated on other industries plus the hotel industry. All of the programs have a similar philosophy and envisage subsidizing bank loans to entrepreneurs. It could be a commercial bank loan as well as a leasing. A beneficiary is receiving a subsidy on interest for the first two years, with a maximum of 3 percent interest rate. In case of agriculture, due to the specificity of the sector, the subsidy period is 66 months.

There are a number of programs that directly or indirectly aim to develop entrepreneurship and SMEs in Georgia. Below I will list and describe them.

**Enterprise Georgia** – is the first governmental institution mandated to facilitate the private sector and, in particular, SME development through a variety of financial and technical support mechanisms, as well as export support. The agency is also an integral part of the new state program “Produce in Georgia” that was initiated by Prime Minister Irakli Gharibashvili to encourage domestic production through increasing productivity and competitiveness of SMEs.

In particular, the programs and direct support measures offered by the agency are focused on the following: (1) Offering support schemes enabling easy start-up and long-term solvency of local enterprises; (2) Encouraging high entrepreneurial culture among Georgian SMEs via training, consultations, business linkages and matchmaking; (3) Assisting SMEs to access information regarding the financial instruments available locally and internationally; (4) Providing SMEs with access to finance via different schemes (interest rate financing, collateral insurance, grants, etc.); (5) Facilitating support mechanisms for technical assistance to local enterprises for improving the production process, operations management and business cycle; (6) Promoting Georgian products internationally on targeted markets via product exhibitions, inbound and outbound trade missions, online marketing, and product completions; (7) Helping export oriented companies access business intelligence (market reports, access guides to targeted markets).

The following programs are available through the Enterprise Georgia agency.

- (1) **Micro and Small entrepreneurship support project** – this program is only implemented in the regions and provides grants in the amount of 5, 10 and 15 thousand GEL. At no risk can an individual commercialize his/her ideas. There are no sectoral priorities. It can be said that this project has a social assistance character, however there are some chances that these projects flourish into business projects.

- (2) **Technical assistance to existing businesses** – the agency co-finances 80 percent of consulting expenses, but no more than 10 thousand GEL. These services involve finance, marketing, optimization, software installation, standardization, etc.
- (3) **Hotel Industry** – the philosophy is the same and envisages subsidization of interest payments on a bank loan, however this program is only for medium and high level hotels with a minimum European standard. Therefore, the program does not imply development of hostels and/or family guesthouses.
- (4) **Film Industry promotion component** – a cash rebate initiative which envisages a 20 percent cash rebate for international producers on qualified expenses incurred in Georgia. Rebate can even be 25 percent if the movie also involves a popularization of Georgia – in terms of product placement.
- (5) **Export Promotion** – this direction was added recently and envisages assistance of firms in internationalization, access to foreign markets, through technical and financial assistance.

**GITA** – the agency is mandated to mediate innovation and technology development in Georgia. It specializes in innovation, IT, business development, start-up, venture capital, Fab Lab, Make-a-thon, etc. One of the main projects of the agency is the Techno Park, which is oriented for engaging innovative individuals through establishing the so-called “single window” principle working space. The Techno Park was built by the initiative of the Prime Minister of Georgia and was opened in 2016. It is built on 3 thousand sq. meter territory in the outskirts of Tbilisi. Techno park unites individuals working in different directions and having various ideas, they are supported through the usage of techno park infrastructure, to create new technology oriented products and services that will be competitive on local as well as global markets.

Techno park also has established a regional Techno park in Zugdidi (western Georgia) which offers such services as FabLab, 3D printer, laser cutter, CNC router, vacuum formation machine, laser sawing machine, etc. It is noteworthy that an innovation center was also established in the village of Rukhi, Zugdidi municipality. The establishment of regional innovation centers aims at increasing access to information technologies, and increasing competitiveness of the population through distance learning opportunities. Regional innovation centers are equipped with computer rooms, and co-working, learning and maker spaces.

The most recent project of GITA is **Start-up Georgia** – established in June 2016, this *venture capital investment program* is part of the so-called 4-point strategy of the Georgian government. The 4 points are: (1) economic reform (taxation reform, streamlining of tax administration, financing start-ups, abolishment of preliminary imprisonment for economic crime; tourism support); (2) education reform (professional education reform - market-oriented learning, for higher and primary education – new assessment schemes, new financing models; increasing teachers’ qualification; (3) spatial planning (regional development, new transport nets, strategic infrastructural projects; (4) governance reform (united “front office”, regulatory impact assessment, increasing engagement of the society, and effective monitoring schemes).



Start-up Georgia is coordinated by GITA and the partnership fund of Georgia. The program comprises two types of components: innovative and high-tech. The agency is financing only unique high-tech innovative ideas, while the fund finances innovative projects. The total funding available for the program was initially 11 million GEL and later was increased to 35 million. The high-tech components does not require co-funding from the side of the beneficiary, available funding is up to 100,000 GEL, and successful projects are also presented to investors in Silicon Valley. Innovative project component requires at least 10 percent of co-funding of the total project budget from the side of the applicant.

Additionally, the agency distributes **mini grants** in the amount of 5 thousand GEL for prototyping innovative ideas and for travelling and participating to international conferences.

The **Business Incubator program** started in 2016 and aims at selecting entrepreneurial teams and transforming their ideas into successful businesses. This is done through mentorship, consultancy, etc. Each selected group receives 50 thousand GEL worth of services. They do not receive direct funding from the agency, however they are assisted in attracting investments from outside sources.

In order to promote and stimulate the development of production-oriented industries in the regions of Georgia, the Ministry of Agriculture established the Agricultural Projects Management Agency (APMA) in 2012. Currently, the Agency implements a number of agricultural projects: 1) Plant the Future; 2) Georgian Tea Plantation Rehabilitation program; 3) Program on Agro-Production Promotion; 4) Preferential Agro-Credit Project; 4) Co-financing of Agro Processing and Storage Enterprises; 5) Agro insurance; 6) Produce in Georgia; and other 7) Seasonal Projects. Most of the projects follow a similar scheme, which is subsidizing or co-financing the projects initiated by entrepreneurs. In most of the cases, the projects are implemented in cooperation with commercial banks.

According to the interviewed policymakers, most of the programs that are being implemented are based on the experience coming from various countries. However, they are adopted and amended according to the Georgian context and reality. At the same time, over the course of the years the programs change a lot, some are added, modified or dropped all together. These decisions are based on the experience and observations, from monitoring the programs' success<sup>62</sup>. Agricultural programs, due to the specificity of the sector, are amended according to the market conditions (global market conditions, harvest prognosis, etc.). According to one of the policymaker: *"Entrepreneurs on all levels have equal access to financial and technical assistance"*<sup>63</sup>. In total 204 projects are funded and only in three cases have they stopped. In these three cases, the beneficiaries covered the loans and quit business activities due to personal reasons. The beneficiaries are monitored constantly, even after the two-year subsidy pe-

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<sup>62</sup> Policymaker 4 (Personal Communication on June 27<sup>th</sup>, 2017); Policymaker 5 (Personal communication on July 19<sup>th</sup>, 2017).

<sup>63</sup> Policymaker 4 (Personal Communication on June 27<sup>th</sup>, 2017)

riod is over. Because the decision is made by the bank, cases of default are at minimum levels. According to the Enterprise Agency, bringing in the banks as an intermediary was done to bring the programs in compliance with market principles. At this stage of development, when there is no capital market, no alternative funding mechanisms (e.g. equity funding), and interest on bank loans is high, the decision was made in the direction of interest loan subsidization. The governmental factor makes banks less rigorous in risk assessment, since the government is also participating in providing the collateral. However, the interviewed entrepreneurs mention that the final decision is up to the banks to take, therefore according to them entrepreneurs still face the same rigorous procedures of risk assessment and in most cases are unable to qualify for a loan. The agency aims at constant improvement and takes experience from Scandinavian countries and Enterprise Ireland.

Not many of the surveyed micro and small business representatives benefit from the government sponsored programs, the absolute majority state that they are not beneficiaries of any program. Those who are mostly benefit from agricultural support programs, the second most common answer is the universal healthcare insurance. It is noteworthy that more than half of the surveyed respondents have actually heard of for example the agricultural support programs; however, they do not comply with the prerequisites for applying. Respondents are not aware of the actual prerequisites that they need to comply with, having a perception or an institutional distrust that these programs are not for them. One can say that there are two interrelated problems with the access to state funded programs: (1) lack of information among the respondents on the specific support mechanisms that are available for the activities they undertake; and (2) lack of capacity to benefit from the programs. There are at least three agencies responsible for entrepreneurship promotion in the country, beneficiaries might as well be confused regarding the role of individual agencies, Smallbone and Welter (2009) call this phenomena the risk of “proliferation” of agencies and their individual roles.

Lundstrom and Stevenson (2005), assert that the state policies should be concentrated on increasing motivations, opportunities and skills of entrepreneurs, while at the same time developing entrepreneurial climate and culture in the country, encouraging and favoring entrepreneurship. Given the importance of hearing of success stories, a question was asked if the respondents know a person who benefited from the state support program and now has a growing business, 61 percent of the respondents answered negatively to this question. In the self-employed group, the number of those who have heard of success stories of fellow citizens is even lower. In the self-employed group, the number of those who have heard of success stories of fellow citizens is even lower. With the help of the media, the state agencies have recently started promoting and sharing success stories of entrepreneurs, however the initiative lacks consistent approach and wider scale efforts, especially on the regional basis.

The self-employed group has a larger share of state program beneficiaries, with almost half of the respondents being engaged in the agricultural support program. During the time when the interviews were taken, the state was running an agricultural program especially targeting small households engaged in the sector. As of 2016, the program has been called off. When asked if the state took actions for promoting entrepreneur-

ship in the country, the majority of the surveyed respondents in both groups answered negatively. One can assert that there is the so-called “implementation gap” (Smallbone and Welter, 2010). Interviewed respondents underlined the issue of lack of strategic policy objectives, clear cut long-term vision that would be tied to the budgetary processes. Parker (2007) states that government programs due to their multiple objectives, are hard to evaluate. Overall, due to the lack of finances allocated to the direct support measures for fostering entrepreneurship, one cannot expect an overwhelming impact.

Several interviewed entrepreneurs benefited from the state provided programs. For example, entrepreneur V.I. is a recipient of a subsidized agricultural loan. He says that this loan helped him to finalize the construction process of the Chateau much quicker than he would have done on his own. He is satisfied with a lower interest rate (12 percent of the 13 percent interest rate is covered by the state), but he still needs to pay quite a lot and the collateral requested was very high, *“I needed one million worth collateral to receive a loan of 220 thousand.”*

The decision to get a loan and benefit from the subsidized loan programs, seems to be connected with the personal risk-taking behavior. Entrepreneur I.N. says *“I have not used the state support measures, because I am afraid of taking a loan, I am very cautious when taking risks.”* One of the interviewed entrepreneurs could not find a program that would fit her needs *“on the one hand the grant sums are too small, and I do not need them, on the other hand the minimum amount required to receive a subsidized loan is too high for my needs. There is nothing in between.”*

The views on the provision of the direct support measures was diverse among the interviewed respondents. Several respondents, who were *not* in favor of subsidizing loans from the state budget, mentioned that the initiatives were necessary for the regional development efforts. Due to the high regional disparity and inactiveness in especially rural areas, directing state budget towards entrepreneurship promotion, if done correctly, is viewed as one possibility.

Several respondents highlighted that the stage of economic development as an important determinant of to what extent the government should be involved. It was mentioned that at the stage of development that Georgia is currently in, assistance, especially in terms of access to finance, is important for entrepreneurship development and SME growth. One expert respondent mentioned that it is cheaper for the government if a person fails after the state provided small grants as compared to failure that might lead to personal bankruptcy of an individual. *“Without government assistance, inexperienced entrepreneurs use their own residences for bank collateral, which might end up as even more expensive alternative for the state, in case the start-up is unsuccessful”*<sup>64</sup>.

