Chapter 6. Pillar E – Innovation and Business Support

Substantial productivity gaps persist between SMEs and large companies in the Eastern Partner region. Targeted policies should therefore be implemented to foster a productive, innovative, and green SME sector. Pillar E assesses the reforms implemented by governments to support SMEs in overcoming challenges to productivity and promoting innovation.

All EaP countries have made progress in the Business development services dimension as all governments have incorporated BDS provision into relevant strategic frameworks. They have also advanced in the Innovation policy dimension with dedicated national strategies adopted, awaiting governmental approval, or underway. However, the focus on SMEs is still limited and monitoring tools remain underutilised. The EaP countries have also made some progress in the Green economy dimension, as policies that support the greening of SMEs have been introduced, albeit with varying degrees of detail.

Further challenges involve the development of incentives for private BDS expansion, the promotion of formal and informal channels for science-industry interactions, and the strengthening of green SME policies by linking them to concrete action plans with measurable targets and timeframes, as well as raising awareness among SMEs of the benefits of adopting green practices.

Introduction

Support to SMEs and incentives to innovation are fundamental elements to enhance competitiveness and boost productivity. Productivity growth is a key driver of economic growth and convergence. It is also the channel through which countries generate the resources needed to lift standards of living and reduce inequality.

Small and medium-sized enterprises (SMEs) are generally less productive than large companies, although this difference varies across sectors and countries. Productivity gaps between firms of different sizes are particularly evident in the manufacturing sector, where production tends to be more capital-intensive and larger firms can exploit increasing returns to scale. A recent analysis of a subset of OECD countries shows that the labour productivity levels of micro, small and medium enterprises in manufacturing are 37%, 62% and 75% those of large companies, respectively. By contrast, productivity gaps are less stark in the services sector, and narrowest in retail trade, which tends to display low labour productivity overall. (Marchese et al., 2019[1]; OECD, 2019[2])

At the macro level, determinants of productivity include framework conditions such as the quality of the competitive environment, the efficiency of the judiciary, the extent of financial market development, and the extent to which economic institutions are facilitating access to inputs and allocation of capital and labour to their best use. At the firm level, drivers of productivity performance relate mainly to managerial/workforce skills and the rate of adoption of innovations.

If skills and innovation are critical for firms of all sizes, the challenge is particularly evident for SMEs, which confront specific obstacles in accessing information, advanced training and consulting, and innovation inputs (such as new technologies, R&D, skilled labour, and knowledge-based capital). Governments can support innovation in SMEs by helping them to develop and use their internal resources effectively, and by building innovation systems that are effective in the commercialisation of research, the absorption of and experimentation with new ideas more broadly, and the inclusion of a large range of SMEs. (OECD, 2019[3]).

From the perspective of the entrepreneur, increasing productivity and introducing innovation-oriented practices are crucial to competitiveness, entry into new markets, and growth. In this respect, the green transformation of SMEs and the need to respond to environmental challenges offer significant business opportunities and could be sources of competitive advantage.

This pillar brings together three dimensions of the assessment, which look closer at the policies in place to foster a productive, innovative, and green SME sector: 1) business development services, 2) innovation policy for SMEs, and 3) green economy policy for SMEs. As such, it is highly connected to other dimensions analysed in the other pillars. Investments in entrepreneurial learning and human capital can directly raise productivity and increase SMEs' ability to develop and adopt new technologies. Enterprise skills, obtained and developed by SME staff and managers through training, are an important means of enabling businesses to make effective use of their full potential. Furthermore, an increase in productivity, quality and innovation can be achieved thanks to SMEs' internationalisation, which exposes firms to international competition, new knowledge and helps them achieve economies of scale. Lastly, productivity gains and innovation-oriented practices can arise only in an effective institutional and regulatory environment that 1) reduces the transaction costs of economic activities and 2) ensures that economic gains

from starting and growing businesses are not expropriated and can be devoted to the generation and diffusion of innovations.

As presented in Figure 6.1, the regional average score for each one of the dimensions in pillar E has increased respect to the previous assessment. Particularly noteworthy is the progress achieved in the *Green economy* dimension, whose average score increased by 39%.

Figure 6.1. SME Policy Index scores for Pillar E: Innovation and Business Support

Regional scores, 2020 vs. 2016

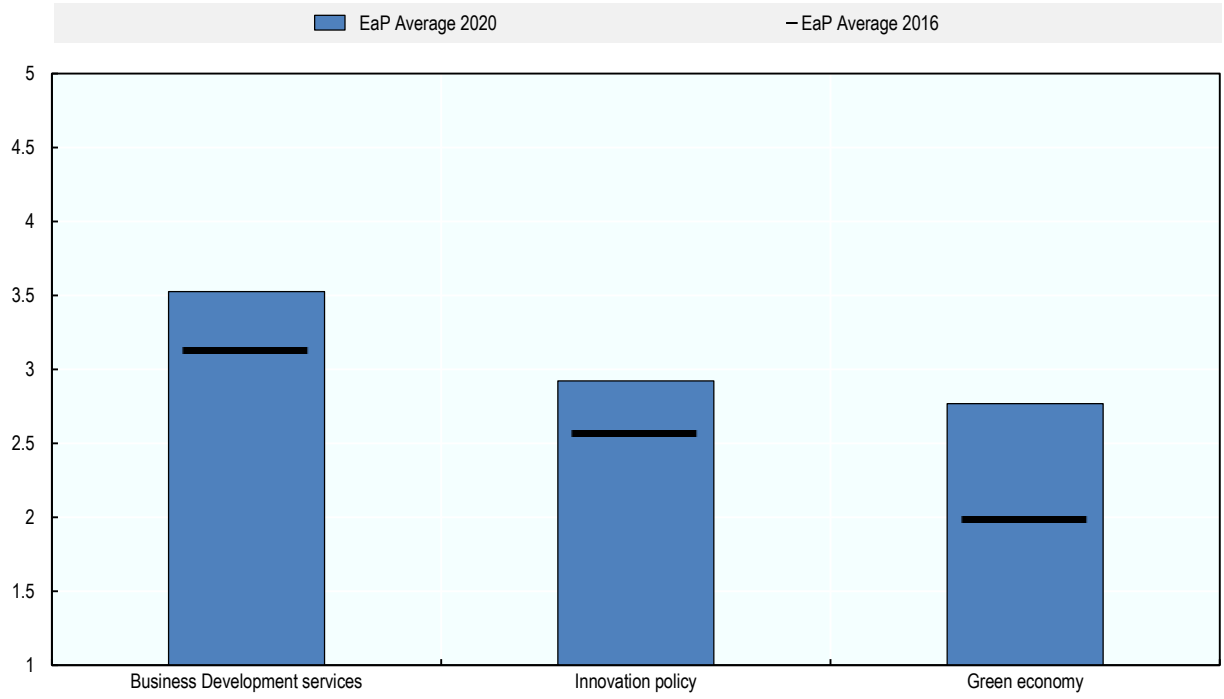

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Table 6.1. Country scores by dimension and sub-dimension, 2020

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average 2020	*EaP average 2016*
Business Development Services	**4.00**	**3.27**	**3.11**	**4.39**	**3.47**	**2.90**	**3.53**	***3.13***
Services provided by government	*4.12*	*3.47*	*3.27*	*4.64*	*3.86*	*2.76*	**3.69**	*3.54*
Initiatives to stimulate private BDS	*3.89*	*2.87*	*2.96*	*4.15*	*3.08*	*3.05*	**3.33**	*2.72*
Innovation policy	**2.96**	**2.83**	**3.21**	**3.27**	**2.99**	**2.28**	**2.92**	***2.57***
Policy framework for innovation	*2.99*	*2.88*	*3.92*	*3.10*	*3.29*	*2.50*	**3.11**	*2.36*
Government institutional support services	*2.53*	*2.50*	*2.95*	*3.58*	*2.52*	*2.63*	**2.78**	*2.87*
Government financial support	*3.03*	*2.96*	*2.83*	*3.39*	*2.83*	*1.63*	**2.78**	*2.89*
Non-technological innovation and diffusion*	*3.29*	*2.92*	*2.42*	*3.18*	*3.04*	*2.12*	**2.83**	-

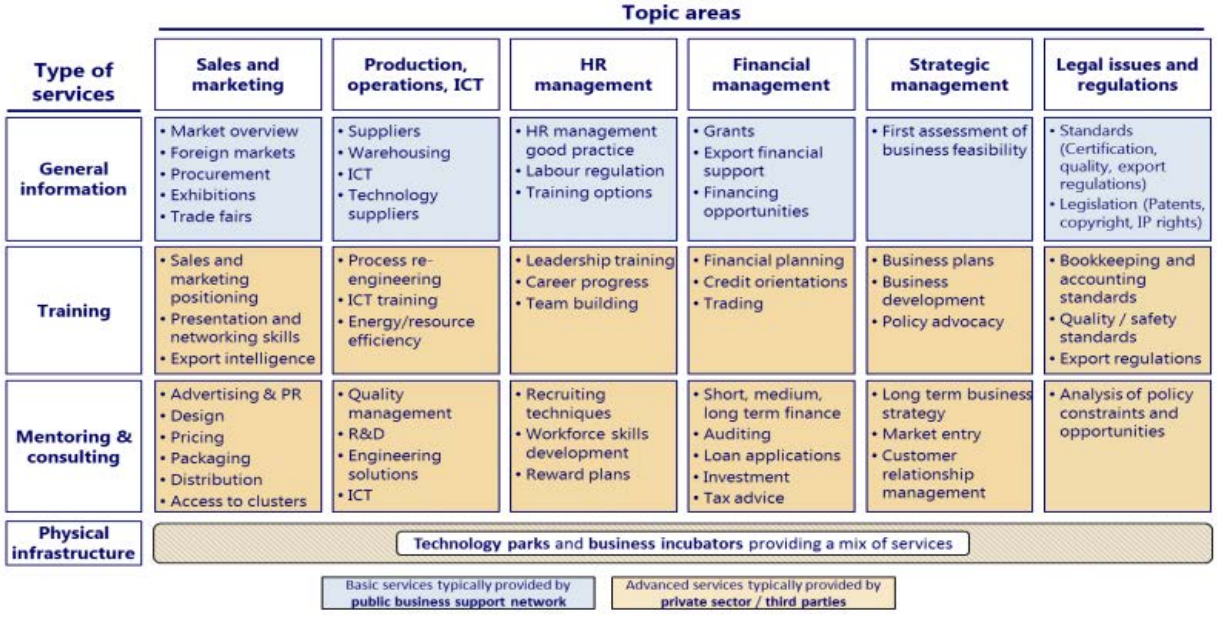
	ARM	AZE	BLR	GEO	MDA	UKR	EaP average 2020	*EaP average 2016*
Green economy policies	**2.40**	**2.31**	**3.41**	**3.05**	**2.92**	**2.54**	**2.77**	***1.99***
Environmental policies	*2.56*	*3.04*	*3.27*	*3.85*	*2.53*	*3.52*	**3.13**	*2.65*
Incentives and instruments	*2.28*	*1.81*	*3.50*	*2.51*	*3.18*	*1.89*	**2.53**	*1.55*

Note: The dimension score is the weighted average of the sub-dimension scores. The following methodological changes have been introduced in the 2020 assessment, which should be taken into account when observing trends in SME Policy Index scores: Under the *Innovation policy* dimension there is a new sub-dimension: *Non-technological innovation and diffusion*.
* This sub-dimension has been introduced in 2020 and was not covered in previous assessments.

Business Development Services

Business development services (BDS) enhance the performance of individual businesses, allowing them to compete more effectively, operate more efficiently and become more profitable (Committee of Donor Agencies for Small Enterprise Development, 2001[4]). Such services include information provision, training, consulting and mentoring on a wide range of topics, from sales and marketing to strategic management and legal issues (Figure 6.2). Entrepreneurs with limited skills and knowledge in the area of starting and operating a business can benefit significantly from BDS, which save time and resources, help to evaluate potential business opportunities, and encourage SMEs to enter and explore new markets. Ultimately, BDS allow firms to focus on their core competencies, while outsourcing non-core tasks to specialised advisors and reducing search costs for relevant information. More-advanced BDS can also provide firms with the knowledge and resources required to innovate, grow and internationalise.

Figure 6.2. Business development services: topic areas and types of services



Source: (OECD, 2017[5]).

