

EU support to SMEs in the Eastern Partnership countries 2014-2020

The way forward for the SME Flagship Initiative

Purpose of the document

This document aims to provide a framework of objectives, priorities and results for the implementation of the SME Flagship up to 2020. After having analysed the status of SMEs development in the Eastern Partnership countries, the approach builds upon lessons learnt from previous & ongoing programmes to define new objectives, which will allow to sustainably increasing the contribution of the SMEs to the national economies.

1 Context

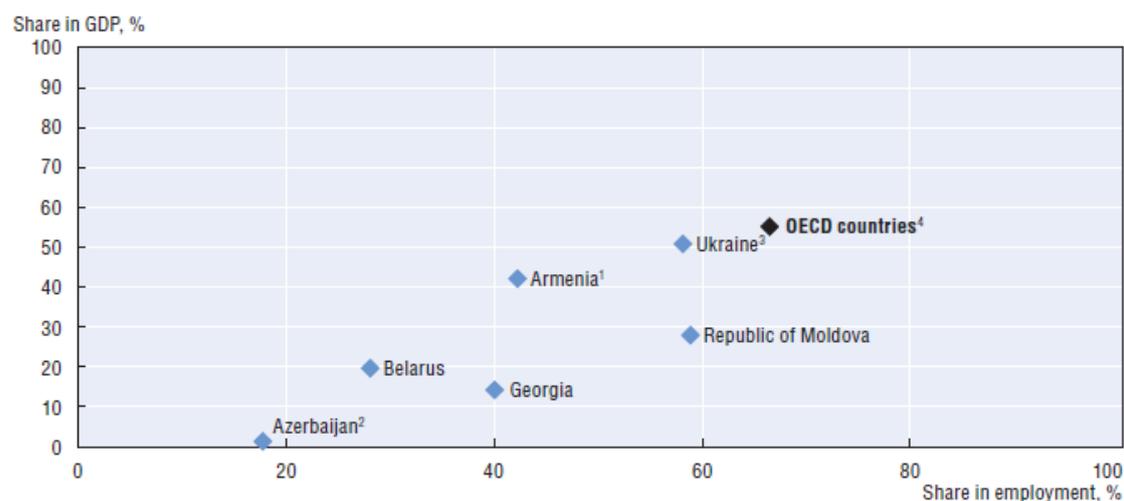
1.1 SME Definition

The definition of SME in the EU has been harmonised in May 2003 thanks to the recommendation 2003/361/EC. As of today, there is no single SME definition prevailing amongst the EaP countries. In this context, the term "SME" used all over this document refers to the national definition of it, as it proves to be more relevant to the situation in each specific country. In the future, with the implementation of the Association Agreements, the related EaP countries will have to introduce the EU SME definition in their national framework. This will greatly help comparing the situation in these countries with the one in the EU.

1.2 Regional scene setter

SMEs in the EaP countries account for over 95% of private enterprises. However, they employ a mere 50% of the working population and their contribution to GDP is on average just over 30%, while in the OECD SMEs employ about 65% of the working population for a contribution to the GDP of about 55%.

SMEs in the EaP region have the potential to make a significant contribution to job creation and are essential economic actors in the expansion and creation of added value in a number of sectors which drive economic growth and development. SMEs in the EaP region play an important role in the process of transition of national economies towards global requirements.



SME sector contribution to employment and GDP in EaP countries, 2010

Source: SME Policy Index 2012

As concluded in the Small Business Act (SBA) Assessment 2012 performed by the OECD for the Eastern Partnership countries, most SMEs in the EaP operate in lower value-added sectors as wholesale and retail trade companies, i.e. in sectors which tend to have lower entry barriers and do not require high upfront investments and skilled labour. One of the reasons for this is that most SMEs in EaP countries represent "necessity entrepreneurship" as opposed to "opportunity entrepreneurship". Necessity entrepreneurship is stimulated by

necessity forcing individuals to pursue self-employment and generate personal income. It has an important social value yet does not drive business expansion and economic growth nor does it provide stable social security or contribute to making those entrepreneurs less vulnerable. In contrast, opportunity entrepreneurship is motivated by the quest for business opportunities and is based on generating new ideas and transferring knowledge. Opportunity entrepreneurship is considered to produce economic value. Thus, it is important to address the human capital questions when developing steps for SMEs

1.3 SMEs as a key element of the development of the Eastern Partnership (EaP) countries

SMEs are not only key to sustainable economic development, but also an important factor in the consolidation of open societies. A business enabling environment and a large SME sector prevent economies from becoming dominated by few entities and thus impede concentration of power in the hands of oligarchs hindering a country's development in both economic and political terms.

Furthermore, SMEs facilitate the adjustment of the economy moving from highly concentrated industries focusing on mass production inherited from the Soviet Union to more flexible production processes and demand-oriented supply. At the same time, SMEs in the EaP region can contribute to counteract unemployment related to the down-sizing of the public sector. They, thus, serve as an important source of jobs especially for those parts of the population, which bear most the burden of economic transition: low-skilled labour, young people, and women.

The EBRD Transition Report 2013 demonstrates that less democratic countries tend to have a higher level of state employment. It also points out that state employees in less democratic countries tend not to be supportive of democratisation. Since state employees usually outnumber their private sector counterparts in such countries, this may dampen public demand for a more pluralistic political system. The conclusion is that an economy dominated by state owned enterprises could slow down democratic transition processes in these countries, whereas investment into the private sector and generation of private sector employment may create a workforce with a stronger focus on democratic governance. Thus, support for SMEs' growth could contribute not only to the national and local socio-economic welfare in a sustainable way but also reinforce demand for democratic change.

Finally, SMEs are an important actor as regards the move towards a green economy – which is particularly important in what is the most energy intensive region in the world, severely affected by a deteriorated environment. Support to SMEs could serve as an efficient 'delivery channel' in the development of green economy sectors. At the same time, the green economy includes new upper value-added sectors which provide new opportunities for SMEs.

2 Identification of the challenges faced by SMEs

The following section analyses the reasons leading SMEs in the EaP countries to represent only a small share of GDP. Several studies have already been published on that matter (cf. list of references at the end of the document); the different reasons identified can be grouped broadly in the following categories:

- Poor access to finance
- Inadequate legal & regulatory framework
- Limited knowledge base / business skills
- Limited access to markets (local & international)

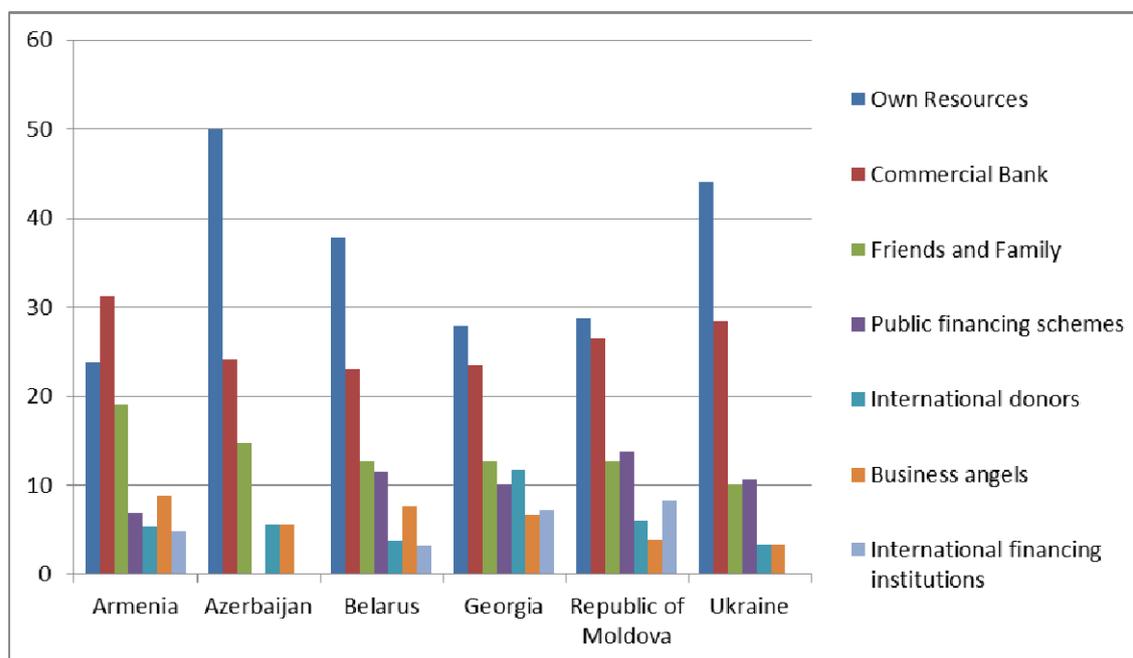
Other constraints preventing SMEs to grow at their full potential include also the political instability, corruption, lack of technology and poor infrastructure (transport, telecom, power, etc.) - however as these issues are not SME-specific there will not be addressed in this document.

2.1 Poor access to finance

The difficulties faced by SMEs to access financing in the EaP countries can be summarized in 6 points¹:

- Rural enterprises are confronted with a funding gap because they are on average more expensive for financial institutions to serve (physical distance from branches and offices). Agricultural production is considered as a risky investment for financial institutions, even if the demand is high (need for productivity and efficiency improvement).
- SMEs without real estate to offer as collateral have only access to limited funding options, which is a problem for companies looking for working capital.
- The limited availability of medium and long term local currency funding reduces the capacity of SMEs to grow and expand.
- Financial literacy gaps affect demand and supply. It affects demand because SMEs with poor knowledge of financial services, available products and financial institutions are less likely to apply for funding. It affects supply because low financial literacy creates communication barrier and misunderstandings between financial institutions and clients.
- Companies which cannot write standardised financial reports are less likely to obtain funding from financial institutions because of the difficulty to evaluate their repayment capacity.

¹ "Private Sector Financing In The Eastern Partnership Countries And The Role Of Risk-bearing Instruments, Synthesis Report", November 2013, p14.



