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**SME-led economic development in transition countries:
Comparative analysis of Georgia and Estonia**

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Author's Declaration

I hereby declare that I am the sole author of this Master Thesis and it has not been presented to any other university for examination.

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The Master Thesis meets the established requirements

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Abstract

The presented Master thesis will analyze the role of SME's development as a key factor of economic growth of country, taking into account the importance of SMEs during the transition process of Post-Soviet countries. It identifies the role of public policy and innovation for development of business environment in transition countries. The empirical part is based on a comparative analysis of case study of two Post-Soviet countries – Georgia and Estonia –, their choices for development, successes and failures during the implementation of policies for SMEs development. Based on the comparative analysis the paper will argue that the SME-sector can improve the beneficial economic and social condition for a country only with support of policies and programs implemented by government and via institutional development. The comparative analysis of Georgia and Estonia will allow detecting the failures of Georgian government in policy making and the problems or benefits which country can face in its way of European integration on the example of Estonia.

Key words: small and medium sized enterprises (SMEs), innovation, public policy, transition country, economic and social development, countries in transition (CIT)

1. Introduction	6
2. Theoretical framework	9
2.1 Defining the SME	9
2.2. The Role of SMEs in Economic Development.....	10
2.3. SMEs and innovation.....	14
2.4 SME policies in transition countries	17
2.5. Role of government in SME development.....	20
3. Comparison of SME Policy Development in Georgia and Estonia	24
3.1. Case study of Georgia.....	25
3.1.1. Post-Soviet Transition of Georgian Economy	25
3.1.1.1 Delayed development and "dark" years of country	26
3.1.1.2 Economical recover - wave of development	28
3.1.2. Development of SME policy in Georgia	29
3.1.3. Role of SME in the Georgian Economy	32
3.2. Case study of Estonia.....	39
3.2.1. Post-Soviet Transition of Estonian Economy.....	39
3.2.1.1 Transition Prior to Accession to the EU.....	40
3.2.1.2 Influence of Joining the EU.....	42
3.1.2. Development of SME policy in Estonia	43
3.1.3. Role of SME in the Estonian Economy	45
3.3. Comparison of SME Policies in Georgia and Estonia	49
3.4. Discussions	51
4. Conclusion.....	54
5. Reference.....	55

1. Introduction

Small and Medium Sized Enterprises (SMEs) are recognized as sector which carries hopes and opportunities in the economic transformation, growth and sustainable development of developing and transition countries by reaching wide socio-economic goals including diminishing poverty, unemployment and creating new jobs. Debates of the scholars on the role of the SMEs in economic development of developing countries and countries in transition (CIT) started long time ago. Increasing attention has received SMEs from policy-makers especially in recent decades. According to the different studies, SMEs have potentiality to contribute in economic growth and innovation development (Storey, 1994; Carree et al., 2007: 288; Fernandez-Serrano, 2012: 1, 2).

SMEs contribution in to the country's economic development mostly depends on various external and internal factors such as: institutional support, governmental policies, foreign investments inflow, international economic relations and national security of the country (Bateman, 2000: 277; Smallbone, 2001:65; Muresana and Gogu, 2012:254; Acs and Preston, 1997:5; Coppieters and Legvold, 2005). Empirical evidence shows that productive performance of SMEs can significantly improve the socio-economic situation in country. In order to reach the SMEs sustainable development and increase its role on economic development hands-off policy is ineffective, the need of governmental intervention via policies is necessary. The state should play active role by offering different programs and reforms which improves the business environment and makes the country more attractive for foreign investors to invest in new business start-ups.

After the collapse of Soviet Union the main goal of Georgia as well as for Estonia was economic transition for planned to market economy. Both countries were considered as developing countries with high socio-economic problems in the first years of independence from Communist regime. Implementation of different programs and policies by government played crucial role to solve the socio-economic problems. Mostly the transition process of Post-Soviet countries has been focused on the divestiture of previously State-Owned Enterprises (SOE) (McIntyre, 2001:1) and creation of good business environment. The privatization process was considered

the basis of economic transition and creation of new business regulations. It is difficult to image and find solution on socio-economic problems without sustainable growth of SMEs sector. But there is need of correct regulations and policies to reach the healthy environment for SMEs development.

Theoretical part of the thesis will focus on role of SMEs in the process of economic development, visions of different academics and different economists on the importance and advantages of SMEs, also views regarding the importance of innovation for SME. Significance of governmental support via policies, reforms and different programs covers the important part of the Thesis. The theoretical part is based on the different scientist studies made on the role of SMEs in the economic development, effects and advantages of SMEs during the transition period on the host countries, comparison of the arguments generated from the neo-classical and evolutionary schools on the role of SMEs in economic development.

Based on the theoretical framework, the empirical part will present the case study of Estonia – the small state successfully achieved the economic transition with the assistance of public policies and SMEs development and case study of Georgia – the country attempting to overcome the socio-economic crisis occurred as a consequence of military conflicts and political instability. As the SME's are considered as the solution of wide socio-economic problems of the country (Cook and Nixon, 2000: 26), hence the cases will be focused on the SME's development in Estonia and Georgia since the 1989. The main idea of empirical part is to make a comparative analyze of the SME's regulations and policies adopted by the authorities in Georgia and Estonia based on the case studies. The comparative analyze gives an opportunity to realize the fails and weak sides of Georgian government in term of SMEs development. Based on the Estonian case, the comparative analyze gives an opportunity to understand the role of EU policies and regulations in Estonian SMEs development and what should Georgia expect from EU in the term of SMEs development.

The empirical part is based on the studies of different economists, interviews, publications and assessments of international organizations, statistical data, scientific works of various authors and etc. For the more detailed understanding of the policies, regulations or processes influencing on

the SMEs role in Georgia's economic development will help the interview with different Georgian public and Non-governmental sector representatives: Mr. KakhaGogolashvili - Senior Fellow, Director of EU Studies at the GFSIS; Prof. VladimerPapavaSenior Fellow, Director of the Center for Applied Economic Studies, former Minister of Economy (1994 – 2000); Prof. MerabKakuliaSenior Fellow and Director of the Center for Financial stability and Competitiveness (CFS) at the GFSIS;Dr, DimitiJaparidzeVice-President of GEA Georgian Employers' Association, director at Competitiveness and Innovations Centre of Georgia).

2. Theoretical framework

The importance of small and medium size enterprises (SMEs) for economic development has been discussed by many scholars (Rosenfeld,1995;Audretsch,1995;Keilbach,2004; North, 2000; Smallbone, 2000, 2001; Cremer, 2000; Perkins, 1992etc.).Bail (2010) in his article notes that the term "small business" was first used in the U.S. in 1953 in the Law "Small Business", but already in 1948 in the adopted law "On certain types of services" small businesses had been mentioned. This document was the first one which tried to present classification of small and medium size enterprises(Bail, 2010: 80).For individuals, SMEs are a good possibility to start theirfirst job and build up their careers; for big companies, SMEs are a startup place and a source of future competition; and, for the whole economy SMEs represent new ideas, innovations, experimentation and the possibility of future progress (Zaman, 2007). Their size gives them flexibility and ability of adaptation, thus, they are able to make fast changes and decisions when they are faced with problems (Liedholm and Mead, 1987; Schmitz, 1995).

2.1 Defining the SME

SMEs are found to be considerably different from large organizations regarding their access to various resources (human, financial – inc. FDI – and technological), organizational structures and company strategies (e.g. Vachani,2005; Russo and Perrini, 2010; Hussain et al., 2012). However, defining the SME is somewhat difficult in a uniform manner. The most common criteria to define the SME is employment, while investment figures, turnover, sales etc. are also used. Hence, there is no universal definition of SMEs. The average sizes of enterprises differs in all economic areas (including the larger ones – e.g. USA, EU, Russian Federation, China and others), and thus, also differs the definitions of SMEs in terms of number of employees and total annual turnover (see e.g. U.S. International Trade Commission, 2010: 1-2; Ayyagari et al., 2007). Consequently, definitions by different characteristics are not uniform across the world (Ayyagari et al., 2007). For example, some countries specify SMEs as an enterprise with less than 500 employees, while others may define with maximum limit of 250 employees (Ayyagari, 2005). In entrepreneurship studies, the American Small Business Administration (SBA)'s definitionof SMEs– standalone enterprise with less than 500 employees –is most widely used

(Wolff and Pett, 2000; 34-37). At the same time, in the European Union (EU) the Commission has defined SMEs as enterprises where the number of employees should be less than 250 employees and annual turnover should not exceed 50 million Euros (EC recommendation 2003/361, Article 2, 124/49). The different categories of SMEs in the EU – medium-sized, small and micro – are presented in table 1 below. As in the empirical part of the thesis, one of the EU countries (Estonia) is analyzed, the European Commission definition for SMEs is followed.

Table 1. Categories of SMEs in the European Union

Company category	Employees	Turnover	Balance sheet total
Medium-sized	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

Source: EC recommendation, 2003/361.

2.2. The Role of SMEs in Economic Development

SMEs play a significant role in economic development of a country and are an important source of development of local and regional communities and national competitiveness (Neumark et al., 2008; Haltiwanger, 1999; Daviddson et al., 1999; Almeida, 2004). SMEs represent a potential to reach wide socio-economic goals including diminishing poverty, unemployment (Cook and Nixon, 2000: 26) and thus, creating new jobs (Hallberg, 2000:16). Furthermore, their role is significant during different times of technological life-cycles especially during the process of ‘creative destruction’ (Baumol, 2002; Acs et al. 1997: 8-10).¹ Small-sized enterprises are considered as the main sources and engine of economic development and growth as they are able to manage with different kinds of economic challenges in a short time (Harper, 1984). Different studies show how SMEs led rapid economic development (e.g. Audstreich and Turik, 2004; Audstreich and Kilbah, 2005). Thus, SMEs are considered to be the key drivers behind innovation, what is nowadays considered the main cause behind economic and social development (OECD, 2009: 5, 6; OECD, 2012).

¹ As an example, revolutions in sphere of ICT directly supported development for big numbers of SMEs (Nooteboom, 1999; 2000). One could even argue, that any economic regime based on development of new technologies directly supports development of SMEs.

Nevertheless, considerable differences between SMEs in developed and developing countries have to be brought out: in the second, the job creation factor is much more significant than output production (Wattanapruttipaisan, 2003). Still, this can be different across sectors and countries: for example in Thailand SMEs create more than half of the countries value added; in Taiwan they are the source of the countries success (Yu, 2007: 7, 8), while in other Asian-countries the effects are not as considerable (Tambunanm 2006). Furthermore, a large number of SMEs – even while being important in job creation – fail in the first years of establishment (see e.g. Lu and Beamish, 2001) which limits their effect on development.²

Lack of (working) SMEs in poorer regions is associated with lagging economic development: developing countries with a large population of micro-enterprises and some large enterprises stunt in growth due to the “Missing Middle” (Kauffmann, 2005; Andreas Widmer, 2011). SMEs can be considered as startup point for the “Missing Middle” (Ramadani, 2011). This topic is thoroughly discussed in the perspective of value-chain financing of the rural poor in various developing countries (Milder, 2008; Jamnadass et al., 2011; Arthur, 2012; Chao-Béroff, 2014). Furthermore, from the perspective of firm size it has been argued that the “Missing Middle” also contributes to inequality within the socio-economic system (Mazumdar, 2010; Mazumdar and Sarkar, 2012; Shaffer and Le, 2013).

In poor countries we can find the big number of small businesses, few of large enterprises and almost nobody is on the middle (see figure 1; also OECD 2005: 2). In high income countries SME’s share in to the GDP is almost 50% and share in employment is over 60% while in low income or poor countries SMEs contribution in GDP is less than 30 % and in employment approximately 17%. (Ayyagari et al., 2003: 10, 11, 29) However, exactly this middle is called as a “Missing Middle” which plays significant role in economic development (Widmer, 2011)

² According to United States Small Business Administration (SBA) in the United States of America (USA) almost 24% of Small businesses failed in two years after their start up and almost 63% failed within six years (Wheelen and Hunger, 1999). The failure of SMEs in first six years is also well known problem for Australia, United Kingdom (UK), Japan, Hong Kong and Taiwan (Lu and Beamish 2001).

Figure 1: The firm size distribution



Source: Widmer,2011³

Nevertheless, the role of SMEs in development is not only emphasized in the developing context. According to the European Commission’s annual report on European SMEs, SMEs have a central role in the economic development in European countries(European Commission, 2013: 15).They are considered as the main source of entrepreneurial skills, potential of new technologies, innovational development and employment. As such, SMEs represents 99% of all enterprises in EU27 member states and helps to create over 75 million jobs for EU citizens(ibid.: 17).⁴Interestingly, 91% of all those enterprises in EU 27 member states are micro-firms, where the number of employees is less than 10 (OECD, 2009: 6).Furthermore, across the worldSMEs are found to contribute more than 66% of the employment (Ayyagari et al., 2011).