A number of expert respondents believe that providing seed funding to entrepreneurs is an important initiative for emerging economies, where access to finance is rather limited. These type of programs are necessary for the development of entrepreneur-

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<sup>64</sup> Expert 7 (Personal Communication on November 11<sup>th</sup>, 2016)

ship and SMEs in the country. However, the duration of such direct support measures should be limited and be available only for some time, before the capital markets and other alternative sources of funding develop. Respondents who are in favor of providing supportive measures state that given the Soviet legacy, entrepreneurship and private sector as such is rather young in Georgia, the government should take a proactive role in supporting startups. An issue of economic feasibility was raised, should we only assist small businesses? What type of assistance programs are less costly? It is critically suggested that large businesses, if assisted, can also develop economy equally well.

Two approaches of assistance models for SMEs were named: tax exemption and subsidizing. Some of the interviewed expert respondents believe that it is administratively a lesser burden to pursue tax exemption programs for small businesses, as opposed to subsidizing loans. The turnover limits given in the tax code could be further revised, since the purchasing power of the money has changed since the introduction of these limits. Another group of interviewed expert respondents doubt the possibility to foster economic growth and development through provision of subsidized loans, however it is possible to at some point, in the short-term horizon, increase economic activity of specific firms. The export development association was engaged in writing the strategy for the entrepreneurship development agency. Their recommendation was to concentrate solely on export promotion, through increasing the skills and education for firm with export potential, and thus increasing their entrepreneurial spirit. However, ultimately the strategy was shaped in a different manner and currently it focuses on general entrepreneurship and SME promotion, without having a focused approach on export oriented firms.

Many respondents see the role of the government in providing education, since without education it will not be possible for an individual to manage money or to use it wisely. Most of the interviewed respondents criticized the current education system. They believe that schools and higher education institutions are not providing the skills that are needed on the job market. High demand and lack of supply in specialized work force was mentioned as a major bottleneck for private sector development and investment attraction. Shortage of skilled labor is mainly observed in such fields as engineering and technical personnel. The respondents believe that the Georgian society needs to change its mindset regarding the professional education, since the drive towards higher education diplomas results in a loss of human resource for the economy and leads to the problem that is usually referred to as “over-education.” In the process of reforming the professional education system, involvement of the private sector seems to be an important factor for success.

Entrepreneurial education also needs further development. The youth should understand what entrepreneurship is and that there are other opportunities of employment apart from traditional ones. Some of the interviewed respondents state that if one has a truly innovative idea, an entrepreneur can develop and grow without the help of the government. There is enough capital inside and even more outside of the country. As one respondent puts it, not many people have a clear understanding of an innovative idea. One interviewed economist states that the government takes money from the budget that is hypothetically paid by a successful business and through the channels of

these support programs invests this money in a high-risk endeavor. Several respondents share an opinion that state supported direct support measure programs can be compared to a one shot stimulating programs that cannot have a long-term economic effect.

Overall, in the view of the interviewed respondents, a favorable business environment represents a combination of both framework conditions and direct support measures. It was additionally highlighted that creation of the external favorable business environment is not enough, without having access to finance. Likewise, it is not enough to only create access to finance if the overall business environment is poor in a country.

Views of the interviewed respondents differ when assessing the initiative of small grants program (provision of up to 5 thousand Georgian Lari (GEL) funding to selected business ideas). Entrepreneurs, policymakers and one expert believe that this initiative is a particularly important one. Most of the experts think otherwise, some even label it as a *“pre-election present”* from the side of the government, through which the pro-government activists are *“rewarded.”* Majority of experts name this initiative as a completely socially oriented program with a maximum of 5 percent survival rate. They believe that at this stage of development this is not a rational decision, research actually shows that providing money, as a gift is a very unsuccessful endeavor, distorting healthy market principles. Furthermore, experts believe that there should be at least some type of cost-share element to this type of grants, since a business idea should come first and then an entrepreneur has to search for the capital, not the other way around as is the case for this initiative.

Almost all of the interviewed expert respondents mention the issue of monitoring and evaluation of the programs, and thus their efficiency. They state that one needs to see a positive correlation between the money spent and the economic returns. Some of the indicators could be an increase in GDP, increase in turnover of a specific sector. As one of the interviewed economist puts it, *“Over the past 5 years, we spent 2.5 billion GEL in agriculture, this sum is 17 percent of the economy, the result is 0”*.

The efficiency of these programs has not been evaluated yet, and policymaker respondents believe that more time is needed until an evaluation can be done. According to the interviewed policymakers it is planned to conduct a full fledged evaluation process after three years. The SME strategy itself states monitoring mechanisms, according to which a high-level coordination group should be formed that will be in charge of the monitoring process. This group is already formed by the Minister’s Decree and all line ministry representatives are part of this group. Besides, working groups are created that prepare a report on an annual basis, one such report has already been prepared in 2016<sup>65</sup>.

It is arguable, whether in such a case, when funds are limited to achieve a large-scale result, the government should concentrate on further improvement of the overall external environment. Reforms directed towards improving business environment are more visible and tangible among entrepreneurs. It is important to *“correctly”* analyze

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<sup>65</sup> Policymaker 2 (Personal Communication on April 19<sup>th</sup>, 2017).

entrepreneurship so that support measures contribute to economic growth and development (Aidis and Welter, 2006).

#### **4.7.3 International Support**

On June 27<sup>th</sup> 2014, Georgia signed the Association Agreements (AA) with the European Union (EU). These agreements aim at fostering economic development, long-term stability, efficiency and predictability to businesses. AAs are also the basis for the creation of DCFTA, which in turn is to create new trade opportunities, boost foreign direct investments, economic modernization and create new jobs in the associated countries.

DCFTA is expected to fundamentally change the business rules and regulations within Georgia. The changes will affect not only exporters to the EU, but all companies, as the domestic business environment will also need to be aligned with EU standards. These changes may be particularly challenging for SMEs, which may need extra skills and more financial resources to adapt. DCFTA represents both an opportunity and a challenge for Georgian SMEs. The agreement, if implemented correctly, could catalyze institutional and regulatory reforms, helping align standards with those of the EU. The Agreement could potentially help exploit the largely untapped opportunities in a number of economic sectors, could create conditions for technology and knowledge transfer for Georgian businesses to help them integrate into global value chains.

As mentioned, the Agreement represents both an opportunity and a challenge. On the one hand, the agreement is expected to bring about opportunities in terms of new markets, access to EU funding, technological know-how and updates, increased competitiveness and capacity. On the other hand, if not informed and assisted, SMEs might face a challenge in complying with the new requirements and in utilizing the full potential of the agreement. Large businesses will not have a problem to readjust, while the smaller ones might suffer, especially those that are engaged in the agricultural sector. Possible challenges might also be connected with the lack of educated specialists in a narrower fields such as veterinary, labor safety and environmental specialists. Export challenges are on the one hand connected with food or other safety standards, regulations and on the other there is a problem related to volumes and uninterrupted supply: one has to have a volume of products on regular basis that are large enough to be exported.

The interviewed experts and entrepreneurs believe that the government needs to be more proactive in providing consultancy and information to businesses on how to adapt to new regulations. Since this is a political choice, the government should support the private sector representatives to adopt. This concerns especially SMEs, since large businesses have the capacity to hire consultants to understand the upcoming legislative changes and to adapt appropriately. Alternatively, this type of consultancy is a “luxury” for SMEs that cannot pay for information. On the governmental level, it was planned to actually establish such a consulting agency on the DCFTA issues, however the idea was not elaborated further.

Georgia is an active member of the Eastern Partnership (EaP) initiative, which is a joint initiative involving the EU, its member states and 6 eastern European partners: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Among other issues, the initiative concentrates on economic cooperation and runs a number of multilateral platforms. A platform on economic integration and convergence with EU policies also focuses on SME cooperation and application of EU best practices to achieve sustainable economic development. The EU funds various projects supporting SMEs in the region.

Georgia cooperates with a number of international organizations that provide various types of assistance to the private sector development in the country, with a particular focus on SMEs. Some of these organizations are the OECD, European Education and Training Foundation (ETF), and European Bank for Reconstruction and Development (EBRD). For example, the Enterprise Growth Program and Business Advisory Services supported by EBRD have assisted more than 800 SMEs in Georgia. Georgia also participates in the East Invest project funded by the EU that also aims at providing SME support. Yet another project supported by OECDs targets development of Green SMEs and increasing environmentally sustainable practices among SMEs.

In 2015, a new EU support project was signed that envisages support for SMEs and the DCFTA implementation process with a total budget of 44.5 million Euros. The project aims at: 1) Strengthening DCFTA policy framework and SME support; 2) strengthening institutions related to trade and private sector; 3) strengthening economic agents and SMEs in parallel with the DCFTA processes.

Through the EU4Business initiative, in the years between 2009-2017, the EU contribution to the Georgian SME sector reached almost 70 million Euros, which triggered 882 million worth of loans to companies thus supporting 37,800 enterprises in loans training provision and advice<sup>66</sup>.

These figures show that apart from the role of the state, the role of international donor organizations cannot be underestimated. The funding provided through such organizations are of critical importance in the directions of fostering reform process and private sector development.

#### **4.7.4 Business Support Organizations**

Apart from the two dedicated state agencies, three organizations directly focused on SME support should be mentioned. These are the Georgian Chamber of Commerce and Industry (GCCI), the Georgian Employer's Association (GEA) and the Georgian Small and Medium Business Association (GSMEA).

GCCI is an independent state agency. Its main function is to provide information and consultation support to businesses, increasing business skills and planning capacities, providing support in export and internationalization. As of now, the Chamber has 1007

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<sup>66</sup> EU4Business. [www.eu4business.eu](http://www.eu4business.eu)

members, 90 percent of which are SMEs. The membership fee is not fixed and ranges from 0 to 10 thousand GEL. SMEs are exempt from membership fees. The Chamber has five regional offices. It is actively involved in organizing roundtable discussions with policymakers, advocating needs of the private sector and providing expertise and capacity building in the direction of EU's AA and upcoming amendments in legislation.

GEA is an independent organization that unites more than one thousand SMEs. The association provides consultations to SMEs in order to increase their entrepreneurial knowledge and skills. Membership fees ranges from 600 USD to 2000 USD based on company size.

GSMEA is an independent organization that aims at advocating interests of SMEs. The organization is actively cooperating with SMEs to develop their entrepreneurial skills. The organization has 106 members.

Apart from these three organizations, there are several sectoral associations that are gaining popularity and membership among SMEs. Influence of entrepreneurship network organization is limited in the developing context. Establishment of effective membership organizations is not an easy task and it takes time (Verhaul, et al. 2001). Georgia is no exception, this study findings show that membership in associations is not very common, therefore individual involvement of SMEs in the decision making process is quite hard. However, significant progress was made in the direction of promoting associations and business network memberships. Even though this culture is still immature in Georgia, findings show that membership of sectoral associations is viewed as particularly beneficial for gaining access to information, sharing experience and advocating for particular issues. Membership in this type of associations is gaining popularity among entrepreneurs. The associations should be more active in communicating and popularizing themselves. Quite often, SMEs do not have enough information about the associations and potential benefits of membership.

#### **4.7.5 SME Development Strategy of Georgia 2016-2020**

The GoG has declared private sector development as a priority and in particular increasing competitiveness of SMEs in the context of the EU's DCFTA requirements. Bringing the private sector in compliance with the DCFTA requirements is important for increasing the export potential and competitiveness of the private sector.

The strategy is built on four strategic directions that are divided into sub directions and are mostly based on the OECD recommendations posed in the SME policy index 2016. Strategic directions and sub directions were shaped based on the international rankings with the aim to improve Georgia's ratings in various directions.

##### **Strategic direction 1: Streamlining legislative, institutional and entrepreneurial environment**

###### **1.1 Streamlining bankruptcy and insolvency procedures;**



- 1.2 Renewal of SME definition;
- 1.3 Improving Statistical information availability on SMEs;
- 1.4 Strengthening of SME support institutions;
- 1.5 Strengthening Public-Private Dialogue;
- 1.6 Establishing Regulatory Impact Assessment (RIA) mechanisms for priority legislations.