Primary financing resources for SMEs

Source: East Invest Survey 2012

2.2 Inadequate legal & regulatory framework

In the EaP countries the legal & regulatory framework is generally cumbersome and does not enable SMEs to fulfil their administrative tasks swiftly. The process of SME creation is generally vague and unclear, with numerous administrations involved. Moreover, the tax policies in the region towards SMEs are usually not suitable for SMEs. As a consequence SMEs lack incentives to move from the informal sector to the formal one and officialise their activities.

Countries	Rank (out of 189)
Georgia	8
Armenia	37
Belarus	63
Azerbaijan	70
Moldova	78
Ukraine	112

Ranking of EaP countries in the *Doing Business 2014*, The World Bank.

Source: *Doing Business 2014*, The World Bank

2.3 Limited knowledge base / business skills

In the EaP countries, the low market relevance of mainstream education and the inertia of the educational system to answer to the changing demands of the labour market make the school-to-work transition difficult. Thus, there is a gap between the needs of the local job market and the professional qualifications of the work force, resulting in the lack of adequately skilled employees and/or a workforce misfit to the local or national market. In addition, the significant transformation of the national economies has induced a high demand for professional reconversion. Vocational training needs are therefore very high.

2.4 Limited access to markets (local & international)

The lack of market awareness and trade instruments in EaP countries prevent SMEs from benefitting from administrative and technical support, and thus impede them to break through larger markets.

Whether at a national or an international level, most SMEs lack an adequate knowledge of market requirements. This is a particularly important issue for those countries that will join a DCFTA with the EU like Georgia, Republic of Moldavia and Ukraine: in order for SMEs to benefit from these agreements, SMEs will need to be able to meet the EU market requirements.

3 EU's role and objectives

3.1 Outline of the EU development policy to support SMEs

In the European Union, the Small Business Act for Europe (SBA) adopted in 2008 put in place an SMEs-focused competitive agenda for the European Union and its Member States based on the principle "Think Small First". EU support for SMEs is also an important feature of the EU development policy. This includes: creating an enabling environment for SMEs, strengthening specific policies (e.g. trade, innovation, access to finance and competitiveness), capacity building of business intermediary organisations, chambers of commerce and business development service providers, and providing support benefitting individual enterprises.

The importance of improving the business environment, promoting a competitive local private sector and providing better and more targeted aid were reiterated in 2011 in the Agenda for Change.

In 2014, the European Commission published its Communication to Council and Parliament on *A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries*, thus highlighting the importance of the Private Sector in the sustainable development of countries and presenting the EU strategic framework for strengthening the Private Sector role.

3.2 Institutional setup: SME Panel and SME Flagship Initiative

The SME Panel (part of Platform 2 of the Eastern Partnership dealing with economic integration and convergence with EU policies) and the SME Flagship Initiative can be

considered key drivers in providing a framework for policy discussions and for implementing programmes. The SME Flagship Initiative was jointly launched by the European Commission and the Eastern Partner Countries in 2009 together with five other flagship initiatives. The dedicated Panel on SME Policy was then established in 2010. Given the success of this Panel its activities were extended in early 2013.

The SME Flagship Initiative aims to address the constraints identified above which, at varying degrees, affect the development of SMEs in EaP countries

Three programmes were part of this Flagship at its inception: East Invest (Eurochambers), Enterprise Growth Programme (EGP)/Business Advisory Services (BAS) (EBRD) and the SME Finance Facility (EBRD, EIB and KfW). Since the kick-off of the Flagship, the number of programmes supporting SMEs has greatly increased, showing the success of this initiative and the relevance of its approach. Currently, there are 10 ongoing programmes with 6 more in the pipeline aiming at supporting SMEs with various instruments. The EU contribution to these ongoing programmes amounts to more than 100 M€ of grant financing (as of 05/2014).

3.3 Evaluations of previous EU programmes

The results of evaluations of previous programmes were taken into account when preparing this strategic document².

Regional evaluation concluded that there was a strong complementarity between regional and bilateral EU interventions conducted in 2004-2010. Indeed, regional interventions presented a specific added value that stemmed from their capacity to address issues that had a trans-national dimension and to provide platforms that stimulated mutual understanding, political dialogue and regional exchanges. As a result, the complex aid architecture combining aid intervention on different levels was praised, but it was strongly recommended to foster synergies between regional and bilateral interventions.

Taken into account these observations, a new wave of programmes, and in particular the SME Flagship, were designed and kicked-off in 2010-2011-2012 with the specific objective to increase access to funding for SMEs.

According to the sectorial evaluation, the EU adopted a "generalist approach" in its support to private sector (all-encompassing portfolio of activities, without defining a specific niche or role in terms of Private Sector Development (PSD) on which the EU would have wished to focus). On the one hand this provided flexibility, but on the other it had a negative impact on the clarity of the EU's role among stakeholders

The evaluation also pointed out the lack of strategy to maximise impact through prioritisation, a focus on value added of the EU aid and on synergies with other actors and activities. Moreover, it concluded that if there was a broad consensus on the importance of PSD for job

² *Evaluation of the European Union's Support to two European Neighbourhood Policy Regions (East and South, ref. 1320), 2013 and Evaluation of the European Union's Support to Private Sector Development in Third Countries (ref. 1317), 2013*

creation, linkages between the EU support for Private Sector Development and employment generation remained very distant.

The evaluation report recommended when programming the EU support for PSD to guarantee that:

- (i) Maximum synergy with other actors is ensured;
- (ii) It is built on EU value added;
- (iii) Coordination between different EU support mechanisms is present;
- (iv) Results and baselines are well defined;
- (v) Employment impact is considered.

These recommendations have been taken into account when developing the present strategic framework.

4 Objectives for 2020 and EU approach

4.1 General and specific objectives

The general objective of the EaP SME Flagship Initiative is to **sustainably increase the contribution of the SMEs to the national economies.**

The specific objective of the SME Flagship is to strengthen the SMEs as vehicles for employment creation and economic development

4.2 Indicator of achievement

The indicators of achievements that will allow measuring the success of the SME Flagship is:

General objective

- Contribution of SMEs to GDP in percentage and absolute figures;

Specific Objective

- Number of jobs directly generated through the activities under the flagship
- Increase of turnover directly generated through the activities under the flagship

4.3 Underlying principles and cross-cutting issues

In line with the priorities identified in the recent communication, the EU will pay particular attention to the number of potential jobs preserved and/or created by EU interventions. The EU should actually focus its effort on projects & programmes that create the maximum number of jobs. Another implication of the general objective will be a steady increase of the competitiveness of SMEs in the EaP countries.

In addition, individual actions that will be financed under the SME Flagship will seek to reduce the imbalance between rural and urban development, enhance corporate social responsibility of companies benefiting from the programmes, promote women entrepreneurship and youth employment and favour green economy. Making public procurement simpler and more accessible to SMEs can also greatly contribute to the development of SMEs – this aspect should be part of the policy dialogue which takes place bilaterally between the EU and EaP countries.

- Rural/Urban balance and sustainable job creation

The imbalance between rural and urban areas is a widespread issue: countries like Armenia, Azerbaijan, Georgia or Moldova shows a very high concentration of SME activity in the capital city (proportion of SMEs in the capital and their output exceeding 50% of the total). This reveals an uneven playing field as regards access to market and financing, and more generally reflects the economic disparities across national territories of the EaP countries.

Support to SMEs active in the regions and enabling favourable conditions for SMEs in rural area shall therefore be a priority of EU assistance, and this support shall contribute to opening opportunities for underprivileged group of population living outside of large urban communities, and thus support inclusive growth and local and regional development. It is likely to lead to the creation of sustainable jobs in remote areas and boost local economy.

Contribution of capital city

	Armenia	Azerbaijan	Georgia	Moldova	Ukraine
# of enterprises	46.5%	36.0%	54.4%	66%	n/a
Output/ turnover	n/a	63.6%	n/a	65%	25.0%

Source: Private Sector Financing in the Eastern Partnership Countries and the Role of Risk Bearing Instruments, synthesis report, 2013, EIB

- Women entrepreneurship and youth employment

The integration of women in business activities and the employment of young actives are also key issues in EaP countries. For many reasons, the population in the EaP countries does not see running a small business as sufficiently more attractive than working as an employee of a large firm, or in a public organisation. These reasons apply as much to women as to men, but there are certain additional factors which make entrepreneurship an even less attractive or viable option for women. Obstacles which particularly women are facing could be of contextual nature – insufficient education, traditional views and stereotypes about women, lack of seed capital and difficult access to finance, limited access to business networks, lack of business training and entrepreneurial skills and shortage of female role models/ambassadors. EU regional assistance will therefore focus on stimulating and supporting women entrepreneurship within the framework of designing and implementing national policies, on providing support to associations of women entrepreneurs and to SMEs managed by women, and adding a focus on mentorship and coaching, as well as development of female role models of entrepreneurs.

As for youth employment, problems generally result from a skills mismatch or an insufficient number of jobs in their field of education. SMEs could play an important role to tackle this crucial issue: potential of youth employment in SMEs is huge, and young professionals could constitute a suitable workforce to accompany SMEs growth, should they be able to match the

skills required. The EU will seek to encourage SMEs that will benefit from its support to hire young well trained employees and make sure SMEs can make the best use of human resources available in the country. As for the relevance of the education towards the labour market, this is part of other EU initiatives.

- Green Economy

Green growth implies decoupling economic performance from the environmental footprint. Investing in green sectors should become a driver of economic growth. This involves greening traditional sectors and supporting the transition of all economic actors, both at producer and consumer level, towards sustainable practices. It also implies seizing the opportunities for developing new green activities, building up new competencies, upgrading skills, transforming and creating jobs. Any prospects and strategies for a growing green economy should take into account the role of SMEs. There is still a lack of national dedicated financial programmes for SMEs willing to get involved in these sectors in the EaP countries. Ensuring that SMEs fully participate in the efforts towards green growth and benefit from policy changes that are supported by the EU through parallel initiatives over the region is one of the key challenges for the EU SME development assistance.