However, BDS markets generally suffer certain gaps and information-related failures regarding both the demand and supply of BDS, which disproportionately affect SMEs:

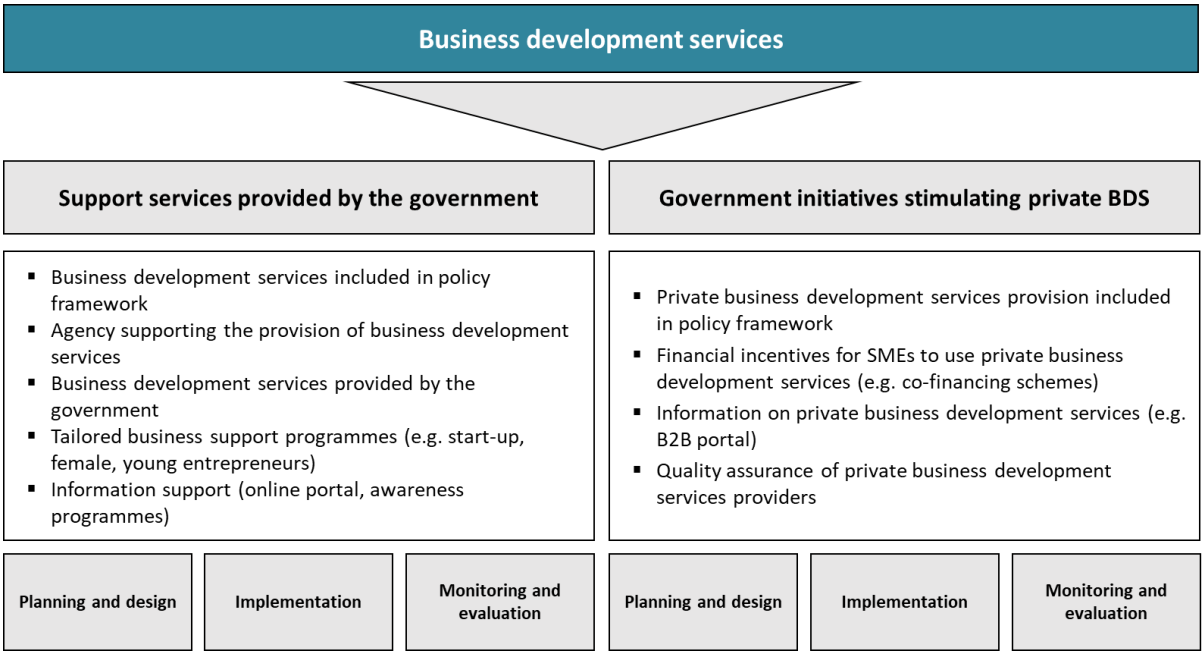
- On the demand side, due to the fact that BDS are "experience goods"[1], SMEs often have minimal *ex-ante* knowledge about the effectiveness and potential impact on firm performance, which limits their expenditure on such services. They also lack information on the availability of BDS and the type of support required, which may vary depending on the type of activity of the firm and its stage of development.
- On the supply side, BDS providers often lack adequate and up-to-date information on the SME training needs required to be able to provide tailored and timely business support. Private BDS providers may also lack the needed skills and face insecurities regarding compensation from SMEs and would therefore prefer working with larger companies due to more substantial contracts, longer engagement and less-risky payments.

Identifying market failures – which are typically the result of information asymmetries, lack of trust between parties, and financial gaps – should be a first step in designing sound policy frameworks regarding the provision of BDS to SMEs. Governments should intervene only to address these market failures, while taking care not to crowd out private initiatives. Policy interventions are then required to ensure that SMEs are informed about the benefits and availability of support services (e.g. information campaigns, awareness raising) and, if needed, incentivised (e.g. co-financing mechanisms) to make use of these. This approach would encourage the development of a sustainable market in BDS provision, shaped by demand and based on a clear understanding of company needs and expectations.

Assessment framework

This dimension considers the availability, accessibility and effective implementation of targeted institutional support services for SMEs. It also assesses the role of governments in identifying and addressing market failures in BDS delivery through public policy tools, such as government-led business support infrastructure and initiatives to promote the development of private BDS markets.

Figure 6.3. Assessment framework – Business Development Services



SME support services provided by the government

The first sub-dimension assesses the recognition of business development services in the overall SME policy framework, including the national SME strategy or equivalent document, to ensure a co-ordinated and strategic approach to providing such services.

Further, this dimension looks at the extent to which public institutions provide targeted BDS to address market failures. In particular, information on starting and operating a business can be provided through a dedicated web portal as well as directly through the relevant institutions. Services should be tailored to the specific needs of each SME segment (e.g. start-ups, exporting firms, high-growth SMEs) and may cover different areas, from market access and infrastructure to access to financial resources or policy advocacy. These services can be delivered through a dedicated SME agency (or equivalent, e.g. a business incubator), often through outsourcing to private providers. Systematic monitoring and evaluation of the services provided (e.g. through feedback surveys) are required to ensure quality control and tailor the existing programmes to the entrepreneurs' specific needs. To raise awareness of SMEs about existing support services and their benefits, information sessions and outreach events for entrepreneurs can be organised. The provision of free services should be considered with care in order to avoid distorting the market and/or reinforcing SMEs' misperceptions about the value and expected benefits of those services.

In general, government interventions should be carefully designed so as to avoid hindering the development of private markets, as well as to ensure that the support programmes are sustainable over time.

Government initiatives stimulating private business development services

The second sub-dimension assesses the mechanisms in place to promote the development of private markets for business development services and stimulate the use of private BDS by SMEs. These include both financial and non-financial incentives.

The development of a private market for BDS is crucial. The expansion of such a market, brings an increase of competition among private providers on the prices and the quality of the services provided. The reduction in the prices makes the services more accessible to SMEs, who are often financially constrained. The increase of the quality ultimately brings higher demand for BDS. However, the effect of competition on quality depends on the extent to which consumers are aware of the services offered and perceive their quality.

Lack of awareness among SMEs about BDS and their providers often results in demand for such services falling below its potential. The government can play a matchmaking role between the private BDS providers and SMEs by offering relevant information on a dedicated website/portal (e.g. a list of private BDS providers) or through information campaigns. Likewise, governments may want to intervene to upgrade the capacity of private BDS providers to respond to the evolving needs of SMEs (OECD et al., 2015[6]). Finally, governments also operate as regulators of BDS markets and may encourage the development of private operators by removing regulatory barriers or introducing quality standards and clear frameworks in key BDS areas (e.g. accounting, legal services).

The limited financial resources of SMEs, coupled with misperceptions about the value and benefits of BDS, often prevent SMEs from contracting private consultancies. To correct for this, governments, on local, regional and national levels, can consider targeted financial incentives (e.g. co-financing mechanisms, vouchers for the purchase of private services). These instruments need to be designed to avoid any market distortions and should take into account the capacity of entrepreneurs to pay. The potential benefits of simple, well-designed co-financing mechanisms (e.g. for first-time use) are clear: SMEs find a way to test advisory services for which they would be willing to pay in the future, and providers of BDS increase their knowledge about the needs of a new segment of clientele. A peer-to-peer effect might also take place wherever a successful recipient of the incentives transfers knowledge to other SMEs.

Analysis

Business development services allow SMEs to compete more effectively, operate more efficiently and become more profitable. This dimension considers the availability, accessibility and effective implementation of targeted support services for SMEs provided by the government, and the role of governments in encouraging and stimulating private BDS provision.

All EaP countries have made incremental progress in this dimension since 2016. Although all governments have now included BDS provision into relevant strategic frameworks, the top performers are Georgia, Armenia and Moldova, where dedicated SME agencies provide a wide palette of services to entrepreneurs. In Belarus, the Ministry of Economy is currently developing a concept note for the establishment of an SME agency, which should improve BDS provision; while Azerbaijan's newly established Small and Medium Business Development Agency (SMBDA) is undergoing a major restructuring of the highly fragmented business-support infrastructure. In Ukraine, the establishment of the SME Development Office co-ordinating the provision of BDS has led to the most significant improvement among the EaP countries since the 2016 assessment. However, the newly established agency still lacks a basic information portal to provide learning and awareness-raising opportunities to remotely located SMEs.

Private BDS markets need further development incentives in the region. In fact, competition between private providers would bring quality and ultimately higher demand for BDS. Only a few countries list private consultancy companies on governmental / SME

agency websites or online portals (Armenia and Moldova), outsource some of the training and consultancy services (Armenia, Georgia, Moldova and Ukraine), and make use of co-financing mechanisms or voucher schemes, which would allow SMEs to choose their preferred private service providers and cover part of their expenses for BDS (Georgia, Moldova; Ukraine for the agribusiness sector only).

In 2017, SMEs in Armenia, Belarus, Moldova, Ukraine and, to a greater extent, in Georgia benefitted from publicly funded or co-funded support in the form of general information (on legislation relevant to starting a business, developing a business plan, etc.), training, mentoring and consulting (Table 6.2).

Table 6.2. Provision of publicly (co-)funded business development services to SMEs (2017)

Number of SMEs/entrepreneurs benefitting, by service category

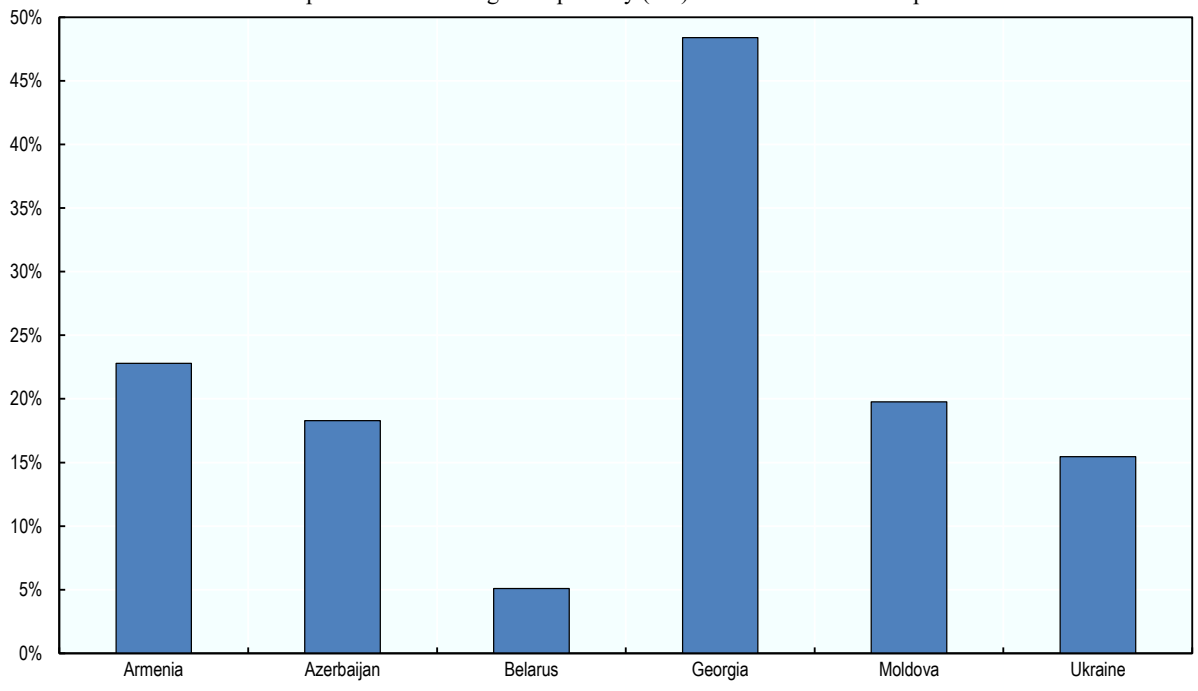
	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
General information	9 990	-	2 070	34 790	3 751	-
Training	2 808	-	1 321	25 144	2 467	-
Mentoring and consulting	500	-	2 223	385	412	-
Total	**13 298**	**31 000**	**5 614**	**60 319**	**6 630**	**242 745**

Note: Disaggregated data not available; 2018 data for Belarus.
Source: Statistical offices, ministries and SME agencies of EaP countries.

Figure 6.4 shows the variation in SMEs' uptake (the number of benefitting SMEs versus the total number of SMEs) of publicly funded and co-funded BDS across the EaP region, with Georgia representing a much larger share than the others. While around half of all SMEs in Georgia benefitted from publicly supported BDS in 2017, only a sixth of SMEs did so in the EaP countries on average.

Figure 6.4. SMEs' uptake of BDS (2017)

% of SMEs/entrepreneurs benefitting from publicly (co-)funded business development services



Note: 2018 data for Belarus.
Source: Statistical offices, ministries and SME agencies of EaP countries.