³ The graph is based on the Widmer’s argument on the SME and Missing Middle and interpreted by “povertycure”, Video is available here : <http://www.povertycure.org/issues/smes-small-medium-enterprises/>

⁴ For an example, in the UK the Federation of Small Business (FSB) estimated that at the start of 2013 there were approximately 4.9 million businesses with 24.3 million employees and with a turnover of 3,300 billion £. Almost 99.2 per cent of those businesses were SMEs (FSB Small Business Statistics. 2013). Consequently, in the United Kingdom SMEs take 99% of all private sector businesses in this region (FBS Small Business Statistics, 2013).

At the same time, there is disagreement in academic debate on the extent of the influence of SMEs on economic development (Beck et al., 2005). First of all, in the manufacturing sectors SMEs face a big competition from cheaper manufactured products from China and elsewhere and have difficulties competing on the market (Wheelen and Hunger, 1999). Further, Cravo(2010) explains with the example of Brazil that a strong SME-sector can influence economic development. He accentuates two main indicators: the share of SMEs in employment and level of human capital in the SME-sector (Cravo, 2010: 717). Furthermore Cravo (ibid.) explains how these aspects of SMEs influence regional development of Brazil, and he argues that the Brazilian SME-sector has no significant correlation with economic development (ibid.: 720). Schmiemann(2008) gives other examples which show the insignificant effect of SMEs on economic development. He finds that while in the EU the Mediterranean and Baltic countries have the largest proportion of SMEs, they do not belong among the countries with highest incomes per capita. Many reformers were expecting that economic freedom and the market will create a large number of SMEs in Central and Eastern European (CEE) countries (Kornai, 1990; Djankov and Murrell, 2002). However, even in the beginning of the transition process there were critics of these expectations as in some satellite states – e.g. Poland and Hungary – already a functioning SME-sector through cooperatives functioned (McIntyre and Dallago, 2003: 36, 63). Moreover Poland and Slovenia showed the considerable level of entrepreneur activity among the other CIT and at the same time becoming entrepreneur in Russia was considered in the lower level than in any country with former socialist economy (Estrin, 2006:3). The differences in the starting points of Post-Soviet countries are obvious not only in the entrepreneur activity but also in the factors which stimulate the entrepreneurship. As for example finance and institutional obstacle to entrepreneurship could be notable differences among CIT (ibid.: 2). Moreover differences in human capital and social-cultural factors considerably influence the following SME policies and their successfulness among the post-soviet countries (North, 1990; Davidson and Honig 2003;). Of course, regional differences are of great importance to SMEs as they are more innovative in highly developed regions compared to low-developed areas (Stam et al., 2007:127). Still, some scholars find that SMEs played a crucial role during the transition period of Central and Eastern Europe (CEE) countries (e.g. Smallbone, 2001).

2.3. SMEs and innovation

Development of new products is essential part for entrepreneur activity, but at the same time it is connected with different risks (Calantone et al., 1995; Simon et al., 2002). Innovation-based development plays an important role in entrepreneur activity during the production process of the new goods and products. Moreover innovation helps the firms to overcome their competitors and make profit as much as possible (Banbury and Mitchell, 1995). Schumpeter argues that entrepreneurs innovate to reach monopoly or at least near monopoly position (Kattel and Kalvet, 2010: 67). Therefore firms invest time and energy in innovation development, and the one of the main ways to innovate is to produce new products (Vermeulen 2003: 4).

Innovation development plays important role as for large firms as for SMEs development. Development of innovational potential of SMEs brings the new ideas, methods and practices for enterprises which are important part in the development of the SME (Slappendel, 1996:108). Innovations in SMEs are quite different from innovation in large firms (Rothwell, 1989; Rothwell and Dodgson, 1994). The flexibility of SMEs makes them privilege against the large firms during the introduction of new technologies in the enterprises (Acs and Yeung, 1999:168, Qian and Li, 2003: 885). Moreover SME's organizational structure which is simpler than large ones give them possibility to be more innovative and face less risks (Harrison and Watson, 1998)

Nevertheless, various scholars explain differently the importance of innovation in SME's development. Some of them (Oakey, 1993; Shaw, 1998; Paniccia, 1998) even argue that the role of innovation in SMEs development is not significant. But such studies are fewer than the literatures which claim the importance of innovation in SMEs development and the strong dependence between innovation and SMEs (Riedle, 1989; Radosevic, 1990; Dodgson and Rothwell, 1991; Bowen and Ricketts, 1992). On the whole, even Schumpeter (Baumol 2002) changed his opinion about the role of 'entrepreneurs' in economic development. This switch is partly explained by Thurik, (2009) and Audresch and Thurik, (2004) by shift in economics with

later the evolution from the “managed economy” to back to the “entrepreneurial economy” (Thurik, 2009: 1, Audresch and Thurik, 2004).⁵

Basically innovation plays important role in SMEs development and gives the opportunity to become competitive (Banbury and Mitchell, 1995). But at the same time SMEs role in innovation development is obvious at least because SMEs are numerous and represents the significant part of economic activity in most countries (Veugelers, 2008: 240). The relationship between SMEs and innovation can be considered as interrelated.

Today, the main reason of SME’s growing importance on innovation is “the reduced importance of economies of scale and scope in production, management and R&D” (OECD, 2010). There is several reason of this process; the first of all in today’s developed world the incomes are raised therefore there is need of new products and variety of products as consumers taste have been developed. For this reason SME’s are the best to fulfill the market (Cruz-Cunha and Varajao, 2011). Changing market, new technologies and variety of product has created a market where the product life have been reduced therefore there is necessity of rapid creation of new products and even more their rapid destruction. The role of SMEs has also in recent decades increased and especially in regards to breakthrough innovations, while their innovativeness on the whole – taking account their size – is not different from other firms (OECD, 2010).

The OECD (2010) research sees the main role of the SME’s for innovation is the creation of new organizational methods, marketing techniques and product development. Therefore there are two basic levels of the process:

⁵ The role of SME’s on innovational development partly depending on shift of “managed economy” to the “entrepreneurial economy” (Thurik, 2009: 1, Audresch and Thurik, 2004). Thurik (2009) in his book emphasize three major historical moments of relationship between SME’s and innovation: First, in the first decades of twenty century, Schumpeter considered entrepreneurs as the major players in development of small firms by introducing new inventions changing old products with new ones. The second period is referred as “Managed Economy” - Schumpeter (1945) discussed about the power of the large firms and their rapid growth, “exploiting high price elasticity of demand” (OECD, 2010). In the middle of 20th century, large companies were dominating and were able to achieve high progress in production, management, distribution and R&D (Galambos, 1997:287, Chandler, 1977, Galbraith, 1972). According to the researches, there was low influence of SME’s on innovation by this period of time (Acs&Audretsch, 1990). The third historical phase started from 1970 and is referred as “Entrepreneurial Economy”- In today’s world structure of advanced economy is changed. The importance of economy of scale has reduced” while the importance of small and medium enterprises on innovation and technological development is growing from day to day (Perez, 2001:25, OECD, 2010).

- *Breakthrough innovations* – support the development and extension of technological frontier.
- *Incremental innovations* – helps the economy to get closer to the technological frontier

Doloreux, (2004:15) argues that innovation activities of SMEs are more concentrated on incremental innovations. Moreover he argues that regional development plays significant role on the innovation development of SME. External collaboration as well as internal aspects play significant role in innovation development. Therefore collaboration with foreign firms, training programs and finance can bring good potential for innovation development for SME (Doloreux, 2004: 9).

According to the Baumol (2005:39), small businesses led the development of majority breakthrough innovations while large ones are more concentrated on incremental innovations. Farther, he argues that large firms spend proportionately more on R&D and more concentrating to improve their existing products and processes, while SME's are without strong ties on it. It is clear that there is important role of SME's in breakthrough innovations, especially in the sector of ICT and biotechnology (Baumol, 2005: 38-41).

Consequently, not all of SMEs equally contribute in innovation, but there are group of small businesses which are highly innovative and have an “individual impacts on job and productivity” (Hallberg, 2000: 8). Furthermore, Audretsch (1995) argues that when comparing innovation rates per employee, SME's are more innovative than large companies.

Today, the main reason of SME's growing importance on innovation is “the reduced importance of economies of scale and scope in production, management and R&D” (OECD, 2010). There is several reason of this process; the first of all in today's developed world the incomes are raised therefore there is need of new products and variety of products as consumers taste have been developed. For this reason SME's are the best to fulfill the market (Cruz-Cunha and Varajao, 2011).

2.4. SME policies in transition countries

According to the different scholars, the role of SME's was expected by many observers as a crucial during the transition period of Central and Eastern Europe countries (CEE)(McIntyre. 2001:57-60; Glass et al., 1999; Dallago, 2003). The collapse of Soviet Union gave the expectation of creation new small and medium sized enterprises in a result of transition to the market economy and creation of competitiveness in new independent countries. One of the main issues for countries in transition (CIT) to transform from centrally planned into market economy was the development and creation of new private business sector (Smallbone, 2001). Estrin (2006) believes that entrepreneurship played an important role in transformation process from old regime which was based on "hierarchical and administrative mode of organizing production" into free market economy. Many reformers share the ideas of Austrian economists (Kirzner, 1973; Schumpeter, 1934) and believe that creation of new firms is the principal process which will support the process of transformation in CIT (Djankov and Murrell, 2002). Expectations from CEE countries were overrated or even false as since 1989 nothing close to the "boom" has happened (Dallago, 2003: 2). The reforms of 1990 were more concentrated on privatization and liberalization of existing enterprises (Estrin, 2009: 3). There are several reasons of disappointed expectations.

First of all is that few number of SME's survived in Soviet period and surprisingly they survived in private hands. There were also numbers of co-operated firms beside private enterprises and of course the main part was owned by state. Another reason is that, SME by itself is not enough to led economic growth and development for CIT (Dallago, 2003:5). There is necessity of proper institutions and structures, even more the policies are essential part in SME's development. Without it, numbers of SME's can growth but it doesn't mean that they will bring profit for economic (Dallago,1991: 36). Hence, the public policies vis-à-vis SME's played important role in CIT. In a first period, many transition countries followed policies based on the neo-liberal stance and usually those policies were approved under the pressure from Internationally Monetary Fund (IMF) and World Bank (Smallbone and Piasecki 1995). The main accents of policies were focused on privatization, stabilization and liberalization. The process of privatization supported the creation of number of new small private enterprises (Aidis, 2005:

307). Liberalization during the transformation process from central planned economy into market economy allowed the creation of new products. During the Soviet Period variety of product was quite low. Liberalization of market allowed creation of consumer demand on products and services which were unlivable in the period of central planned system (Aidis, 2005a: 22). By the end of 1990 the general picture has been changed, and number of tendency of creation of new business went down in most CIT (Smallbone and Piasecki, 1995). According of some economic observers (Smallbone and Piasecki, 1995; Geroski, 1995; Kontorovich, 1999; Glas, 2000 ;) one of the main reasons of low tendency was lack of financing and decreasing of customer demand. Beside this, increasing of regulations and increasing level of domestic competition also played a crucial role in decreasing level of private sector. Aidis and Sauka (2005: 7) argue that importance of SME's in transition period is high. They bring several reasons of how SME's can benefit:

- Ability to provide economic benefits (by flexibility in terms of experimentation, adaptability and learning's);
- Ability to reduce unemployment by offering new alternative employment opportunities (EBRD1995);
- Ability to play crucial role in the early phase of economic development in transition countries;

Smallbone (2001) make accent on role of SME's in CIT as a contributor to the wide social transformation process, which according of his word is the important part of transformation process from socialistic market into democratic based market. Piasecki (1995) argues that the appearance of private sector and market economy is impossible to reach without the contribution of SME's which allows liberalization of social knowledge.