- Corporate Social Responsibility

SMEs are the predominant form of enterprise across the EaP countries. Working on the ground they tend to keep close relations with employees, local communities and business partners which generally imply that they have naturally a more responsible approach to business than large corporations. Although CSR is mainly discussed in the context of larger enterprises, it also is a strategic tool to enhance the competitiveness of SMEs. The specific impact, however, often cannot be expressed in hard facts and figures and it can take some time until they become manifested.

In the difficult business climate prevailing in most of the EaP countries, the role of EU support could include raising awareness on CSR and supporting the implementation of relevant standards (ISO 26000 or simplified standards) in medium-sized enterprises that are benefiting from EU assistance.

Each programme within the framework of the SME Flagship will be asked to report back on these cross-cutting issues.

4.4 Specific objectives

In order to structure the interventions within the framework of the SME Flagship, a results framework has been developed (see Annex II) which contains a set of specific objectives, measurable indicators of achievement and related sources of verification.

A. Improving access to finance

- a) Improve the capacity of SMEs to access financing, in particular to prepare investment projects

As identified in the problem analysis, SMEs are often lacking the necessary competencies to prepare investment projects that could be financed by Local Financial Institutions (LFIs). Insufficient financial literacy, lack of sound accounting system, general lack of understanding of the elements required by the LFIs to take a decision (business plan, feasibility studies,

etc.), poor corporate governance are often issues preventing SMEs to develop bankable projects.

All these aspects should be tackled by (i) building the capacity of SMEs on core business management issues, and (ii) providing relevant consultancy services to the SMEs. In order to address these needs sustainably, this objective should follow an approach encompassing established governmental or semi-governmental structures (SME agencies, Chamber of Commerce, etc.) that play a role in the provision of consultancy services to SMEs in countries where the business development services market is not yet fully developed.

b) Support the provision by LFIs of financial products responding to the needs of SMEs

Most of the available financing for SMEs in the region consists of debt financing, provided in foreign currency with a short-term duration, in the main cities of the country. As already mentioned requirements for collateral are very strict. One specific reason explaining this situation is the lack of know-how amongst local bankers on how to address the needs of SMEs. It is particularly true in specific sectors, such as agriculture where some tailor-made products are necessary (for example factoring), or green economy, which is a new area of operation for most of the LFIs. Moreover, the lack of information about past loans prevent bank to foresee the potential needs of SMEs and predict future behaviours. The EU will therefore address these gaps by supporting the establishment of a credit bureau and designing programmes aiming at building the capacity of local bankers. A special attention shall be paid to the co-financing by the LFIs, and about the concrete results achieved through the training delivered (number of new financial products on the market, new sectors covered, reduction of the risk perception, etc.).

c) Lower the risk perception of SME lending by LFIs

The banking sector in most EaP countries has barely recovered from the financial crisis leading to a risk-adverse policy for most of the banks active on local markets. LFIs impose therefore strict collateral requirements to SMEs and very high interest rates that are making debt financing not accessible to SMEs. This results in a de facto quasi absence of long term financing for most of the SMEs in the region, thus considerably hampering the potential of existing SMEs to grow and limiting the development of start-ups. Consequently, EU assistance will aim at encouraging local banks to finance more operations with more SMEs, especially in new sectors targeting in particular those SMEs which do not have yet access to financing. The EU support will encourage LFIs to improve their capacity to assess risks and expand their lending to the SME sector with less collateral. The EU could also support the revision of the regulatory framework to improve the use of collateral by facilitating mortgaging and liquidation.

d) Increase local currency lending by LFIs

There is a systemic under-supply of local currency financing to SMEs in the EaP countries which leads SMEs to take unsustainable currency risk and increasing the credit risk for the financial sector. Most local currency funding comes from deposits, which tend to be short-term, therefore banks typically lend out these funds only for short term, creating a large gap for long-term local currency funding.

LFIs also face a shortage of local currency: (i) depositors prefer to keep their deposits in foreign exchange, (ii) the local currency deposits are short term with the risk of withdrawal, (iii) there are very few sources of non-bank funding such as pension and insurance companies, and (iv) the large majority of cross-border lending by International Financial Institutions and the market are denominated in foreign exchange. This forces the local financial intermediaries to provide foreign currency loans to SMEs which then exposes the SMEs to significant currency risk (since most of them only operate with local currency).

Even when LFIs make funding in local currency available, the differential in local currency loan interest rates to foreign currency loan interest rates is very high, with SMEs too often deciding to borrow in foreign currency and bear the currency risk. Evidence over the last several economic cycles demonstrates that when large depreciations occur, a high percentage of SMEs default on their foreign currency loans leading to SME insolvencies, economic contraction, job losses and systemic financial sector problems requiring bail-outs from governments that do not have the resources.

The EU will address this objective by putting in place guarantee mechanisms to cushion the local currency risk.

B. Tackling inadequate policy & regulatory framework

a) Improve SME policies in the EaP region in line with the Small Business Act

Further to the publication of the 2012 edition of the SBA Assessment in the EaP countries (published by the OECD), the partner countries have expressed their genuine interest to reform and improve their SME policies along the principles of the SBA. Some of the countries have already implemented concrete recommendations made by the OECD (Moldova, Armenia). The European Union will, therefore, continue to actively promote and support the implementation of the SBA in the EaP countries.

b) Empower business support organisations (BSOs) to be able to represent effectively SMEs in the policy dialogue with the public sector

Most of the existing BSOs in the EaP were created during the Soviet era as top-down governmental initiatives and still are characterised by a lack of operational independence, orientation towards large businesses and low capacity. As a result, BSOs have had only limited experience as service providers, and they lack capacity to help SMEs to grow and develop and to represent their interests in the public-private dialogue. The European Union will therefore continue its effort to enhance the capacity, knowledge and outreach of BSOs. EU assistance in the EaP countries will aim to reinforce the capacity of BSOs to take an active role in such a dialogue in order to express SMEs positions and defend their interests. In addition the EU will continue its support to East Invest, a network of BSOs from the EU and the EaP aiming at opening new business opportunities for SMEs in both regions.

c) Encouraging SMEs involvement in anti-corruption mechanisms

Tackling systemic corruption in EaP countries is not the direct purpose of the SME Flagship. Many EU-led initiatives have been put in place to address corruption including a specific Anti-Corruption Panel set-up under Platform 1 of the Eastern Partnership. However, given that corruption is the single biggest obstacle which SMEs in the EaP region are facing, the EU will

accompany other initiatives by ensuring that SMEs benefiting from EU support are 'corruption free'. This could combine a declarative approach (signature of a charter for all participating SMEs, displaying plates with the EU flag mentioning "corruption free" at the entrance of the SMEs' premises, etc.) with a whistleblowing mechanism that could be managed by SME associations. This feature will also be a way to mitigate the reputational risks the EU faces when working with the private sector in the EaP region.

d) Supporting SMEs to move from the informal to the formal sector

The presence of a large informal economy is usually the result of a low quality of public administration and weak institutional structure, poor national regulations and an unfavourable business environment. Opting for the informal sector is often a deliberate decision of firms or individuals and is based on the balance of costs and benefits of staying in or moving out of the formal sector. The existence of the informal sector results not only in fewer revenues for the state and regional budgets, but also in a lack of social protection of entrepreneurs and employees most of whom belong to already vulnerable groups such as women, youth and low-skilled employees. In order to counteract this situation and to assist enterprises to enter the formal sector it is necessary to create the conditions that would provide clear advantages to firms operating within the framework of the formal economy. The EU wants support partner countries in identifying the appropriate incentives to accompany the formalisation of SMEs.

C. Improving knowledge base / business skills

a) Assist BSOs & local consulting companies in designing and proposing business services to SMEs

In EaP countries the market of private business services providers is not well developed: it is dominated by international consultancy firms that target large companies, whereas business services for small firms are often limited to public support schemes and donor funded programmes. Likewise, support services for start-ups are insufficient and often limited to donor-funded "incubators". The EU assistance will aim to develop sustainable local market of business support services, to strengthen local companies' capacities in delivering to SMEs services which are adapted to their specific needs. It must ensure that these companies use resources effectively and are able to deliver services on a continuous basis. This is especially important in view of the implementation of the DCFTAs in which the business service providers could play a crucial role to advise SMEs on how to comply with the new regulations.

b) Develop the offer for vocational training for SMEs

There is often a mismatch between professional qualification and market's needs in the EaP countries. In this context vocational training can play a significant role to requalify work force to better fit the market needs. Local BSOs can be used as a service provider to propose vocational trainings. Such an offer could be developed jointly with the support of European BSOs or of a consortium of local partners' BSOs. Furthermore, efforts will be made to link the training to the national education system, thus ensuring that the students will get an

appropriate diploma and the possibility to have the skills so acquired recognised by all employers

To ensure the relevance of the training offered it will be important to distinguish the needs of each target group (start-ups, medium size enterprises, etc.) and to provide targeted resources and ensure that quality of the training is monitored and data is available for continuous improvement of quality and access. Moreover, It is proven that loan repayment and start-up survival rates are improving if early training is ensured for start-ups so a suitable training can also improve access to finance. In order to ensure access to relevant, flexible and high quality training opportunities, the EU will base its future intervention on the Training Needs Analysis, which is being performed as part of the Small Business Act assessment.

- c) Support universities in order to develop and deliver entrepreneurial curricula for students and vocational training for entrepreneurs

EaP countries experience significant outflows of labour, especially in Armenia, Georgia and Moldova where the stock of emigrants represents ¼ of the population. Many of them are young educated males, who are forced to look for illegal and low-skilled jobs abroad due to the inability to find employment in their home countries. This situation results in demographic depletion, brain-drain, and a high dependence on remittances from neighbour countries and jeopardises the sustainable development of the country of origin in the long run. The reasons for this outflow stem from insufficient job opportunities in home countries, but also from a mismatch between the needs of the local job market and the professional qualifications of the young population. In survey conducted jointly by the EBRD and the World Bank, inadequately educated workforce was listed among the most significant problems encountered by firms in the EaP region. The sense of initiative and entrepreneurship is one of the key competences which every young adult graduating should acquire throughout all levels and forms of life-long learning, the EU will seek to support universities in order to develop and deliver entrepreneurial curricula for students and support educational institutions to introduce entrepreneurship training as key competence throughout the education system.