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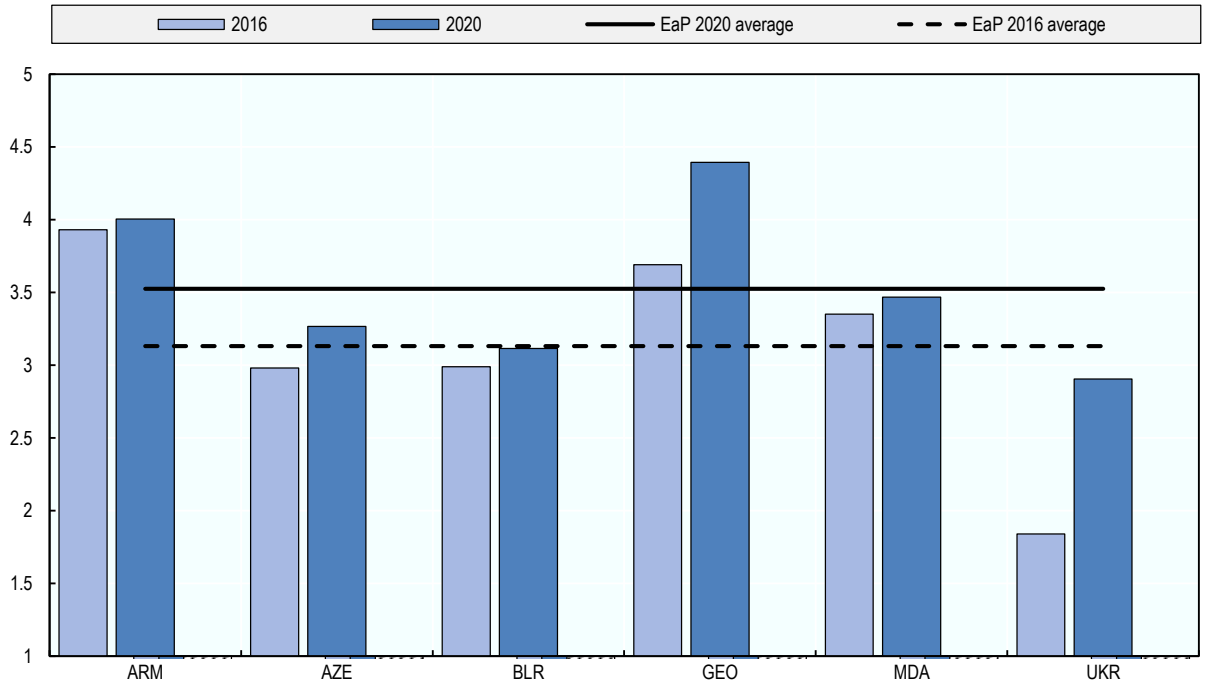
The results of the SBA assessment show that all EaP countries have made progress in the business development services dimension since 2016, with modest score increases for all countries starting from an already strong base and a noteworthy improvement by Ukraine (Figure 6.5). As a result, this dimension is the fifth best-scored in this assessment round, with an average score of 3.53.

All EaP governments have now included BDS provision into relevant strategic frameworks and expanded the direct provision of services to SMEs. However, the provision is rarely based on SME needs analysis and market research; result-oriented monitoring and evaluation beyond the number of conducted activities and number of companies benefiting from support is not available yet. The top three performers in the region – Armenia, Georgia and Moldova – provide a wide range of services to entrepreneurs through their dedicated SME agencies (Enterprise Georgia, SME DNC and ODIMM), ranging from general information sessions on how to start a business to targeted support services for specific firm-segments (e.g. start-ups, high-growth enterprises). The lack of a dedicated institution for the provision of SME support programmes and/or limited co-ordination among existing bodies render the provision of BDS to SMEs more difficult, as is demonstrated by Belarus's and Azerbaijan's performance, respectively.

Figure 6.5. Scores for the *Business Development Services* dimension compared to 2016



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More remains to be done in all six countries to take a move towards a market-based provision of business development services. Co-financing mechanisms, easily linking SMEs and private providers, are available only for selected programmes in certain countries (e.g. Georgia, Moldova and Armenia, and only starting in Ukraine); indirect instruments, such as sub-contracting private training providers, remain the governments' preferred option. No quality-assurance or reputational mechanisms, which could help spur competition, quality and ultimately the demand for privately provided services, are yet in

place (with the exception of Moldova, where ODIMM's website offers firms the option to rate their experience with private BDS providers). Finally, digital business diagnostics and self-assessment tools could make initial advice more accessible and ensuing BDS provision more efficient by highlighting challenges and priorities at an early stage (see Box 6.1 for an example of successful IT platform for business diagnostics).

Box 6.1. French Chambers of Commerce – IT platform for business diagnostics

Online business diagnostic tools represent a low-cost approach to encouraging and supporting SMEs to benchmark their business performance and to identify potential areas for improvement. However, they mostly require relatively codified information for their operation and produce generic advice. The impacts are also likely to be low unless combined with additional face-to-face diagnostic support and advice. Although digital business diagnostic tools may appear in the private market, public agencies can have a significant role to play in their development because of the importance of firm-level benchmarking data from official sources and the need for data protection.

An important use of digital diagnostic tools can therefore be as an entry point to other business advice services, through self-referral by SME managers. Upon completion of the digital diagnostic, the tools can point the managers and entrepreneurs to further information, advice and resources that they can use to help improve their firm's performance in priority areas identified.

In France, the Permanent Assembly of Chambers of Commerce and Industry has developed an IT platform that automatically draws up a summary report on the situation of any given SME, based on its answers to a questionnaire. The SME can then use the results of this diagnostic to revise its priorities and areas requiring further support or allocate additional resources, in one or more of the following domains: 1) administrative and financial management; 2) commercial and marketing aspects; 3) production, purchasing and supplies; 4) human resources management; and 5) the future of the business. The success of this initiative derives from its ease of use, the fact that it can be adapted to the requirements of very small businesses, and the "bottom-up" approach adopted.

To date, it has been expanded to cover more than half of the 104 Chambers of Commerce and Industry in France in 26 regions. So far, more than 10 000 diagnostics have already been carried out, but it is expected that, once this approach expands and becomes increasingly available and better known across France, this digital diagnostic tool will support the assessment of an additional 10 000 SMEs every year.

Source: (OECD, 2018[7]).

Government provision of BDS would benefit from regular SME needs analysis and market research, as well as result-oriented monitoring tools

The first sub-dimension assesses whether BDS are recognised in the overall SME policy framework.

All EaP countries have made considerable progress in including and recognising the importance of BDS provision in relevant strategic documents (e.g. SME strategies, action plans, roadmaps). However, in all EaP countries, the setting of priority actions has been undertaken without prior SME skills/training needs analysis or research on BDS supply and demand – and thus without an analysis of market gaps and failures.

Table 6.3. Scores for the *Support services provided by the government* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.83	3.92	2.83	4.83	3.17	3.17	3.63
Implementation	4.78	3.60	3.61	4.89	4.72	3.17	4.13
Monitoring & evaluation	3.13	3.38	3.25	3.75	3.13	1.13	2.96
Weighted average	**4.12**	**3.67**	**3.27**	**4.64**	**3.86**	**2.76**	**3.72**

Note: see Annex A for information on the assessment methodology.

Armenia, Georgia, Moldova and Ukraine rely on their SME agencies to co-ordinate the business support infrastructure and/or provide SME support. As for Belarus, which only recently adopted its SME Strategy 2030, the Ministry of Economy is currently developing a concept note for the establishment of an SME agency, which should improve BDS provision by restructuring the entire business support infrastructure. Azerbaijan, which has recently established its Small and Medium Business Development Agency (SMBDA), is currently undergoing a major restructuring of its highly fragmented business support infrastructure, and the results of this undertaking are yet to be determined.

At the implementation level, basic business-related information is available on dedicated SME agency or ministry websites and online portals in all EaP countries with the exception of Ukraine. However, although government SME support programmes and services have been growing in the past few years, they remain limited in size and uptake (Figure 6.4). The countries with established SME agencies, such as Enterprise Georgia, Armenia's SME DNC and Moldova's ODIMM, have by now accumulated substantial experience in providing entrepreneurs with a wide array of services, many of which are offered free of charge. Georgia, the top performer in this dimension, offers targeted SME support programmes, designed in close co-operation with the private sector and delivered through strong institutional channels, including Enterprise Georgia, GITA (targeted at innovative SMEs) and the Agricultural Projects Management Agency (targeted at the agriculture sector). All three agencies have well-established connections with donors and manage donor-funded BDS programmes (e.g. a full-cycle Start-up Business Support programme in Armenia).

In this assessment round, Ukraine showed the most notable progress, thanks to its newly established SME Development Office (SMEDO) co-ordinating the provision of BDS in the country. It oversees the Ukrainian business-support infrastructure, which comprises around 500 business support centres, incubators and technology parks that offered around 25 000 training events and seminars in 2018. In addition, SMEDO launched an entrepreneurship support network jointly with several municipalities. The network, active in Ternopol, Cherkasy, Chernigov and Zaporozhe, provides access to information on microbusinesses, available state support and local BDS providers, as well as offering business regulation consulting.

Provision of BDS could be improved in Belarus and Azerbaijan. Since 2016, the number of certified business-support entities in Belarus that are eligible for government support grew by 50% (incubators) and 10% (business support centres). However, the limited co-ordination and lack of monitoring and evaluation, paired with unclear benefits and criteria for obtaining the status of business support entity, hamper the efficient provision of BDS to SMEs. In Azerbaijan, the Baku Business Training Centre has traditionally been a key player in this dimension: until 2018, it provided BDS to SMEs free of charge based on SME needs analysis. However, the large-scale institutional redesign and the establishment

of SMBDA have put into question the continuity of service provision, which is yet to be determined.

Overall, formal result-oriented monitoring and evaluation of the existing business development measures and infrastructure occurs on an ad hoc basis, leaving missing evidence about the effectiveness of SME support programmes and services. Criteria including quality, efficiency and client satisfaction could be adopted to measure the impact of BDS on SMEs' revenue, productivity or other performance criteria to improve government provision of BDS.

Uneven stages of development of private BDS markets in the EaP countries require further incentives to ensure sustainability of private BDS provision

This sub-dimension measures government mechanisms to promote the development of private markets for BDS provision and to stimulate the use of private BDS by SMEs.

BDS provision in EaP countries is still far from market-based – with a few exceptions including Armenia, Georgia and Moldova, which are starting to involve more and more private providers in the provision of BDS. In the three countries, private sector involvement in BDS provision has been ensured through a co-financing mechanism implemented by the national SME development agencies. Moreover, the agencies' websites list private sector BDS providers. Because basic government services are often free of charge (and as such mostly reliant on state or donor budgets), these services might also distort market competition and inhibit the development of a private sustainable BDS market by discouraging entrepreneurs from paying for such services. Limited financial resources, coupled with low awareness rate of BDS availability and benefits, could explain the relatively low uptake of private BDS in EaP countries, except for Georgia.

Table 6.4. Scores for the *Government support for private BDS* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	4.00	2.75	3.75	3.50	2.50	4.00	3.42
Implementation	4.43	3.34	3.00	4.71	4.00	3.00	3.75
Monitoring & evaluation	2.50	2.00	1.50	4.00	2.00	1.50	2.25
Weighted average	**3.89**	**2.87**	**2.96**	**4.15**	**3.08**	**3.05**	**3.33**

Note: see Annex A for information on the assessment methodology.

To bridge those gaps and stimulate the use of private BDS, EaP governments can make use of several tools and incentives, which could be expanded in the near future:

- First and foremost, governments can list private consultancy companies on governmental or SME agency websites or online portals (Armenia and Moldova), ideally including an option to rate the company and service received (e.g. Moldova's ODIMM).
- A second step consists of outsourcing some of the training and consultancy services provided as part of a technical assistance component of comprehensive SME support programmes to private providers (Armenia, Georgia, Moldova, Ukraine).
- Finally, some EaP countries make use of co-financing mechanisms or voucher schemes, which would allow SMEs to choose their preferred private service providers and cover part of their expenses for BDS (Georgia, Moldova; Ukraine for agribusiness sector only).

Certification programmes and quality-assurance or reputational mechanisms for private providers are in in their infancy. Moldova has paved the way with ODIMM's online portal enabling SMEs that have benefitted from training to rate their experience and make it visible to other firms. Ukraine and Belarus have made a first step in the direction of certification programmes with their plans to offer support to private consultancies in order to increase their professional standards and enhance their offer towards higher-value-added services.

The EBRD's Advice for Small Business Programme, which operates in all EaP countries, is also worth mentioning, given its support to enable SMEs to access local consulting services and to develop a sustainable infrastructure of business advisory services. The programme provides co-financing for SMEs to retain local and international consultants, as well as capacity building for consultants in EBRD's countries of operation. The programme has strong demonstration effects and has acquired a solid track record as well as in-depth knowledge of domestic BDS markets.[2] Since 2010, 1919 SMEs in the EaP countries have received advisory assistance, 72% of SMEs increased their turnover within a year of project completion, 60% of SMEs increased their number of employees, and €194.8 million in financed was accessed by beneficiary SMEs from the EBRD and other financial institutions.[3]

Overall, private BDS markets need further development incentives in EaP countries. The three above-mentioned steps could be implemented in all countries and co-financing schemes expanded to various sectors, thus stimulating BDS uptake and firms' initiative.

Box 6.2. Developing a sustainable market for business development services: *Produce in Georgia*

In Georgia, a co-financing mechanism implemented by Enterprise Georgia within the framework of the *Produce in Georgia* programme covers part of the costs of participating SMEs that contract private consultants.

Produce in Georgia programmes are designed after extensive formal and informal consultations with stakeholders, as well as research on market failures and SME needs. Data on programme implementation is systematically collected by the implementing organisations and presented in regular progress reports.