During the transition period the activity of SME's (especially small enterprises) was considering more as "proprietorship" rather than entrepreneurship (Scase, 1995: 15). In spite of all variety of roles, SME's were considered one of the main contributors in economic development process and process of transformation in CIT. SME's are partly influence by public policies which by it side are significant part for development of SME's in CIT especially in the early years of transition process (Aidis, 2005). Hence the contribution of SME's for economic development is

basically depend on external processes (including political stability, national security and policies adopted by government). Basically contribution of government in creation of good business environment is a crucial role in development of SME and should be discussed separately. For example in Poland by adopting new correct administrative and legal reforms supported the sharp increase of small business in the country (Smallbone, 2001: 67)⁶. As a result by 1997 Poland reached the number of SME's which created 61 per cent of total employment (Piasecki et al., 1998). Comparing with Ukraine which spent less attention on policies, Poland reached more in process of SME's development. In Ukraine in spite of big population reached the number of SME's which were able to offer a workplace only for 10 per cent of total employment (Smallbone, 2001: 67-68). Farther in table 2, will be shown EBRD indicators in term of legal and administrative reforms, also in table will be shown a competition policy in CIT (not all countries is shown). The indicators are rated from 1 to 4, where 1 means the little reform; 4 indicate the standard which is applicable for advanced industrial economies:

Table 2: Progress with Market Reforms in Selected Transition Countries:

	Price liberalization	Banking Reform	Large-scale privatization	Small-Scale privatization	Competition policy
Group 1: Countries where market reforms have been slow or not properly installed					
Belarus	1	1	1	2	2
Russia	2-	2-	3+	4	2+
Ukraine	2	2	2+	3+	2
Group 2: Countries where market reforms are more advanced					
Estonia	3	4-	4	4+	3-
Hungary	3+	4	4	4+	3
Czech Republic	3	3+	4	4+	3
Poland	3+	3+	3+	4+	3
Note: (i) Group countries: average score below 3; Group 2 stage countries: average above 3 (ii) Compiled from EBRD, Transition report 1999/1=little progress, 4+=standards and performance typical of advanced industrial economies.					

Source: EBRD, Transition Report 1999; Smallbone 2001:67.

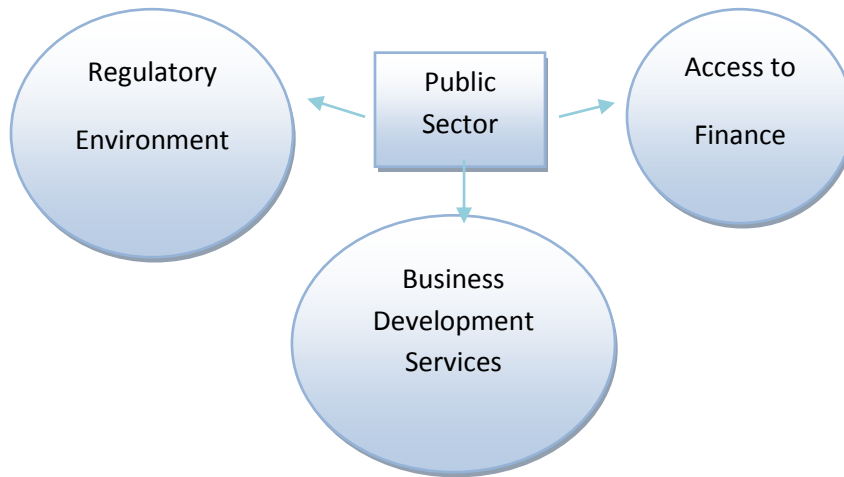
⁶ The number of small enterprises rise from 0.57m in 1988 to 0.96m in 1990, and by 1997 reached 2.5 (Smallbone 2001).

Curran (2000) is criticizing such kind of indicator models and argues that political and economic reforms are not enough during the transition path. Curran (2000) sees the learning of social, historical and cultural basis of country as important factor during the transition. Curran is not alone in his assumption, Dembinski and Unterlencher (1993) as well as Rosenbaum (1999) believes that economic and political reforms alone are not sufficient. Therefore many researchers connect quicker or slower path of transformation exactly with countries startup point, its culture and history. Mugler (2000) and Shleifer (1997) believe that in the countries where economic and political reforms were quicker, SME's development was also on high level. Apart of this, Mugler (2000) argues that the important point is the history. He give's an example of Poland where agriculture reminds in private sector during the Soviet Period. Because of this fact Poland's transition path was quicker. The same can be said about Hungary. Taking everything into account, it can be said that there is no one main source of SME's development. Political & Economic reforms, history and culture of country, regional development and national security should be learnt together to reach the good environment for SME. Consequently the role of government and governance is important during the creation of correct environment for SME's development.

2.5. Role of government in SME development

SMEs are recognized by policymakers, economists and researchers as the important lever of economic development. Therefore, SME's developments become the significantly important for government and public administrators (for example, Audretsch, Grilo and Thurik, 2009; Lundström and Stevenson, 2005; Smallbone, 2010; Welter and Smallbone, 2011). The governments and public administrators of different countries have their own way and view of the development of environment for SMEs. To reach the result policymakers try to make some different experiments and create the different programs. According to the World Bank, public sector has direct opportunities to improve the SMEs development via three main steps: improving the regulatory environment, foundation of financial institutions which can significantly solve the finance access problem for SMEs and foundations which can support the development of SMEs by offering different plans and programs (see the figure 2).

Figure 2 Public Sector's involvement to stimulate the SME's development



Source: World Bank Institute Presentation September 14-16, 2003.

It is also notable the fact that the access to finance is one of the most significant problem for SMEs and new business start-ups, moreover most of SMEs cannot finance the innovation development of enterprises (Wei-Yen and Nee, 2004:157; Malhorta et al., 2007:55; Stepanouand Rodriguez, 2008:10; Baldock et al., 2008; Blackburnand Schaper, 2012)⁷

Therefore support of financial institutions, tax regulations and increase of competitiveness which support SMEs development should be priority of Government (Beck et al., 2008:1395-1398). The regulatory environment also plays significant role during the SME's development as it can be considered as a guarantee of the unchangeable basic conditions⁸ (Demirguc-Kunt, 2006). Regulatory environment also helps SME's to understand which laws are acceptable to their situation and allow them to have an access to applicable law (Harvie and Lee, 2002: 84). Government should pay attention on the procedures which will make the regulations more suitable for SME.

Smallbone (2001) argues that government's influence on macroeconomic environment will allow state to influence on SME's development. Interest rates and property rights need high level of

⁷ Access to finance is a key determinant for business start-up, development and growth for small and medium sized enterprises and they have very different needs and face different challenges with regard to financing compared to large businesses".(European Commission, 2013).

⁸ According to the World Banks report, the creation of regulatory environment: "provides SMEs assurance that the Government will not unfavorably change the basic conditions underlying their business decisions" (World Bank, 2003).

attention from government, otherwise it they can discourage foreign investors and entrepreneurs to make their long-term investments. According to the Smallbone (2001) Government has enough leverage to influence on SME's. Legislation could be one of the main leverage of influence. Creating of different policies can effect on development of SME's. Although government has different ways of influence, Altenburg (1999) considers direct support policies and programs as the most obvious ways of influence. Therefore for most of countries in transition creating direct programs and policies could be the way out (Curan 2000a). But at the same time government should not forget about development of market-related institutions such as banks. The development of business infrastructure side by side with correct policies and programs could be strong basis for SME's development.

Development of education system by government can be considered as indirect influence on SME's development (OECD 2013:21). As for example regions in countries of Latino America as well as Central and East Asia lag in education what is considered as the main barrier for SMEs (ibid). Better situation is in EU countries but still needs development; the European Commission considers education as an important background for doing business⁹. The education should give the possibility for future entrepreneurs to get basic knowledge and skills of doing business. Methods of teaching at schools, colleges or universities should be supported by government (Henry et al. 2003).

Very bureaucratic registration and the long list of different financial requirements also made the difficulties for business at early stage (Smallbone, 2001). In advanced transition economies such as Poland or Hungary small and medium sized enterprises accounts almost 50% of GDP while in less advanced transition economies such as Russian Federation SME's account even less than 20% of GDP and the main reason as it was mentioned above are very bureaucratic costs, corruption, high inflation rates, insufficiency of financial resources and inadequate financial institutions (Ayyagari et al., 2003). Lack of competition is also a big problem for SME's development. One of the best ways to solve competition problem is to allow foreign banks and grant their access to domestic market (Southiseng, 2010). Unfortunately numerous countries

⁹"Europe needs more entrepreneurs, more innovation and more high-growth SMEs. This is why it is necessary to stimulate the entrepreneurial mindsets of young people. The important role of education in promoting more entrepreneurial attitudes and behaviors is now widely recognized." EU commission 2012

including Russian Federation, Brazil, China, India and many others try to hamper foreign banks access to domestic market (UNCTAD, 2006)¹⁰. And the last but not least are oligopolistic banks which has extremely bad influence on the SME's development and directly harm to the financial access for SME's (Wieneke, 2011). Accordingly governments influence on SME's development is quite high on the both indirect and direct ways. The development of institutions, creation of policies and regulations, correct reforms and creation of different programs for business development considerably influence on development of SME and their contribution into the economic development.

¹⁰"I want to confirm that the Russian government agrees with our banking community that activities of foreign bank branches in Russia should today be restricted or, in fact, prohibited," Putin said

3. Comparison of SME Policy Development in Georgia and Estonia

The basis of the political and economic transformation for CIT is the development of entrepreneurship and creation of new small and medium sized business by adopting policies, creating new institutions, business infrastructure and environment which will attract the development SMEs (Szabo, 2006).

In Georgia and Estonia, SME also played significant role in transition and facilitated the transition from a planned economy to a market oriented (Japaridze et al., 2012; Smallbone, 2003). After the collapse of Soviet Union one of the main priority for Georgia as well as for Estonia has been the becoming a member of European Union (Gogolashvili, 2012). Therefore economic transformation and the development of socio-economic level of country was the main goal for both countries.

Case study of Georgia is mostly focused on the reforms and policies and discusses about the mistakes made by government since the transition period. This gives an opportunity to identify the weaknesses in policymaking and analyze the role of SME in Georgia. The case of Estonia starts with economic overview and policies adopted since the collapse of Soviet Union. Furthermore Estonia case is focused on the role of EU policies on the SMEs development. And the statistical analyze of SMEs share in economic development. Accordingly, based on the cases of Estonia and Georgia, comparative analyze will identify the policy differences in regard of SMEs development in Georgia and Estonia. At the same time Estonian case based on EU policies, allows to analyze the risks and benefits in term of SMEs development in Georgia during the European integration.

3.1. Case study of Georgia

3.1.1. Post-Soviet Transition of Georgian Economy

After the collapse of Soviet Union Georgia started the struggle to protect the independence of the country. One of the main challenges of post-soviet Georgia was to find the way to the democratization and liberalization of economy (Gegeshidze, 2011: 27). From the beginning of independence Georgia started defining country's foreign and domestic. The foreign policy was fundamentally against Russian's interests and in the future it became the reason of political and military conflict with Russian Federation what consequently damaged the developing process of SME and economic all in all (Shane, 2010; Boden, 2011: 125). At the same time of the main challenge for Government of Georgia was to find such way of development of country which mostly suits traditions and social preferences of the country (Milanovic, 1998: 5). In other words governments economic view depend on actual public demand what means that Georgia was "demand driven" (Gogolashvili, 2011:176).

The transition of Georgia started with social, economic, political and territorial problems(Wellisz, 1996: 5; Boden, 2011: 127)¹¹. The macroeconomic environment, as well as whole country, was totally unbalanced and uncontrolled (Gogolashvili, 2011: 175). To speak about economic policies and reforms from 1989 till 1995 is quite unserious because of crisis¹² in which country appeared (Papava 2011).

Mistakes made by authorities during the transition from planned economy into the market were made on the very first stage of transition (Papava, 1995). As a result of mistakes, Georgia got high level of inflation reduction of GDP and high level of unemployment. In 1993 the GDP of Georgia represented almost 30% of GDP of 1990s level (Khaduri, 2010). Until the 1995 economic situation was on very difficult level and needed rapid and radical reforms. Currency

¹¹International Organizations and different institutions together with government of Georgia took a part in developing of economic and social reforms but unfortunately they doesn't reach the result as on the final stage reforms were interrupted because of bureaucratic and oligopolistic interests (ibid:177) .

¹² The nation didn't have any unity and government in a head with President Gamsakhurdia was without vision about the future of country. The First President of Georgia Gamsakhurdia was faced with regional problems and decided to isolate Georgia. He thought that it will be a good way to survey against Russian aggression. Maybe there was logic but unfortunately regional isolation and nationalism create unhealthy environment for business development (De Waal 2011).As a result of civil war and ethical conflict by 1992 Georgia's president was killed and territorial integrity destroyed by separatists (in Abkhazia and South Ossetia) in direct support of Russian Military Forces (Boden 2011: 127; Gegeshidze 2011; Papava 2011;Wellisz 1996).

reform adopted in 1995 significantly helped to stabilize the macroeconomic situation and create the environment for SME's development more attractive (Kakulia. 2008; Papava et al., 1996).