D. Improving access to market

- a) Supporting SMEs to trade with the EU and within the EaP region

A number of researches conducted across the EaP region have shown that most of the entrepreneurs are focusing on keeping their companies alive without investing into making their business grow and expanding into new markets. This is largely due to persistent barriers which limit SMEs' growth perspectives.

Internationalisation of the SMEs is thus a key issue, as reflected in the Small Business Act. The EU assistance to the SMEs in this respect will be devoted to supporting the trade between the EaP SMEs and the EU, organised around two pillars (i) compliance with the EU standards as a prerequisite for EaP SMEs to be able to export to the EU (ii) support to suitable export financing instruments.

SMEs active in a country that has signed a DCFTA with the EU are compelled to comply with the legislation corresponding to the provisions of this agreement. As the implementation of DCFTAs is a very country specific issue that will be led by national governments with the

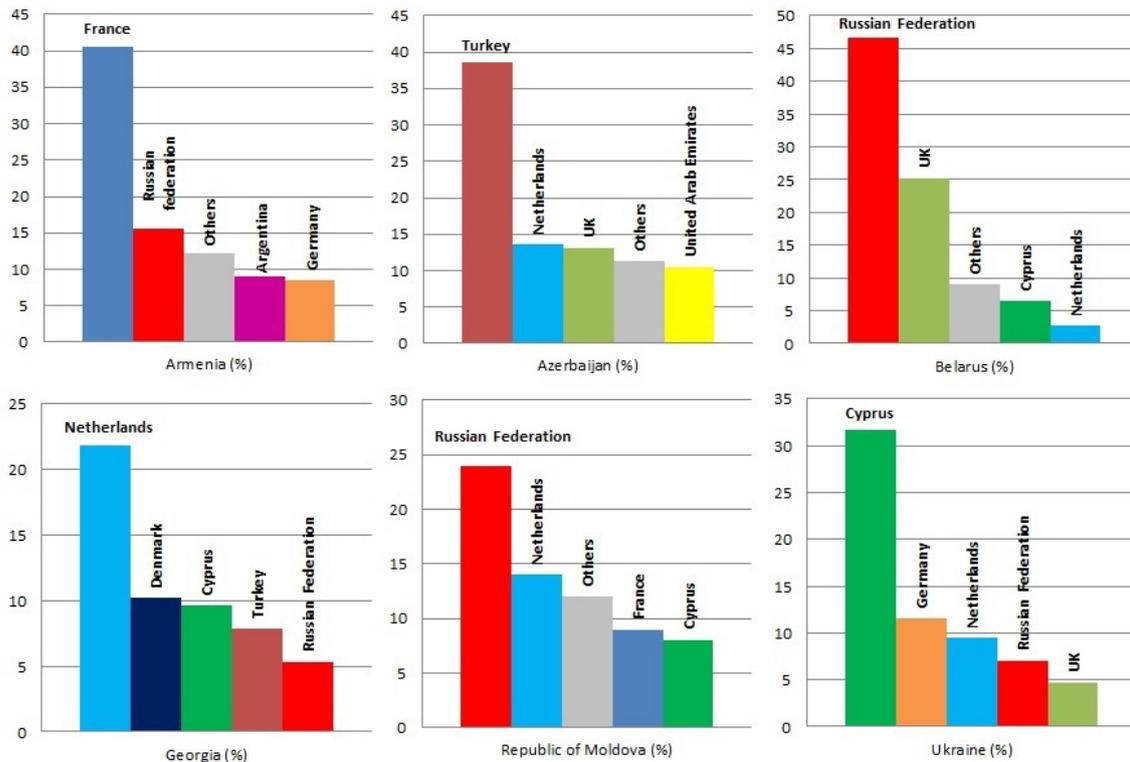
support of the EU bilateral cooperation, the EU will concentrate its multilateral support on assisting SMEs on trade issues..

b) Enabling SMEs to benefit from FDI

The flow of EU FDI directed at EaP countries has not always brought about the desired effect for the local economy. This is in particular due to the lack of capacity of local SMEs to act as business partners for EU companies investing in their country, but also due to a lack of knowledge of EU companies as regards the local economic set up. The integration of EaP SMEs in value chains will be one of the specific objectives of the Flagship and will particularly target the sectors where EU investors are the most active.

The EU will therefore support SMEs in order to integrate them in value chains, would they be local, national, regional or international. In particular, the EU assistance will focus in ensuring that SMEs can integrate the value chains involving European companies (in the agriculture and agro-food sectors at the first place, but also in innovative sectors).

The EU assistance will seek to (i) raise awareness of the EU companies investing in the EaP countries about the existing local companies and inform local SMEs about opportunities to work with EU companies (ii) provide specific consulting services to SMEs so they can integrate the global value chain (iii) provide access to banking services necessary to SMEs to become subcontractors of EU companies.



Five main sources of Foreign Direct Investments for the Eastern Partnership Countries³

³ See graphs in annex III. Sources are in the annex III too.

c) Support to SMEs to implement the DCFTAs

The implementation of DCFTAs will substantially reduce technical trade barriers, in the for industrial and agricultural production between EU and each of the EaP countries. To do so, it includes provisions related to standardisations of products in line with European norms & standards. SMEs face severe difficulties to access finance in the EaP countries, particularly long term financing for investments, and the implementation of the DCFTA will require significant investments for the SMEs in the countries concerned. Benefiting from new trade opportunities with the EU will also require specific financial products. In order to support the SMEs in their approach to conform to the rules, the EU will set up a specific set of instruments seeking to support SMEs to finance necessary investment and capacity building to comply with the DCFTA provisions.

5 Proposed approach

5.1 Support to be tailored to local needs

EU regional activities in the field of SMEs should be well coordinated with EU bilateral cooperation and complementary with other donors' support in order to ensure efficient resource spending and to avoid duplicating actions. It will be done by improving communication between stakeholders, primarily by making the best use of the EaP SME Panel, which shall be used as the coordination nexus for EU support to SMEs in the region.

The ratio between larger and smaller companies benefiting from EU support has to be monitored in order to avoid that EU support only benefits larger SMEs. Programmes should have specific features that take into consideration needs and abilities of companies of different sizes. Furthermore, the nature of the financial needs should also influence the type of support provided. Acknowledging the importance of both financing working capital and investments, an appropriate balance of the EU interventions in the EaP region should be found, as it is through increasing investments that SMEs can contribute more substantially to sustainable job creation and inclusive growth.

Programmes designed to support individual SMEs (access to finance, technical assistance, etc.) will specifically target a certain stage of development of SMEs as the needs in terms of financing and assistance greatly differ depending on the SME's maturity.

A key feature of programmes developed to support SMEs at micro level is the requirement for co-financing from beneficiaries. This will not only be a way to leverage the EU grant but will also make SMEs understand the market value of the assistance delivered. It will also inspire a greater feeling of ownership. At the same time, these programmes will contribute to the development of a local market for business advisory services. Sustainability of EU interventions will be ensured by putting in place exit strategies (e.g. increasing over time the share of co-financing required) to allow the beneficiary SMEs to become progressively financially independent from EU support.

In the longer run, the EU can also envisage a specific approach in its programmes to foster growth of "opportunity entrepreneurship", thus giving a chance for start-ups to emerge, develop, grow and expand beyond national boundaries – thereby facilitating greater regional integration.

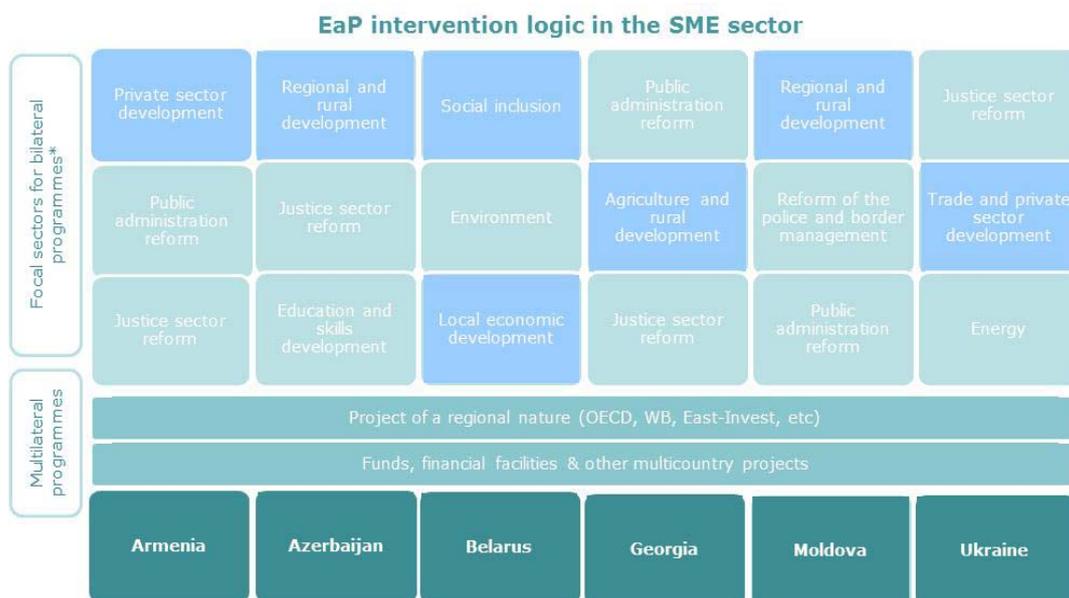
5.2 The European Union intervention logic in the SME sector in the EaP

The EU combines two main approaches in its cooperation programmes in the EaP: a regional and a bilateral one. These are complemented by thematic support.