The programmes comprise various sub-programmes such as the industrial component "Host in Georgia" or the Micro and Small Business Support component. Sub-programmes include financial support and a mandatory technical assistance component, which facilitates entrepreneurs' access to BDS related to the introduction of technologies, training and consultation on management, productivity, sales and marketing, financial accounting, and the introduction of technical standards.

Companies co-finance up to 20% of the consultancy/training costs, while the state pays up to GEL 10 000 (~ EUR 3 000*) directly to BDS providers. To obtain state support, a firm must provide a written analysis of its current operations combined with the rationale for its interest in consulting services, a detailed description of the project, projected results, and the credentials of the selected consultants. Hence, SMEs are free in their choice of BDS providers, representing a best practice among the EaP countries.

Source: (Enterprise Georgia, 2018[8]).
Note: Exchange rates as of October 2019, https://www1.oanda.com/lang/it/currency/converter/

The way forward

Despite the above-mentioned efforts, more could be done to help countries move towards a more market-based and sustainable provision of BDS:

- All EaP countries could **establish a solid co-ordination mechanism among all bodies involved in BDS provision**, as a prerequisite to ensuring effective and targeted delivery of services to SMEs. This is especially true for Azerbaijan and Belarus, which, respectively, are undergoing a major restructuring (with the recent establishment of SMBDA and a multitude of substructures, with at times overlapping mandates and activities) and starting to establish an SME agency as co-ordinating body for BDS.
- All EaP countries could **improve their monitoring and evaluation of the current business support infrastructure and services provided**, including measuring the effectiveness and impact on SME performance via quantitative measures, annual reviews. This should go hand in hand with regular SME skills-needs analysis and research on demand and supply of BDS to offer the most needed and relevant services for firms.
- Belarus, Georgia, and Ukraine should **develop single information portals** that 1) contain information on all institutions and bodies offering support programmes which include BDS components and 2) list private quality-assured BDS providers, to bridge the information gap among SMEs on the value and benefits of such services. These information portals could also have digital business diagnostic tools embedded into their websites.
- All EaP countries should **consider establishing quality assurance mechanisms for private providers**, such as certification programmes, upscale training organised and funded by the government, and/or reputational mechanisms with online reviews and ratings from SMEs (this is already established in Moldova).
- In general, there is a need to **move towards a more market-based provision of quality BDS to SMEs in the EaP region**. Governments should move away from being direct providers of BDS to becoming regulators and promoters of private services. To this end it is important to offer simple co-financing mechanisms for first-time use of BDS, enabling firms to choose their preferred private providers and thus stimulating BDS uptake and individual initiative. Where such mechanisms are already in place, they can be scaled up, moving away from dependency on donor support, and expanded to further support programmes.

Innovation policy for SMEs

The OECD/Eurostat *Oslo Manual* (4th edition) defines a business innovation as "a new or improved product or business process (or combination thereof) that differs significantly from the firm's previous products or business processes, and that has been introduced on the market or brought into use by the firm" (OECD/Eurostat, 2018[9]).[4]

The manual also distinguishes between three types of innovation, based on their degree of novelty: an innovation can be new to the firm, new to the market or new to the world. The first type refers to the diffusion of an existing innovation (the innovation may have already been adopted elsewhere, but it is new to the firm). Innovations are new to the market when the firm is the first to introduce the innovation to its market (based on product or

geography). An innovation is new to the world when the firm is the first to introduce the innovation for all markets and industries.

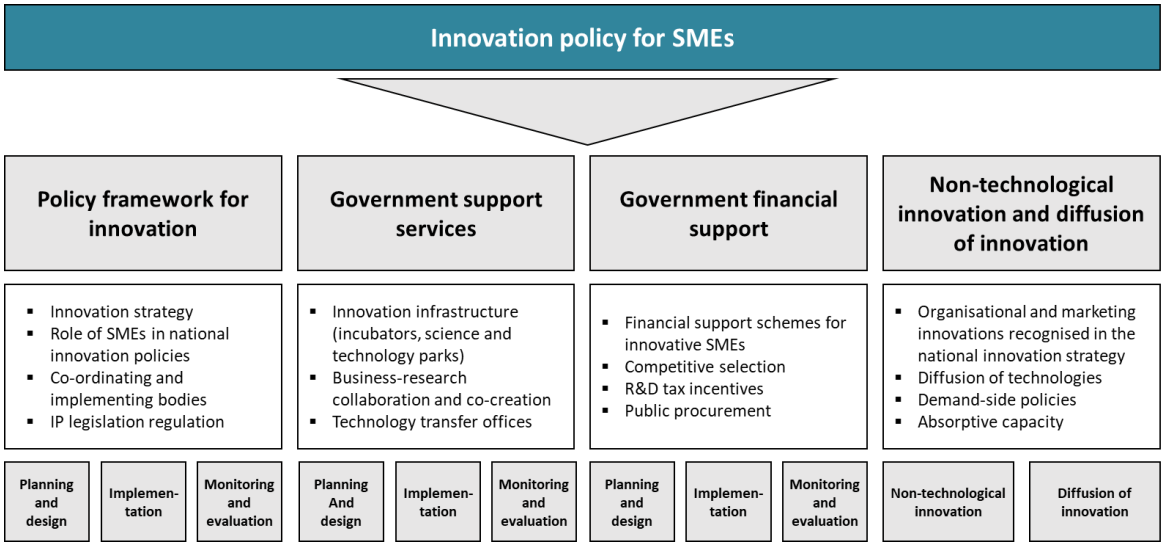
SMEs play a central role in the generation and diffusion of innovations. However, due to their limited size and limited financial and staff capacity, SMEs often face difficulties in developing and scaling up innovative activities over a long time. Although SMEs cover a wide spectrum of firms, with many of them being innovation leaders in their field, evidence suggests that SMEs tend to introduce fewer new products and technologies than large, more established firms, but also that they are fast and flexible in developing and commercialising higher-quality and "breakthrough"-style innovations (OECD, 2010[10]). Many SMEs with innovative ideas and competitive products face challenges in developing prototypes, going to market, and scaling up their operations. These can often only be overcome through co-operation with large enterprises (which have greater purchasing power and easier access to diverse markets) or investors. As both clients of and suppliers to large enterprises, SMEs also contribute to the innovation activities of these larger entities.

Government support for innovation often takes the form of public investment in science and R&D. While such a role is key to sustaining basic research and developing general-purpose technologies (Mazzucato and Perez, 2014[11]), policy makers should also foster innovation at the enterprise level – by building an ecosystem conducive to co-operation among firms and with research centres, facilitating access to technology, protecting intellectual property, and introducing financial incentives for firms to engage in innovative activities.

Assessment framework

The assessment framework for this dimension has been slightly updated since 2016, with the inclusion of a set of questions to capture policies supporting non-technological innovation and diffusion of innovation in the economy. Four sub-dimensions have thus been considered in this round of SBA assessment: 1) the strength of the policy framework for innovation (with particular reference to SME innovation); 2) government support services for innovative SMEs; 3) government financial support for innovative activities; and 4) policies designed to spur non-technological innovation and diffusion of innovation (Figure 6.6).

Figure 6.6. Assessment framework – Innovation policy for SMEs



Policy framework for innovation

This sub-dimension looks at the level of development of the overarching policy framework for supporting innovation in the business sector, with a specific emphasis on SMEs. In particular, the assessment focuses on the existence and quality of innovation strategies, the adoption of well-resourced action plans with SME-specific initiatives, the presence of a co-ordinating body tasked with developing innovation policy in consultation with the private sector, IP legislation regulation, and the regular monitoring of the impact of various policy measures.

Well-performing policy frameworks can pivot around a single strategic document presenting a medium-term vision for the country's innovation ecosystem, and/or rely on other strategic policy documents (e.g. national strategies for entrepreneurship, education and science, industrial policy). They should keep a close focus on the core objectives of innovation policy, i.e. fostering investment in R&D and innovation activities inside the firm, facilitating prototyping and commercialisation, and promoting research-industry technology transfer and co-creation. Moreover, the strategic documents should be underpinned by capacity to develop and implement innovation policy instruments and by the governments' ability to ensure effective co-ordination among relevant stakeholders.

Government support services for innovative SMEs

The second sub-dimension captures the availability and quality of institutional measures to support innovation in the SME sector, with a focus on innovation infrastructure – incubators, science and technology parks, innovation centres, and technology transfer offices.

Best practices in this area recognise the need to support both "breakthrough" and "incremental" innovators. While the former include highly innovative firms often experiencing high-growth, the latter consist of those SMEs that usually outsource R&D and prefer to obtain a license for patents or adopt existing technologies and use them to introduce new products or processes to their operations. In both cases, governments can facilitate SMEs' access to knowledge, skilled personnel and laboratories by directly establishing innovation support organisations (science parks, technology transfer offices), clarifying the legal framework for licensing and intellectual property, setting up incentives for commercialisation of publicly-funded research, and increasing SMEs' awareness of the research capabilities available in the country.

Government financial support

The third sub-dimension examines the availability of direct and indirect financial support measures to encourage SMEs to innovate. These can take the form of grants, soft loans, guarantees, and even equity investment (direct support), as well as broad-based fiscal incentives such as tax breaks and credits on R&D expenditures or investment in innovative equipment (indirect support). The role of demand-side policies such as public procurement of innovation is also considered here.

Small, knowledge-intensive companies can face additional obstacles to obtaining financing due to the relative intangible nature of the assets they might be considering posting as collateral and the risk inherent in innovation, which makes future cash flow projections uncertain. Governments can help SMEs overcome such obstacles by making it easier for firms to engage in innovation activities and reducing the financial risk of investing in innovative projects. Well-designed financial support aims at "crowding-in" private

investment in R&D, typically requiring a matching component from the beneficiaries in the case of direct support, and letting businesses decide on the nature of their innovative activities in the case of indirect fiscal incentives. Furthermore, effective financial support measures acknowledge the complexity of engaging in innovation activities and accompany firms along the entire innovation cycle (development, engineering, production and commercialisation).

Non-technological innovation and diffusion of innovation

The fourth and final sub-dimension is introduced with this round of SBA assessment and looks at policy interventions to strengthen non-technological innovation (organisational or marketing processes) as a complement to more conventional support for science and technology. It also captures whether institutional measures are in place to facilitate the diffusion of innovation in the business sector.

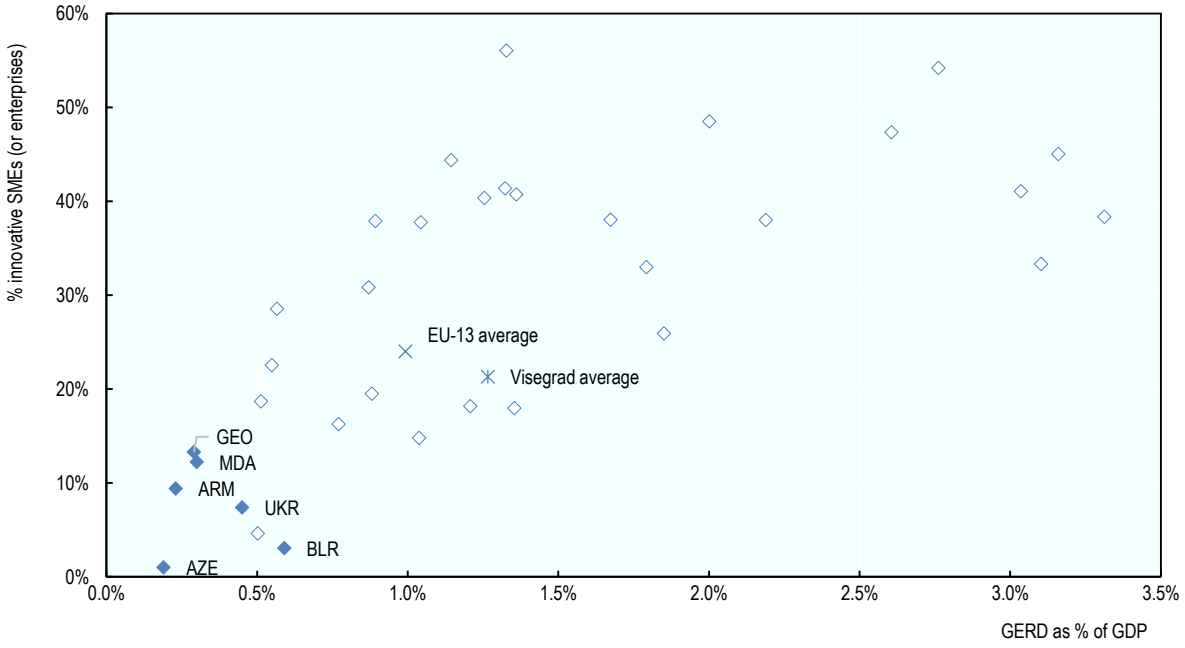
Policy settings acknowledging that innovation has both technological and non-technological aspects perform well in this sub-dimension. The commercialisation of new products often requires new marketing methods, and a new production technique will increase productivity only if it is supported by changes in the organisation of the firm. Governments can also perform an important role to promote diffusion of innovation by increasing enterprises' ability to absorb existing technologies, i.e. through skills development and mentoring programmes.