#### **Strategic direction 2: Improving Access to Finance**

- 2.1 Improving financial education;
- 2.2 Supporting SMEs to establish International Financial Reporting Standards (IFRS);
- 2.3 Increase capacities of SMEs in fundraising issues;
- 2.4 Attraction of private investment and venture capital for entrepreneurs and startups;
- 2.5 Supporting SMEs to get loans from banks and micro-finance institutions;
- 2.6 Improving grant funding for SMEs;

#### **Strategic direction 3: Development of entrepreneurs' skills and increasing entrepreneurial culture**

- 3.1 Identification of labor market needs and development of relevant employment programs;
- 3.2 Training Needs Assessment for SMEs;
- 3.3 Establishment of continuous entrepreneurial learning systems at all levels;
- 3.4 Development of entrepreneurship oriented professional education system;
- 3.5 Increasing access to informal education;
- 3.6 Ensuring technical assistance to entrepreneurship;
- 3.7 Development of educational component on the Enterprise Development Agency website;
- 3.8. Widening the scope of entrepreneurs' service centers;
- 3.9 Promoting women entrepreneurship;
- 3.10 Promoting "green practice" of entrepreneurs.

#### **Strategic direction 4: Export promotion and internationalization of SMEs**

- 4.1. Increase awareness regarding DCFTA and its requirements;
- 4.2 Supporting entrepreneurs in complying with DCFTA requirements;
- 4.3 Stimulating export activities among SMEs;
- 4.4 Supporting entrepreneurs in international trade networking activities (through the Enterprise Europe Network (EEN));
- 4.5 Popularization of Responsible Business Conduct (RBC);
- 4.6 Ensuring FDI and SME linkages;

#### **Strategic direction 5: Supporting innovation, research and development**

- 5.1 Stimulating innovation in SMEs through increased R&D;
- 5.2 Establishing effective innovation and R&D schemes;
- 5.3 Supporting commercialization of innovations and R&D;
- 5.4 Increasing capacities of entrepreneurs in usage of information and communication technologies (ICT);
- 5.5 Establishing innovation infrastructure (FabLabs; iLabs; TechPark; Broadband, computerization).

The Government is viewed as one of the key influencers in creating conditions that constrain or enable the process of entrepreneurship in a country. One should not only concentrate on the direct support measures and programs targeting the SME development, because any benefits coming from the latter programs can be easily outweighed by the negative effects that other government policies and actions can have on the business environment. This is specifically typical to the transition context. In case of Georgia, the government has pursued different types of policies targeting entrepreneurship and SME development. The role of international organizations is quite strong in shaping many of the policy decisions that are aligned with the international best practices. However, due to the internal constraints and weak capacities of entrepreneurs, many of the direct support measures or international programs and funding is less accessible for entrepreneurs.

It is essential to ensure synergies between the public policy initiatives targeting entrepreneurship and SME development. United Nations Conference on Trade and Development (UNCTAD) calls for coordination and coherence of the entrepreneurial ecosystem consisting of institutions, people and processes. Successful entrepreneurial policy framework requires what UNCTAD calls the “whole government” approach.

## 4.8 Factors affecting entrepreneurial outcome in Georgia

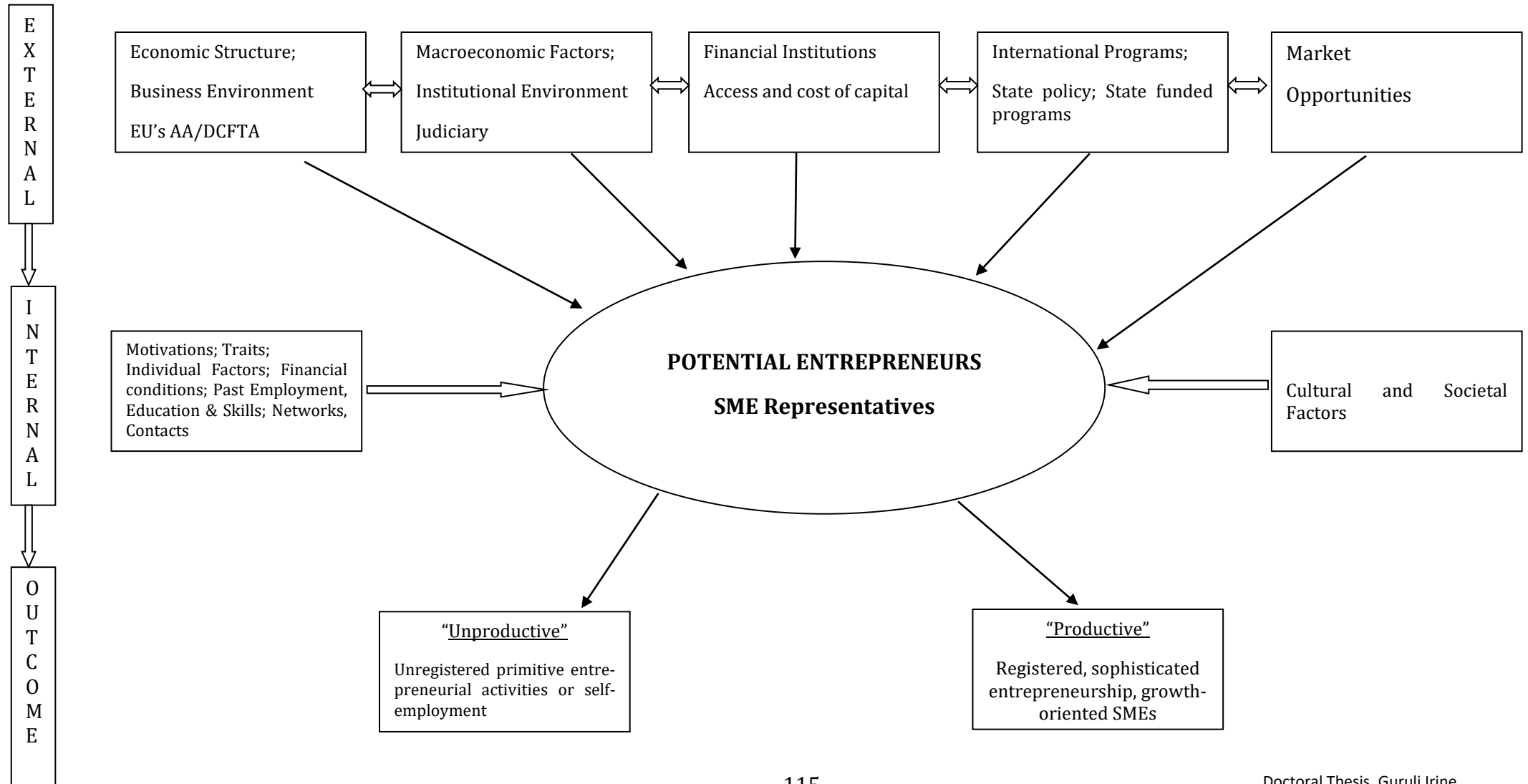
Through the graph presented below (f.27), I try to summarize the main findings of this study. As a result of the thesis one can conclude that the entrepreneurial outcome in Georgia is based on the interplay between the external and internal factors. We see two types of entrepreneurs currently operating the country: the registered enterprises that have a potential of growth and development, which can be labeled as “productive ones”, and the unregistered, self-employed or micro enterprises that are engaged in generic business activities and do not have growth and development potential, these can be labeled as “unproductive” entrepreneurs.

On the side of the **external factors**, five main factors affecting entrepreneurial outcome in Georgia were identified: 1) political orientation, EU aspirations, the association agreement and the opportunities and challenges that it presents, overall economic structure of the country including macro business environment; 2) macroeconomic factors and economic stability, inflow of foreign funds, institutional environment, legislative, taxation issues and independence of the judiciary; 3) availability and functioning of financial institutions banks, microfinance, access and cost of capital, development of alternative funding sources; 4) international programs and donor support, availability of international and state supported funds and programs; 5) market opportunities, changes on the domestic and international scales. These five factors do not only affect potential entrepreneurs and SME representatives, but also inter alia affect one another. That is to say, increase in the number of international and domestic grants, would also affect availability and access to finance. Likewise, stable macroeconomic environment, improved economic structure and utilization of the AA and DCFTA would positively affect access to new markets and new funds.

This study identified the following **internal factors** affecting potential entrepreneurs and SMEs, these are: motivations and individual traits, financial and socio-economic conditions of individual persons and their past employment, cultural and societal factors, education and skills, as well as networks, contacts and acquaintances affect the type of entrepreneurial outcome they pursue. As a matter of fact, these internal factors also help entrepreneurs to differently perceive and react to the opportunities or challenges posed by the external environment. That is to say, one can assume that with the right skills and knowledge, as well as the right contacts one might have less difficulty in overcoming some of the external barriers, for example those that are associated with access to finance.

**Entrepreneurial outcome** is not a static condition, but rather in itself affects external factors and environment in a country. That is productive or unproductive entrepreneurs feed back into the external environment and shape the economic structure, business environment, macroeconomic and institutional factors in a country.

Figure 26 **Factors Affecting Entrepreneurial Outcome in Georgia (author's conclusions)**



## 5 Selected cases of entrepreneurs

This chapter presents cases of three interviewed entrepreneurs that I found the most interesting. These cases will help the reader to gain better insights and feel the reality of the entrepreneurial context on the ground.

### 5.1 Case 1 Traditional Chateau: from Family Traditions to Entrepreneurship

**Entrepreneur V.I.**

**Male 35 years old, married, his wife is also actively engaged in the business activities**

The entrepreneur's father has been engaged in entrepreneurial activities for quite a long time already. He was active in different fields and V.I. has been helping him through the process and experimenting from time to time with different ideas. Father's business activities is the main source of the family income. The latest family endeavor is the Chateau in Kakheti region.

The idea came jointly together with their foreigner family friend. He visited Georgia, tasted Georgian wine and expressed his interest to start growing grapes and making his own wine. This was back in 2004. The deal was that the Georgian side would be responsible for finding the land, setting up the winery, testing the market, while the foreign partner would provide co-investment of 50 percent. 50 percent from the side of V.I. was given by his father and came from the savings previously made in the construction business. In parallel, V.I. and his family works in the capital to accumulate additional sums for further investments. Due to financial hardships, they decided to sell half of their share to another person. Therefore, currently, they own 25 percent only.

Since the family is originally from the wine making region of Georgia – Kakheti, they had information on the different areas of the region, and picked the area that in their view was the best for setting up the winery. Initially due to Georgian traditions, they had preliminary knowledge of grapes and winery; most of the people from Kakheti have this type of knowledge. However, now V.I. knows a lot more about the wine technology, he developed a lot and works on being up to date with his knowledge and information.

In 2005, they planted their first grapes. Since 2004 up until now, they employ around 40 people, all of them are locals; this is done due to the social responsibility, although it might also be so that bringing in outsider workers could be problematic for the local villagers, meaning they might find it unethical and unexcitable. As of now, the winery counts 8 hectares and they are planning to add three more hectares next year. It costs approximately 15 thousand dollars for bringing one hectare of land to the harvesting stage. It is noteworthy, that the land and other fixed assets are registered on an individual name, hence it is easier for management purposes. The 50 percent "share" of

the foreign partner is not registered on paper but rather is a gentleman agreement between the parties, the 25 percent of share that V.I. recently sold is registered officially.

Up until 2013, the company was only concentrated on wine production and sale. However, in 2013, due to the specificity of sales, it was decided to bring in the new component of chateau. Namely, to build a hotel at the production site for generating additional revenues.

Administrative barriers – problems are mainly related to land ownership and registration. Due to the moratorium on the sale of agricultural land to foreigners, sale of arable land to Georgians has also become problematic. Instead of purchase, the government is offering a long-term lease. However, administratively making the long-term lease happen is also quite burdensome. If a land that one intends to lease is cultivated by a peasant and is in his/her *de facto* ownership, the government tends to refuse the lease request. In all other cases, the lease is granted upon hidden auction procedures, therefore the entire procedure might take up to 3 months and quite a lot of energy and time. Furthermore, there are many limitations on the land if it is leased. For example, one cannot build anything on that land. This is a recent change, while back in 2004, V.I. could register land on his name through an open auction, without additional barriers. He believes that if an entrepreneur is willing to start up a business, employ local population, create additional value added in the region, the state should support in at least not imposing additional barriers. When the land is leased, there are minor problems related to presenting soil analysis on annual basis after 5 years of lease agreement. They were fined due to changes of regulations that they were not aware of. In short, if it is a preliminary (initial) registration it is almost impossible to purchase land, it is much easier to purchase from someone else. However, in the conditions when 70 percent of agricultural land is not registered, this becomes almost impossible.