In the 1993 Government of Georgia implemented the trade liberalization process together with immediate release of price control. In the other worlds it was well known "Shock Therapy"¹³ based on neo-liberal economic theory (Gogolashvili 2012; Myant 2008). As a result of reforms Georgia reached the price liberalization and tax system reforms. According to the Former Minister of Economy of Georgia Vladimir Papava, plan wasn't fully realized and was not suitable by social protection side (Papava 1996).

3.1.1.1. Delayed development and "dark" years of country

The business history of Georgia faced many different challenges and problems since the independence of Georgia. The business environment in the period of 1990-1991 was under the high pressure as from authorities as from different criminal groups, highly represented by that period (Wellisz, 1996: 7). Moreover Georgia was highly depended on Russian economy and even first year of independence Georgia was still depended on money supply form Russia.¹⁴

In 1994 government of Georgia started big steps in state development what implies adoption of new policies and reforms (Gogolashvili, 2011). The one of the main achievement was the creation of "Anti-Crisis program of the Republic of Georgia"¹⁵ which basically brings changes in economy of Georgia and improved the business environment (ibid). Basically this was the only progressive step made until 2003. Unfortunately Shevardnadze and his government together with "Anti-crisis program" brought the corruption which significantly harmed the as SMEs as business at all. As the result of Government's irresponsibility by the 2003 Georgia got the

¹³Poland was the first country which developed this reform created and implemented by Leszek Balcerowicz (Prime minister of Poland in 1989-1993; author of "plan Balcerowicz" also known as "shock therapy"). In a few years the plan of Balcerowicz was borrowed by many other CEE countries, including Georgia Plan was based on 11 main principles actions which supported the economic recover. In the fact for Poland to reach a result took approximately 2-3 years as the progress of economy started in 1992 (Myant ,2008). Unfortunately Georgia couldn't manage the result as Poland had and mostly it was depended on lack of free institutions which could support SME's development.

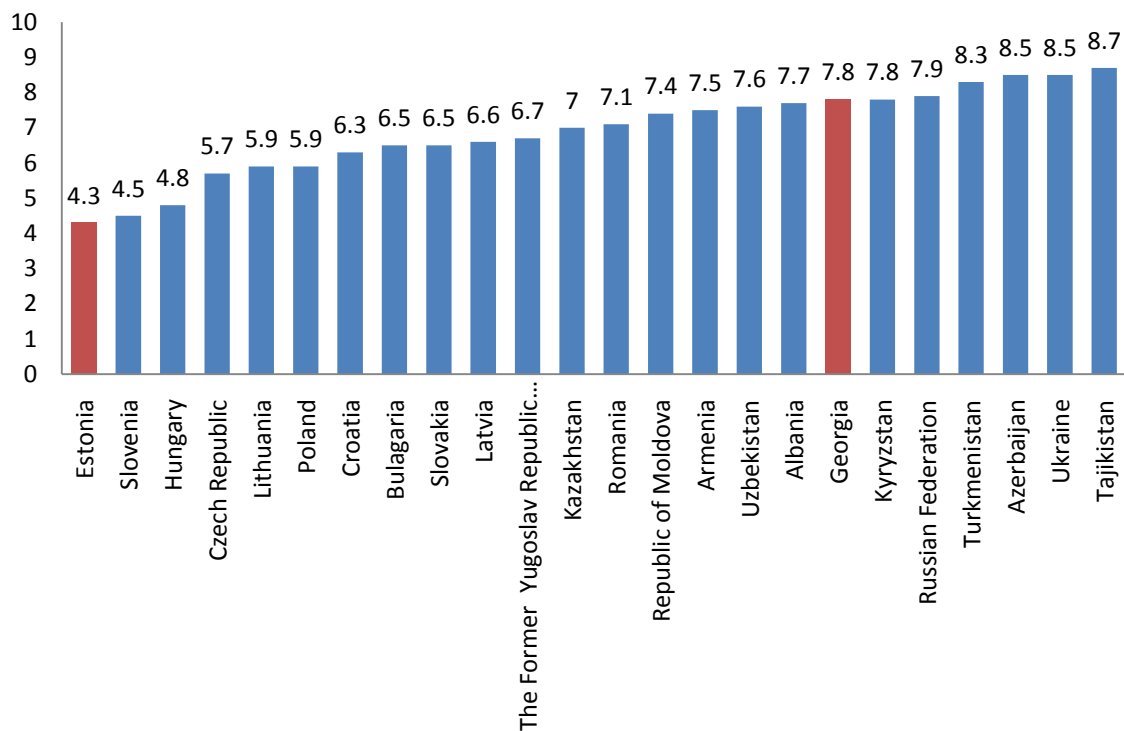
¹⁴ . In 1998 Russian Federation faced the serious economic problems and the Russian default also strongly hated the Georgian economic (Kakulia, 2008).

¹⁵ President Shevardnadze introduced the Washington consensus style economy which brings the economic recovery and more or less solved the problem with budget deficit (IFAIR 2012).

population where 52% were officially below the poverty level (Meskhia, 2008). King (2001) used the word “Potemkin villages” to describe the situation which appear in Georgia from 1989 until 2003.

According to United State Agency for International Development (USAID) Georgia was considered as: “simultaneously as the single most corrupt and reform-prone country in the post-Soviet space” (Christophe, 2005). According to the Transparency International in 2000 Estonia was on the first place of less-corrupted countries among the other Post-Soviet countries and took the 27th place in world rating (Transparency International 2000)(see the figure 3). Georgia by that time was in the leading position among the most corrupted countries.

Figure 3: Transparency International Corruption Index in 2000¹⁶



Source: Transparency International: Corruption Perception Index 2000.

¹⁶ Scale 0-10 (Highly corrupt=10, highly clean=0)

In achievements Georgia became the “good” competitor for any most corrupted African state (Christophe, 2005). Consequently the corruption highly damaged the SMEs development and FDI inflows.

3.1.1.2. Economical recover - wave of development

“Georgia is the world champion in economic reforms. No other country and no other government in the world has done as much as the Georgian government did to improve doing of business and for creating opportunities”

Mikhail Saakashvili, President of Georgia (2003-2013)

The economic recover of Georgia starts with “Rose Revolution” in November 2003 led by Mikhail Saakashvili¹⁷. The most significant reform (anticorruption reform) was done in the first years of Saakashvili’s rule. In 2004 government of Georgia made total reform in the Ministry of Internal Affairs ruled by new Minister Ivane Merabishvili¹⁸ (De Waal, 2011; Chêne, 2011). The anticorruption reform was the good signal for foreign investors to invest in business (IFAIR, 2012). The revolution brings new hopes and perspectives in country. The first year of new government was the “problem-solving year”¹⁹, the problems which previous government left (Gogolashvili, 2012).

The correct reformation brings the FDI inflow and in 2007 it reached more than \$2billion (De Wall, 2011). From the business side Georgia reached the best ranks in its history. According to the doing business Georgia ranks 8 in the ease of doing business. Table 3 shows that Georgia ranks the highest position among Post-Soviet countries and on the second place in Europe after Denmark in ease of doing business.

¹⁷The main reason of revolution was the already mentioned corrupted government and socio-economic crisis of Country (Papava 2006). Therefore the main goal of President Saakashvili and his cabinet was to fight against corruption.

¹⁸ “the entire staff of the notoriously corrupt traffic police around 13000 people was fired and a much smaller, better-paid, more honest organization was created in its place” (De Waal 2011)

¹⁹ In March of 2011 on the official speech in Washington D.C. Mikhail Saakashvili stated: “Georgia was a classical failed state. And bureaucracy was killing any initiative in the society. There was crippling poverty, serious inadequate infrastructure, and an economy shackled by corruption. As you know, the peaceful, popular revolution brought to power a young team of reformers that I happen to lead. The situation back in Georgia was so catastrophic that we had to build our state almost from scratch”

Table 3:Ease of doing business:

	Ease of Doing Business Rank	Starting Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Paying Taxes
Singapore	1	3	3	28	3	2	5
Hong Kong	2	5	1	89	3	3	4
New Zealand	3	1	12	2	3	1	23
Georgia	8	8	2	1	3	16	29
Lithuania	17	11	39	6	28	68	56
Estonia	22	61	38	15	42	68	32
Latvia	24	57	79	33	3	68	49
Armenia	37	1	8	3	13	4	16
Azerbaijan	70	10	180	13	55	22	77

Source: Doing Business 2014

In 2006 Georgia made big steps in licensing law cut from 909 until 159 and in tax reform by eliminating 12 of 21 taxes²⁰. The economic development of country reached its historical pick (Rinnert, 2011). Huge work of new government brings the development of business environment and as a result in 2007 Georgia received 51 000 registered companies compared with 36 000 in 2003 (OECD, 2011; Doing Business, 2010; IFAIR, 2012).

3.1.2. Development of SME policy in Georgia

The “Rose Revolution” brought improvements in SME sector by implementing different policies and reforms(Japaridze and Elizbarashvili, 2012). The Law on the support of Small and medium sized enterprises were adopted by 1999 which explains the definition of SME in Georgia and its role (Japaridze andElizbarashvili, 2012). In June 2002, President of Georgia accepted the state

²⁰ From January 1, 2005 the Parliament of Georgia left only 8 taxes including: Income tax, tax for exploiting natural resources VAT, excise tax, social tax, property tax, gambling business tax and profit tax.

aid program:”The State Aid Programme of Small and Medium Sized Enterprises in 2002-2004”
The law was consisted with two main direction where the first one was connected with financial support of SME and the second one was connected with Education and Training sphere²¹ (JaparidzeandElizbarashvili, 2012).

In 2006 the law “On the Georgia National Investment Agency” changed the previous law on support of SME and the definition of SME was regulated by the National Investment Agency. According to this definition –small sized enterprises in Georgia are enterprises where number of employees does not exceed 20 and total annual turnover is less than 500 000 Georgian Lari (GEL) while medium sized enterprises are considered as enterprise with less than 100 employees and turnover is not more than GEL 1 500 000 (JaparidzeandElizbarishvili, 2012). The interesting fact is that there is another definition of SME in Georgia according to the Tax Code. And what is more interesting the definition of SME by Tax Code and Georgian National Investment Agency contradict each other. According on the Tax Code, small sized enterprises’ annual turnover should be not more than GEL 30 000 and medium sized with GEL 500 000 (ibid., 2012).

Liberal trade policy brings for the country progress and upward tendency in foreign trade turnover (Mamukelashvili, 2011: 173). The aggressive and transparent privatization process in Georgia started in 2004 when Minister of Economy KahkaBendukidze announced total privatization:“We are going to sell everything except our honesty”(Business Day 2013). Indeed government sold everything to private property including the Ports, Railways and Energy stations. Government steps made the country attractive for FDI inflow and for SMEs development(Mamukelashvili, 2011: 177).

The implementation of central collateral registry significantly improved the procedures of credit getting system for SMEs. The important steps were done also in the investment protection. As it was mentioned previously the anticorruption reform made by Government of Georgia significantly improved the business environment (Japaridze and Elizbarashvili 2012). Until 2006 Government’s contribution in support of SME was insignificant as Government did not consider

²¹ The Education and Training Programmes were adopted in support of SME in Georgia before 2006:

SME as the main source of economic development. In 2006 Embargo on Georgia good by Russian Governments significantly hit on the economic development. Soon in May 30 of 2007, Government of Georgia introduced a resolution #110 developed for support of SME in Georgia²² (Gogolashvili, 2011). The idea of program was that SME were allowed to take 5 years cheap loans from bank if they present that they will create new work places. On the same time government was founding the start-ups with 20%. Totally the cost of this program for government composed GEL 5.5 million (Papaiashvili andÇiloglu, 2012).