Analysis

SMEs can play a central role in the generation and diffusion of innovation. However, due to their limited size and capacity, they often face difficulties in developing and sustaining innovative activities over a long time period. This dimension provides a framework for assessing support for innovation activities in SMEs.

The performance of innovation systems in the EaP region lags that of EU members. A quick comparison of key indicators reveals how EaP countries allocate a smaller share of their national income to financing research and development – a core input to developing and absorbing new technologies – than their European neighbours, and how this contributes to a less innovative private sector, as measured by the share of enterprises introducing innovations (Figure 6.7).

Figure 6.7. Innovation performance in EaP countries, EU-13 and Visegrad, 2017



Note: Data shown are for 2017 or latest available year. Data address SMEs with product or process innovation. GERD = gross expenditure on research and development. EU-13 Member States = Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia. Comparison should be made with caution, due to different sources.
Source: (UNESCO Institute for Statistics, 2019[12]) European Innovation Scoreboard for EU countries and Ukraine; SBA assessment for Belarus, Georgia and Moldova, (GIZ, 2018[13]) for Armenia (all innovative enterprises) and OECD et al. (2015[6]) *SME Policy Index: Eastern Partner Countries 2016* for Azerbaijan.

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Despite a legacy of strong technical and scientific education systems and research institutions inherited from the Soviet Union, and a relatively better standing than central Asian countries on several measures of innovation,[5] EaP countries have a long way to go to build performing innovation systems.

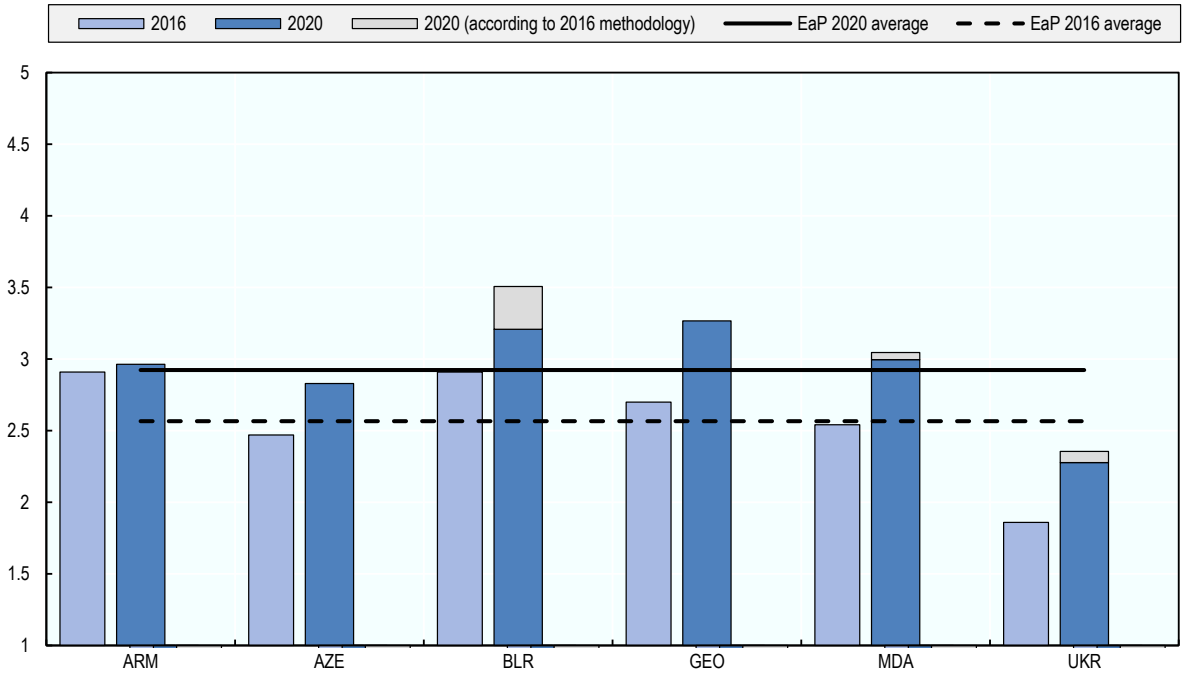
The results of the SBA assessment confirm these trends and shed some light on the reasons for the region's lukewarm performance in innovation. "Innovation policy for SMEs" appears as the dimension with the third-lowest average score across the EaP region (2.92), albeit improving since the 2016 assessment (2.57). Countries' scores range between 2.28 and 3.27, which suggests that at least some of the fundamental building blocks of solid legal and policy frameworks for innovation or evidence of effective policy implementation are still missing in the countries assessed. (Figure 6.8).

Overall, since the 2016 assessment, all EaP countries have further developed their policy frameworks for innovation, with dedicated national strategies adopted (Belarus, Moldova and Ukraine), awaiting government's approval (Azerbaijan, Georgia), or still being developed (Armenia) and a strengthened role for state bodies in charge of policy co-ordination. However, the focus on SMEs is still limited and monitoring tools remain underutilised. Government support services are expanding at different speeds, with Georgia and Belarus leading the way in setting up the innovation infrastructure (techno-parks, innovation centres), but with initiatives to support business-science collaboration still at an

infant stage. Financial support instruments for innovative businesses are available in the form of grants and fiscal incentives, but in several cases, they are mostly donor-driven (Georgia) and lacking risk-sharing mechanisms with beneficiaries (Azerbaijan). Lastly, while non-technological innovation has begun to be recognised in the policy and legal frameworks, active measures to promote it remain isolated.

As an example of good practice in this regard, Box 6.3 discusses Horizon 2020, the biggest EU research and innovation programme.

Figure 6.8. Scores for the *Innovation policy* dimension compared to 2016



Note: Methodological changes have been introduced to the 2020 assessment and should be taken into account when observing trends in SME Policy Index scores.

StatLink http://dx.doi.org/10.1787/888934087173

Box 6.3. Horizon 2020: EU support for research and innovation

Horizon 2020 is the biggest EU research and innovation programme. Almost EUR 80 billion of funding has been made available over seven years (2014 to 2020) – in addition to the private and national public investment that these resources can attract – to help achieve smart, sustainable and inclusive economic growth. The goal of the programme is to support the generation of world-class science and technology, remove barriers to innovation, and make it easier for the public and private sectors to work together to deliver solutions to major societal challenges. In particular, Horizon 2020 provides grants to research and innovation projects through open and competitive calls for proposals.

The 2018-20 Horizon 2020 work programme focuses its efforts in four areas with a combined budget of over EUR 7.6 billion: 1) building a low-carbon, climate resilient future, 2) connecting economic and environmental gains (the Circular Economy), 3) digitising and transforming European industry and services, and 4) boosting the effectiveness of the EU's Security Union.

EaP countries participate in Horizon 2020 with different degrees of involvement. Moldova and Ukraine are the two countries that have benefitted the most until now, with the highest amounts of contributions received, largest size of average grant awarded, and greatest degree of SME participation.

Table 6.5. Horizon 2020 – Participation of EaP countries

Country	Net EU Contribution (EUR)	Participating entities (number)	Average grant (EUR)	SME share of EU contribution	Rank contribution per inhabitant
Armenia	1,576,090	31	65,670	12.90%	4
Azerbaijan	488,263	10	54,251	0%	6
Belarus	2,261,885	46	53,854	0%	5
Georgia	3,023,065	35	100,769	8.57%	2
Moldova	5,276,257	59	114,701	15.25%	1
Ukraine	24,706,564	207	164,710	23.67%	3

Note: OECD analysis on selected indicators since the beginning of the programme (January 2014-July 2019); Armenia, Georgia, Moldova and Ukraine are H2020 "associated countries" and as such enjoy equal participation rights in H2020 as EU member states. Azerbaijan and Belarus' status as "third countries" does not grant participation rights in the "SME instrument", H2020's main tool to channel direct financing to SMEs.
Source: https://ec.europa.eu/info/funding-tenders/opportunities/portal/screen/opportunities/horizon-dashboard

Policy frameworks for innovation are improving, but focus on SMEs still limited

This sub-dimension measures the level of development of the innovation policy framework and its main building blocks, including the availability of a comprehensive innovation strategy (national and/or regional), a co-ordinating body in charge of innovation policy development, and legislation on intellectual property (IP) rights.

The EaP countries have made substantial progress in developing their policy frameworks for innovation, albeit at different rates. Policy design is moving away from a patchwork of innovation policies scattered among a multitude of independent documents and towards the development of dedicated national strategies for innovation. These are now in full implementation phase (Belarus and Moldova), awaiting government approval (Georgia, Azerbaijan) or still being developed (Armenia, Ukraine). Belarus is the regional leader in

this sub-dimension with its "National Programme of Innovation Development 2016-2020", setting out a vision for the country's direction of innovation, well-defined actions and substantial resources allocated to it (see Table 6.6).

The policy co-ordination and implementation functions have also become clearer since the latest SBA assessment. An interesting trend across the region is the emergence of dedicated government bodies in charge of promoting innovation in the business sector, alongside more traditional institutions providing support for fundamental research. The former group appears to be taking an increasingly important role in ensuring coherence with overall government action impacting innovation (i.e. education, industrial, and SME policy). Examples of such agencies include Georgia's Innovation and Technology Agency, or the recently created National Innovation Agency in Azerbaijan and National Agency for Research and Development in Moldova.

While the above are welcome developments with respect to the policy frameworks for innovation, SMEs as such are still rarely identified as a target group of national innovation strategies, and monitoring of innovation policies could be further enhanced. From this lack of focus on the SME sector and absence of regular impact monitoring derives a region-wide scarcity of performance indicators that examine at the extent to which small and medium sized enterprises are benefitting from the diversity of measures put in place by governments. One exception here is Georgia, which has introduced simple results-oriented key performance indicators[6] as part of its monitoring of the SME Development Strategy.

Table 6.6. Scores for the *Policy framework for innovation* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.25	3.06	4.27	3.55	3.79	3.46	3.57
Implementation	3.66	3.57	4.05	3.23	3.47	1.76	3.29
Monitoring & Evaluation	1.00	1.00	3.00	2.00	2.00	2.50	1.92
Weighted average	**2.99**	**2.88**	**3.92**	**3.10**	**3.29**	**2.50**	**3.11**

Note: see Annex A for information on the assessment methodology.

Although the network of innovation infrastructure is expanding, science-industry collaboration remains underexploited

This sub-dimension assesses the availability and implementation of institutional support measures for innovative SMEs, including innovation infrastructure such as incubators, science and technology parks, technology transfer offices, innovation centres and others.

Government in-kind support services for innovative companies have steadily expanded in the EaP region since 2016. The progress is particularly pronounced in Belarus – where 16 technology parks and 9 technology transfer offices (all publicly funded) providing favourable conditions in which to do business, invest in R&D, and facilitate innovations from the development phase through to the practical application stage – and Georgia, where 28 "Fablabs"[7] and three techno-parks offer space and equipment to develop prototypes. Georgia and Moldova have also recently introduced new laws that bring clarity to the legal framework for the innovation infrastructure (e.g. incubators, techno-parks, accelerators) by specifying objectives, technical requirements and criteria for selecting resident companies. Even though Ukraine has made some progress in this area, technology incubators and accelerators are not clearly defined in the legal and institutional framework.

In contrast with these positive developments, policy measures and physical facilities to promote science-industry interactions, technology transfer and co-creation of knowledge are generally underdeveloped across the EaP region. Research and development resources have traditionally been directed to basic research, public universities and research organisations with few incentives available to respond to enterprise needs. This is particularly evident in some countries, where, despite a legacy of research excellence (Ukraine, Belarus) and a widespread network of scientific laboratories (Azerbaijan), technology transfer offices are rarely involved in the commercialisation of research through licensing or the formation of academic spin-offs, and information about R&D facilities remains largely unavailable to the business community.

To overcome such shortcomings, the EaP countries have announced initiatives to bridge gaps in industry-science co-operation, although their results are yet to be observed. These include Georgia's plans to create a network of business accelerators hosted by universities, Ukraine's recently-launched Technology and Innovation Support Centres (which offer advanced IPR management services to universities and research institutions), or Moldova's plans to increase public knowledge of scientific resources. More needs to be done in terms of monitoring and evaluation, especially in Armenia and Belarus (see Table 6.7).

Table 6.7. Scores for the *Government support services* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.43	2.47	2.80	4.33	2.80	2.63	3.08
Implementation	2.50	2.60	3.64	2.95	2.18	2.16	2.67
Monitoring & evaluation	1.00	2.33	1.67	3.67	2.77	3.67	2.52
Weighted average	**2.53**	**2.50**	**2.95**	**3.58**	**2.52**	**2.63**	**2.78**

Note: see Annex A for information on the assessment methodology.