The bulk of the cooperation between the EU and EaP countries is implemented at bilateral level. This bilateral cooperation covers many sectors that are closely related to SME development. Removing trade barriers, support to the implementation of DCFTAs, improving the business climate and local development are examples of topics which can be covered by bilateral cooperation and which enhance SME development.

Regional programmes and bilateral programmes should be designed in a way as to mutually reinforce each other and should exploit where relevant all possible synergies with the three focal sectors targeted by bilateral cooperation. In each of the Eastern Partnership countries there are possible synergies between at least one focal sector and the SME regional programmes as illustrated in the table below.

The relationship between SME regional and bilateral programmes will therefore depend on the focal sectors that have been chosen. This is obvious in the case of Armenia and Ukraine that have "support to the private sector" as a focal sector, but this link is also present in the other countries that have local development issues as a focal sector. In the latter case, the regional SME programmes will seek synergies with those bilateral programmes which target SMEs as an important contributor to the local development. In a further step, EU Delegations will be able to utilise the regional programmes as a "pilot", being able to build upon the most successful programmes and upgrade them into a fully-fledged bilateral programme.



* Not yet confirmed as of 1.02.2014

Regional programmes may usefully complement and/or support regional platforms already in place (such as those established by the OECD or the WB)) they are also particularly relevant to support programmes that have an inherent regional nature (network of BSOs as in the case of East Invest, trade facilitation programmes, etc.). The European Union uses also the regional approach to improve efficiency, and achieve economies of scale, for instance for

multi-country programmes implemented by the same entity. This is the case for programmes such as the SME Finance Facility or EGP/BAS implemented by the EIB and the EBRD.

Support to SMEs will continue to be a priority in the regional programmes during the 2014-2020 budgetary period. It will be funded through the Neighbourhood Investment Facility (NIF) and through the Eastern Neighbourhood bilateral and regional envelopes.

EU interventions will be designed to be complementary with activities of other donors, in particular Member States, in order to avoid overlapping and seek additionality. The EU does not have financial and organizational capacities to meet all vast needs of SMEs in the EaP countries, thus the EU interventions will focus on those selected areas where they already proved to be effective and where they will provide an added value.

5.3 EU aid instruments for private sector support

EU support for private sector development and its engagement with both the local and international private sector are guided by a set of clear principles that will help to enhance the effectiveness of EU engagement with the private sector. These include:

- Measurable development impact
- Additionally
- Neutrality
- Shared interest and co-financing
- Demonstration effect
- Adherence to social, environmental and fiscal standards

The respect of these criteria will lead to increased clarity and transparency on roles, expectations and accountabilities in public-private collaboration, and can contribute to better coordination of private sector development support programmes and partnership initiatives.

Keeping these principles in mind and in order to achieve the specific objectives described in section 4.4 above, the European Union will use different instruments, adapted to the needs. Possible interventions could include:

Blending of loans and grants (through the NIF)

- Guarantee schemes (for EFIs, local financing institutions or SMEs);
- Direct and indirect incentive payments to SMEs
- Risk capital
- Contribution to funds active in the region and providing debt financing or equity to local financing institutions, such as EFSE (European Fund for Southeast Europe) or GGF (Green for Growth Fund).

Technical Assistance

- To governments;

- To intermediary bodies (BSOs, local banks, association of accountants, of auditors, SME associations, etc.);
- To SMEs directly.

Direct grants (through Call for Proposals)

- To CSOs (Civil Society Organisations) in the region, possibly including universities, BSOs, etc.

6 A renewed setup for the SME flagship

In order to achieve the intended results a number of changes must be made to the set-up of the SME Flagship.

6.1 SME Panel as SME Flagship advisory body

To coordinate the work of the SME Flagship and ensure it is aligned to the policy work of the SME Panel, the latter should serve as an advisory/coordinating body. This would ensure that the SME Flagship is effective in supporting national SME policies as well as the policy dialogue within the framework of the Eastern Partnership. Coordination will be of particular relevance to eliminate overlapping activities and identify existing gaps.

The SME Panel will regularly review the implementation of the SME Flagship Initiative on the basis of this Strategy. It will give advice on the choice of the most suitable instruments and measures used by the European Union to support SMEs in the EaP. It will also be encouraged to advice on the specific economic sectors that should be targeted by cooperation programmes.

The SME Panel will equally play an active role in the monitoring of the impact of the SME Flagship. Within this context, evaluation reports will be presented by the responsible project partners (International Financial Institutions, BSOs, etc.) and on the basis of these, the results of programmes will be discussed.

The SME Panel will also provide the opportunity to coordinate between various project partners and lending facilities (Eligible Financing Institutions). Given the considerable number of projects active under the SME Flagship, the SME Panel is a unique forum for all stakeholders to exchange views on ongoing projects, maximise synergies and streamline the agenda of events.

Furthermore, the Financing Institutions and other stakeholders participating in the SME Panel will play a role in ensuring a consistent and solid pipeline of regional projects that could be financed by the EU under the multilateral envelope of the ENI (European Neighbourhood Instrument). In particular, the Eligible Financing Institutions looking for financing for regional projects in the SME sector through the Neighbourhood Investment Facility (NIF) will be invited to present their proposals at the SME Panel.

6.2 Reinforcing the SME Panel's support function

To reinforce the ability of the SME Panel to stimulate discussion on key policy issues and review the performance of the Flagship it proposed to set up an Advisory Desk that will be tasked with the following:

- Review and consolidate reporting on the SME Flagship;
- Review and advice on the Flagship performance including follow-up of Key Performance Indicators;
- Drafting of background documents and desk studies to support the SME Panel policy discussions
- Provision of expert opinion on technical/policy questions;

Specialised expertise will be drawn from the resources of the study facility and a six-month work plan proposed to the approval of the SME Panel.

Annex I. Indicative list of Indicators⁴

	Specific objective	Results	Indicators of achievement	Source of verification
Improving access to finance	Improve the capacity of SMEs to access financing, in particular to prepare investment projects.	Increase the number of SMEs able to prepare investments projects	Number of investment projects proposed by SME	LFIs reports
	Ensure that Local Financing Institutions (LFIs) do propose suitable products to SMEs	Increase the number of LFIs products suitable to SMEs	Number of LFIs products used by SMEs	LFIs reports
	Lower the risk perception of SME lending by LFIs	Increase the number of loans to SMEs Increase the number of new SMEs served by LFIs Increase the number of new sectors covered Increase the number of new regions covered	Number of medium and long-term loans granted to SMEs Number of loans in new regions Number of loans in new sectors Number of loans for new SMEs Average amount of loan for enterprise	LFIs reports
	Increase local currency lending by LFIs	Increase the number of loans in local currency	Number of local currency loans granted to SMEs	LFIs reports
Tackling	Improve SME policies in	SME policies are established and		

⁴ Definitive list of indicators measuring the impact of the flagship will be agreed within the framework of the advisory desk taking into account availability of data, feasibility of the indicators and actions supported.

inadequate policy & regulatory framework	the EaP region in line with the Small Business Act	<p>implemented in the partner countries in line with the Small Business Act for Europe.</p> <p>SMEs are benefitting from the transformation of national regulations leading to a more business-friendly environment.</p>	<p>Draft laws are passed in accordance with the SBA and related policies are implemented.</p> <p>Number of SMEs expressing satisfaction with transformation of national legislation.</p>	<p>Publication of laws and other administrative acts on governmental websites</p> <p>2015 edition of the joint EU/OECD SBA Assessment in the Eastern Partnership region</p> <p>Regular written updates from Partner Countries together with updates presented within the framework of the SME Panel (policy dialogue)</p> <p>On-ground company surveys</p>
	Empower business support organizations (BSOs) to be able to participate to the public-	BSOs propose a wider range of services to SMEs and participate more actively in sectoral policy	<p>Increased number of affiliated members to BSOs.</p> <p>Increase of the turnover generated</p>	<p>BSOs' annual reports</p> <p>BSOs' annual</p>

	private dialogue	dialogues Increase in successful matchmaking between EU and EaP SMEs.	by business services provided by BSOs. Increased success rate of start-ups and increased growth of SMEs which have been provided business services.	reports
	Encouraging SMEs involvement in anti-corruption mechanisms	A mechanism is put in place to make SMEs benefiting from EU grant corruption-free	Number of companies that have signed up to an anti-corruption charter.	EFIs' reports
	Support SMEs to move from informal to formal sector	Companies from the informal sector have moved to the formal one.	Number of companies from the informal sector that have moved to the formal economy.	Reporting form institutions working with the target companies
	Foster enterprise creation	An easy and quick way to create enterprises	Numbers of enterprises created	Chamber of commerce
	Accelerate the process of starting a business	Reduce the duration to start a business	Number of countries where the duration required to start a business has been reduced, with EU support Average duration to start a business	Chamber of commerce
Improving knowledge base / business skills	Assist BSOs & local consulting companies in designing and proposing business services to SMEs	Present new offers to SMES Increase the number of SMEs purchasing these offers	Number of new services proposed by BSOs Number of SMEs purchasing these the offers	BSOs annual report
	Develop the offer of vocational training for SMEs	Market of local business services providers has developed	Number of SMEs purchasing BDS Amount of annual sales of BDS	National statistics

		Increase capacity of SMEs Provide suitable offers	Percentage of SMEs accessing BDS services	
	Support universities in order to develop and deliver entrepreneurial curricula for students and vocational training for entrepreneurs	Increase the number of student attending entrepreneurial curricula Increase the number of entrepreneurs attending vocational training	Number of students attending entrepreneurial curricula Number of entrepreneurs attending vocational training	University figures
Improving access to market	Supporting SMEs to trade with the EU and within the EaP region	Increase of trade between UE and EaP countries	Percentage and volume of flows towards EU Percentage and volume of flows within the EaP countries	National statistics
	Enabling SMEs to benefit from FDIs	Higher number of SMEs able to work with foreign investors.	Number of SMEs acting as sub-contractors of foreign investors.	Statistics from bi-national chambers of commerce.
	Support to SMEs to implement the DCFTAs	Increase the number of SMEs complying with the DCFTA	Number of SMEs which have complied with the DCFTA	Chamber of commerce