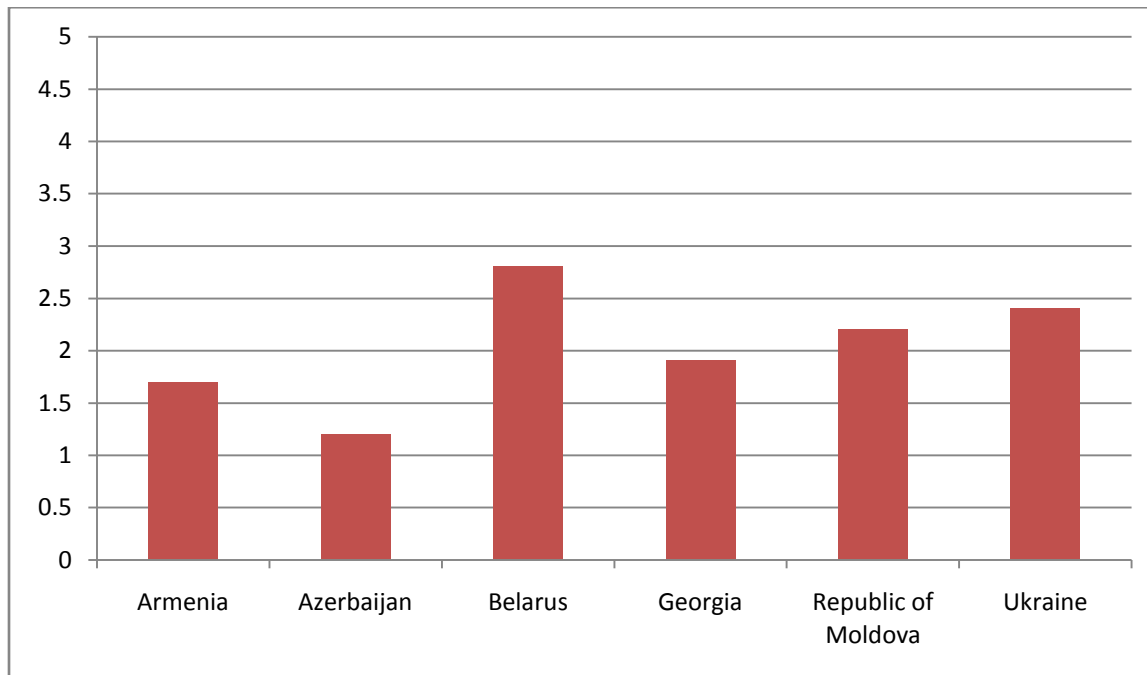
Another interesting project in support of SME was launched by Tbilisi City hall (“Start Business with support of Tbilisi City Hall”). The Idea of Program to support the creation of new SME’s or its extension. According to the City Hall this program could support the creation of new work places, development of manufacture and tourism. Also the City Hall called SMEs to use this support in term to improve the infrastructure of enterprises and introduce new techniques (OSGF, 2007).

The contribution of different international organizations in development of SME in Georgia is significant but unfortunately the government of Georgia did not have any concrete policies in supporting of SME and that is why different programs adopted by government or international organizations were just a fragment in SME’s support (Japaridze andElizbarashvili, 2012).

The theoretical framework discussed the importance of innovation development of SME, therefore the innovation policies should be considered as priority for Government. Unfortunately Government of Georgia doesn’t pay enough attention to innovation policies for SMEs. Therefore on the figure 4 we can see that even among the Post-Soviet Countries Georgia takes quite low position (European Commission, 2013a).

²²Programme name “ Employment through the small and medium sized enterprises development “

Figure 4: Innovation Policy for SMEs²³:



Sources: EPC 2012

According to the figure 4, Belarus is taking the leading position in innovation policies. One of the main reasons of such success is that the government of Belarus highly supports the creation of institutions or organization which supports the innovation development of SME (Council of Ministers of Republic of Belarus, 2011). Unlike Belarus where government supported the foundation of High-Tech park which significantly improved the innovation development, in Georgia innovation policies for SMEs too often remain just on the paper and are not realized due to financial insufficiency or by other reasons (Shatberashvili, 2012).

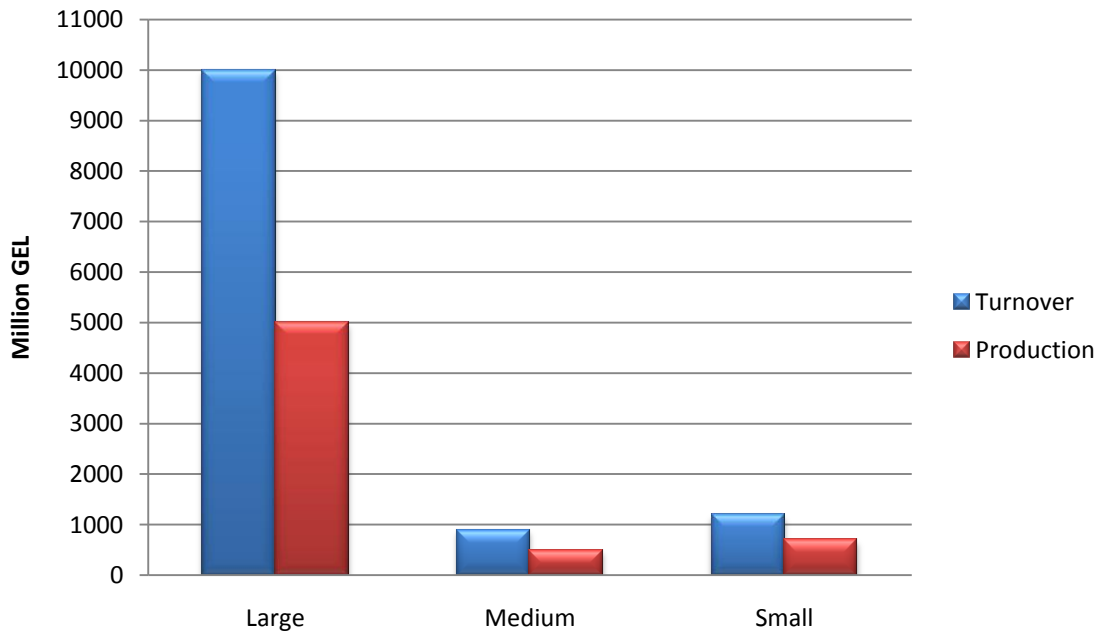
3.1.3. Role of SME in the Georgian Economy

The annual growth of economic became significant since 2003. Reforms and policies introduced by President Saakashvili and his cabinet significantly improved the economic performance of country and helped to overcome the state crisis (Gogolashvili, 2011). But the impact of government diligence could be considered unsatisfactory in term of small business development. The total SME production in 2013 made less than 1500 million what in compare with previous

²³ The indicators are based on five level of policy where 1=weakest and 5=strongest.

years is quite low indicator (Japaridze and Elizbarashvili, 2012; Geostat, 2013). The figure 5 indicates shows the difference in total turnover between the large, medium and small enterprises.

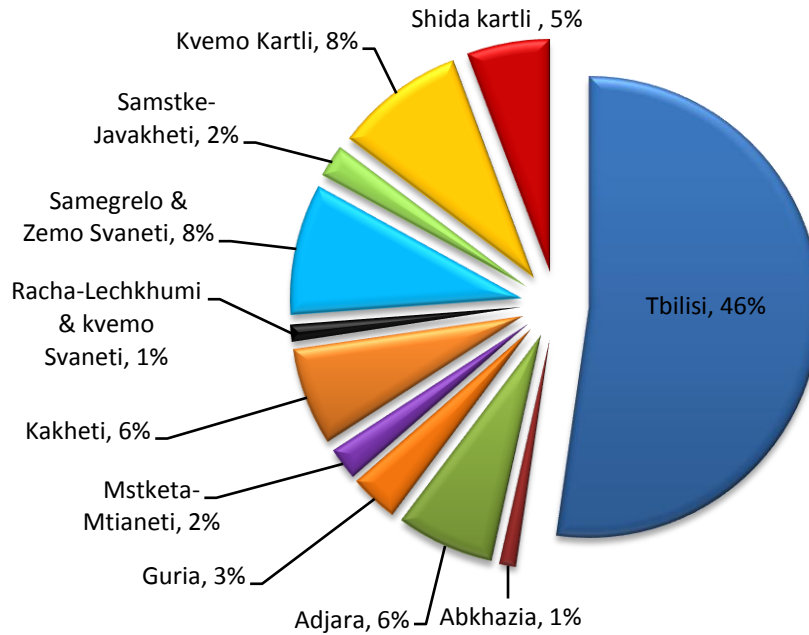
Figure 5: The total turnover of enterprises by size in 2013



Source: Geostat 2013

The role of SMEs in regional development of country particularly did not have any sense. The 46 % of all enterprises are located in the capital of Country in Tbilisi (Geostat, 2012). According to the statistics of 2012 there are some regions like Racha-LechkumiandKvemoSvaneti which shows very low level of SME's development and unfortunately the situation is not improved.

Diagram 1: SMEs registered in Georgia by regions:



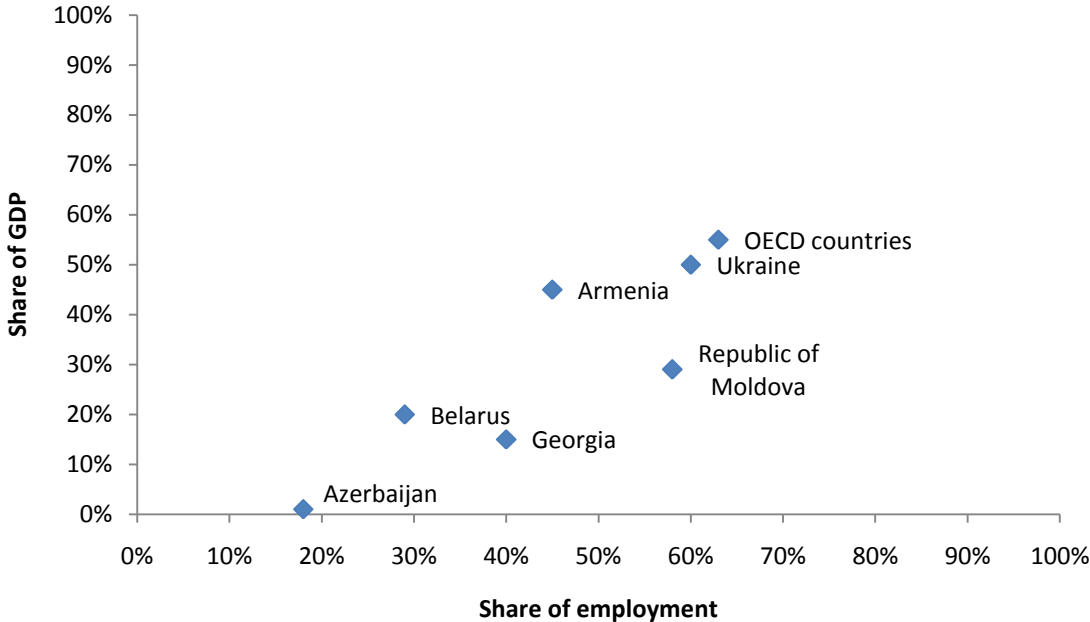
Source: Japaridze and Elizbarashvili 2012; Geostat 2012

The tendency of newly registered enterprises doesn't change the situation in regions as basically most of them prefer to start their business in capital. Mostly such kind of tendency is occurred since 1990s. The war and economic crisis made the people migrate from their hometowns to capital (Brown, 2010).

The development of SME and business environment in Georgia can bring the high results in economic development of country. Statistically more than 95 % of all enterprises in the Eastern Partnership countries are SMEs (OECD, 2012). The number of employed people by SME is raising more and more, but the SME's average share in GDP is hardly exceeds 30 % (EPC, 2012). The reason of such a low contribution can be found on the sector in which SME took activity. Mostly SMEs are concentrated on the sectors which demands less start-up capital and less qualified employees. The same is in Georgia because of insufficient number of employees SME's contribution on economic development is not as high as it should be (Papiashvili and Çiloglu, 2012).

Basically in whole region of Eastern Partnership countries as well as in Georgia, SME's are represented mostly as micro enterprises and the main goal of such enterprises are to get income for family and not for farther development of their business (EPC, 2012). In my opinion the term of "Missing Middle" implemented by Andreas Widmer really suits to describe the problem connected with SME's contribution in Georgia's economic. Basically the situation where entrepreneurs does not invest in their business' farther development and think only on low income make the government to understand that entrepreneurs starts their business because of todays need and not because of farther growth of enterprises and as a result SME's contribution in GDP is not significant (EPC, 2012).

Figure 6: Share of SME's sector on employment and GDP level of Eastern Partnership countries



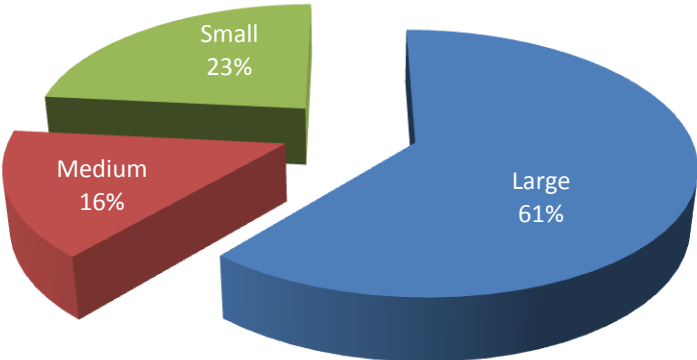
Source: Geostat 2012; NCD of SME Armenia 2012; State Committee on Statistics of Azerbaijan; National Committee on Statistics of Belarus 2012; National Bureau of Statistics of Republic of Moldova 2012; State Committee on Statistics of Ukraine 2012; OECD 2012

According to the OECD research, Enterprises in Eastern Partnership countries are seek the way how to survive and save the company; they do not try to invest in innovation (OCED, 2012).