*Market constraints* – there is a market for wine and it is easy to sell. However, if the point of sale is a supermarket/shop, receiving reimbursement is very problematic. This was the main reason why V.I. decided to invest in the Chateau concept. The idea was that in one place one would produce and sell, accept guests, and thus, merge the wine tourism in the concept.

V.I. is a beneficiary of the agro credit program, through which the state offered him a subsidized agro loan. It is a 7-year loan; he pays 1 percent interest and the original sum. The state pays 12 percent interest for the first two years. He says he would have applied for the loan even without the state program, however after three years. The state program helped him to fasten the processes. He positively assesses the program, however the collateral was huge, and he needed to present 1 million worth of a collateral to receive a loan of 220 thousand. As of now, the business is not profitable; they are in the heavy investment phase. For the state support, V.I. believes that the state role should be in supporting the overall infrastructure, bringing communications to the regions, coverage with gas, water supplies and investing in good road infrastructure.

## 5.2 Case 2 Textile Store from Hobby to a Successful Business

### Entrepreneur I.N Female, 55 years

From early childhood she liked to sew. During her travels to Moscow, she was visiting fashion galleries, attending various exhibitions and got a good sense of fashion and textile industry. Due to the financial hardship, she decided to turn to her hobby in order to earn some money for survival. Her initial investment was 300 USD. With that money in 2004, she went to Turkey to purchase textile for further resale in Georgia. The factory that she turned to, she knew due to her prior experience in the field, she was aware that this particular factory was one of the best in terms of quality and originality of the products they had. Out of the 300 USD, she bought 170 USD worth of textile and the rest she spent on her travel by bus. Yet again, her knowledge of the field helped her in identifying designer salons that could have potential interest in purchasing the material. I.N. was successful in selling the textiles she bought and went to Turkey for the second time. In order to sell quickly she only had mark-up of 10 percent. Up till now, she sticks to this principle.

This process continued for about a year and she managed to accumulate some money to rent one corner in the salon and have her own space for selling. After a couple of years, she managed to rent her own space and open up a store. Currently she owns the store. Particular value added in her store is that it goes beyond the sale of textile. She herself is involved in assisting a customer in choosing the material, she sketches possible designs for them, advises how much and what type of the material will be needed for a particular design. Currently, the store also has all types of accessories that could go with the material in the sewing process. It can be said that the store is unique not only for Georgia, but also for the region. Customers of the store represent different countries of the region.

*State administration:* she cannot identify any obstacles, along with growth there was a need of hiring an accountant. Import and taxation procedures are transparent and clear. I.N. hopes that the tax rates decrease someday.

*Access to finance* – she got a mortgage for purchasing the store. It was easy for her to receive a bank loan due to her credit history. She used her own apartment where she resides as an additional collateral for receiving this mortgage. It is a ten-year loan; therefore as of now, she does not have any growth prospects. She is quite cautious with how much she grows; she does not like large liabilities and prefers to take it easy. I.N. does not have real plans on expansion through adjacent sectors; she thinks that is it better to do one thing perfectly than several and not so well. She had offers for selling part of her business, but she is hesitant to do so. She prefers the whole business to be hers, to avoid possible conflicts with partners.

*Key to success:* precise knowledge of the sector, textile technology and materials; continuous training and learning; pricing strategy and high quality materials chosen with taste.

*Moto:* if you work hard, everything is possible, even in Georgia.

### **5.3 Case 3 Tea production from Entrepreneurship to Social Entrepreneurship**

#### **Entrepreneur N.P., female 45 years old**

N.P. had a high-paid job, but wanted to do something interesting and inspiring. The job was boring, she could not develop herself, and she lacked self-realization. So the idea of thinking about some type of business came into her mind. She had diverse set of ideas, but decided to start from something that did not need particularly large amount of resources. She decided to start production of handmade, premium niche, mixed herbal tea of various sorts. All her assets at the initial stage included a small house and a small piece of land in the village in Georgia and one thousand GEL. At the beginning, she purchased bio certified seeds for growing aromatic herbs from France and grew them in a handmade greenhouse.

A small grant from the international donor organization in the amount of 7 thousand EURs helped her in rehabilitating the house according to the EU standards, providing watering system, and establishing a dryer. Her experience in France helped her in these works; she had seen something similar and conducted the works according to that model. Production, drying, mixing and packaging was taking place in that village with the help of local women. In parallel, she rented and renovated a brand shop in Tbilisi, which also served as a small café for tea drinking. In order to maintain the shop and other expenses she sold part of her share to two more people and currently there are three individuals in the business. She takes care of distribution, main points of sales are the brand shop/café and touristic places.

*Sale* – she uses her own shop for sales. Entrepreneurs that rely on other stores/supermarkets face cash flow problems due to late repayments. It takes 4-5 months or even more.

*Access to finance* – banks have no interest in reading a business plan. They are only interested in the collateral. There is no such thing as a business loan per se.

*Taxation* – taxation incentives in the agricultural sector only concern primary production. Processing is not fostered, for creating value added in the country it is important to concentrate on motivating processing entrepreneurs.

*State programs* – she could not find the right program. The sums are either too small or too large for her needs.

*Raw material* – not all type of herbs are produced by N.P. she also relies heavily on the suppliers. That is the key challenge for her, finding reliable, trustworthy suppliers. There is no drying infrastructure in the regions of the country, so she transports raw



materials and dries them at her factory. The problem with that is that sometimes the raw material goes bad during long haul transportations. This is when the idea of having her own plantations came.

Orphanage house in Tbilisi owns 30 hectares of land, they expressed interest in working in the direction of employing individuals reaching the age of 18 who can no longer stay at the orphanage. In that case, the company will purchase the herbs harvested by the orphanage house. As of now, preliminary soil analysis was conducted and the soil is a good fit for the herbs that the company needs. So, it turns out that the company is transforming into a social venture. The brand name created will be used for social purposes as well. The volume will be quite large and if there is no market for processed tea of this volume domestically, they will be trying to venture to international market or sell the herbs harvested in bulk. Even though the markup for selling in bulk is lower, payments are faster and this sum will be reinvested in further development of the brand.

*Key to success* – contacts, networks, knowledge of the field.

## 6 Conclusions and Contributions

Reforms undertaken during the course of the past years and steps taken towards EU integration involved significant changes for entrepreneurs and SMEs operating in Georgia. These changes brought simplification and improvement of business environment and presented opportunities by opening of new markets and new possibilities. However, further reforms and steps need to be taken towards achieving increased capacity of Georgian entrepreneurs and SMEs to become sources of innovation, job creation and sustainable economic development.

Notwithstanding the fact that in parallel to the reform process, the number and turnover of SMEs in Georgia have substantially increased, it is still arguable whether these firms play an important economic role as agents of change through entrepreneurial and innovative activities. Composition of SMEs in Georgia, as well as characteristics of the self-employed, show high concentration of their activities in “unproductive” entrepreneurship. These “unproductivity” characteristics are low income generation, low growth potential, low innovation and value added, low job creation potential.

Potential of SMEs in Georgia is yet to be exploited in the following directions: diversification of economic structure; identification and emergence of new sectors and new markets; internationalization and integration into the global economy; establishment of SMEs as sources of innovation; strengthening research and development component; contribution to economic development through linkages with other businesses and through inter-firm level cooperation; acting as suppliers to larger firms; and increased collaboration with academia. The country’s western orientation and EU aspirations will play a positive role in the development processes.

Study findings varied according to the business size. In case of self-employed and micro business owners, one can assert that internal constraints related to business owner characteristics prevail, while in case of small and medium-sized enterprises that have larger growth and development potential at this stage, external barriers represent a major constraint. It can be stated that self-employed and micro group is similar in characteristics and constraints they face, while small and medium size enterprise representatives tend to also perceive similar constraints and have alike characteristics.

This study results revealed that apart from the factors that are at the discretion of the government, there are a number of other external factors affecting entrepreneurship and SME development that are not solely dependent on governmental policy, these include international market tendencies and macroeconomic situation in the neighboring countries.

Since gaining independence, the government of Georgia has been employing various public policy tools for fostering entrepreneurial activities in the country. However, one can argue the economic impact of these policies, especially impact of the so-called direct support measures is questionable. In line with the reforms undertaken by the government of Georgia over the course of past years, respondents believe that the overall business environment is gradually improving.

Indirect support measures fostering business environment have a larger effect on the entrepreneurial outcomes as compared to direct support measures that benefit only a handful of entrepreneurs. This study findings can lead to the conclusion that more efforts should be directed towards combating institutional weaknesses rather than to the provision of direct support measures that due to budgetary constraints have a limited impact. In practice, however these are not mutually exclusive approaches. Both can be used to promote entrepreneurship and SME development.

The findings show that Unstable, highly volatile and unforeseeable macroeconomic environment represents a major challenge for entrepreneurship and SME development in the country. This study additionally reveals challenges related to access to finance due to the high cost of capital, rigidity and risk assessment practices of bank institutions. These findings highlight that the perceived constraint of lack of finance is not the only problem. Most of the entrepreneurs do not see the need to apply for loans. Therefore, the problem does not solely lie in the supply of capital but also effective demand for it. Entrepreneurs also lack business sophistication and competitive capacity in Georgia.

On the side of the internal barriers, the problem of skills and education of the entrepreneurs as well as the general workforce in the country was identified as an acute issues that needs due attention.

As a result of this thesis one can conclude that the entrepreneurial outcome in Georgia is based on the interplay between the external and internal factors. There are two types of entrepreneurs currently operating the country: the registered enterprises that have a potential of growth and development, which can be labeled as “productive ones”, and the unregistered, self-employed or micro enterprises that are engaged in generic business activities and do not have growth and development potential, these can be labeled as “unproductive” entrepreneurs. Entrepreneurial outcome is not a static condition, but rather in itself affects external factors and environment in a country. That is productive or unproductive entrepreneurs feed back into the external environment and shape the economic structure, business environment, macroeconomic and institutional factors in a country.

This study has theoretical and practical contributions. It is of interest for researchers and policymakers. The study presents not only a specific country environment, but also dwells into different stages of transition process and its impact on entrepreneurship and SME development, describes factors affecting entrepreneurial outcome in the advanced transition countries; analysis expends on building on the notion of formal and informal institutions, to add value to the question of how can they be transformed to convert unproductive entrepreneurial activities into productive forms that generate value-added to wider economy; special attention is paid to different policy choices and usage of direct and indirect support measures for fostering entrepreneurship. The thesis extends research on emerging economies to the region that is not so often on the radar screen of researchers. Therefore, the study contributes to emerging economy and entrepreneurship literature and serves as a practical guide for policymakers for promoting entrepreneurship in emerging context.

The study results have important policy implications. The following policy recommendations can be derived from the thesis:

- Improve regulatory framework and policymaking practices for businesses

Consistent economic policymaking practices are needed to overcome turbulent macroeconomic environment with unstable national currency and inflation risks.

Greater efforts are needed to create foreseeable business and investment environment. This includes provision of inclusive policymaking practices that are based on rigorous analysis and *ex ante* regulatory impact assessment for legislative changes having significant effect on private sector and economy.

Greater transparency and certainty must be ensured in the policymaking practices. The government should announce foreseen changes and give a possibility to the private sector to engage in the dialogue process and be on board as early as possible.

More specific reforms should be taken in the direction of improving exit procedures for businesses and the so-called “second chance” for entrepreneurs.

Reform of judiciary and establishment of trustworthy alternative dispute settlement mechanisms needs to become a priority for improving Georgia’s rankings for potential domestic as well as foreign investors.

Further steps are needed for improving protection of private property rights and the rule of law.

Along with the streamlining of tax administration, further reduction of tax burden seems to be a necessary precondition for achieving higher economic development. This specifically concerns indirect tax rates.

In order to foster entrepreneurial mindset in the society, relevant state agencies should pay particular attention to further displaying successful entrepreneurs and sharing experience.