Annex II. SME sector related projects in EaP region

Start date	End date	Contract title	Description	Contracting party	Planned amount M €	Action location
2006	2018	Identification and promotion of energy efficiency investments	<ul style="list-style-type: none"> • Awareness raising campaigns regarding EE; • Establishment of credit lines within local banks and provision of technical, financial, legal and environment expertise to beneficiaries 	EBRD	9,5 M€	Ukraine, Moldova
2009	2016	Framework for Capacity Building to support Financial Intermediaries in Azerbaijan and Georgia	<p>Provides technical assistance for financial intermediaries aimed at:</p> <ul style="list-style-type: none"> • increasing sustainability of these institutions; • improving the local financial sector's efficiency, effectiveness and transparency; • provision of better access to financing for enterprises. 	EBRD	3,030 M€	Azerbaijan, Georgia
2009	2015	Regional Energy Efficiency Programme for Corporate Sector	<ul style="list-style-type: none"> • Project preparation (e.g energy audits); • Support during project implementation (energy management training and project management assistance). 	EBRD	2,140 M€	Armenia, Azerbaijan, Georgia, Moldova and Ukraine
2009	2019	Subscription and management on behalf of the European Commission of a participation in the European Neighbourhood Fund (ENBF) window of the European Fund for South East Europe (EFSE)	Provides additional development finance to the small and micro enterprise sector and to private households via local financial intermediaries in the Eastern Neighbourhood region.	Kredita nstalt für Wieder aufbau	5,1 M€	Eastern European Neighbourhood region

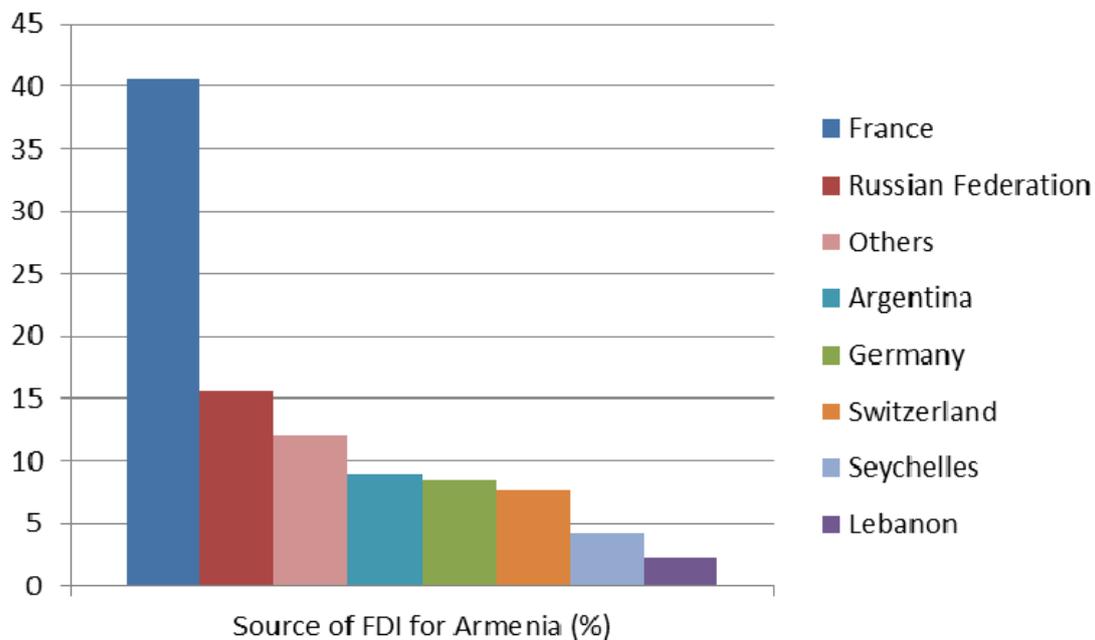
2009	2016	NIF Trust Fund to the Technical Assistance Framework "Financial Sector Institution Building and Crisis Response"	<ul style="list-style-type: none"> • Provides technical assistance to the banks particularly affected by global financial crisis; • Improves the efficiency, effectiveness and transparency of the bank sector, resulting in provision of better access to financing for SMEs; • Maintains or creates successful and healthy institutions financing the real economy by following sound business practices. 	EBRD	12 M€	Neighbourhood region and Russia
2010	2017	EAST INVEST I + II	Promotes trade and investment through SME networking and consolidation of business associations.	Eurochambres	7+6.5 M€	Eastern Neighbourhood countries
2010	2020	SME Finance Facility - EIB window	A wide range of financial services and products to SMEs and financial which increase the availability of long-term funding to the SME sector.	EIB	5,1 M€	Eastern Neighbourhood countries
2010	2019	SME Facility - EBRD / KfW window	A wide range of financial services and products to SMEs and financial which increase the availability of long-term funding to the SME sector.	EBRD	10,2 M€	Eastern Neighbourhood countries
2010	2020	EGP-BAS Programme in the Eastern Partner Countries, phase I	EGP - supports substantial managerial and structural change within companies by providing the advisory services of experienced senior executives from economically developed countries. BAS - supports short-term projects that have narrowly-defined objectives by providing the advisory services of local experts, primarily trained by EBRD.	EBRD	10 M€	Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine
2013	2016	EGP-BAS Programme in the Eastern Partner Countries, Phase II	-//-	EBRD	8 M€	Eastern Neighbourhood countries

2013	2019	Subscription and management on behalf of the European Commission of a participation in the Green for Growth Fund	<ul style="list-style-type: none"> • Broadens the financing base of EE and RE investments; • Increases awareness and deepening the financial sector servicing those development needs, • Harmonizes and coordinates donor initiatives. 	EIB	13.5 M€	Eastern Neighbourhood countries
2013	2016	Supporting SME Competitiveness Reforms in the Eastern Partner Countries - Implementing the Recommendations of the SME Policy Index 2012	<ul style="list-style-type: none"> • Assists to the EaP countries with the implementation of policy reforms based on policy recommendations resulting from the study; • Increases of government responsiveness to SMEs' needs and requests and an improved public private dialogue at national level; • Strengthens policy dialogue and peer review at regional level with regard to SME competitiveness in the EaP region; • Increases cooperation between SME stakeholders from the region and facilitate exchange of best practices. 	OECD	2.5 M€	Eastern Neighbourhood countries (priority countries: Armenia, Georgia and Belarus)
2014	2017	STAREP (Strengthening Auditing and Reporting in the Eastern Partnership Countries)	<ul style="list-style-type: none"> • Builds stakeholder awareness of, and commitment to, corporate financial reforms; • Provides EaP officials with technical advice on the content of CFR reforms and the process to conduct them; • Improves the capacity of CFR institutions to fulfil their mandate effectively and provide business support services required by SMEs; • Supports access for SME borrowers to finance through modernised accounting and financial reporting. 	WB	1 M€	Eastern Neighbourhood countries

Annex III. SMEs in the EaP: snapshot of the situation

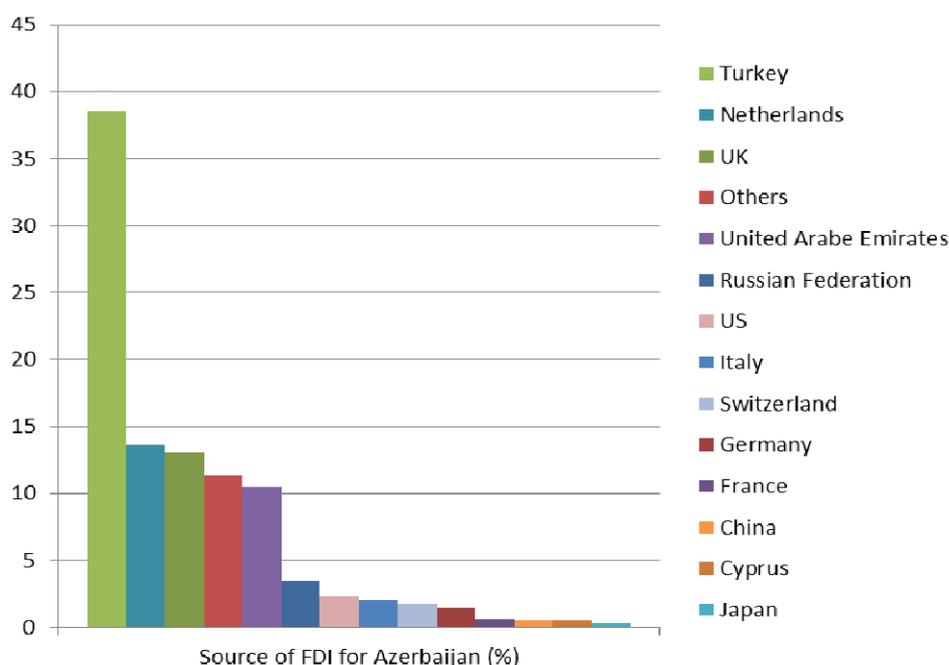
Overview of countries

The SME sector contributes considerably to **Armenia's** economy. Since 2000, the Armenian government has pursued a pro-active approach to supporting SME growth. The sector experienced robust growth until 2008 when it was particularly hit by the global crisis – in 2009 GDP growth contracted by 14.1%. Economic activity started its gradual recovery in 2010, which further strengthened in 2012 (GDP growth of 7.1%), however the SME sector has not yet regained its pre-crisis performance level. The contribution of the SMEs to GDP in Armenia is estimated at 42% and accounts approximately for 42% of total employment. Despite this significant contribution to the economy, the role of SMEs in attracting FDI and their contribution to exports are very small due to the lower competitiveness of SMEs in comparison with larger companies. In 2012 the Armenian government pursued to implement structural reforms focused on improvements in the business environment and deregulations. These efforts were acknowledged by the World Bank, which in 2014 rated Armenia 37th (out of 189 states) for the ease of doing business. In the Transparency International Corruption Perceptions Index 2013 Armenia was ranked 94 out of 177 states. The launching of negotiations with the EU on a DCFTA in 2012 should be considered positively as regards further economic integration and enhanced trade relations. The DCFTA was the starting point in the country's reform process in a number of areas, such as the elimination of technical barriers of trade. However, in 2013 Armenia decided to join the Russia-led Customs Union putting a hold on the initialling (and signing) of the DCFTA with the EU.



