

CURRENT STANCE OF ENTREPRENEURSHIP AND SME DEVELOPMENT IN GEORGIA: PERSPECTIVES AND CHALLENGES

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Abstract

The paper analyzes external and internal factors impeding and determining entrepreneurship and Small and Medium Enterprise (SME) development in Georgia and scrutinizes the role of the state in the process. Thirty in-depth interviews were conducted with different stakeholders. The study findings show that notwithstanding the rigorous reforms leading to improved business environment, establishment of a vibrant SME sector in Georgia is still a challenge. In the paper, the author identifies major institutional and private sector specific weaknesses and provides policy recommendations. The study presents not only a specific country environment, but also explores different stages of transition process and its impact on entrepreneurship and SME development, describes factors affecting entrepreneurial outcome in the advanced transition countries.

Keywords: entrepreneurship, SME, transition economies, economics.

I. INTRODUCTION

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

There is no universally agreed definition of entrepreneurship. The definition oftentimes varies based on the research focus (Wennekers et al., 2002). Based on the above-mentioned assumptions, the working definition for this study is the following: Entrepreneurship is a set of activities that based on the context can generate economic value and may take formal or informal forms.

Environment of a country shapes dynamics of entrepreneurship, the environment is shaped by interdependence between economic development and institutions, which affect other characteristics as governance quality, access to resources, and entrepreneurial perceptions (Acs, et al., 2008). In management literature the term “context refers to circumstances, conditions, situations, or environments that are external to the respective phenomenon and enable or constrain it” (Welter, 2011). One cannot disengage entrepreneurship from the context, because the interactions between the context and entrepreneurship helps the interpretation of entrepreneurship from phenomenological and theoretical perspectives (Basco, R., 2017). Contextual influences affect the role of entrepreneurship and as well as their structure and performance (Karlsson and Dahlberg, 2003).

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

As a matter of fact, Georgia can be regarded as a particular case in the emerging economies, as a fast reformer, being at the advanced stage of transition, having undertaking a number of reforms to streamline the business and economic environment, the impact of the reforms implemented have not been as strong as envisaged. Putting business-friendly policies in place did not translate into a vibrant private sector, entrepreneurship and job creation is not keeping pace with the economic growth and other macroeconomic indicators. That is why, studying the case of Georgia is particularly interesting for adding value to the studies conducted on the contextual entrepreneurship and transition environment.

The purpose of this paper is to identify and analyze external and internal factors impeding and determining entrepreneurship and SME development in Georgia and scrutinize the role of the state in the process through studying importance of direct and indirect support measures provided by the state.

II. METHODOLOGY

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

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

For the purpose of the study, the interview guide was prepared divided into three main topics: (1) Barriers to Entrepreneurship and SME Development; (2) Drivers of Entrepreneurship and SMEs; (3) the Role of the government. Each block in its turn was subdivided into narrower themes and assigned main, probing and follow-up questions. In total 13 main and 24 probing questions were prepared.

III. RESULTS

Below the major constraints of entrepreneurship and SME development named by the respondents are listed and summarized.

Access to Finance

Smallbone and Welter assert that the most difficult in the reform process is creation of market institutions. These includes banks and financial institutions, business and training support services. These institutions also include state agencies that potentially impact the private sector. Capital markets are immature in the most of the emerging economies. While banks have a conservative approach to financing private enterprises and especially small ones, that are viewed as high risk loans. In most banks we see lack of willingness and request of very high collateral from the side of the banks to finance small enterprises, while entrepreneurs in most of the cases are unable to provide the required collateral (Smallbone and Welter, 2009b).

A number of interviewed entrepreneurs believe that personal history and personal contacts at the banks or the size of the collateral are far more important than a well-written business plan. Startups have no chances of getting funding, as entrepreneur G.K puts it "I have a successful business, but I also wanted to start an agricultural activity, the bank considered my new activity as a start-up and refused to give me a credit". When characterizing the state funded programs most of the respondents mention that since the final decision regarding granting of a credit is up to the banks, it is quite problematic for inexperienced entrepreneurs to take advantage of these programs. According to international ratings, such as GIZ private sector development report, the World Bank doing business indicator, access to finance has improved over the course of the past years (independent expert no 3).

In order to overcome the above-mentioned barriers the government is currently working on development of alternative sources of funding such as through capital markets, venture capital, and crowdfunding. However, these are relatively new initiatives and will take time to develop (policy-maker no 2).

Taxation and Tax administration

Taxation and tax administration is not highlighted as an issue; however, tax rates were mentioned by some respondents as too high for the region. It might be so that taxes to be paid by individuals are comparably low, but corporate taxes such as VAT and profit taxes, are higher than regional average (independent expert 1, entrepreneur N.I.).

Respondents believe that overall environment in terms of taxation has been improving, however frequent amendments to tax code are troublesome for the SME owners. Frequent changes to existing laws and regulations that are characteristics to the transition period, requires constant readjustment of knowledge by small

business managers (Smallbone and Welter, 2009a). In line with the abovementioned, predictability and stability of economic and political environment was named as one of the major constraint for doing business in Georgia.

Private Property

In many transition countries, legal framework represents a main barrier to small business and entrepreneurship development. These includes laws relating to private property, bankruptcy, written contracts, taxes and commercial activities (Smallbone and Welter, 2009b).