- Improved access to information and capital

Steps need to be taken to ensuring equal access to information regarding the state funded programs and direct support measures. In order to streamline access to capital, the government can establish favorable financing programs for SMEs by developing early-stage risk capital with special emphasis on relatively innovative startups and SMEs. Along with the interest rate subsidy, further attention should be paid to the provision of the necessary collateral.

Reforms for creating alternative sources of capital are rather timely, yet need further economic advancement and development.

In line with the provision of second chances for entrepreneurs, post-petition financing mechanisms could be considered. The unavailability of post-petition financing is a limi-

tation in the framework for reorganization for viable businesses. This mechanism could be additionally introduced during the reform process of the insolvency law.

- Entrepreneurial learning and improvements in research and development

Business and managerial skills and lack of subsequent entrepreneurial knowledge represent a constraint in business growth and development. Additionally, skill mismatch is a frequently cited problem by entrepreneurs looking for human resource. Primary and higher education systems need to reorient to produce more industry-relevant skills.

At the basic education level, school curriculum needs to factor in prerequisites that encourage innovative thinking. In addition, more emphasis is needed on industry-relevant vocational training and education courses that cater to the technical needs of the various priority sectors identified by the government and the private sector.

Another important area is the provision of adequate managerial and marketing competencies, as the analysis showed that many founders had these skills, which possibly set them apart and provided them with the requisite skills to start their entrepreneurial activity.

Investments in research and development is practically nonexistent, even among high-growth firms, and there is virtually no industry-research collaboration. Synergies must be built between these two communities in the priority areas identified by the government.

## 7 Limitations

The researcher is aware of several limitations of this study. Firstly, the study mainly concentrates on assessment of formal institutions, while the informal institutions, given the methodological limitations are not being analyzed in depth. For the purpose of this study, not only SMEs, but also the self-employed and micro enterprises are considered as proxy for entrepreneurship which might be a cause of a possible bias.

The longitudinal study surveyed the self-employed, micro and small enterprises, thus the study assumes that the medium-sized enterprises are of similar opinion, which is a cause for another possible bias. The limitation is mitigated through in-depth interviews, which will collect data on SMEs. Longitudinal study and the interviews were conducted with a one-year difference. This lag in time, might be a cause for misinterpretation, the risk is mitigated through rigorous analysis of secondary data.

Mixed methodology and analysis of data collected via the method might be a cause of a number of limitations and might be a reason for a subjective nature of the study. Although, as mentioned in the methodology, the research deals with people, their actions and behaviors and aims at exploring a particular phenomenon, therefore this approach could be regarded as appropriate, if it serves to collect and merge diverse data.

Sampling method used for conducting in-depth interviews, i.e. non-probability snow-ball sampling might be a further cause for possible bias. Although, due to the fact that the desired population is very small, and in some cases hard to identify, this is the only feasible option to proceed. However, this technique is particularly useful for choosing particularly informative cases. In particular, the extreme case or deviant sampling will be used to focus on unusual or special cases, so that the outcomes will enable the researcher to learn the most and answer research questions and meet research objectives in the most effective way.

## **8 Future Research**

Further research can be done in unfolding the role and determinants of the informal sector in Georgia. In particular, studying the entrepreneurial potential of the self-employed and other actors working in the informal sector. This could uncover the motives for not registering their business activities even further to identify whether the reason lies in institutional weaknesses or other personal characteristics.

Additional research could be beneficial for studying the affect and role of the direct support measures on entrepreneurial outcomes and entrepreneurial climate in the country. Importance of such measures could be studied by identifying their possible impact and sustainability as well as spillover effects.

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## 10 Appendices

### 10.1 Survey Questions for Self-Employed

#### A.CONTROL INFORMATION [TO BE COMPLETED BEFORE INTERVIEW]

<b>A.1a</b> Language of the interview	

Time face-to-face interview begins:

<b>A.2 Sampling region</b>	
Region A	1
Region B	2
Region C	3

<b>A.3</b> Name of city/town/village	

<b>A.4 Size of locality</b>	
City with population over 500'000	2
Over 100'000 to 500'000	3
20.000 to 50.000	4
Less than 50.000	5

Day (dd)	Month (mm)	Year (yyyy)	Hour (00 to 23)	Minutes (00 to 59)

#### READ THE FOLLOWING TO THE RESPONDENT BEFORE PROCEEDING.

The goal of this survey is to gather information and opinions about the emergence and evolution of entrepreneurship. The information gathered here will help to develop new policies and programs that enhance employment and economic growth. It will be repeated every 6 months, for 2 years. That is why we would be grateful if you would allow us to record your name and phone number in order to get back in contact with you in 6 months.

The information obtained here will be held in the strictest confidentiality. Neither your name nor the name of your business will be used in any document based on this survey.

Name, surname of the interviewee	
Male / female	
Phone number of the interviewee	

Email address of the interviewee	
Age	
Marital status	
Number of children	
What is your educational background?	
Do you have any training in business or management?	

### BLOCK 1. GENERAL INFORMATION AND HISTORY

<b>B.1</b>	What is your activity?	
Agriculture		1
Trade		2
Wholesale		3
Repair of machinery		4
Tourism		5
<b>OTHER (SPECIFY)</b>		

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<b>B.2</b>	Is this activity your main source of revenue, or do you have other ones ?	
The only one	1	<b>GO TO QUESTION B4</b>
Other one	2	
<b>DON'T KNOW</b>		

<b>B.3</b>	What are your other activities?	
Agriculture		1
Trade		2
Wholesale		3
Repair of machinery		4
Tourism		5
<b>OTHER (SPECIFY)</b>		

--

<b>B.4</b>	Do you get help from a friend or a family member or other people on a regular basis ?	
Yes <b>(SPECIFY HOW MANY)</b>		1
No		2
<b>DON'T KNOW</b>		4

<b>REFUSED</b>		<b>-9</b>	
<b>B.5</b>	Do you hold an accounting record?		
Yes		1	
No		2	
<b>DON'T KNOW</b>		4	
<b>REFUSED</b>		<b>-9</b>	
<b>B.6</b>	Do you operate with contracts and written terms of transactions or mainly orally?		
Mainly orally		1	
Mainly with written terms and contract			
<b>DON'T KNOW</b>		4	
<b>REFUSED</b>		<b>-9</b>	
<b>B.7</b>	For how long have you been doing what you do now?		
1-3 years		1	
3-5 years		2	
More than 5 years		3	
<b>OTHER (SPECIFY)</b>		4	
<b>DON'T KNOW</b>		<b>-9</b>	
<b>B.8</b>	How did you start this activity?		
You heard about someone doing the same thing?		1	
It is an activity that you were already doing in the past as an employee		2	
Because some people ask you to?		3	
Because there was nothing else to do?		4	
<b>OTHER (SPECIFY)</b>		5	
<b>DON'T KNOW</b>		<b>-9</b>	
<b>B.9</b>	Would you describe what you do as a "business"?		
Yes		1	
No		2	
<b>OTHER (SPECIFY)</b>		5	
<b>DON'T KNOW</b>		<b>-9</b>	
<b>B.10</b>	Do you think that you earn enough revenue from your business?		
To live comfortably		1	
To live normally		2	
To live very simply			
To survive			
<b>DON'T KNOW</b>		<b>-9</b>	

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<b>B.10</b>	Could you give us an approximate idea of the turnover that your activity is generating	
	0-200 GEL	1
	200-1000 GEL	2
	1000-2000 GEL	
	More than 2000 GEL	
	<b>DON'T KNOW</b>	<b>-9</b>
	<b>REFUSED</b>	

<b>B.11</b>	Would you say that the revenue that you get from your activity is stable?	
	Yes, very stable	1
	More or less stable	2
	Not stable at all	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>B.12</b>	Would you say that your activity is	
	Growing fast	1
	Growing slowly	2
	Stagnating	
	Decreasing	
	<b>DON'T KNOW</b>	<b>-9</b>

## BLOCK 2. PROJECTS / EXPECTATIONS / INTENTIONS

<b>C.1</b>	Do you plan to sell more of your services or products in the coming 3 months , 6 months, or 2 years? <b>MORE THAN ONE ANSWER IS POSSIBLE</b>	
	No	1
	3 months	2
	6 months	3
	2 years	4
	<b>DON'T KNOW</b>	<b>-9</b>

**GO TO QUESTION C3**

<b>C.2</b>	To do so, what you are going to	
	Find new partners / distributors /sales	1
	Invest in new equipment	2
	Change the way you conduct your business	3
	Change the marketing	4
	<b>OTHER (SPECIFY)</b>	5

<b>DON'T KNOW</b>	<b>-9</b>	

<b>C.3</b>	Do you plan to hire people in the next 6 months?	
Yes <b>(PLEASE NOTE THE NUMBER OF PEOPLE)</b>	1	
No	2	
<b>DON'T KNOW</b>	<b>-9</b>	
<b>REFUSED</b>		

<b>C.4</b>	Do you plan to get help from more people in the coming 6 months, and if so, how many?	
Yes <b>(PLEASE NOTE THE NUMBER OF PEOPLE)</b>	1	
No	2	
<b>DON'T KNOW</b>	<b>-9</b>	
<b>REFUSED</b>		

<b>C.5</b>	Do you plan to register your activity as a business in the coming 6 months	
Yes	1	
No	2	
<b>DON'T KNOW</b>	<b>-9</b>	
<b>REFUSED</b>		

<b>C.6</b>	Do you think the general situation for small businesses will get	
Better	1	
Worse	2	
Will not change		
<b>DON'T KNOW</b>	<b>-9</b>	

## INTENTIONS TOWARD ENTREPRENEURSHIP

<b>C.7</b>	Do you plan to sell NEW product , NEW services or products or services of BETTER QUALITY?		
No		1	<b>GO TO QUESTION C9</b>
NEW product and services		2	
Product and services of BETTER QUALITY		3	
<b>DON'T KNOW</b>		<b>-9</b>	
<b>C.8</b>	To do so, are you going to		
Find new partners / distributors /sales?		1	
Invest in new equipment?		2	
Change the way you conduct your business?		3	
<b>OTHER (SPECIFY)</b>		4	
<b>DON'T KNOW</b>		<b>-9</b>	
<b>C.9</b>	Are you, alone or with others, expecting to start a new business, including any type of self- employment, within the next three years?		
Yes		1	<b>GO TO QUESTION D1</b>
No		2	
<b>DON'T KNOW</b>			
<b>REFUSED</b>		<b>-9</b>	
<b>C.10</b>	Do you plan to do anything to start this business such as looking for equipment or a location, organizing a start-up team, working on a business plan, beginning to save money, or any other activity that would help launch a business?		
Yes		1	
No		2	
<b>DON'T KNOW</b>			
<b>REFUSED</b>		<b>-9</b>	



### BLOCK 3. MOTIVATIONS

<b>D.1</b>	What is the motivation for doing what you do? (NOT MORE THAN 3 ANSWERS ARE POSSIBLE)	
	Take advantage of a business opportunity	1
	No better choice for work	2
	To be my own boss	
	To increase my income	
	To provide jobs for family members	
	For my own satisfaction and growth	
	So I will always have job security	
	To build a business to pass on	
	To be closer to my family	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>D.2</b>	Which of the following reason do you think is the most important to start a business?	
	Increase personal income	1
	Just to maintain income	2
	Greater independence	
	Status	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>D.3</b>	Would you stop doing what you do for the same revenue, but as an employee?	
	Yes	1
	No	2
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>D.4</b>	Would you be ready to follow training or courses if it could improve your business?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>D.5</b>	Would you be ready to take more financial risks to develop your business?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

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#### BLOCK 4. FORMAL AND INFORMAL INSTITUTIONS

##### LEGAL FRAMEWORK

<b>E.1</b>	Do you have to have some kind of registration or official document to do what you do	
Yes		1
No	<b>SPECIFY WHAT KIND OF DOCUMENT IF POSSIBLE</b> (Registration, licence, ect..)	2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

