

Executive summary

The Eastern Partnership (EaP) is composed of six countries (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine) which collectively cover over one million km² and are home to 74.4 million people. The region is located in the vicinity of large markets including the European Union, Russia and Turkey and benefits from a vast area of agricultural land and considerable energy and natural resources. Although the pace of structural reform varies from one country to another, the region as a whole is on a trajectory of economic transformation, shifting progressively away from a growth model based on large enterprises specialised in intermediary outputs and commodity transformation, towards a more diversified and open economic structure.

Over the last five years, the macroeconomic situation has been volatile. The region as a whole contracted in 2014-15 before starting to recover in 2016 and gradually gaining further momentum in 2017-18, supported by more favourable external economic conditions and successful macroeconomic stabilisation efforts. Going forward, sustained and resilient growth will depend on a supportive regional economic environment and on the ability of EaP countries to address remaining structural weaknesses that were revealed during the 2014-15 economic contraction, such as limited diversification and lack of competitiveness in key sectors like manufacturing, agriculture, and wholesale and retail trade.

Against this backdrop, supporting the development of small and medium-sized enterprises (SMEs) has become a clear priority for all six EaP governments. Thanks to their capacity to innovate and adapt to fast-changing market conditions, SMEs can facilitate the shift towards a more diversified and demand-driven economy, acting as engines of higher-quality job creation and sustainable growth. However, their potential in the EaP region remains untapped. Although representing up to 99% of all firms, they account for 57% of private sector employment and 47% of value-added. The vast majority of SMEs are subsistence micro-entrepreneurs operating in low-value-added sectors and with limited propensity for export.

Since the last edition of the SME Policy Index in 2016, EaP countries have made significant progress in building a more SME-friendly business environment. All six countries have been proactive in setting up a strong institutional basis for SME policy making through the design of SME strategies and the set-up of operational agencies to deliver tangible support programmes. Business-related legislation has been further simplified and regulatory barriers reduced, e.g. by streamlining registration procedures, extending the scope of e-government services and strengthening the legal framework for insolvency. Moreover, EaP governments have increasingly developed targeted support mechanisms to enhance SMEs' access to finance, skills and innovation through financial (grants, tax incentives) or non-financial instruments (expansion of business/innovation support infrastructure and business development services).

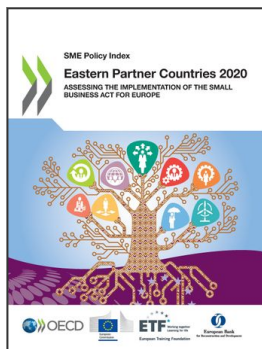
However, SMEs across the region still struggle with numerous challenges that hamper their growth and productivity. More attention should be given to establishing level-playing-field conditions for companies of all sizes and regardless of their ownership structure as a precondition for market-driven private sector growth. In addition, more tailored support

programmes are needed to increase productivity and enable SMEs to be competitive in export markets. Finally, governments need to strengthen their monitoring and evaluation systems to allow for informed SME policy making and to ensure optimal use of public resources.

Based on the assessment's findings, the report makes the following principal recommendations:

- **Establish a level playing field for all firms.** First, EaP governments need to strengthen their efforts to create a more competition-friendly business environment in which new and more efficient firms can challenge incumbents, allowing for productivity growth, stimulating innovation and enabling companies to become internationally competitive. Empowering competition agencies to stop and prevent unfair business practices – in the areas of cartels and merger control, for example – will be an important step in this direction. Second, further improving the transparency, independence and efficiency of commercial justice systems would be key to improving contract enforcement procedures, enabling SMEs to access affordable, timely and transparent dispute resolution mechanisms. And third, EaP governments should pay greater attention to promoting compliance with business integrity norms and regulations to reduce market distortions generated by unethical business practices.
- **Enhance SME competitiveness and productivity.** Further support is needed for efforts to help SMEs improve their productivity, boost their competitiveness and in turn reach new markets. To this end, it is necessary to build on the promising recent institutional changes by strengthening the capacity of SME agencies in terms of resources, staff, and scope of action to enable the delivery of targeted SME support programmes developed in close co-operation with the business community. An important instrument would be regular market research and analysis of demand for and supply of skills, which should be strengthened across the region to better identify SME needs and design support programmes accordingly. In general, EaP governments ought to carefully assess their resources and capabilities in order to deliver tailored support in a more efficient and co-ordinated manner, setting clear objectives and attributing responsibilities in an inclusive way, as well as building on the complementarities between the various areas assessed in this report.
- **Strategically invest in entrepreneurial human capital.** Without a comprehensive strategic vision of the importance of modern, internationally competitive competences and skills of citizens none of the other policy objectives will be possible to achieve – including improving the productivity, competitiveness and capacity of institutions. It is important to focus formal education and non-formal learning programmes on key competence development, ensure adequate support for and investment in teachers, and provide practical entrepreneurship experience for all students as part of education-business cooperation. To achieve quality and relevance of skills supply, education and training should be sensitive to gender- and individual target group needs, based on high-quality skills intelligence and underpinned by a comprehensive, cross-sectoral vision on human capital development goals in the country.
- **Strengthen monitoring and evaluation to allow for informed SME policy making.** Monitoring and evaluation of SME support programmes are being carried out mostly on an ad hoc basis across the region; regular evaluation of their efficiency and effectiveness, including setting and analysing result-oriented key

performance indicators, has yet to become embedded into the policy cycle. Given the increasing amount of government support for SMEs, governments need to ensure they are making optimal use of public resources. Therefore, an impact assessment should become a necessary precondition for scaling up government support measures. As new laws and regulations are being introduced and existing laws revised, an assessment of their impact would be helpful in order not to fall back into a highly-regulated economy. Moreover, it would be necessary to monitor and evaluate the impact of simplified tax regimes on business demography and SME performance, and to ensure that tax exemptions do not discourage SME growth or encourage the diversion of activity into the informal sector. Finally, it is necessary to improve the monitoring and evaluation of the current business support infrastructure and services provided, including measuring the effectiveness and impact on SME performance.



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