The one of the main barriers for SME’s development in Georgia is incorrect policies and access to finance. In most of CEE countries, political and economic situation creates additional barriers for SME’s development. Form the beginning of 2007 political situation in Georgia has been quite instable what has changed the business environment on the bad side. In addition, some of the opposition parties and representatives of different non-governmental organizations started blaming government in “elite corruption” (Transparency International 2012). The Georgian Yong Lawyers Association (GYLA), Studio Monitor and the local NGO’s claimed the different fact of government’s direct intervention to business activities. Interesting fact is that even after the power change in 2012 by reason of “Elite Corruption” new government could not prove their charges against the Saakashvili’s cabinet. Unfortunately the image of “Corrupted Government” created by opposition badly influenced on FDI inflow and SME’s development since 2007 (EPC 2012).

To indicate the role of SME for economic development we should asses their contribution in macroeconomic indicators such as: The share of SME in GDP and share of SME in employment (Papiashvili andÇiloglu, 2012). According to the Georgian Statistic center, the 38.8% SME employment index is a clear evidence of low competitiveness among the SME segment and their insufficient contribution to employment (EPC, 2012).

Diagram 2: Indices of employment in Georgia in 2013 according to size of enterprises

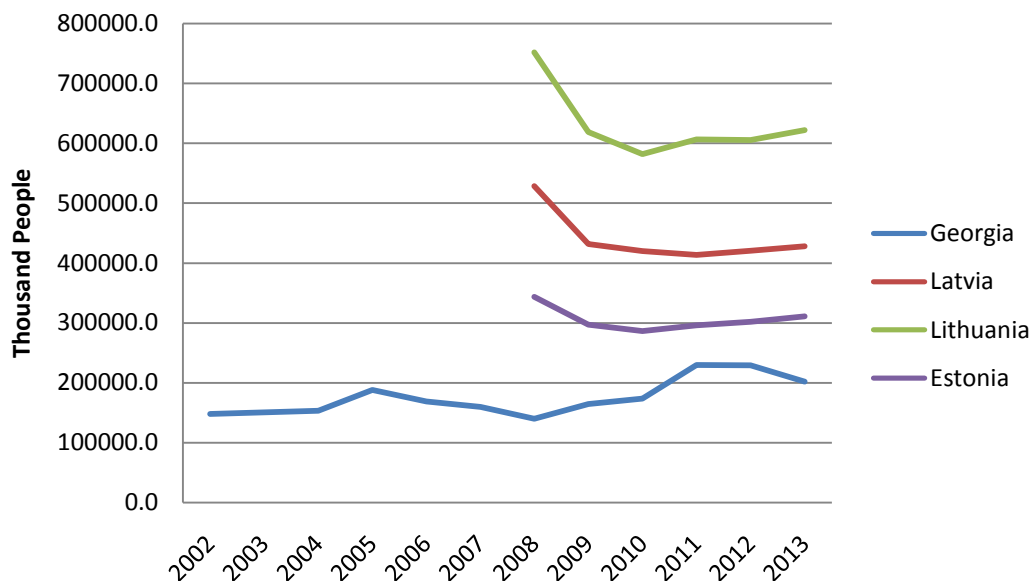


Source: Geostat 2013

The SME's share in employment shows that Georgia needs to improve the environment and create more competitive environment for SME's development (Japaridze and Elizbarashvili, 2012). In the 2013 SME's share in employment among the enterprises significantly decrease what means that government change in 2012 significantly influenced on business environment (Geostat, 2013).

According to the European Commission, the share of SME in the Baltic countries is significantly more than in Georgia (see the figure 7). For example in Latvia according to the statistics of 2013 share of SME in employment is 77.3 per cent, in Estonia²⁴ 78.7 per cent and in Lithuania 75.1 per cent (Eurostat 2013). The average index of SME share in employment by EU 27 member states amount 66, 7 per cent in 2013 Eurostat 2013). Hence the index of SME and its contribution in the employment is quite far from impeccability

Figure 7: SME's share in employment among the enterprises in Georgia from 2002 -2013



Source: Geostat 2013

Another important economic indicator is value added. In this Indicator large firms are perform better results than SME in Georgia (Papiashvili and Çiloglu, 2012). Despite the different policies

²⁴ In 2013 in Estonia SME amounts 311237 employees while in Georgia SME amount only 201821, and what is notable the population of Georgia is 4 times more than population of Estonia.

reforms and programs adopted by government of Georgia, SME's contribution into national income is not significant as well as its role in employment (ibid., 2012).

3.2. Case study of Estonia

3.2.1. Post-Soviet Transition of Estonian Economy

*“Government can make efforts with business environment -
but without population with entrepreneurial mind-set those
efforts won't lead to the success!”*

Ministry of Economic Affairs and Communications of Estonia

After the collapse of Soviet Union Estonia as well as other post-soviet countries faced the common goal – transition from planned to market economic. The path of Estonia transition was quite different from other post-soviet states (Liuhto, 1996: 121). Post-communist countries were too much interdependent while coexisting therefore Estonia received “economic heritage” which needed strong reformations and transformations (Van Arkadie and Karlson, 1992: 105). During the Soviet Period, Estonia many times experienced the economic experiments implemented by Soviet Union (ibid). The economic experiments made by Soviet Government since 1950 was not successful and pleasant for whole Soviet Union, but they positively effected on the entrepreneur sector and economic of Estonia (Sutela, 1991: 49).Entrepreneurship by it side is assessed as driving force decentralization and step to the market economy (Vanesaar and Loomets, 2006:1).

Estonia managed to develop the entrepreneurial sector since the beginning of transition, what brings the new enterprises and SME which significantly contributed in economic growth and employment of Estonia (Smallbone et al., 1999; Venesaar, 1999; 2006). Based on different studies, SMEs significantly contributed in regional development of country during the first years of transition (Raagmaa, 1996). The history of SMEs development in Estonia starts even before of collapse of Soviet-Union. Estonia was the first country which started researches to implement new form of organization production. In support with Estonian Academy of Sciences Institute of Economics and different researchers, Estonia elaborated the fundamental program for small business development (Venesaar, 2006: 275). This research was successful in setting up new SMEs (ibid).

The development of entrepreneurship and successful reformations regarding the SMEs development put Estonia one step ahead in transition process among other Post-Soviet countries (Terk,1991). Basically the transition process of Estonia was successful and the small state reached transform “from totalitarian empire to pluralistic free market democracy (Drechsler, 1995: 111). The successful transformation and government with democratic values attracted scholars from West Europe and the relationship between EU and Estonia launched (ibid).

3.2.1.1 Transition Prior to Accession to the EU

The transition process of Estonia was successful and more rapid than in any Post-Soviet country, but of course Estonia did not manage to escape from socio-economic problems in the first year of transition (Liuhto, 1996: 123). Estonian economic had experience of coupons, collapsed manufacturing sector, long queues for gasoline, inflation almost 1,000%, increased social inequality and ect.(Laar,2009: 8). First half of 1992 was really difficult for economic of Estonia because of the inheritance from Soviet regime, but at the same time government of Estonia committed different economic problems (Vanesaar, 2006).

Shortage of clear strategy of how to process farther was the main problem of Estonian government in the first years of Transition. Some of the politicians thought about the “third way”- smoothing between the command and market economic. The way was based on declaring of state of emergency where government was able to interference in business activity but this plane was declined even before its implementation (Laar, 2009:8). Despite the different failures, Estonia was the only country of the disintegrating Soviet Union that had been able to transform its economic structures so successfully that no transitional period had to be applied to the country’s accession to the EU (ibid).

In 1992, government formatted in a head with Prime Minister Tiit Vähi set three main goals²⁵ which helped the economic transformation (Knöbl et al., 2002). Estonian Government managed to accomplish all three goals successfully what brings the hopes for socio-economic

²⁵ “Currency reform, the adoption of a new Constitution, and the organization of the first post-war democratic elections in the autumn of 1992” (Laar 2009:8).

development. Estonia became the first country among any other post-soviet countries which, earlier than others, successfully implement new own currency (Khoury and Wihlborg, 2006: 127). Adaptation of new constitution attracted the West Europe countries and what are more important international organizations²⁶ announced its interest in Estonia (Odling-Smee, 2001: 18)

Estonia had three main secrets of success, which supported rapid transition from planned to market economic (Laar, 2009:9). First of all Estonia severed all the links connected with Soviet-Regime and on the rule of the state came the power which was not connected with System of Communists rule (ibid). Secondly the effective civil service successfully contributed in Estonian transition (Uudelepp, 2013). Finally process of liberalization and cutting down regulations and rules highly influenced on economic recovery of Estonia and brings the perspectives for EU integration²⁷ (Estes, 2013: 57).

Despite successful first years of transition, Estonia experienced the two banking crises. During the first banking crisis Estonia learned find the minuses of financial system and eliminate poorly managed institutions (Fleming et al., 1997: 42). The second banking crisis brings Nordic “intervention” in Estonia, Sweden and Finland actively purchased local banks (Estes, 2013: 59). Basically even the banking crisis brings the farther success for Estonia. In 2008 Nordic-owned banks successfully overcame the financial crisis (ibid). Therefore the transition of Estonia can be considered as most successful among other Post-Soviet countries because of the successful reformations and the ability of Estonia government to learn from mistakes (Laar, 2009; Khoury and Wihlborg, 2006; Estes, 2013; Vanesaar, 2006).

²⁶ International Monetary Fund actively support the economic development of Estonia since 1992 (Knöbl et al 2002)

²⁷ Estonia Liberal Economic policies allowed identifying the Estonian way to the West Europe by integration in EU and different international organizations: IMF-1992; WTO -1999; the European Union - 20044; Organization for Economic Cooperation and Development (OECD) - 2010. the Eurozone – 2011 (Estes 2013: 57)

3.2.1.2. Influence of Joining the EU

Estonian economic was highly depend on the Russian and other Post-Soviet countries' market. Almost 90% of Estonian trade was conducted with Post-Soviet countries in 1992 (Laar, 2009:11). Therefore the main challenge of Estonia was to redirect the trade potential of country on the Europe(Frye and Mansfield, 2009). Enterprises faced the serious problems because of trade redirecting, as the trade with Europe demand the qualified production from Estonian enterprises while Russian market as well as other Post-Soviet countries easily accepted low quality and cheap products (Laar, 2009:11). The government of Estonia officially asked the enterprises to redirect to the West, and as a consequence Estonia occurred under the high economic and political pressure from Russia (Peters, 1994). Estonian government did not pull back and therefore entrepreneurs started production of such goods which could be competitive for EU market. Generally orientation on West which was officially announced supported the reorganization of organizational and production structure of enterprises (Vanessaar, 2006). Painful decision made by government of Estonia met the expectations and formatted Estonia as independent state in term of energy, security, political and economic activities. Such Estonia became attractive for West and cause for irritation of Russia (Laar, 2009). Therefore Estonia had to take the next step, step in European Union.

Diplomatic relationships between Estonia and EU started in 1991, when the trade agreement signed between EU and Baltic states (Pisuke, 1996). Already in 1993 Estonia started the negotiations on Association Agreements(Europe Agreements)²⁸ and soon in 1997 Estonia started its preparation to integrate in EU (Kull, 2009:17).

From the beginning of 1990s, EU member countries highly supported the independence of Estonia and considered Estonia as a future partner state (Pisuke, 1996). During the financial crisis in Estonia in 1991-1992, EU strongly supported with humanitarian aid²⁹what helped to avoid socio-economic crisis. Moreover in 1993, 12 million EUR was allocated by PHARE programme, to support the privatization process and development of SMEs (Kull,

²⁸ Association Agreements (Europe Agreements) – Estonia was set on the same peg as with CEE countries on the way of European Integration, moreover it was linked in security aspects what considered Estonia's integration in North Atlantic Threat Organization (NATO)

²⁹ EU send humanitarian aid included fuel, fodder, grain and ect., but only for domestic use.

2009:18).Estonia effectively used the financial aid and deserved a lot of sympathy from EU and International Organizations; as a consequence Estonia signed free trade agreement with EU (ibid).