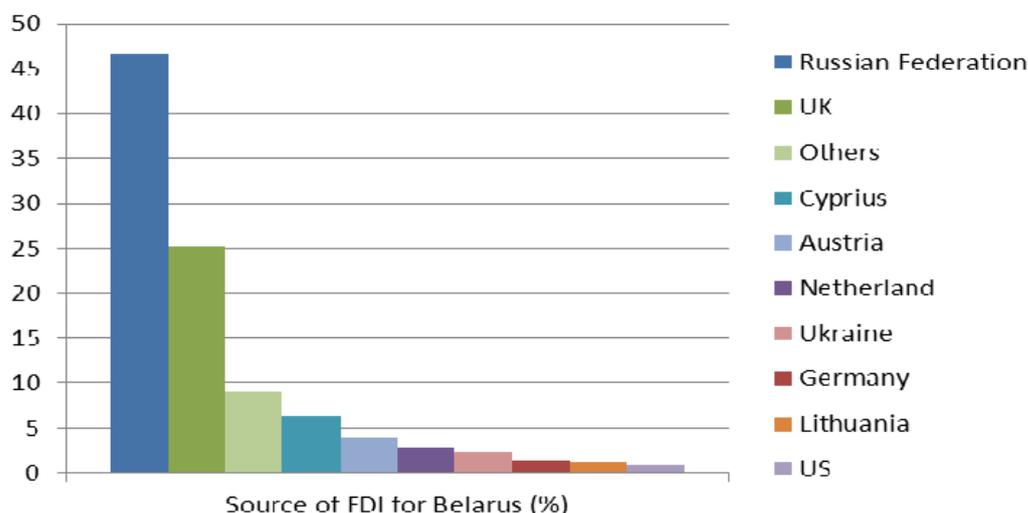
Source: Armenian Development Agency, FDI by countries 2012

Azerbaijan defines small entrepreneurship as one single category for micro, small and medium sized firms. SMEs in this country account for 94% of the total number of enterprises, yet their contribution to GDP is estimated at 2% and their contribution to employment – 6%. Development of entrepreneurship constitutes one of the priorities of Azerbaijan’s state policies aimed at diversification of the national economy which is heavily dominated by the oil industry. Economic activity rebounded in 2012 after an abrupt halt in 2011. GDP growth accelerated to 2.2% in 2012 from 0.1% in the previous year. This recovery was fuelled by the on-going expansion of the non-oil sector driven by fiscal transfers from hydrocarbon sales – contributing to further diversification of the economy away from the energy sector. Currently, Azerbaijan does not have a strategy for SME development *per se*, but elements of support to entrepreneurship and specific measures have been included in the wider national State Programme on Socio-Economic Development of Regions of the Republic of Azerbaijan (2009-2013) and the State Programme on Poverty Reduction and Sustainable Development in the Republic of Azerbaijan (2008-2015) as well as the associated action plans. These and other measures contributed to significant progress in improving the business environment, with noticeable progress in areas such as tax payment, investor protection and starting a business. These efforts were acknowledged by the World Bank, which named Azerbaijan the region’s main reformer in 2007-08. However, there is still considerable room for improvement as the country holds 70th (2014) position in the Ease of Doing Business Index by the World Bank, which is a relatively weak result compared to its direct neighbours: Georgia (on 8th place) and Armenia (on 37th place). The country features a poor state of structures and institutions as regards the financing of SMEs – e.g. the *EBRD Transition Report 2013* indicated a large transition gap between the level of Azerbaijani (and Belarusian) lending entities and that of mature industrialised economies. Another problem of the Azerbaijani SME sector is the high level of corruption – in the Corruption Perceptions Index 2013 Azerbaijan occupies 127th position out of 177.



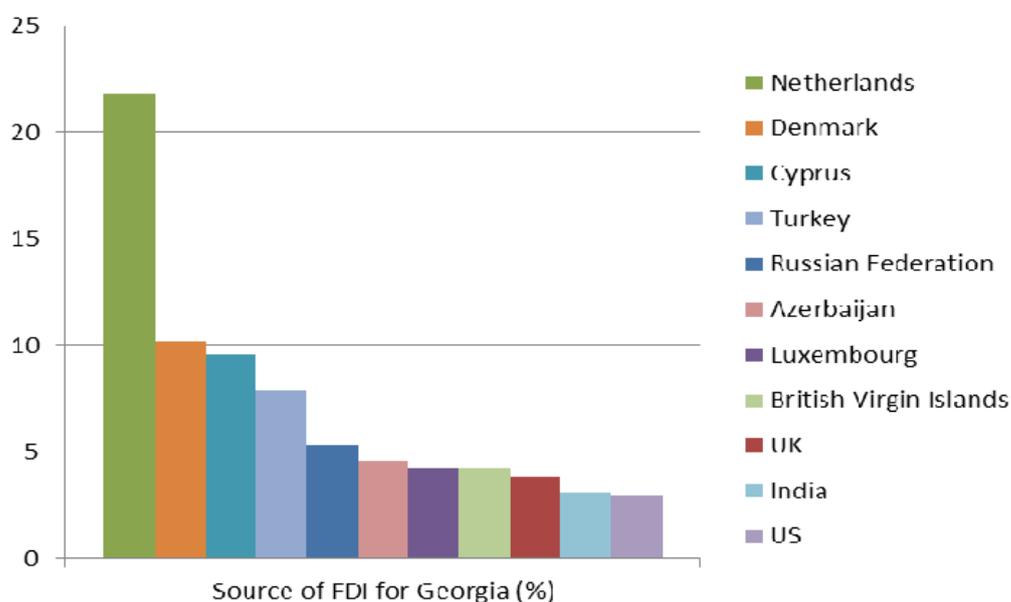
Source: Statistical Committee of Azerbaijan, 2013

The **Belarusian** economy is still made up primarily of large industrial enterprises inherited from the Soviet period. As per the *EBRD Transition Report 2013* Belarus' efforts to transform the centrally planned economy received a score of 2- for large scale privatisation and a score of 2+ for small scale privatisation (on a scale from 1 to 4+). This is the worst result among all EaP countries (the best result showed Armenia with 4- and 4 respectively). State-owned enterprises generate about 70% of GDP and 50% of employment. SMEs account for 97% of the total number of enterprises, yet they employ only 28% of the workforce and generate 20% of GDP. This is low in comparison to other EaP countries in which SMEs, on average, contribute to one third of GDP and about one half of employment. Nevertheless, in recent years, Belarus took a more liberal approach towards the development of the private sector. A number of legislative acts including the presidential directive "On Developing Entrepreneurial Initiative and Encouraging Business Activity" have been adopted, setting the basis for SMEs policy reforms. Significant progress has been made in eliminating the administrative burden for businesses. This was also acknowledged in the *Ease of Doing Business Index 2013* of the World Bank – the country made significant progress and was ranked 58th overall, a significant progress compared to the 85th position in 2009. The world financial crisis which was followed by the currency crisis in 2011 in Belarus had a particularly strong impact on small businesses that were relying on the import of goods. Furthermore, as state-owned enterprises could count on state support, this additionally worsened the position of small businesses as they were negatively impacted by this unfair competition. The number of active small and medium-sized enterprises decreased as a result, whereas the number of active microenterprises increased mainly as a coping mechanism for self-employment. Macroeconomic stability was restored in 2012, however, this came at the expense of a significant weakening of economic activity. GDP growth slowed down to 1.5% in 2012 from 5.5% in 2011 and 7.7% in 2010. Belarus' focus on achieving and retaining macroeconomic stability slowed down the implementation of structural reforms. In fact, there was some retreat in privatisation with the abolishment of the sell-off list and *de facto* nationalisation of some enterprises. That was reflected in the World Bank *Doing Business 2014* report where Belarus was downgraded to 63th position in ease of doing business rank. A high level of corruption (in the Corruption Perceptions Index 2013 Belarus occupies 123rd position out of 177) has also a detrimental impact on the business climate for SMEs.



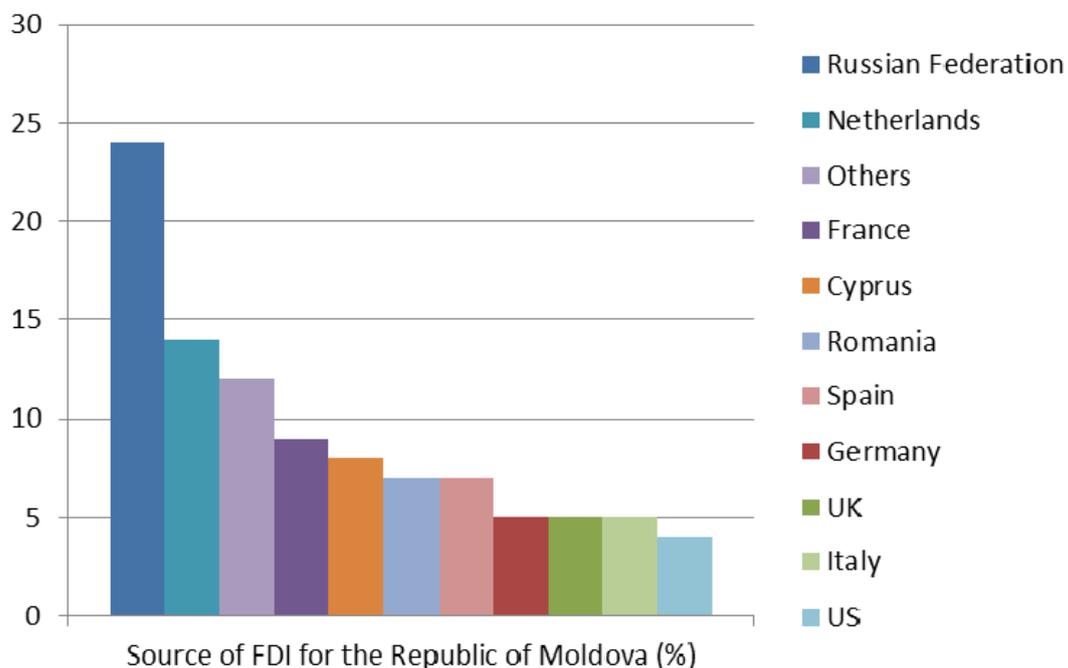
Source: *Belarus Digest*, 24 April 2013 (Data from 2012 to be verified)