Financial support for innovative SMEs is generally available, but its design and scope could be improved

The third sub-dimension analyses the financial incentives and services EaP governments are providing to encourage SMEs to innovate.

Lack of access to finance is traditionally one of the main constraints on SME innovation. The problem can be worse for small, innovation-oriented companies in EaP countries, where the angel investment, private equity and financial markets are less developed than in the EU.[8]

Since 2016, the EaP governments have expanded direct and indirect financial incentives for firms to engage in innovative activities. Direct measures include grants and vouchers that are generally awarded on a competitive basis at each phase of the innovation project, from research and design to production and commercialisation.

Table 6.8. Scores for the *Government financial support* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.25	3.07	3.47	3.60	3.80	2.47	3.28
Implementation	2.86	2.86	2.26	3.40	2.60	1.26	2.54
Monitoring & evaluation	3.00	3.00	3.00	3.00	1.66	1.00	2.44
Weighted average	**3.03**	**2.96**	**2.83**	**3.39**	**2.83**	**1.63**	**2.78**

Note: see Annex A for information on the assessment methodology.

While all countries have introduced some form of direct financial support, the design, size and take-up of such instruments vary widely. On the one hand, Georgia and Belarus offer substantial grants in the range of USD 50-200 000 for innovative activities without specific sectoral targeting; these have proved very popular. On the other hand, companies' participation in such schemes in Azerbaijan and Moldova is lower, involves smaller amounts, and is limited to the narrow segment of ICT projects. The extent to which risk-sharing mechanisms are considered when designing grants and vouchers for innovation also differs from country to country, with Georgia's Innovation Matching Grants requiring 50% of eligible project costs to be secured from beneficiaries, and Azerbaijan's grants, issued by the ICT Fund, not requiring a matching component.

Indirect financial incentives for innovative firms exist, but are still a rare feature in the EaP region. Only Armenia, Belarus and Moldova have introduced VAT and tax exemptions for investment in R&D, with expenditure-based provisions in Belarus echoing some EU good practices and making it possible to deduct R&D expenses from a company's profits with a multiplier of up to 1.5 (see Box 6.4). Lack of monitoring and evaluation of the impact of such tools makes it hard to evaluate the extent to which SMEs, rather than large companies, are benefitting from such broad-based incentives and increasing their innovation activities.

Lastly, demand-side policies such as public procurement of innovation remain the exception rather than the rule and there are concerns about the low transparency of the process. Of all the EaP countries, only Moldova appears to have integrated innovation as a policy objective of its public procurement framework. This has been formalised with the introduction of "innovation partnerships" in the Law on Public Procurement, whereby contracting authorities effectively create incentives to invest in innovation by committing to acquire a good or service that is not available in the market at any given moment.

Box 6.4. Indirect financial incentives for innovation in Italy's Impresa 4.0 National Plan

Impresa 4.0 is Italy's ambitious strategy to support industrial change through measures seeking to promote investments in innovation and technology. The Italian government earmarked EUR 18 billion for the period 2017-2020 to implement the programme, which has three components: tax incentives, easier access to finance, and skills development.

The first group of measures, in particular, includes 'hyper' and 'super' depreciation schemes, which introduce incentives for companies to invest in their technological and digital transformation processes. With hyper-depreciation, investment costs in technological equipment and intangible assets are increased (for the purposes of reducing corporate profit tax) by 150% of their value; for super-depreciation this is 40%.* A third measure introduces a tax credit corresponding to 50% of incremental expenditures in R&D – such as labour costs for hiring highly-skilled and technical employees or research

contracts with universities – with respect to a baseline set by the firm's average annual investment in R&D in the previous three years. These benefits are automatically accessible when preparing the financial statements through self-certifications.

Results from business surveys show that super- and hyper-depreciations played a "very" or "enough" important role in around 60% of manufacturing companies' decisions to invest in 2017. Moreover, an independent assessment of Enterprise 4.0 performed by Italy's National Statistical Office reveals how companies benefitting from the R&D tax credit hired an average of six extra employees in R&D when compared with non-beneficiaries, and two extra employees when compared to a sub-sample of companies with the same characteristics and *ex ante* history of investment in R&D.

*. The incentive applied depends on the specific kind of investment good purchased by the firm.
Source: (European Commission, 2017[14]); (Ministero dello Sviluppo Economico, 2019[15])

Support for non-technological innovation and diffusion of innovation is only sporadic

This sub-dimension assesses the policy instruments in place to strengthen non-technological innovation (organisational or marketing processes) and analyses whether institutional measures have been established to facilitate the diffusion of innovation in the business sector.

Non-technological innovation is not the object of dedicated policy frameworks in the EaP region. Some countries, however, recognise the potential of organisational and marketing upgrades to increase firms' performance and therefore include them among the projects eligible for public support. This is the case in Armenia, Azerbaijan and Georgia, while other EaP countries remain focused on an understanding of innovation which is primarily tangible and technology-oriented.

Table 6.9. Scores for the *Policy framework for non-technical innovation* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Non-technological innovation	4.17	3.33	1.67	4.20	3.42	2.67	3.24
Diffusion of innovation	2.42	2.50	3.17	2.15	2.67	1.57	2.41
Weighted average	**3.29**	**2.92**	**2.42**	**3.18**	**3.04**	**2.12**	**2.83**

Note: see Annex A for information on the assessment methodology.

Public support for the diffusion of innovation is not developed across the EaP region. In addition to isolated examples of demand-side policies that could create a market for new technologies mentioned in the previous section, only Georgia seems to have introduced some measures (i.e. "Innovation Agents") that explicitly aim at performing a firm's gap analysis and assessing its readiness for a technological upgrade.

The way forward

The EaP countries have ample room for improving their policies to build a more innovative SME sector. Reform priorities in this area should focus on the following:

- All EaP countries should consider **increasing the role of SMEs in the national strategic frameworks for innovation**. The EaP governments can improve their

innovation strategies by establishing specific baselines for SMEs' innovation performance, and engaging SMEs in the definition of realistic policy targets.

- All countries should improve the **monitoring of the uptake and impact of financial and non-financial instruments for innovation (**with a breakdown by enterprise size class). This will help them understand the extent to which innovation policies are effectively reaching the desired beneficiaries.
- All EaP countries, and especially Armenia, Georgia, and Ukraine should **strengthen formal and informal channels for science-industry knowledge transfer and co-creation**, which can be achieved through a number of policy tools. Formal channels include collaborative research (projects carried out jointly by public researchers and private firms, with at least partial funding by the industrial partner), intellectual property transactions (licensing of IP generated by public research to industry), and academic spin-offs (direct commercialisation of knowledge and technology developed by universities). Informal channels are particularly relevant for SMEs; these include increasing the private sector's knowledge of the R&D resources available in the country, as well as the sharing of facilities/laboratories between industry and public research bodies (OECD, 2019[16]).
- All countries should **better design financial instruments to support innovation activities among SMEs.** Direct financial support should aim at crowding-in private investment. EaP governments, and especially Azerbaijan, should therefore ensure that a matching component is required when awarding grants/soft loans in order to share risk with the beneficiaries of financial instruments for both technological and non-technological innovation. To increase science-industry linkages, financial support could also be made available *conditional* on SMEs collaborating with public research institutions.
- All countries should **leverage the market-creating power of demand-side policies to spur innovation diffusion**. Beyond achieving the "best value for money", all EaP countries could consider the use of public procurement as a channel for raising innovation and SME development as secondary policy objectives. The support for SMEs to participate in procurement for innovation can be a direct financial incentive, a guarantee or an indirect measure like an SME participation quote, administrative assistance, training offers or other access-facilitating measures for public tenders (OECD, 2017[17]). By linking innovation activities to mission-oriented funding (e.g. grand social or environmental challenges), governments can help to increase the social returns of innovation investment – while also making SME innovation more relevant and potentially competitive in global markets.

SMEs in a green economy

SMEs play a central role in the economies of every EaP country, making up the vast majority of all enterprises and contributing to employment and economic growth. They also have the potential to be key drivers in the shift towards a greener economy, and to be engines of competitiveness and innovation in the process. Improving the environmental performance of SMEs is also essential given the underappreciated responsibility of SMEs for industrial emissions. Although figures are not available on the extent of pollution that SMEs are responsible for in EaP countries, research shows that SMEs cause 60-70% of all

industrial emissions in the EU (Constantinos et al., 2010[18]). Implementing policies to support SME greening can enhance their competitiveness by lowering operational costs, improving market access, supporting participation in green supply chains, and incentivising the deployment of new technology. Last but certainly not least, such policy can also contribute to a cleaner environment (OECD, 2018[19]).

Green SMEs can be broadly divided into two groups: green innovators and green performers. Green innovators are SMEs that are part of the green economy, introducing eco-innovative technologies and practices and providing green goods and services. Green performers consist of conventional SMEs that adopt greener business practices in order to enhance the efficiency of resource use, lower their costs, and shrink their environmental footprint (UNEP, 2017[20]).

While green innovators are important, they may already be supported by innovation policies, and already motivated to "go green". On the other hand, shifting conventional SMEs to green performers requires active policies to support them, and to ensure that there is a strong business case for them to adopt greener practices. SMEs, especially small and microenterprises, tend to be cost-conscious and focussed on short-term profitability rather than long-term investments or compliance with environmental regulation (Lynch-Wood and Williamson, 2013[21]). In addition, SMEs are often unaware of the benefits of adopting green practices and lack knowledge on availability and implementation, meaning that they have more difficulty making the business case for their use (Blundel, Monaghan and Thomas, 2013[22]).

Governments have a range of different tools at their disposal for supporting SMEs in adopting greener practices. These can be roughly divided into regulatory, financial, and informational tools. *Regulatory* tools involve using the regulatory system to incentivise better environmental performance, including by providing incentives for firms that exceed environmental standards or self-report issues. *Financial* tools include ensuring that SMEs are able to access financial resources to implement green practices, as well as helping to create markets, for example by implementing green public procurement policies. *Informational* tools include providing SMEs with the information they need to adopt green practices, as well as providing recognition and certification for those that do. Good policies can help shift the conversation about greening SMEs into a discussion about the business benefits that greening can bring, rather than the costs (OECD, 2018[19]).

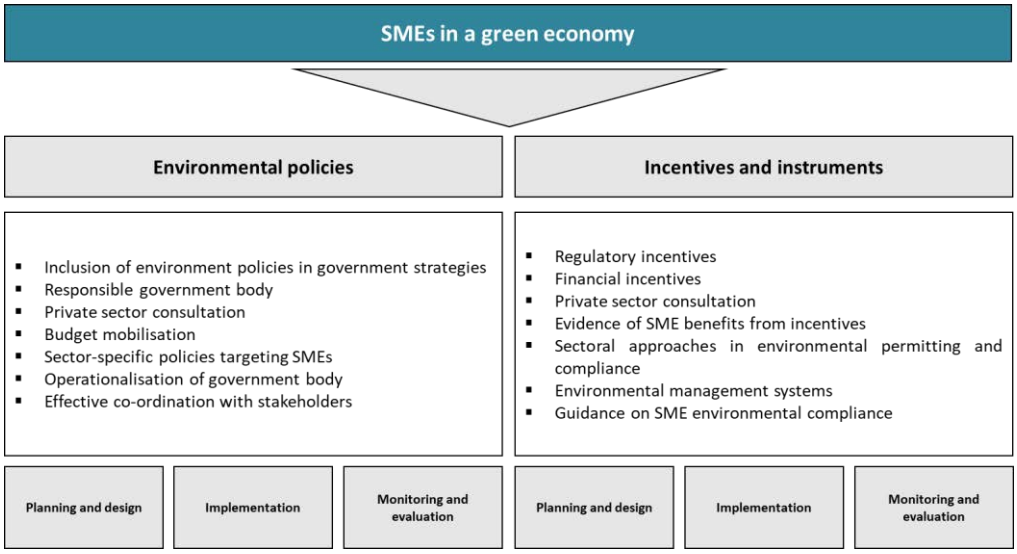
A key issue for SMEs is understanding the benefits of adopting more resource-efficient practices, and the positive impact that these practices can have on their bottom line. While businesses may be aware that they can reduce their costs by using less energy, water, and material inputs and by cutting their waste levels, they may not be aware of how to do it, or whether they are able to fund it (OECD, 2018[19]). Addressing this issue includes supporting access to finance, as well as providing direct support to SMEs in terms of what measures they can take to improve their performance. Governments also have a role in improving the business case for SMEs, by developing new markets through green public procurement, and by recognizing green achievement through awards and ecolabels and communicating it to the public (OECD, 2018[19]).

Assessment framework

The assessment framework for greening SMEs has two sub-dimensions. The first focuses on the existence of *environmental policies* to support green SMEs, the depth and breadth of those policies, and structures to operationalise them. The second looks at the existence

and implementation of regulatory, financial and informational *incentives and instruments* to support green SMEs.