--

<b>E.4</b>	In your relationship with the state administration, what kind of problem do you encounter most?	
	I don't have any relationship with state administration	1
	Tax problem	
	Labor regulation (social taxes, working hours..)	2
	Business regulation (licenses)	3
	<b>OTHER</b>	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>E.5</b>	How do you solve this problem?	
	Read law/ask lawyer	1
	Talk with friends or colleagues	2
	Ask directly the administration	3
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>E.1</b>	In your relationship with your "supplier" or "clients", what kind of problems do you encounter most?	
	Late or no payment	1
	Late or no supply	2
	Transaction not according to what was agreed / contract	
	<b>OTHERS</b>	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>E.2</b>	When such problems happen, what do you do?	
	Read law/ask lawyer	1
	Ask a public officer	2
	Find a peaceful solution with the person concerned	
	<b>OTHER</b>	
	<b>DON'T KNOW</b>	

<b>REFUSED</b>	<b>-9</b>
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<b>E.3</b>	Have you ever gone to court for a problem with your partner, supplier, or client?
------------	---

Yes	1
-----	---

No	2
----	---

<b>DON'T KNOW</b>	
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<b>REFUSED</b>	<b>-9</b>
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<b>E.13</b>	I am going to read some statements that describe the administration in general and how it could affect businesses. For each of them, could you please tell me if you Strongly disagree, Tend to disagree, Tend to agree, or Strongly agree.
-------------	---

	Strongly disagree	Tend to disagree	Tend to agree	Strongly agree	<b>DON'T KNOW (SPONTANEOUS)</b>	
"The state administration is fair, impartial and uncorrupted."	1	2	3	4	<b>-9</b>	
"The state administration is quick."	1	2	3	4	<b>-9</b>	
"The state administration is clear and predictable."	1	2	3	4	<b>-9</b>	

#### INFORMAL INSTITUTIONS - ATTITUDE TOWARD ENTREPRENEURSHIP

<b>F.1</b>	How do you think Georgian look at people who started businesses like you?
------------	---

They think it is good for the economy and the country	1
---	---

They think that people who start businesses are thieves	2
---	---

They think that people who start business do it only for the money	3
--	---

They think that people who start businesses are conman	
--	--

They do not think anything	
----------------------------	--

<b>DON'T KNOW</b>	
-------------------	--

<b>REFUSED</b>	<b>-9</b>
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<b>F.2</b>	Would you agree that Georgian culture favors "businessmen"?
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Yes	1
-----	---

No	2
----	---

<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>F.3</b>	Would you agree that Georgian culture looks positively at those for take risks to develop a business?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>F.4</b>	Are the terms of the your work relationships always written in a contract or is it oral	
Written contract		1
Oral		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>F.5</b>	In business, do you think a moral, honest behavior is rewarded or, on the contrary, one has to learn to cheat sometime?	
Moral honest behavior is rewarded		1
Cheating is part of business life		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>F.6</b>	In general, do you trust your partner, clients and suppliers?	
Yes always		1
I like to deal with people recommended by others		2
No never		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>BLOCK 5. NON-MATERIAL AND MATERIAL RESSOURCES AND OPPORTUNITIES</b>		
<b>NETWORK</b>		

<b>G.1</b>	Do you receive help on a regular basis from your	
Parents		1
Children		2
Other family members		
Friends		
<b>OTHERS</b>		
<b>REFUSED</b>		<b>-9</b>

--

<b>G.2</b>	Many people may give you advice on your business. Have you received advice from the following?	
Your spouse or life companion		1
Your parents		2
Other family or relatives		
Partners		
A former boss		
Somebody in another country		
Somebody who has come from abroad		
Somebody who is starting a business		
Somebody with much business experience		
A researcher or inventor		
A possible investor		
A bank		
A development agencies		
A public advising service for business		

A costumer	
A supplier	
A firm that you compete with	
A firm that you collaborate with	
<b>OTHERS</b>	
<b>REFUSED</b>	<b>-9</b>

## INFORMATION AND KNOWLEDGE

<b>G.3</b>	What is the main sources of information that you use for your activity? ( <b>CHOOSE 2 OF THE ANSWERS BELOW</b> )	
Media		1
NGOS		2
Supplier and customer		
Friends and acquaintances		
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.4</b>	Would you say that these information have an influence the conduct of your business	
No influence		1
Some influence		2
A lot of influence		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.5</b>	Where did you learn to do what you do now	
Previous job		1
On the spot		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.6</b>	Do you use what you have learnt at school for your activity?	
No, not anything		1
To some degree yes		2
Yes, it helps me very much		3
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.7</b>	What is your educational level?	
University, college degree		1
Apprenticeship		2
Obligatory school		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

#### OTHER FORM OF RESOURCES & OPPORTUNITIES

<b>G.8</b>	Do you benefit from a government sponsored support program, and if so, which one?	
Yes <b>PLEASE SPECIFY WHICH ONE</b>		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.10</b>	Have you heard of people benefiting from aid program who have now a growing business?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

#### PERCEPTION OF OPPORTUNITIES

<b>G.11</b>	Do you know someone personally who started a successful business in the past year?	
Yes		1



No	2
REFUSED	-9

**G.12** Do you think there will be good opportunities for starting a business in the area where you live in the next 6 months?

Yes	1
No	2
DON'T KNOW	
REFUSED	-9

**G.13** Do you feel that you have the knowledge, skill and experience required to start a different business from the one you are running now?

Yes	1
No	2
DON'T KNOW	
REFUSED	-9

**G.14** Would fear of failure prevent you from starting a new business, or proposing new product or new services?

Yes	1
No	2
DON'T KNOW	
REFUSED	-9

#### MATERIAL RESSOURCES AND OPPORTUNITIES

**G.15** Last year, what was the main market in which you sold your main products or services?

Local – main product sold mostly in same municipality where the business is located	1
National – main product sold mostly across the country where the business is located	2
International - main product sold mostly to nations outside country where the business is located	
DON'T KNOW	

<b>REFUSED</b>	<b>-9</b>
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<b>G.16</b>	What are the material resource essential to the conduct of your business?	
Farm		1
Field		2
Animals		
Real estate		
Equipment		
Machinery (including car or truck)		
<b>OTHER</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

--

<b>G.17</b>	Did you purchase these items yourself or did you inherit them?	
Purchased		1
Inherited		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

--

<b>G.18</b>	Do you plan to use these items for some new other activities?	
Agriculture		1
Trade		2
Wholesale		
Repair of machinery		
Tourism		
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

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## FINANCE

<b>G.19</b>	At this time, do you have a bank account?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.20</b>	At this time, do you have a credit or loan, if so, could you tell the volume of the loan	
No, I don't have credit nor loan		1
Yes, up to 5'0000 GEL		2
Yes, between 5'0000 and 20'0000 GEL		
Yes, between 20'000 and 100'000 GEL		
Yes, above 100'000 GEL		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.21</b>	Do you have now or in the past had to take a credit from	
Bank		
Microfinance		1
Aid program		2
Friends and family		
None of the above		
<b>OTHERS</b>		
<b>REFUSED</b>		<b>-9</b>

**GO TO QUESTION G23**

**GO TO QUESTION G23**

<b>G.22</b>	To your opinion, are these sources of finance more convenient?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.23</b>	When you have a money problem in your business, how do you resolve it?	
You talk with your bank , microfinance, credit institution		1
You talk with your friends or family		2
You talk with your partner or supplier		
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>G.24</b>	Do you benefit from trade credit from your supplier?	
Yes		1
No		2
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
		<b>GO TO QUESTION G26</b>
<b>G.25</b>	Could you run your business without benefiting from this trade credit from your supplier?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
		<b>GO TO QUESTION G26</b>
<b>G.26</b>	This year, did you apply for any loans or lines of credit?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
		<b>GO TO QUESTION G28</b>
<b>G.27</b>	What was the <b>main</b> reason why you did not apply for any line of credit or loan?	
<b>INTERVIEWER: ONE ANSWER ONLY</b>		

No need for a loan - establishment had sufficient capital	1
Application procedures were complex	2
Interest rates were not favorable	
Collateral condition are too high	
Size of loan and maturity were insufficient	
It is necessary to make informal payments to get bank loans	
Did not think it would be approved	
DON'T KNOW	
REFUSED	-9

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<b>G.28</b>	To what degree is <b>finance</b> an obstacle to your current activity?
No obstacle	1
Minor obstacle	2
Moderate obstacle	
Major obstacle	
Very severe obstacle	
DON'T KNOW	
REFUSED	-9

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## 10.2 Survey Questions Micro and Small Businesses

### A.CONTROL INFORMATION [TO BE COMPLETED BEFORE INTERVIEW]

A.1a Language of the interview	

A.2 Sampling region	
Region A	1
Region B	2
Region C	3

\_\_\_\_\_

<b>A.3 Name of city/town/village</b>	

<b>A.4 Size of locality</b>	
City with population over 500'000	2
Over 100'000 to 500'000	3
20.000 to 50.000	4
Less than 50.000	5

Time face-to-face interview begins:

Day (dd)	Month (mm)	Year (yyyy)	Hour (00 to 23)	Minutes (00 to 59)

**READ THE FOLLOWING TO THE RESPONDENT BEFORE PROCEEDING.**

The goal of this survey is to gather information and opinions about the emergence and evolution of entrepreneurship. The information gathered here will help to develop new policies and programs that enhance employment and economic growth. It will be repeated every 6 months, for 2 years. That is why we would be grateful if you would allow us to record your name and phone number in order to get back in contact with you in 6 months.

The information obtained here will be held in the strictest confidentiality. Neither your name nor the name of your business will be used in any document based on this survey.

Name, surname of the interviewee	
Male / female	
Phone number of the interviewee	
Email address of the interviewee	
Age	
Marital status	
Number of children	
What is your educational background?	
Do you have any training in business or management?	

# BLOCK 1. GENERAL INFORMATION AND HISTORY

<b>B.1</b>	What is the activity of your enterprise?	
Agriculture		1
Trade		2
Wholesale		3
Repair of machinery		4
Tourism		5
<b>OTHER (SPECIFY)</b>		

<b>B.2</b>	Is this the first business activity for you?	
Yes, the first one	1	<b>GO TO QUESTION B4</b>
No, I had other business experiences	2	
<b>DON'T KNOW</b>		

<b>B.2</b>	What happened to the previous business?	
It was sold because you needed money	1	
It was sold because you wanted to do something else		
It failed because of insufficient sales		
It failed because of lack of finance		
It failed because of taxes and government intervention	2	
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		

<b>B.2</b>	Is this enterprise your only one or do you have other ones?	
The only one	1	<b>GO TO QUESTION B4</b>
Other one	2	
<b>DON'T KNOW</b>		

<b>B.3</b>	What is the activity of the other enterprise?	
Agriculture		1
Trade		2
Wholesale		3
Repair of machinery		4
Tourism		5
<b>OTHER (SPECIFY)</b>		

<b>B.5</b>	In this firm, are you	
Sole owner and manager		1
Partner and manager		2
Owner only or partner only		3
<b>OTHER (SPECIFY)</b>		4
<b>DON'T KNOW</b>		-9

<b>B.4</b>	Do you work alone or do you employ regular employee, and if so how many?	
Alone		1
Employee <b>SPECIFY HOW MANY</b>		2
<b>DON'T KNOW</b>		

GO TO QUESTION B6

<b>B.6</b>	How many occasional paid helpers do you have	
I don't have any occasional paid helpers		1
<b>WRITE HOW MANY PAID HELPERS</b>		2
<b>DON'T KNOW</b>		4
<b>REFUSED</b>		-9

<b>B.6</b>	How many occasional unpaid family helpers do you have	
I don't have any unpaid family helpers		1
<b>WRITE HOW MANY UNPAID HELPERS</b>		2
<b>DON'T KNOW</b>		4
<b>REFUSED</b>		-9

<b>B.7</b>	Do you hold an accounting record?	
Yes		1
No		2
<b>DON'T KNOW</b>		4
<b>REFUSED</b>		-9

GO TO QUESTION B6

<b>B.7</b>	Do you do it yourself or you have an accountant?	
Yes, I do it myself		1
No		2



<b>DON'T KNOW</b>	4
<b>REFUSED</b>	-9

<b>B.8</b>	Do you operate with contract and written terms of transaction or mainly orally?	
Mainly orally		1
Mainly with written terms and contract		
<b>DON'T KNOW</b>		4
<b>REFUSED</b>		-9