Protection of private property rights was named as a problematic factor for doing business in Georgia. Entrepreneur V.I. who owns a winery complains about the complications related to the purchase of agricultural land in Georgia. He states that after the moratorium on sale of agricultural land to foreigners, enacted in 2013, purchase of arable land is also restricted for the citizens of Georgia. Procedures for long-term rent of arable land are no less complicated. The procedures are rather vague, involve central and local governments and ultimately the land is rented out on be basis of an auction. "If you want to rent state owned agricultural land, you need to have good contacts, access to information, insider knowledge on how to proceed, the procedures are not transparent and they take several months to finalize".

Insolvency Law

The study reveals insolvency law to be a drawback in entrepreneurship and SME development, not giving entrepreneurs a "second chance", due to the lengthy procedures and heavy concentration on the survival of the debtor. As independent expert no 2 puts it, business closeout is a lengthy process and does not give a second chance to an entrepreneur. The legislation is not tailored to help businesses overcome their problems. Due to the prolonged bankruptcy procedures, business representatives do not have an incentive to finalize the closeout procedure, it is a rather easier to register a new company instead. The Law clearly departs from "best practices" and focuses strongly on the survival of the debtor, therefore not protecting rights of creditors. Procedures are the same for all types of businesses, one of the respondent remembers that there was a case when it took one year and seven months to liquidate a company that has not conducted any operations.

Dispute Settlement

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

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

The role of public policy

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

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

After gaining independence in 1991, Georgia embarked on the formation of the institutional and legal framework. Transition to the market economy involved establishment of new formal institutions, pursuing privatization, restructuring of the financial sector and appearance of the first private enterprises. The newly created formal institutions were not functioning well, widespread corruption was commonplace, tax system was rather unfavorable.

After the change in power in 2003, Georgia kick started a rigorous reform process. The revolutionary reforms were taken in the direction of creating a favorable business environment, eradication of corruption, complete liberalization for fostering entrepreneurship and SME development. The country managed to achieve outstanding improvements in such directions as ease of doing business, reducing tax and administrative burden, suppressing of corruption levels.

Starting from 2012 we see stronger involvement of the Government of Georgia (GoG) in the private sector development process. This decision was also stipulated in the national socio-economic development

strategy. Two new agencies were established during the process, directly mandated to develop entrepreneurship and innovation in the country. A number of what Smallbone and Welter (2001) refer to “direct support measures” in the form of soft loans, grants, consultation and educational programs were introduced at a larger scale.

Decision Making Practices

Several respondents mentioned top down approach in decision-making as an important drawback in policymaking practice. Public private dialogue mechanisms are not formalized yet and take place on an ad hoc basis. One such platform for public private dialogue is a council under the Ministry of Economy and Sustainable Development, which is quite representative and aims to negotiate all issues with business representatives (Expert no 7). The council was created by the decree of the Minister of Economy and Sustainable Development. It unites various business support organizations, associations, non-governmental sector representatives, and department heads from other line ministries. As of now, two meetings were held; the first one was dedicated to the pension reform and the second one to the Open Government Issue. Identification of issues to be discussed is usually bottom up and comes from the private sector; follow up on the discussed issues is an important part of the council work (policy-maker no 2).

Direct support Measures

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

The views on the provision of the direct support measures was diverse among the respondents. Several respondents, who are not in favor of subsidizing loans from the state budget, mentioned that the initiatives were necessary for the regional development efforts. Due to the high regional disparity and inactiveness in especially rural areas, direction of state budget in the form of entrepreneurship promotion, if done correctly, is viewed as one possibility. Entrepreneur V.I. says that he lacked state support when starting up his winery, according to him he had to handle everything, including such basic infrastructure as bringing communications to the place: gas, electricity and water supply.

Currently, several agencies are mandated to develop entrepreneurship. They can be differentiated according to the size of funding they provide. A number of respondents believe that providing seed funding to the entrepreneurs is an important initiative for emerging economies, where access to finance is rather limited. These type of programs are necessary for development of entrepreneurship and SMEs in the country. However, duration of such direct support measures should be limited and should be available only for some time, before the capital markets and other alternative sources of funding develop. Given that due to the Soviet legacy, entrepreneurship and private sector as such is rather young in Georgia, the government should take a proactive role in supporting startups. An issue of economic feasibility was raised, should we only assist small businesses? What type of assistance programs are less costly? When large businesses, if assisted, can also develop economy equally well.

IV. DISCUSSION/CONCLUSION

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

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

Potential of SMEs in Georgia is yet to be exploited in the following directions: diversification of economic structure; identification and emergence of new sectors and new markets; internationalization and integration into the global economy; establishment of SMEs as sources of innovation; strengthening research and

development component; contribution to economic development through linkages with other businesses and through inter-firm level cooperation; acting as suppliers to larger firms; and increased collaboration with academia. The country's western orientation and EU aspirations will play a positive role in the development processes.

The study results revealed that apart from the factors that are at the discretion of the government, there are a number of other external factors affecting entrepreneurship and SME development that are not solely dependent on governmental policy.

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

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

The study reveals challenges related to access to finance due to the high cost of capital, rigidity and risk assessment practices of bank institutions. These findings highlight that the perceived constraint of access to finance is not the only problem. Major constraints identified during the study are problems related to lengthy insolvency procedures, poor dispute settlement mechanisms, bottlenecks in the legislations related to the protection of property rights and business processes.

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

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

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