Figure 6.9. Assessment framework – SMEs in a green economy



Environmental policies

The first sub-dimension examines whether policies are in place to support the greening of SMEs, whether or not they are developed, and whether there are clear plans developed to support policy implementation. This is measured directly and indirectly through a number of indicators, including whether there is budget mobilised to support policy implementation, whether there is a specific government body tasked with implementation and to what extent stakeholders consulted in the development of the plans.

The first factor in this sub-dimension is the most fundamental: whether or not environmental policies targeting SMEs are integrated into government strategies at the national level. The rest of the first thematic block, *planning and design*, looks at the extent to which those policies are developed – including whether an action plan exists, and whether there are measurable targets, a timeframe, and an expected impact. Taken together, these indicators help paint a picture of how fleshed-out a given approach is – and whether or not the intention to support green SMEs is paired with realistic and actionable plans. In keeping with this focus, the first thematic block also considers whether the policies cover both eco products and services as well as innovation, and to what extent stakeholders in the private sector were consulted.

The second thematic block, *implementation*, gets into the nuts and bolts of how environmental policies are turned into concrete action. This includes questions about budget allocation, outreach to business groups and local government, and whether there is an operational government agency assisting SMEs with adopting greener practices.

Finally, the third thematic block, *monitoring and evaluation*, measures the extent to which implementation and impact are being assessed, and whether there is a body responsible for assessment.

Answering these questions helps paint a full picture of how developed each country's plans and actions are for supporting SMEs in adopting greener practices.

Incentives and instruments for greening SMEs operations

The second sub-dimension explores the existence of different instruments and how they have been implemented. It measures whether the government provides regulatory and financial incentives to SMEs, whether there is any evidence that SMEs benefit from those incentives, and how those incentives and support schemes are structured and delivered. This sub-dimension also looks at how governments recognise sustainability actions taken by SMEs.

In the short term, activity in this sub-dimension can help kick-start the greening of SMEs and provide data about which approaches work best for different sectors and different types of enterprises. In the longer term, the measures tracked in this sub-dimension allow governments to apply incentives and support schemes that help SMEs become greener in the most impactful and cost-effective manner. How governments set and enforce environmental regulation, and incentivise compliance, can help support the greening of SMEs. Rules-based regulatory regimes for SMEs (rather than complex permit systems) are important, as are policies to promote good practices (such as reduced environmental compliance inspections for SMEs that have implemented Environmental Management Systems (EMS), and reduced compliance costs for self-reporting of incidents). Support schemes and financial incentives may include preferential tax treatment for investments in more environmentally sustainable equipment; financial support for efficiency audits; or the implementation of green procurement strategies for the public sector.

These aspects are further measured through questions about what kind of incentives are in place, whether evidence is gathered on their effectiveness, whether the government provides assistance with compliance, and whether programmes exist to provide official recognition to SMEs that are implementing greening projects.

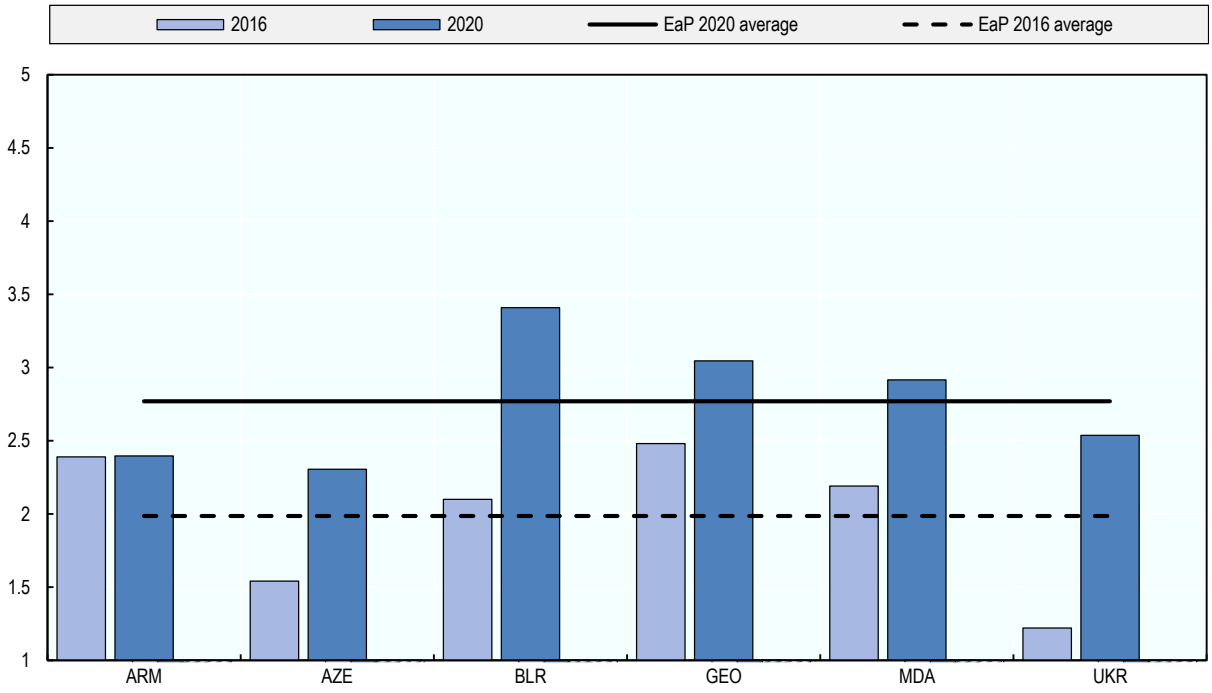
Analysis

In all EaP countries, SMEs represent the vast majority of all enterprises, which makes them responsible for a considerable portion of industrial emissions. Moreover, implementing policies to support green SMEs can enhance their competitiveness by lowering operational costs, improving market access, supporting participation in green supply chains, and incentivising the deployment of new technology. This dimension assesses government support for SMEs in adopting greener practices through regulatory, financial and informational tools.

Since the 2016 assessment, all the EaP countries have introduced policies that support the greening of SMEs, albeit with varying degrees of detail in terms of both planned activities (e.g. in Georgia) and concrete targets (as in Belarus and Azerbaijan). Moldova is the standout exception in having a clear target: its Green Economy Promotion Programme for 2018-2020 sets a target of 30% of SMEs implementing green economy principles by 2020, including resource efficiency and cleaner production techniques. Most countries in the region (Belarus, Georgia, Moldova and Ukraine) reported consultations with stakeholders in the development of green policies. Environmental legislation is also being updated to recognise the capacity and risk differences inherent in small firms compared to larger ones. A series of encouraging initiatives on risk-based environmental impact assessments have been adopted in Armenia and Belarus. Most countries are now experimenting with different forms of support or building on existing programs. Even though there are pilot projects on green procurement (Ukraine) and there is growing interest in supporting environmental management systems, those projects are not subject to monitoring or impact evaluation. Belarus, Moldova and Ukraine are in the process of establishing green requirements for

public procurement, while Armenia and Georgia showed a growing interest in supporting environmental management systems. However, the scale and reach of these projects remain in question, as there is little to no monitoring and evaluation of their impact. Longevity is also an issue, as donor funds remain a key source of support for SME greening.

Figure 6.10. Scores for the *Green economy* dimension compared to 2016



StatLink http://dx.doi.org/10.1787/888934087192

Policy frameworks for greening SMEs continue to develop, but concrete action plans and measurable indicators are needed

The first sub-dimension, *environmental policies*, evaluates the degree of introduction of greening policies into the policy framework for SMEs, industry and innovation. It examines whether strategic enterprise and innovation policy documents cover eco-efficiency and eco-innovation, and assesses the extent to which these concepts are embedded into national policy frameworks.

There has been progress across this sub-dimension at the most fundamental level: all countries in the EaP region include some form of environmental policies applicable to SMEs in their planning, either in specific SME policy documents or broader green economy policy documents. This is important, as it sets the stage for everything else that follows, including the tools, incentives and instruments covered in the subsequent sub-dimension.

Table 6.10. Scores for the *Environmental policies* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.13	2.95	4.40	4.90	3.30	3.90	3.76
Implementation	2.60	3.80	3.40	3.40	2.60	3.00	3.13
Monitoring & evaluation	1.50	1.50	1.00	3.00	1.00	4.00	2.00
Weighted average	**2.56**	**3.04**	**3.27**	**3.85**	**2.53**	**3.52**	**3.13**

Note: see Annex A for information on the assessment methodology.

However, a closer look reveals a huge amount of variability in the level of detail and planning involved in those policies. While it is a positive sign that SME greening is included in high level strategies, in many cases they lack expected impacts or measurable targets. As mentioned earlier, Moldova stands out in this regard in that its Green Economy Promotion Programme for 2018-2020 sets a target of 30% of SMEs implementing green economy principles by 2020, including resource efficiency and cleaner production techniques. While all countries in the region, excluding Azerbaijan, do have action plans linked to policies for greening SMEs, in many cases the lack of detail in them exacerbates challenges around implementation and measuring success. Armenia's SME State Support Annual Program 2018 calls for enhanced support for energy efficiency and involvement of SMEs in the green economy, but does not link to clear policies to achieve those goals.

As a counter-example, Georgia's SME Development Strategy 2016-2020 and its associated Action Plan supports the development of a training manual for resource efficiency and clean production (RECP), RECP assessments for enterprises, workshops and training events, as well as training in waste management for management-level employees at SMEs. These are clearly described actions that can be implemented and scaled up, and can work in harmony with other Georgian policies such as the Waste Management Strategy 2016-2030, which introduces an Extended Producer Responsibility Strategy for SMEs.

Ensuring that policies to support greening SMEs are coordinated with each other can strengthen synergies between them and extend their reach. A good example of this is the European Commission's Green Action Plan for SMEs, which combines actions across a range of different areas related to greening SMEs, and also includes the collection of data to help inform decision making (Box 6.5).

Box 6.5. The European Commission's Green Action Plan for SMEs

The European Commission's Green Action Plan (GAP) for SMEs is a significant, multipronged approach that aims to support SMEs to improve productivity, reduce costs, greening entrepreneurship, and developing European leadership in green processes and technologies. It has two overall objectives: raising SMEs' awareness of the benefits of resource efficiency improvements and business opportunities related to the circular economy, and informing SMEs about programs for supporting greener performance.

Actions under the GAP are broken up into four sections: 1) greening SMEs for competitiveness and sustainability, 2) green entrepreneurship for the companies of the future, 3) opportunities for SMEs in a greener value chains, and 4) access to markets for green SMEs.

An important component of the GAP is the gathering of information through surveys conducted directly with SMEs, to better understand the challenges they face in adopting

greener practices. These "Eurobarometer" surveys provide vital information on drivers and obstacles that SMEs face, thus helping to design better policies. GAP also includes actions on vocational education and training to tackle sector-specific skills gaps around environmental technologies and eco-innovation. In doing so, it also fosters co-operation between industry and vocational education, to ensure that the skills developed match with market needs.

In its breadth and organization, the GAP is a good example of how action plans for greening SMEs can encompass a variety of areas ranging from technology development to business communication and training.

Source: European Commission, "Green Action Plan for SMEs", https://ec.europa.eu/growth/smes/business-friendly-environment/green-action-plan.

It is worth noting that in some cases, countries (e.g. Belarus and Azerbaijan) have green economy policies that will affect SMEs but do not specifically target SMEs. While still a positive development, the policies are neutral regarding enterprise size and do not reflect the specific challenges that SMEs face. For instance, Belarus' National Action Plan for Green Economy Development (2016-2020) includes measures targeting specific sectors of the economy, such as the energy sector, construction, transportation, and agriculture. SMEs operate in all those sectors, but are not specifically targeted by the National Action Plan, which may mean they have challenges accessing programs.

Developing policies in consultation with affected stakeholders is always a good idea. Most countries in the region (Belarus, Georgia, Ukraine, and Moldova) reported consultations with sectoral representative and business groups in the development of green policies. Consulting with business groups helps ensure that policies meet the needs of the business community, while also helping to convey information to the business community on their introduction.

Another way that uptake can be supported is by direct outreach from the government body responsible for providing support to SMEs on implementing green practices. While all countries in the region have designated a responsible body, in most cases that body remains the ministry responsible for environmental issues, and they do not conduct specific outreach to SMEs. Although some have websites, passive information provision is not a substitute for direct outreach to the business community.

A related challenge is in countries that have shared responsibility for SME greening policies across multiple government agencies. For instance, in Ukraine, both the Ministry of Ecology and Natural Resources and the Ministry of Economic Development, Trade and Agriculture (MEDTA) are deemed responsible in the SME Strategy for assisting firms seeking support for greening. This is confusing for the SMEs themselves, and may arise co-ordination challenge, as well as hinder the effectiveness of policy development and implementation, as the leadership structure is unclear.