<b>B.8</b>	Are you a member of any business association, and if yes, which one?	
Yes ( <b>SPECIFY WHICH ONE</b> )		1
No		
<b>DON'T KNOW</b>		4
<b>REFUSED</b>		-9

<b>B.9</b>	When did you start your business, if you have many different businesses, when did you start your main business?	
1-3 years ago		1
3-5 years ago		2
More than 5 years ago ( <b>SPECIFY WHEN</b> )		3
<b>DON'T KNOW</b>		-9

<b>B.5</b>	How did you choose the sector of your business?	
You heard about someone doing the same thing?		1
It is an activity that you were already doing in the past as an employee		2
Because some people ask you to?		3
Because you did not have any other employment opportunity?		4
<b>OTHER (SPECIFY)</b>		5
<b>DON'T KNOW</b>		-9

<b>B.6</b>	Do you think that you earn enough revenue from your business?	
To live comfortably		1
To live normally		2
To live very simply		
To survive		
<b>DON'T KNOW</b>		-9

<b>B.7</b>	Would you say that the revenue that you get from the activity of your business is stable?	
Yes, very stable		1
More or less stable		2
Not stable at all		

<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>B.7</b>	What is your annual turnover?	
	0-50'000 GEL	1
	50'000 – 100'000 GEL	2
	100'000 – 250'000 GEL	
	250'000 – 500'000 GEL	
	Above 500'000 GEL	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>B.7</b>	Do you reinvest any profit in the business, and if so how much percent of it?	
	No, I don't reinvest anything	1
	Yes, I do reinvest the profits (SPECIFY THE % REINVESTED)	2
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

## **BLOCK 1. PROJECTS / EXPECTATIONS / INTENTIONS**

<b>C.1</b>	Did your business grew since its creation, if so can you express it in percent?	
	No, it did not grow	1
	Yes it grew, but I don't know by how much	2
	Yes it grew by <b>(SPECIFY BY HOW MUCH IT GREW)</b>	3
	<b>DON'T KNOW</b>	<b>-9</b>
	<b>REFUSED</b>	

<b>C.1</b>	Do you plan to sell more of your services or products in the coming 3 months , 6 months, or 2 years? <b>MORE THAN ONE ANSWER IS POSSIBLE</b>	
	No	1
	3 months	2
	6 months	3
	2 years	4
	<b>DON'T KNOW</b>	<b>-9</b>

**GO TO QUESTION C3**

<b>C.2</b>	To do so, what you are going to do?	
	Take a loan or credit	
	Find new partners / distributors /sales	1
	Invest in new equipment	2
	Change the way you conduct your business	3

Change the marketing	4	
OTHER (SPECIFY)	5	
DON'T KNOW	-9	
C.3	Do you plan to get unpaid help from family and friends in the coming 6 months, and if so, how many?	
Yes (PLEASE NOTE THE NUMBER OF PEOPLE)	1	
No	2	
DON'T KNOW	-9	
REFUSED		
C.4	Do you think the general situation for small businesses will get	
Better	1	
Worse	2	
Will not change		
DON'T KNOW	-9	
<b>INTENTIONS TOWARD ENTREPRENEURSHIP</b>		
C.5	Do you plan to sell NEW product , NEW services or products or services of BETTER QUALITY?	
No	1	GO TO QUESTION C.7
NEW product and services	2	
Product and services of BETTER QUALITY	3	
DON'T KNOW	-9	
C.6	To do so, are you going to	
Find new partners / distributors /sales ?	1	
Invest in new equipment ?	2	
Change the way you conduct your business ?	3	
OTHER (SPECIFY)	4	
DON'T KNOW	-9	
C.7	Are you, alone or with others, expecting to start a new business, including any type of self- employment, within the next three years?	
Yes	1	GO TO QUESTION D1
No	2	
DON'T KNOW		
REFUSED	-9	
C.8	Do you plan to do anything to start this business such as looking for equipment or a location, organizing a start-up team, working on a business plan, beginning to save money, or any other activity that would help launch a business?	
Yes	1	
No	2	
DON'T KNOW		

REFUSED	-9
---------	----

D.1	What is the motivation for doing what you do? (NOT MORE THAN 3 ANSWER ARE POSSIBLE)
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## BLOCK 2. MOTIVATIONS

Take advantage of a business opportunity	1
No better choice for work	2
To be my own boss	
To increase my income	
To provide jobs for family members	
For my own satisfaction and growth	
So I will always have job security	
To build a business to pass on	
To be closer to my family	
DON'T KNOW	
REFUSED	-9

D.2	Which of the following reason do you think is the most important to start a business
Increase personal income	1
Just to maintain income	2
Greater independence	
Status	
DON'T KNOW	
REFUSED	-9

D.3	Would you stop doing what you do for the same fixed salary as an employee
Yes	1
No	2
DON'T KNOW	
REFUSED	-9

D.4	Would you be ready to follow training or courses if it could improve your businesses
Yes	1
No	2
DON'T KNOW	
REFUSED	-9

D.4	Would you be ready to take more financial risks to develop your business
Yes	1

No	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>D.4</b>	Are you generally a person who is fully willing to take risks or do you try to avoid taking risks? Please give a number from 0 to 10 where the value 0 means "completely unwilling to take risks" and the value 10 means "completely willing to take risks".
<b>WRITE NUMBER HERE</b>	1
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>D.4</b>	To what extent the way in which things in your professional are going or will go in the future life depends on you
Nothing really depends on me	1
Outcomes mostly depend on other factors	
Outcomes mostly depend on me	
Everything depends just on me	
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

### BLOCK 3. FORMAL AND INFORMAL INSTITUTIONS

#### LEGAL FRAMEWORK

<b>E.1</b>	In your relationship with your partner, what kind of problem do you encounter most?
Late or no payment	1
Late or no supply	2
Transaction not according to what was agreed / contract	
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>E.2</b>	When such problems happen, what do you do?
Read law/ask lawyer	1
Ask administration	2
Find a peaceful solution with the person concerned	
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>E.3</b>	Has your firm ever gone to court for a problem with your partner, supplier, or client?
Yes	1
No	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>E.4</b>	In your relationship with the state administration, what kind of problem do you encounter most?	
	Unfair treatment from tax authorities	1
	Labor regulation (social taxes, working hours)	2
	Business regulation (licenses)	3
	Property rights	
	DON'T KNOW	
	REFUSED	-9
<b>E.5</b>	How do you solve this problem?	
	Read law/ask lawyer	1
	Talk with friends or colleagues	2
	Ask directly the administration	3
	DON'T KNOW	
	REFUSED	-9
<b>E.6</b>	Over the last year, how many times was your business inspected by state authorities (tax officials or business regulation	
	It was not inspected at all	1
	WRITE NUMBER OF TIMES	2
	DON'T KNOW	
	REFUSED	-9
<b>E.10</b>	Do you think that property rights are well protected?	
	Yes very well	1
	Yes sometimes	2
	No, not very well	3
	Absolutely not protected	
	DON'T KNOW	
	REFUSED	-9
<b>E.10</b>	Do you think that the state provide fair grounds for competition	
	Yes, the state ensure that business competition is fair	1
	No, the state favors big business	2
	DON'T KNOW	
	REFUSED	-9
<b>E.10</b>	Do you think the tax rate is an obstacle to the development of your business?	
	No obstacle	1
	Minor obstacle	2
	Moderate obstacle	3
	Major obstacle	
	Very severe obstacle	

<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>E.11</b>	Do you think that licenses and permits are an obstacle to the development of your business?	
No obstacle	1	
Minor obstacle	2	
Moderate obstacle	3	
Major obstacle		
Very severe obstacle		
<b>DON'T KNOW</b>		
<b>REFUSED</b>	<b>-9</b>	

<b>E.13</b>	Do you consider the labor code as an obstacle to the development of your business?	
No obstacle	1	
Minor obstacle	2	
Moderate obstacle	3	
Major obstacle		
Very severe obstacle		
<b>DON'T KNOW</b>		
<b>REFUSED</b>	<b>-9</b>	

<b>E.13</b>	Does the change of the labor code in spring 2013 concerned you and what do you think of it?	
It does not concern me	1	
It does concern me and think it destroys businesses	2	
It does concern me and think it will strengthen businesses	3	
It does concern me, but I think it will not change anything to small and mid-sized businesses		
<b>DON'T KNOW</b>		
<b>REFUSED</b>	<b>-9</b>	

<b>E.14</b>	I am going to read some statements that describe the administration in general and how it could affect businesses. For each of them, could you please tell me if you Strongly disagree, Tend to disagree, Tend to agree, or Strongly agree.	
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	Strongly disagree	Tend to disagree	Tend to agree	Strongly agree	<b>DON'T KNOW (SPONTANEOUS)</b>	
"The state administration is fair, impartial and uncorrupted."	1	2	3	4	<b>-9</b>	
"The state administration is quick."	1	2	3	4	<b>-9</b>	
"The state administration is clear and predictable."	1	2	3	4	<b>-9</b>	

#### INFORMAL INSTITUTIONS - ATTITUDE TOWARD ENTREPRENEURSHIP

<b>F.1</b>	How do you think that your fellow Georgian look at people who started businesses like you?	
------------	--	--

They think it is good for the economy and the country	1
They think people who start businesses are thieves	2
They think people who start business do it only for the money	3
They think people who start businesses are conman (machination)	
They do not think anything	
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

**F.2** Would you agree that Georgian culture favors "businessmen"?

Yes	1
No	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

**F.3** Would you agree that Georgian culture look positively at those for take risks to develop a business?

Yes	1
No	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

**F.4** Do you think that contract provide a strong guarantee?

Yes, they provide a strong guarantee	1
No they don't	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

**F.4** What other factors do you consider a guarantee as well?

Family ties	1
Ethnicity	2
Regional ties	
Religious faith	
<b>OTHERS</b>	
<b>REFUSED</b>	<b>-9</b>

**F.5** In business, do you think a moral, honest behavior is rewarded or on the contrary one has to learn to cheat sometime?

Moral honest behavior is rewarded	1
Cheating is part of business life	2
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

**F.6** In general, do you trust your partner, clients and suppliers?



Yes always	1
I like to deal with people recommended by others	2
No never	
DON'T KNOW	
REFUSED	-9

#### BLOCK 4. NON-MATERIAL AND MATERIAL RESSOURCES AND OPPORTUNITIES

##### NETWORK

<b>G.1</b>	Do you receive physical and financial help on a regular basis from your	
Family & friends		1
Family member abroad		
State run organization or program		2
Foreign aid		
OTHERS		
REFUSED		-9

<b>G.2</b>	Many people may give you advice on your business. Have you received advice from the following	
Your spouse or life companion		1
Your parents		2
Other family or relatives		
Partners		
A former boss		
Somebody in another country		
Somebody who has come from abroad		
Somebody who is starting a business		
Somebody with much business experience		
A researcher or inventor		
A possible investor		
A bank		
A development agencies		
A public advising service for business		
A costumer		
A supplier		
A firm that you compete with		
A firm that you collaborate with		
OTHERS		
REFUSED		-9

##### INFORMATION AND KNOWLEDGE

<b>G.3</b>	What is the main sources of information that you use for your activity? (CHOOSE 2 OF THE ANSWERS BELOW)	
Media		1
NGOS		2

Supplier and customer	
Friends and acquaintances	
<b>OTHERS</b>	
<b>DON'T KNOW</b>	
<b>REFUSED</b>	<b>-9</b>

<b>G.4</b>	Would you say that these information have an influence the conduct of your business	
No influence		1
Some influence		2
A lot of influence		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.6</b>	Do you use what you have learnt at school for your business?	
------------	--	--

No, not anything		1
To some degree yes		2
Yes, it helps me very much		3
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.7</b>	What is your educational level?	
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University, college degree		1
Apprenticeship		2
Obligatory school		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

#### OTHER FORM OF RESOURCES & OPPORTUNITIES

<b>G.8</b>	Do you benefit from an government sponsored program, and if so which one?	
------------	---	--