Georgia's economy demonstrated a remarkable recovery after the 2008-2009 dual shock caused by the military conflict with Russia and the global recession. The average GDP growth in 2010-2012 recorded 6.5%, with a slight slowdown in 2012 due to political turmoil. These achievements were underpinned by sound macroeconomic policies, market-oriented reforms and significant donor assistance pledged by international donors in the aftermath of the conflict with Russia. Despite the growth of the Georgian economy and employment figures, the SME sector still shows weak performance in terms of added value. SMEs account for 96% of all enterprises in the country, employing 44% workers; yet they account only for 19.3% of added value and 16.1% of turnover. Given these figures, SMEs do not play an important role on the economic policy agenda. There is no SME strategy *per se*, however, the State Strategy for Regional Development of Georgia (2010-2017) states support for entrepreneurship as one of its objective. Georgian SMEs became beneficiaries of implemented economy reforms which considerably improved country's business environment, e.g. adoption of New Tax Code in 2005. These efforts were recognised by the World Bank, which estimated the country as a frontrunner in this area since 2005. The Bank ranks Georgia 8th among 189 economies in its *Doing Business 2014* report in its ease of doing business rank. Georgia's first anti-corruption strategy drafted in 2005-2006 and a corresponding action plan adopted in 2007 (second strategy and plan were adopted in 2010) became an important instrument to support business: by simplifying regulatory practice and overcoming administrative hurdles. In the current Corruption Perceptions Index Tbilisi occupies 55th position out of 177. Significant progress was achieved as regards economic integration and deeper trade relations, as Georgia has initialled a DCFTA with the EU and signature is foreseen for autumn 2014.



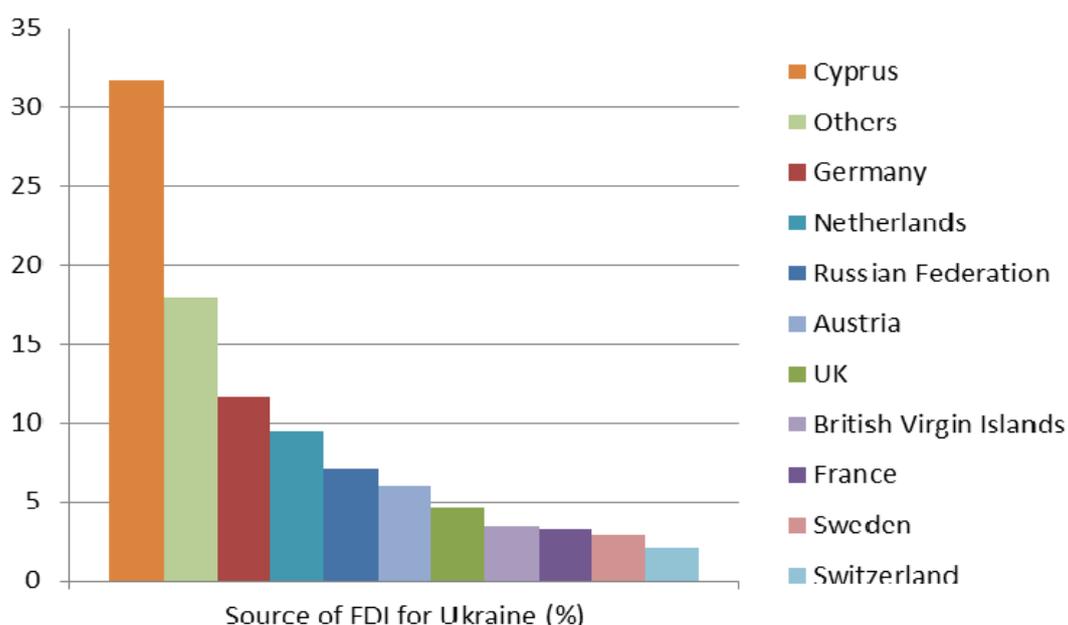
Source: National Statistic Office of Georgia, 2013

The economic performance of the Republic of **Moldova** is modest – with a GDP per capita of 1,586 EUR (2012) it is the lowest in the EaP countries. Its economic growth is mainly based on the increased demand fuelled by remittances sent by workers abroad and trade based on basic agricultural and manufactured products. The world crisis severely affected Moldova and its GDP contracted by 6% in 2009. After a slight recovery in 2010-2011 (7,1% and 6.8% of GDP growth) economic activity slowed down again in 2012 (-0,8%) as a result of adverse weather conditions hitting the Moldavian agricultural sector and weaker export demand from the EU. These changes had a considerable impact on dynamics within the SME sector. SMEs represent approximately 97% of the total number of enterprises and employ 59% of workers and account for 28% of GDP. In 2007-2010 the number of micro and small enterprises increased by 15% and 27% compensating for the 11%-decline in a number of medium sized companies which were severely hit by the financial crisis. In recent years the Moldavian government undertook some initiatives to improve the business climate by simplifying its legislative and administrative procedures and staying committed to complete structural reforms. This was reflected in the World Bank’s Ease of Doing Business 2014 rank, where Moldova changed its position from 86th in previous year to 78th. Similarly, it moved up six places in the *Global Competitiveness Report* for 2012-2013 to 93rd place among 144 countries. However, Moldova is still lagging behind most countries of the EaP. The most important factors impacted upon business are corruption (102nd place in the Corruption Perceptions Index 2013), political instability, an inefficient bureaucracy and poor access to finance. Regardless of the change of government in 2013, European integration stayed a declared priority for Moldova which has initialled a DCFTA with the EU and signature is foreseen for autumn 2014.



Source: IMF Data Warehouse 2012

Ukraine's economy was also severely affected by the global financial crisis. Following a strong recovery in 2010-2011 (respectively 4.1% and 5.2%) Ukraine re-entered a period of recession and, observed a slowdown of investment with GDP growth dropping to 0.2% in 2012. The operating environment for businesses failed to improve despite measures undertaken by the new government, which adopted in 2010 an ambitious Programme for Economic Reforms. However most initiatives were not implemented and remained on paper. In fact there were a number of adverse trends, such as an increase of corruption, inefficient progress in public finance management reform, and increased pressure on businesses from the tax and customs administration. These changes were reflected in Ukraine's low ratings in a number of comparative studies, including the World Bank's Ease of Doing Business Index 2014 where Ukraine occupies 112th position out of 189 and Transparency International's Corruption Perceptions Index 2013 (144th out of 177). The shares of SMEs as regard the total number of enterprises remained stable (99%) over the last years. Yet at the same time, both employment and turnover has been significantly reduced and accounted for 58% and 51% respectively. That downward trend suggests that the sector is in need of more enabling policies to foster SME competitiveness.



Source: *Investukraine*, a department of State Agency for Investment and National Projects of Ukraine

Annexe IV: Examples of EU previous programmes

The EBRD Small Business Support program

The European Bank for Reconstruction and Development (EBRD) Small Business Support (SBS) instruments, that is Business Advisory Services (BAS) and the Enterprise Growth Programme (EGP), connect SMEs to local consultants and international advisors who can help transform a large variety of businesses by providing high quality consultancy services, industry expertise and management skills, which give entrepreneurs access to unique insights, advice, and the know-how to take their companies to another level.

In 2011, the EU has provided EUR 10 million for implementation of the SBS activities in the Eastern Partnership countries under EU SME Flagship initiative. In October 2013 EUR 8 Million has been provided by the EU to continue SBS operations under EU NIF, phase I. Here below are some results of this program:

- 68 EGP projects launched and 15 completed with

- **94%** of completed projects were rated as successful or highly successful
- **94%** of CEOs reported to have improved business prospects as a result of working with the EGP
- **81%** of enterprises showed an increase in turnover
- **50%** of the enterprises increased the number of employees
- **66%** of the enterprises received external investments in total of **EUR 24 million**
-

- 761 BAS projects launched with

- **70%** of one year after evaluated projects were rated as successful or highly successful
- **88%** of the BAS assisted enterprises reported an increase in turnover, on average by **48%**
- **66%** of BAS-assisted enterprises reported an increase in the number of employees on average by **19%**, and BAS contributed to the creation of **3,047 new jobs** (net)
- **16%** of BAS assisted enterprises received investments in the total amount of **EUR 33.3 million**
- **73%** of BAS assisted enterprises declared to have engaged a consultant again after the BAS project

The European Fund for South East Europe

The European Fund for Southeast Europe provides sustainable funding to micro and small enterprises helping them to grow, generate additional income and to create employment, as well as to low-income families assisting them in the improvement of their housing conditions. It does so with a strong commitment to responsible finance.

EFSE is more than just a fund: Its public private partnership model is an international role model for an intelligent and innovative development policy of the 21st century. It does not only bring together public and private investors, it also provides a platform for the coordination of donor activities in Southeast Europe. This pooling of resources multiplies the impact of budget funds towards a common goal - to promote responsible financial sector development in Southeast Europe, including the European Eastern Neighbourhood Region, ensuring micro and small enterprises and low-income private households have sustainable access to financial services.

Facts:

- **17** Partners Lending Institutions in the 6 EaP countries
- **EUR 13,4 million** average investment per PLI
- **66,8%** of the **EUR 227 million** portfolio dedicated to MSMEs
- **20581** active borrowers
- A total amount of **EUR 606 million sub-loans** disbursed since November 2009
- Technical assistance on **226 projects** with an amount of **9.8 million** since November 2009

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