The preparation of EU integration started in Estonia in 1991. Estonia followed the example of Sweden and Finland and created special group who was researching the benefits that can come with EU integration (Smith, 2001). Opened Estonian embassies in most of EU countries showed the official political will of Estonian Government to access in EU (Sillaste-Elling, 2009: 27). Basically the integration process of Estonia was successful story, which gives the possibility to attract more investors and develop entrepreneurship including SME sector.

3.1.2. Development of SME policy in Estonia

Estonia is Post-Soviet country with a very short entrepreneur history. Unlike Central Europe countries, Estonian entrepreneurship is unique with its rapid development. Since the independence, Government of Estonia actively participated in SME's development through different policies, reforms and programs (Kuusk and Jürgenson, 2008). During the integration process with EU, one of the most important goals of Estonian government was to integrate Estonian SME's policies with EU policies.

Government regulations were the main factors encouraging the SMEs development during the transition period. Since 1999 Estonian government made radical decisions in restructuration of seven main foundations which were collaborating with enterprises³⁰ (Smallbone and Welter, 2008). The main goal of transformation was to increase the influence and the role of institutions on SMEs development. To reach the correct transformation government of Estonia outlined several points by which foundations could function on the direct way (Oitmaa, 2011: 402).

- Transformation of Institutions and bringing them on the level of EU countries institutions by support of different International Organizations;

³⁰Foundation for Enterprising Credits, Estonian Investment and Trade Development Foundation, Export Credit and Guarantee Foundation, Estonian Regional Development Agency, Foundation "Estonian Home", Foundation "Innovation Fund", Estonian Infrastructure and Transport Development Foundation (Oitmaa 2001:401)

- Increasing the transparency of instruments used by institutions in term of entrepreneur development;
- Developing of different commercial structures which share the information about different programs adopted by government and make them accessible for entrepreneurs;

Two more foundations were created in a result of Estonian reformations: Business Guarantee Foundation (KredEx) and Enterprise Estonia (EAS) (OECD, 2012). The decision of creation of those new foundations was made by two main reasons (Oitmaa, 2001:402):

- Isolating the possible financial risk connected with guarantees
- Giving the state guarantee to foundations became easier and more transparent

EAS became one of the foundations that implemented the EU structural funds for Estonia. The agencies that act by EAS used all resources and possibilities to support and assist private sector (Oitmaa, 2001).

The advantage of Estonian government was the initiative of SMEs development not only in Tallinn but also in regions. In this process the Regional Development Agency of Estonia plaid crucial role by creating three regional centers which provides entrepreneurs with information about policies and programs (source: official website of ERKAS).

Second foundation “KREDEX” was created to support the SMEs development and guarantees the loans for young families. Kredex offered the loans, venture capital, credit incurrence and ect., to support the development of enterprises and give the possibility to open new start-ups (source: official Website “Kredex”). Beside the loans, Kredex actively participates in technical incurrence. Those two foundations gave the possibility for entrepreneurs to get the loans and with support of EAS invest in technical development on correct way (Oitmaa, 2001).

In the period of 1996-2000, Estonian government actively worked on policies and reforms which were considered important for SMEs development (Kuura, 2006: 467). According to the Estonian SME Policy Draft Version, 2000 government highlighted the internalization process of

enterprises in term to increase the export capacity of enterprises. Moreover innovational and technological development of SMEs was outlined as one of the most important point (Oitmaa, 2001).

Basically the development of different policies and programs in support of SMEs started in Estonia in the beginning of 1992, when all political groups agreed to think about the farther development of entrepreneurship and especially small and medium sized enterprises. 77% of enterprises stated that government actively supports the entrepreneurship (Kuura, 2006). Due to the steps made by government Estonian entrepreneurship became competitive among other EU countries. SMEs Share in employments significantly rose and socio-economic condition of country is growing. Of course there is still a lot to do in this sector but as it was cited in the begging of Estonian case: population with entrepreneurial mind-set should be more active.

3.1.3. Role of SME in the Estonian Economy

Development of entrepreneurship can be considered as a positive fact in economic development since the first years of Estonian independence (Vanessaar, 2006). High growth of entrepreneurship and significant contribution of SMEs in employment significantly improved the economic potential during the transition process (Smallbone and Venesaar, 2004). Foreign donors and financial support from International Organizations significantly improved the SMEs development in the regions of Estonia and decreased socio-economic problems of state (Traistaru et al., 2003).

SMEs play important role in Estonian economic development by creating new work places and stimulation sustainable economic growth (Eurofound, 2013). Large number of SMEs in Estonia (99.7 % of all non-financial business economy) creates large number of working places and significantly contributes in countries GDP (see the table 4). The contribution of micro sized enterprises represents almost 86% of SMEs, therefore the contribution of micro-sized enterprises and their role on Estonian economic is significant (Eurostat 2014).

Table 4: Key indicators for Estonian enterprises by 2014

	Total	SMEs 0-250	Micro 1-9	Small 10-49	Medium 50-249	Large >250
Number of enterprises	59363	59200	52157	5880	1163	163
Share in total (%)	100%	99.7%	87.8%	9.9%	1.9%	0.2%
People employed	411468	324141	115849	107098	101194	87327
Share in total (%)	100%	78.7%	28.1%	26%	24.5%	21.2%
Value added (EUR millions)	8509	6379	1801	2109	2468	2131
Share in total (%)	100%	74.9%	21.1%	24.7%	29%	25%

Source: Eurostat, DIWecon, DIW, London Economics

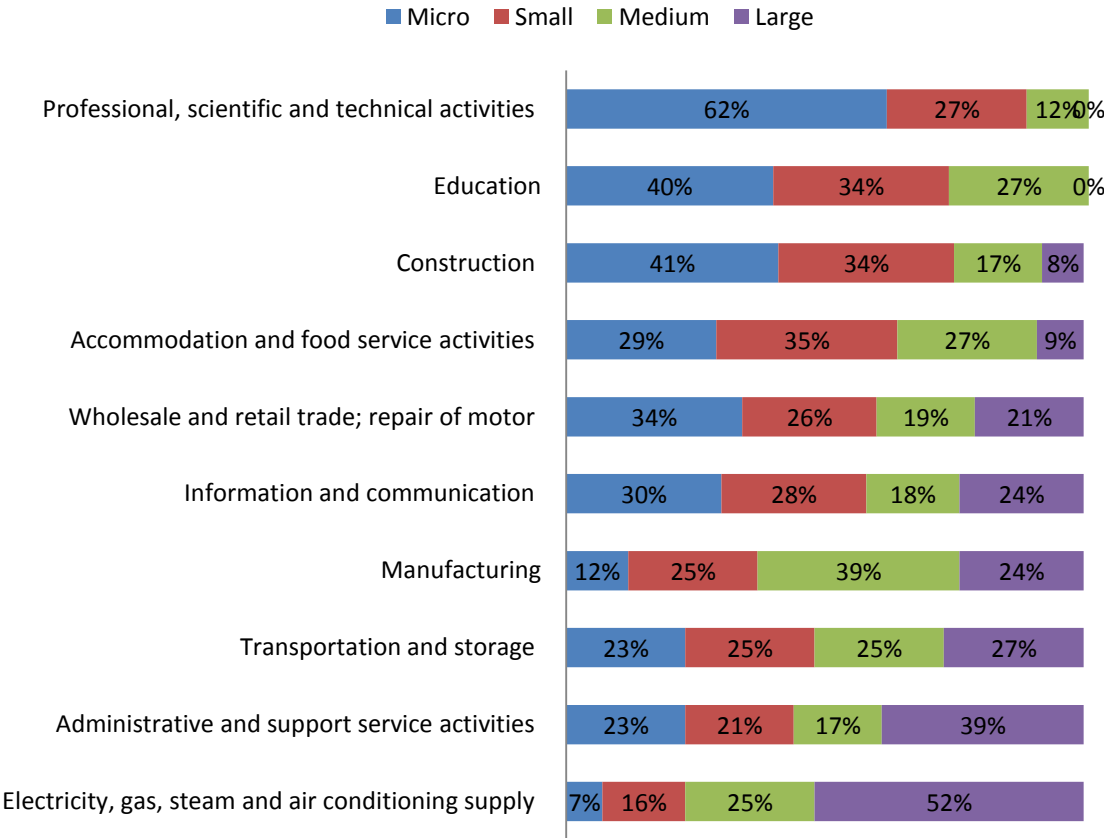
The SMEs not always represented on this way. The number of micro-sized enterprises has significantly increased since 1994. Nowadays micro-sized enterprises represent almost 81% of total companies, while by 1994 the share of micro-sized enterprises has been only 66% (Eurofound, 2013; Eurostat, 2014; Venesaar and Loomets, 2006). Moreover micro-sized enterprises doubled the share in employment (10.7% in 1994 to 28.1% by 2014) while the share of other SME groups significantly reduced (Eurostat 2014; Venesaar and Loomets, 2006).

The entrepreneur activity has significantly increased since the independence of Estonia, but the share of SMEs on employment was not as successful as the activities had risen. The reason of unproductivity and unprofitability per employee can be found in the enterprises that continued its development on tradition way (low technology) (Ministry of Economic Affairs and Communication of Estonia, 2011). SMEs low expenditures on the R&D and a low share of high-tech employment, negatively influenced on the development of enterprises (Spin, 2010).

Global financial crisis of 2008 became the important factor for SMEs restructuring. Financial crisis significantly hit Estonian economic and reduced the GDP by 13.9% in 2009 (SBA, 2011). Accordingly the restructuring of SME was highlighted. The importance of SMEs in

employment increased since 2009. The figure 9 shows the contribution of SMEs in employment different spheres of activity. Mostly SMEs (share in employment) are concentrated in education and professional, scientific and technical sectors (Eurostat, 2014). At the same time SMEs are less active in energy sector and administrative service sectors where the large enterprises offer more working places.

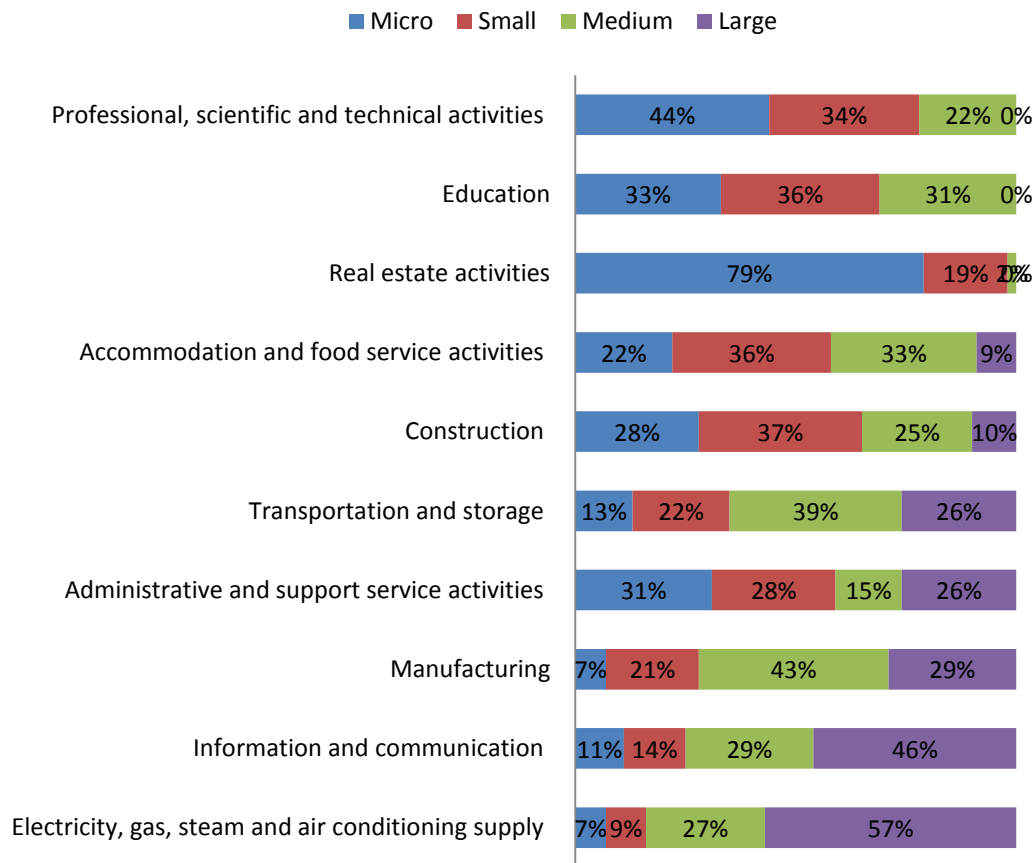
Figure 8: Share of Estonian SMEs in total employment 2014



Source: Author’s calculations based on data from Eurostat 2014

Turning to value added, notable is that education and research sectors are most popular among SMEs (see the figure 9). While the share of large enterprises in value added are more concentrated among ICT and energy sectors (Eurostat, 2014).