Yes <b>PLEASE SPECIFY WHICH ONE</b>		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.8</b>	Have you heard about the agricultural fund that the government launched in spring 2013 and do you intend to benefit from it?	
------------	--	--

No I haven't heard, and might use it if I get more information		1
No I haven't heard, but won't use it anyway because I do not trust any government initiative		2
Yes I have heard, but won't use it because I do not trust any government initiative		
Yes I have heard, but I do not qualify for such a program		
Yes I have heard and already benefit from it		
<b>DON'T KNOW</b>		

**GO TO QUESTION G9**

REFUSED		-9	
G.8	Could you tell how do you think this program is effective		
Not effective at all		1	
It helped my enterprise a little bit		2	
It help my enterprise			
Very effective, it helped my enterprise a lot			
DON'T KNOW			
REFUSED		-9	
G.9	Have you heard of people benefiting from aid program who have now a growing business?		
Yes		1	
No		2	
DON'T KNOW			
REFUSED		-9	
PERCEPTION OF OPPORTUNITIES			
G.11	Do you know someone personally who started a business in the past 2 years?		
Yes		1	
No		2	
REFUSED		-9	
G.12	Do you think there will be good opportunities for starting a business in the area where you live in the next 6 months?		
Yes		1	
No		2	
DON'T KNOW			
REFUSED		-9	
G.13	Do you feel that you have the knowledge, skill and experience required to start a business different from the one you are running now?		
Yes		1	
No		2	
DON'T KNOW			
REFUSED		-9	
G.14	Would fear of failure prevent you from starting a new business, proposing new product or new services?		
Yes		1	
No		2	
DON'T KNOW			
REFUSED		-9	
MATERIAL RESSOURCES AND OPPORTUNITIES			

<b>G.15</b>	Last year, what was the main market in which you sold your main products or services?	
	Local – main product sold mostly in same municipality where the business is located	1
	National – main product sold mostly across the country where the business is located	2
	International - main product sold mostly to nations outside country where the business is located	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>G.15</b>	In 2013, the Russian market reopened, does it concerns you or do you think of it as an opportunity to do some business?	
	It does not concern me and I do not think it is a business opportunity	1
	I never exported to Russia, but I thinking of it now that it is possible again	2
	I used to export to Russia, but I do not look at the Russian market as an opportunity anymore	
	I used to export to Russia and I am looking forward to renew transacting with my former partners	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>G.16</b>	What are the material resources essential to the conduct of your business?	
	Farm	1
	Field	2
	Animals	
	Real estate	
	Equipments	
	Machinery (including car or truck)	
	<b>OTHER</b>	
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>G.17</b>	Did you purchased these items yourself or did you inherit them?	
	Purchased	1
	Inherited	2
	<b>DON'T KNOW</b>	
	<b>REFUSED</b>	<b>-9</b>

<b>G.18</b>	Do you plan to use these items for some new other activities?	
	Agriculture	1
	Trade	2
	Wholesale	
	Repair of machinery	
	Tourism	
	<b>OTHERS</b>	

<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>FINANCE</b>		
<b>G.19</b>	At this time, do you have a bank account?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>G.20</b>	At this time, do you have a credit or loan, if so, could you tell the volume of the loan	
No, I don't have credit nor loan		1
Yes, up to 5'0000 GEL		2
Yes, between 5'0000 and 20'0000 GEL		
Yes, between 20'000 and 100'000 GEL		
Yes, above 100'000 GEL		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>G.21</b>	Do you have now or in the past had to take a credit from	
Microfinance		1
Bank		
Aid program		2
Friends and family		
None of the above		
<b>OTHERS</b>		
<b>REFUSED</b>		<b>-9</b>
<b>G.22</b>	To your opinion, are these sources of finance more convenient?	
Yes		1
No		2
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>
<b>G.23</b>	When you have a money problem in your business, how do you resolve it?	
You talk with your bank , microfinance, credit institution.		1
You talk with your friends or family		2
You talk with your partner or supplier		
<b>OTHERS</b>		
<b>DON'T KNOW</b>		
<b>REFUSED</b>		<b>-9</b>

<b>G.24</b>	Do you benefit from trade credit from your supplier?		
Yes		1	
No		2	GO TO QUESTION
OTHERS			
DON'T KNOW			GO TO QUESTION
REFUSED		-9	GO TO QUESTION
<b>G.25</b>	Could you run your business without benefiting from this trade credit from your supplier?		
Yes		1	
No		2	
DON'T KNOW			
REFUSED		-9	
<b>G.26</b>	This year, did you apply for any loans or lines of credit?		
Yes		1	
No		2	GO TO QUESTION G28
DON'T KNOW			GO TO QUESTION G28
REFUSED		-9	GO TO QUESTION G28
<b>G.27</b>	What was the <b>main</b> reason why your business did not apply for any line of credit or loan? INTERVIEWER: ONE ANSWER ONLY		
No need for a loan - establishment had sufficient capital		1	
Application procedures were complex		2	
Interest rates were not favorable			
Collateral condition are too high			
Size of loan and maturity were insufficient			
It is necessary to make informal payments to get bank loans			
Did not think it would be approved			
DON'T KNOW			
REFUSED		-9	
<b>G.28</b>	To what degree is <b>finance</b> an obstacle to the operation of your business?		
No obstacles		1	
Minor obstacles		2	
Moderate obstacles			
Major obstacles			
Very severe obstacles			
DON'T KNOW			
REFUSED		-9	

## 10.3 Key Informant Interview Guide

Thank you for taking your time and agreeing on an interview. During the interview we will discuss the topic of entrepreneurship and SME development in Georgia, namely we will touch upon the factors that foster and hinders entrepreneurship and SME development, in particular external and internal barriers and the role of the government in the process.

In entrepreneurship I mean activity that results in business creation and SMEs a vehicle where entrepreneurship thrives.

Main Questions	Probing Questions
<b>Topic 1 Barriers to Entrepreneurship and SME development</b>	
<b>1. 1 External Factors</b>	
<p><b>Let us discuss external and internal factors that shape entrepreneurship and SME development. Under external factors I mean the so-called “framework conditions” (legislation, access to finance, infrastructure, tax administration, markets, society, government policies, etc), under internal barriers I mean the “soft skills” of entrepreneurs (education, managerial skills)</b></p>	
<p>- How would you characterize the external environment in which the entrepreneurs operate? Please be as specific as possible and bring examples.</p> <p>- In case of failure, how would you assess the chance for a second start for Georgian entrepreneurs? Can you think of any examples?</p> <p>- It goes without saying that formalization is problematic in Georgia, statistics say that 60 percent of employed are self-employed, how would you assess the business formalization process?</p> <p><i>Under formalization I mean registration of business and its full integration into the economy.</i></p> <p>What are external obstacles to business formaliza-</p>	<p>- If we look at external factors, what would you say is the major challenge for entrepreneurship and SME development in Georgia?</p> <p>- How would you characterize the following dimensions for entrepreneurship and SME development: stable legislation, access to finance, dialogue with the SMEs, attitude of the society towards entrepreneurship, governmental policies for promoting entrepreneurship.</p> <p>- How would you assess the DCFTA and EU's AA in relation to entrepreneurship and SME development in Georgia? What would be the potential benefits and obstacles?</p> <p>- What are the barriers in SME internationalization?</p> <p>- What is being done for streamlining the corporate bankruptcy law?</p> <p>- Why do you think that notwithstanding a number of tax simplification and tax exemptions, substantial number of entrepreneurial activities are not registered?</p>

tion?	
- Does the environment provide equal chances of participation for small and large companies? Are there size related disadvantages? What are these disadvantages?	- For example in state procurement, access to finance, access to state programs.
<b>1.2 Internal Factors</b>	
- How important are internal factors in fostering entrepreneurship and SME development in Georgia? Could you think of specific examples?	<ul style="list-style-type: none"> <li>- Are entrepreneurs equipped with the rights skills?</li> <li>- Is there access to proper entrepreneurial and managerial education?</li> </ul>
How would you assess which factors represent a greater obstacle - external or internal ones? Why? Please bring specific examples if possible	
<b>Topic 2. Drivers of Entrepreneurship and SMEs</b>	
- What are the key economic, social, and cultural processes driving entrepreneurship in Georgia?	<ul style="list-style-type: none"> <li>- Which groups are specifically affected by these processes? How do these processes affect specific groups? What are the main quantitative and qualitative evidences on that? (please list all relevant sources)</li> </ul>
<b>Topic 3. The Role of the Government</b>	
- How important is the role of the state in entrepreneurship and SME development?	<ul style="list-style-type: none"> <li>- What are the measures of support that the government should provide?</li> <li>- How can the government influence external and internal barriers to entrepreneurship and SME development in Georgia?</li> </ul>
<b>3.1 Indirect Support Measures – Business Environment</b>	
<ul style="list-style-type: none"> <li>- What type of indirect measures are in place in Georgia for supporting entrepreneurship?</li> <li>- How does the government make decisions affecting business environment?</li> </ul>	<ul style="list-style-type: none"> <li>- Are entrepreneurs/SMEs involved in the policy shaping process?</li> <li>- What are the government decisions on entrepreneurship and SME policy based on? Best practices? Research? EU requirements?</li> </ul>
- Who are involved in the policymaking process and How?	- How informed are the stakeholders on the government policies?
<b>3.2 Direct Support Measures – specific programs tailored for supporting entrepreneurship and SME development</b>	
- What are specific policies/programs that are tai-	Which state institution(s) implement



<p>lored especially to support entrepreneurship in Georgia?</p>	<p>this policy/program?</p> <p>Which groups do they specifically target? Who can participate? What are the prerequisites for participation?</p> <p>Are any specific sectors/groups prioritized by the state? Why?</p> <p>What types of services do these policies/programs offer?</p> <p>How have these policies evolved over time? For what reasons did they change over time (if applicable)?</p> <p>In what way is implementation of these policies monitored? Are they evaluated?</p> <p>What are the challenges faced during the implementation of the policy/program?</p> <p>How would you assess the impact of the implemented policies so far? How do you monitor and evaluate the impact of a policy?</p>
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Would you have any recommendations for overcoming the obstacles we discussed? What would you advise the government to do in this direction?

## **10.4 List of Respondents**

### *Policymakers/government entities*

#### **The Ministry of Economy and Sustainable Development of Georgia**

Ms. Tsisnami Sabadze – acting head of the economic growth policy and planning department;

Mr. Giorgi Chitadze – head of the division on trade negotiations and DCFTA implementation

#### **Entrepreneurship Development Agency (“Produce in Georgia”)**

Ms. Mariana Morgoshia – Head of the Agency;

Mr. Otar Antia – Head of the Entrepreneurship Department.

#### **Agricultural Programs Management Agency**

Mr. Giorgi Jibladze – Deputy Head of the Agency

Mr. Giorgi Avaliani – Head of Public Relations

#### **Georgian Innovation and Technology Agency**

Ms. Mariam Sharangia – Manager of Startup Beats

#### **Georgian Chamber of Commerce and Industry**

Ms. Nato Chikovani

#### **Administration of the President of Georgia**

Ms. Maia Melikidze – Economic Advisor to the President of Georgia

#### **National Statistics Office of Georgia**

Mr. Gogita Todradze – Deputy head of the Office

#### **National Bank of Georgia**

Mr. Giorgi Bakradze – Advisor to the President

### *Experts, non-governmental organization representatives, researchers*

Mr. Mikheil Chelidze – Head of the Georgian Small and Medium Size Business Association;

Ms. Nino Evgenidze – Executive Director of the Economic Policy Research Center;

Ms. Maya Grigolia – Head of Private Sector Development at ISET Policy Research Center;

Mr. Zviad Khorguashvili – Economist, Free University of Georgia

Mr. Mikheil Kukava – Senior Consultant, PMCG Research Center;

Ms. Irina Kvakhadze – Deputy Head of the Business Association of Georgia;

Ms. Gvantsa Meladze - Head of the Georgian Exporters' Association

Mr. Beso Namchavadze – Economist, Georgian Reformer's Association;

Ms. Ana Sabakhtarishvili – Head of the Infrastructure Builders' Association of Georgia

Ms. Nino Zambakhidze – Head of the Georgian Farmers' Association