Monitoring and evaluation remain an underdeveloped area for all countries in the region, except for Ukraine and Georgia, which show promising steps (see Table 6.10). In most cases, there are no clear plans for monitoring or evaluating the impact of policies. This is true even in the case of Moldova, which as noted clearly defines some targets for SME greening, but does not have a clear definition of what "implementing green economy principles" would entail for an SME. Monitoring is essential to ensure that policies are effective – and if they are not, they can be improved. This is especially important in cases where policies are not targeted specifically at SMEs, such as Belarus. Having proper

monitoring and evaluation in place can provide a clearer idea of how much SMEs are actually benefiting.

SMEs need greater information and resources about why and how they can benefit from green practices

The second sub-dimension looks at the provision of institutional and financial incentives for SME greening. It evaluates the availability of environment-related information, expertise and funding targeted at SMEs. It also measures governments' efforts to promote environmental management systems and standards, as well as compliance with environmental regulations.

While the planning discussed in the previous sub-dimension is vital to ensuring the implementation of effective policies, this sub-dimension looks at the specific policies to green SMEs that each country has deployed, including regulatory, financial, and information tools.

Table 6.11. Scores for the *Incentives and instruments* sub-dimension

	ARM	AZE	BLR	GEO	MDA	UKR	EaP average
Planning & design	3.34	2.04	4.63	2.38	3.79	1.63	2.97
Implementation	1.59	2.00	2.41	2.70	2.33	2.48	2.25
Monitoring & evaluation	2.00	1.00	4.00	2.33	4.00	1.00	2.39
Weighted average	**2.28**	**1.81**	**3.50**	**2.51**	**3.18**	**1.89**	**2.53**

Note: see Annex A for information on the assessment methodology.

Environmental regulation remains one of the key means by which governments can directly improve the environmental performance of SMEs. However, under existing regulatory systems in the region, the focus is on larger polluters, often leaving SMEs de facto un-regulated. Shifting to a risk-based approach to environmental permitting and regulation lowers the burden on most SMEs while ensuring that SMEs that do pose a potential environmental impact are regulated. It also provides a window for enhancing interactions between companies and regulators. In the region, there have been a series of encouraging initiatives on risk-based environmental impact assessments (EIAs). For instance, Armenia is shifting to a risk-based approach for EIAs that will have a positive benefit for SMEs. Belarus and Georgia are also adopting a simplified EIA process for small enterprises. The next step will be expanding that risk-based approach from the EIA process to regulation as a whole (OECD, 2018[19]).

Access to green finance for smaller SMEs continues to be an issue in the region. Growing amounts of green finance are becoming available through retail banks, generally backed by international finance institutions (IFIs), but high borrowing costs and relatively short repayment periods make it difficult for small SMEs to access them. For example, in Georgia, banks that collaborate on green credit lines with IFIs often use international standards to assess borrowers, with funds tending to flow to larger enterprises. For example, the Bank of Georgia makes loans to SMEs for energy efficiency, backed by lines of credit with EBRD, EIB, and KfW, among other IFIs. However, the average loan size is often in excess of USD 1 million, which is significantly larger than most small enterprises require. The situation is similar for other EaP countries (OECD, 2019[23]). Although a number of countries, including Ukraine, have included access to green finance for SMEs in their SME strategies, the level of implementation to date remains unclear. Integrated solutions (like

Resource Efficient Scotland, discussed in Box 6.6) provide both loans and technical assistance to SMEs, with a wide range of loan sizes available that is more accessible for small firms.

Box 6.6. Resource Efficient Scotland: A case study in access to green finance for SMEs

Although SMEs may be aware of the business opportunities afforded by adopting more efficient practices, and the improvement they can have on their bottom line, they often lack financing that has long enough terms, low enough interest rates, or is available in small enough amounts. Resource Efficient Scotland (RSE) attempts to address that by providing accessible finance to SMEs that want to invest in greener practices.

RSE is an initiative jointly funded by the Scottish Government and Zero Waste Scotland, a publicly funded agency that works to implement sustainability initiatives in Scotland. Through it, SMEs can apply for financing of up to GBP 100 000, although loans can also be significantly smaller. Loans are interest free, with the exception of renewable energy projects, for which there is a 5% interest rate.

Access to finance is also paired with a free consultation service from RSE to ensure that businesses are able to effectively undertake efficiency measures. A specialist visits the enterprise and provides a report with recommendations on what approaches will help reduce the enterprise's resource use. The specialist will also provide support on an ongoing basis, helping with everything from completing the loan application to determining how to install new equipment.

In the past, SME resource efficiency support from Zero Waste Scotland supported around 4 000 businesses with one-on-one support and financing for resource efficiency, with total program savings of GBP 36 million on energy bills over a five-year period, with average savings of 24% or GBP 8 000 on their annual energy bills.

Source: Zero Waste Scotland (2019), "Scottish Government SME Loan", https://www.zerowastescotland.org.uk/content/resource-efficient-scotland-sme-loan-scottish-government; Resource Efficient Scotland website, https://www.resourceefficientscotland.com; Sarah George (2018), "Scottish Government launches 'cashback' scheme to help SMEs bolster energy efficiency", *edie*, https://www.edie.net/news/6/Scottish-Government-launches--cashback--scheme-to-help-businesses-bolster-energy-efficiency--.

Size considerations are vital in this context. For instance, Azerbaijan has tried to incentivise participation in the green economy through the creation of special economic zones and tax incentives for specific sectors (including renewable energy), but they are not targeted at SMEs and it remains to be seen if they are accessible to them. The same holds true for environmental management systems (EMSs). Belarus, for example, in 2017 introduced STB ISO 14001-2017, an EMS standard based on ISO 14001. While Belarus reports strong uptake so far, with more than 270 enterprises gaining certification, the ISO 14001 standard can be complex for smaller enterprises to implement without support, and there is no information available on the number of SMEs that have actually implemented it. Developing a simplified environmental management system with gradated complexity makes more sense for SMEs, as it allows them to progressively advance their environmental performance in an understandable format.

Three countries (Belarus, Moldova and Ukraine) are currently establishing green requirements for public procurement, with Ukraine already piloting green procurement

requirements in a number of regions. This is a very positive move, as it creates a market incentive for SMEs to reach standards. For instance, Moldova has set the goal of at least 15% of total public procurement to be "sustainable" by 2020. Public procurement can be a powerful tool for sending market signals and making the business case for greening. However, clearly defined qualifications for what constitutes "sustainable" need to be in place, and SMEs need to be supported to ensure that they are aware of the opportunity, and that they have the tools available to meet the qualifications.

The way forward

- All the EaP countries could **further strengthen green SME policies by ensuring that they are linked to concrete action plans with measurable targets and timeframes**. This helps show progress overtime, and gives policy makers valuable information about what works and what doesn't.
- Although there is support from IFIs in the region to provide access to green finance, it is aimed at larger enterprises, with the collateral requirements, loan amounts, and terms not appropriate for small enterprises. It is important for all EaP countries to **develop green loan programs that are accessible to SMEs**, including for relatively small loans for resource efficiency measures.
- Armenia, Azerbaijan, Georgia and Moldova could **strengthen communication to SMEs on how and why to "go green".** SMEs often need support in understanding what technologies and practices to adopt and what financing options are available to them. There should be a single, accessible government agency to ensure that SMEs are clear about where they can go for information and support. Integrating support for SME greening into SME development agencies (e.g. Enterprise Georgia) is a viable approach.
- **Belarus and Ukraine could take further steps to link green public procurement with simplified EMS/eco-certification**. Greening public procurement can create a powerful market motivation for SMEs to improve their environmental performance. However, the requirements to participate in green public procurement must be clear, straightforward and accessible for SMEs. Environmental management systems that are adapted to the capacity of SMEs can help small firms improve their environmental performance. This also provides a way for them to achieve eco-certifications, which in turn can be criteria for participation in green public-procurement policies.

Policy instruments – Innovation and Business Support

Table 6.12. Dimension challenges and policy instruments – Pillar E

Dimension	Challenges / Opportunities	Policy instruments
Business Development Services	**Market failures due to informational asymmetries.** Although SMEs have limited knowledge of the benefits of BDS, BDS also do not cater to the specific needs of SMEs and might lack the insurance mechanisms necessary to help them deal with SMEs, which are riskier engagements than large companies.	**Inform SMEs about the benefits and availability of BDS**. Develop single information portals providing details on all BDS programmes and list of quality BDS providers. **Help BDS providers navigate the SME sector.** Introduce quality assurance mechanisms (e.g. certification programmes) to enhance trust among the parties, while enhancing the monitoring and evaluation of the current infrastructure.

Dimension	Challenges / Opportunities	Policy instruments
	BDS provision is not shaped by market-driven demand. The efficiency of BDS provision is severely hampered by a lack of coordination among providers, the reliance on state/donor budgets, and low awareness of the availability and benefits of BDS.	**Improve the efficiency of BDS provision.** Establish co-ordination mechanisms among private and public BDS providers to ensure effective and target delivery of BDS services. **Promote private initiative.** Intervene to address market gaps, coordination failures and absence of implementing bodies without hampering private initiative. In particular, focus on BDS regulation and promotion of such services, and allow firms to choose their preferred private providers.
Innovation policies for SMEs	**Lack of policy focus on SME sector.** SMEs are seldom identified as a specific category of the business sector with its own peculiar challenges. This translates into a poor availability of data on performance indicators, lack of granular M&E, and weak performance of SME support policies.	**Highlight the role of SMEs in national innovation strategies.** Establish baselines for SMEs' innovation performance, introduce *ad hoc* indicators for SME performance to enhance M&E, define attainable policy targets.
	Lack of financial support or poor access to finance. Financial instruments to support innovation are available but often only in the form of grants; missing risk-sharing mechanisms prevent innovative SMEs from realizing their full potential.	**Better design financial instruments to support innovative activities among SMEs.** Introduce financial instruments to provide state economic support for innovation, conditional on collaboration between the parties. Introduce risk-sharing mechanisms between the innovators and the funding parties. Lastly, provide direct financial support to promote private investments.
	Poor diffusion of innovation. Transfer of knowledge and co-creation are concentrated in public institutions distant from the incentives of the private sector. Public procurement is rare across the region, with damaging consequences for the strength of incentives for SMEs.	**Reinforce formal and informal channels for knowledge transfer and co-creation.** Promote collaborative research, intellectual property transactions, and academic spin-offs. At the same time, stimulate the private sector by supporting research-industry relationships and expanding awareness of the availability of R&D resources. **Stimulate the market with demand-side policies.** Introduce direct measures (e.g. financial incentives and guarantees) and indirect measures (e.g. SME participation quota and training) for public tenders on different levels to bolster innovation and make it globally competitive.
SMEs in a green economy	**Lack of a strong business case.** Lack of awareness of the benefits of greener practices translates into a weak incentive for SMEs to switch to more sustainable models, with significant efficiency and environmental costs.	**Improve knowledge.** Reach out to SMEs to advise them regarding what measures they can take and which economic and environmental benefits they might enjoy. **Design demand-driven, green policies**. Develop green schemes in collaboration with business representatives to ensure wide adoption of green practices. **Introduce stronger incentives.** Establish green requirements for public procurement and introduce eco-awards and eco-labels for compliance.
	Lack of resources to meet the requirements. Despite positive progress in the EaP region, SMEs need to be supported with clear definitions of sustainability and the tools necessary to achieve the national green objectives.	**Introduce a simplified environmental management system (EMSs) targeted specifically at SMEs.** Systems adapted to SMEs' needs can promote wider adoption, improve firms' environmental performance, and help firms achieve eco-certifications.

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Notes

[1] An "experience good" is a product or a service that can be only evaluated after it has been purchased and experienced.

[2] https://www.ebrd.com/work-with-us/advice-for-businesses/business-advice-in-your-country.html.

[3] http://www.eu4business.eu/programme/advice-small-businesses?destination=programmes%3Ffield_related_community_tid%5B0%5D%3D1%26community1%3Don%26partner_list%3D&_ga=2.159786174.288675495.1571831769-336436535.1568706339

[4] The taxonomy of business functions adopted in the latest edition of the *Oslo Manual* maps well onto the previous edition's categories of process, marketing and organisational innovations. Hence, the "non-technological" innovations referred to in this *SME Policy Index* can be considered a subset of the broader "business process" innovations considered by the latest *Oslo Manual*.

[5] See, for instance, the position of EaP countries in the Global Innovation Index, which ranks countries based on the quality and performance of the "inputs" (e.g. human capital, infrastructure, market sophistication) and "outputs" (e.g. patents, hi-tech exports, IP receipts) of national innovation ecosystems (Dutta, Lanvin and Wunsch-Vin, 2018[24])

[6] Share of SMEs introducing product innovations and ICT usage for commercial purposes by SMEs (share of SMEs using e-invoicing, e-procurement, e-sales).

[7] *Fablabs*, or digital fabrication laboratories, are set up to inspire entrepreneurs to turn their ideas into new products and prototypes by giving them access to a range of advanced digital manufacturing. For more information see https://www.fablabs.io/

[8] See for instance the IMF's Financial Development Index database: https://data.world/imf/financial-development-fd.