Figure 9: Share of Estonian SMEs in total value added, 2014



Source: Author's calculations based on data from Eurostat 2014

According to the Kaarna(2012) Estonian SMEs are mostly trading with neighbor countries leading by Finland (61%); Latvia (31%), Sweden (26%) and Russia (16%). Moreover Estonian SMEs managed to enter to international market mostly by direct contact with clients.

Basically role of SME in economic development of Estonia is significant. Moreover SMEs development brought the successful and rapid transition for Estonian economic (Laar 2009). SMEs development improved the socio-economic sector what gave the strong economic and possibility to integrate in EU (Kull, 2009). EU integration by it side, significantly improved the quality of production and gave the possibility to export the good and services (ibid). Successful policies and reforms adopted by Estonian government significantly improved the role of SME in economic transition and growth.

3.3. Comparison of SME Policies in Georgia and Estonia

Development of SME policies started in Georgia much later than in Estonia. The main and most important SME policies and programs in Georgia were adopted after the “Rose Revolution” in 2003 while Estonian government actively supported SMEs development since the 1992 (Japaridze and Elizbarashvili, 2012; Kull, 2009).

Georgian SMEs experienced lack of institutions and financial support for development. Unfortunately government of Georgia till 2005 could not manage to support of any institutions and foundations which could support the entrepreneurship. At the same time Estonia successfully created the foundations (EAS; Kredex and ect) which played significant role in entrepreneur development.

Foundation of Regional Development Agency played important role in SMEs development in different regions (in Estonia) what brings the total SMEs share in employment. Development of SMEs in region can be considered as one of the key factors which pushed the SMEs development. Even in this component Georgia is less developed, although must take into account the fact that Georgian regions experience high military and political pressure from Russia (Gogolashvili, 2011). Accordingly the geopolitical role significantly influenced on policymaking.

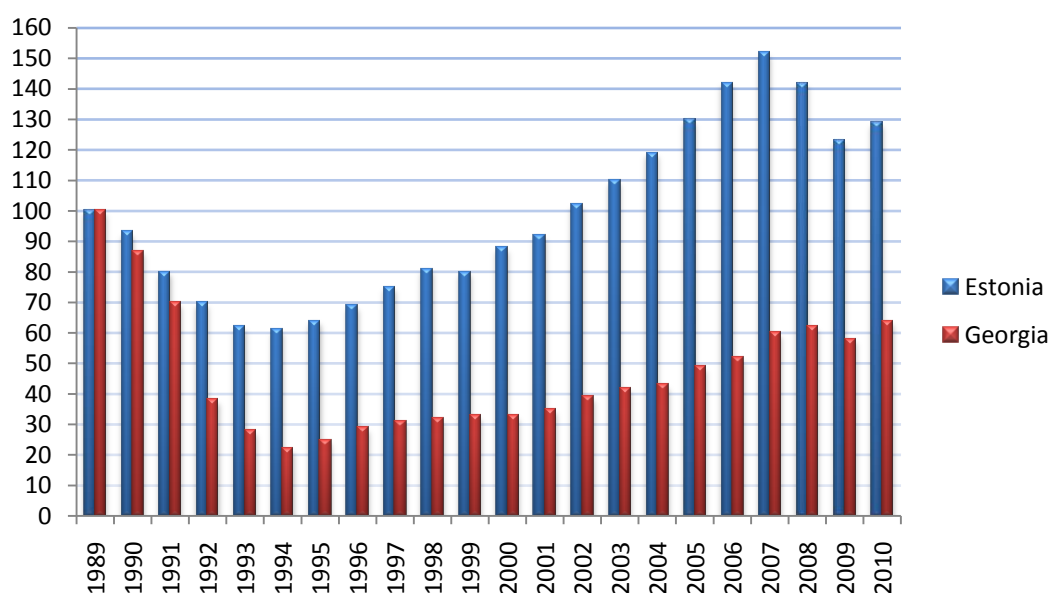
Important difference was in the stabilized region. Until the 2000 Caucasus Region was unstable what did not allow governments of Georgia attract attention on SME policies³¹. Moreover Baltic Region was more attractive for foreign investors because of stability than the Caucasian region (Hunya, 2004; Kakachia, 2011). According to the EAS “Estonia is the country with good reputation, the business environment of which is among world’s best” indeed Estonia is known in the world as secured, open and developed country. To reach those results Estonia put a lot of power and made different painful policies (eg. redirecting of trade and restructuration of enterprises).

Notable fact is that since the independence of Estonia, EU and different international organizations expressed sympathy towards this state and highly supported as on political level as

³¹ War in Abkhazia, South Ossetia, Nagorno-Karabakh and Chechnya highly damaged the security of region what became the barrier for investors and SMEs development.

financially³² what helps Estonian government not only write the programs and reforms on paper but also actualize them. Moreover Nordic states significantly contributed in SMEs development in Estonia (Pisuke, 1996). All those facts significantly improved the socio-economic level of country and raised entrepreneur spirit. In the first years of transition Georgia's economy experienced serious losses. The 75% of GDP fall highly damaged the development of country and was the worst index among the other countries in transition (EBRD, 2005). Figure 10 indicates the result of crisis and shows that Estonia was more progressive also in this way.

Figure 10: Comparison of real GDP levels of Estonia and Georgia:



Source :EBRD 2010

Accordingly the start-up point of Georgia and Estonia were quite different what basically affected the SME policies development. At the same time a strong resembles observed in policy making between Georgia of 2003 and Estonia of 1993. “Public Service” reform and tax reformation owned by Georgia from Estonia gives the possibility to improve the business environment in Georgia (Savi and Metsma, 2013; BennetandSchalkwyk, 2011). Moreover Russian embargo on Georgian product in 2006, and Georgian SMEs redirecting on EU market can be compared with Estonian SMEs trade redirecting in 1992.

³² 12 million EUR was allocated by PHARE programme in 1993.

3.4. Discussions

The research starts with introduction of Small and medium size enterprises as a sector which played critical role in economic development and problem solving in socio-economic sphere among the countries in transition. Based on the different scholars was defined that the role of SMEs are not always significant on the socio-economic development. But most studies see the SMEs as important and integral part of economic development (see example: Carree et al., 2007; Smallbone, 2001). It was defined that there is need of specific environment to develop entrepreneurship. Moreover governmental policies, reforms and different programs played critical role on SMEs development during the transition process (Muresana and Gogu, 2012; Acs and Preston, 1997).

Sustainable development of any enterprises depends on the level of its competitiveness. Innovation and technological development gives the possibility to survive in competitive market. Theoretical part discusses about the importance of innovation and explains that SMEs can be more innovative than large firms. Moreover developed and innovative SMEs sector can significantly improve the economic condition and solve the social problems.

The cases studies of Georgia and Estonia is a good example of how important the role of government and polices on the SMEs development can be. At the same time those cases give a good evidence of external factors which could influence on entrepreneurship. The case study of Estonia shows the importance of the state unity during the policy making. Moreover political stability of Estonia significantly improved the policy making process and developed the SMEs sector. Important fact about Estonia is that, this state defined its political and economic directions since the first years of independence what gave the possibility to identify the way of policies development. Relationship with EU and support of different international organizations and neighbor countries (Sweden and Finland) played significant role in SMEs policies development and their actualization (Kull, 2009). The case study of Georgia explains that theinsufficiency of finance and political destabilization can significantly damage the SMEs sector. The absence of policies regarding to the SMEs development in region can be a reason of SMEs insignificant share in social-economic development.

If Georgia plans to develop the economy via entrepreneurship (especially SMEs) it is very important to make distinction between politics and economic development, especially taking into account the fact that shift of political powers entails closing of different enterprises in Georgia³³. “State and economy go together, they are integrated and they are not hostile to one another” (Drechsler, 2001:16) - consequently the political interest of governing party should not conduct only own interest but also should take in account the interests of entrepreneurs.

The achievements of Georgian government in fighting against corruption and strengthening rule of law, in implementing different infrastructural projects, improving public services, tax reforms and implementing projects for the support of SMEs significantly improved the reputation of country in the period of 2003-2008. Georgia became the attractive country for FDI and for business development (Kakulia, 2009). But government missed such a good opportunity to support the SMEs development. The hands off (SME) policy started since 1992 was not significantly improved during the 2003-2008 period. By the 2009 small and medium enterprises contributed only 8% and 10.5% to the total output respectively (National Statistics Office, 2010). Consequently the role of government of Georgia in SMEs development was not as progressive as in Estonia.

The period of 2003-2008 was for Georgia as a period of investments and good possibility for business development, but unfortunately the lack of (SME) policies became the reason of SMEs insignificant development. By the end of 2006 Small and Medium Enterprises Authority of the Ministry of Economic Development of Georgia was founded but the organization did not had any concrete plan and steps in supporting of SMEs. The war with Russian in 2008 had the two aims: destroy the financial and economic stability of the state and destroy the secured reputation of country and scared the foreign investors. The enemy’s will of destroying the financial and economic stability of state was failed because of strong fiscal and monetary policies adopted by government but business sector experienced great losses (Chanukvadze, 2011).

³³ As an example: attempt of seizure of Barambo and Zedazeni in 2012.

Based on the presented research, I would like to distinguish number of recommendations, which in my opinion could be important for SMEs development in Georgia.

First of all, the strategic plan must be designed specifically for small and medium sized enterprises (For example Estonian government implemented the specific strategic documents which significantly increased as the number of SMEs as their productivity and contribution in economic development of country³⁴).

Important is also that entrepreneurship in Georgia needs not only policies and financial aids but also professional staff. Technological and innovation development of Georgian SMEs is on quite low level what does not give the possibility for SMEs to develop and growth. It is quite difficult to be a competitive in the world market without innovation development. Therefore Initiatives of President of Georgia regarding to the education reforms and scholarships for Georgian students abroad was the great step also for SMEs development. Moreover almost finished Technological University in Georgia (Batumi) was the clear illustrate of need of education policies in country³⁵. Here again we face the problem of political controversy which highly damages the entrepreneurship.

Based on the Estonian case, where the attention is paid to training and advanced training for entrepreneurs and business sector in Georgia also should be develop a similar Estonia Foundation, which provides training staff and providing them with skills that will contribute to the professional staff in the country.

And finally, the EU-Georgia Association Agreement could significantly improve the business environment of country and make the state attractive for foreign investors. Moreover it can significantly influence on Georgia's joining in NATO what will guarantee the security in the county and maybe even in whole region.

³⁴ 1)“Enterprising Estonia” - national policy for the development of small and medium-sized enterprises in Estonia in 2002-2006; 2) Research and Development Strategy “Knowledge-based Estonia”2001-2006; 3)“Success Estonia 2014”– Estonian competitiveness strategy (Source: Ministry of Economic Affairs and Communications (of Estonia), 2011)

³⁵ Under the initiative of president of Georgia Mikhail Saakashvili was started the building of Technological University in Batumi, almost finished university building was stopped by new government because of the cost of the building.

4. Conclusion

This paper has reviewed the comparative analyze of the SME policies in Georgia and Estonia, in account has been taken the historical facts form other CIT countries. Thesis was based on the attitudes of different economic schools and scholars on the role of SMEs for economic development and the innovation as important factor for SMEs development. In this regard, the presented case studies of Georgia and Estonia described the differences of SME policies in two Post-Soviet countries. Regarding to Georgia where notable quantitative success was achieved in SMEs development since the “Rose Revolution”, share of SMEs in GDP and employment could be more significant. At the same time Estonian case brought a think that only policies and finance is not enough for the development of entrepreneurship. Critical fact is the external factors such as geopolitical location, national security and support of international organizations.

Unlike Georgia, Estonia successfully reached to overcome the external problems and nowadays is considered as the secured and open state for investors and entrepreneurs. Moreover Estonian case showed that SMEs development in regions should be promoted by the institutions which directly collaborate with central government.

History of successful and less successful countries proves the importance of SMEs. Theory of Andreas Widmer regarding of “Missing Middle” is a striking example which indicates on the importance of SME policies. The theory proves that problem of African countries as well as other undeveloped countries is the large number of micro and large enterprises while the SMEs are considered as the missing part. Basically this problem is actual in Georgia and needs high support from government.

Georgian case proves that the principles of liberal economic can significantly increase the number of SMEs and their contribution in economic development. At the same time should be mentioned that foreign policy of state and the geographical location significantly influence on SMEs development and the good evidence is Estonian case.

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