

The Role of SME Sector in Georgian Economy

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Abstract

The purpose of the paper is to investigate the economic role of Small and Medium Enterprises (SMEs) in Georgian economy to define the perspective of their development. This issue has a special meaning for transitional countries, which are developing their growth policy.

To see the picture Georgia's short statistical review has been done as well as survey was carried out.

The main result of the investigation is that, despite SMEs make a considerable number of business enterprises in Georgia, they have occupied insignificant segment of Georgian economy according to their contribution into the main macroeconomic indicators - turnover, output, value added, national income, etc. Even a share of number of employed in this sector is less than that in European countries.

SME sector is economically low efficient because productivity of labor of employed person is two – three times lower than that in average in the country.

The survey identifies a lack of clear government SME's program as a key concern of SME sector development in Georgian.

Keywords: small and medium enterprises, macroeconomic indicators, barriers to development.

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1. Introduction

In 2009 there was heated debate about the role of small and medium enterprises (SMEs) in Georgian economy. Both sides – advocates and opponents- presented valuable arguments to support their opinions (Should the government, 2009). Nowadays the situation has changed and there is a general consensus about importance of SMEs for transformation and development of Georgian economy (Georgia: Country, 2011; p.7).

Despite the great achievements in economic performance, economic growth, poverty, and unemployment are still the most painful issues for the Georgian government and most Georgians.

Globally SMEs account for 99% of business numbers and 40% to 50% of GDP (www.internationalentrepreneurship.com). In most economies the majority of jobs are created by small enterprises.

Thus, some questions arise – what is the macroeconomic function of small and medium businesses in Georgian economy? Is there perspective for SME sector development in Georgia? What are the main obstacles? These and related questions are discussed in this paper.

The paper is organized as follows. Section 1 explains the actuality of the topic. Section 2 provides brief analysis of statistics (on number of operating enterprises, turnover, output, value added, employment, etc.) of Georgian enterprises by their size comparing SME sector with large businesses. Section 3 presents the results of conducted survey that reveal the existing barriers to the development of the small business in Georgia. Section 4 defines the role of

small and medium enterprises in European countries economies as a large segment of the private sector. Section 5 provides a conclusion and defines directions for further research related to the Georgian government policy towards SMEs.

2. Georgian SME sector profile

Georgia's economy is largely private sector in orientation (Papiashvili, Ciloglu, 2011). Improvement in business environment causes the stable growth of private sector in Georgia as it is illustrated by the dynamic of businesses. Particularly, in 2008 the number of SME businesses in Georgia was roughly three time more than that in 2003 (Entrepreneurship, 2008; p.22; Entrepreneurship, 2009, p.27). Since 2008 the share of SMEs in total number of businesses has been about the same and has counted 95-96 percent of total business enterprises (see Figure 1). In 2010 shares of registered taxpayers were distributed as followings: large business was less than 1%, medium business is 5-25%, and small business was 70-95% (Tax Reforms, 2011; p.26).

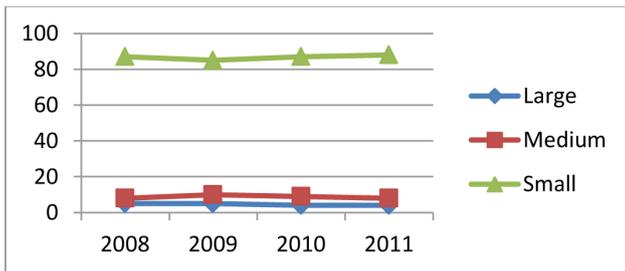


Figure 1. The number of operating enterprises by their size, as percent of total.

*9 months of 2011

Source: GeoStat

In 2011 according to the number of operating enterprises, SMEs prevailed in most fields of economic activity, especially they were leading in hotel and restaurant sector (98,5%); real estate (98%); agriculture, hunting, forestry (98,7%); wholesale and retail trade (96%); transport and communication (92,5%); construction (96%); education (96%), etc., and even in manufacturing (96%). Large enterprises were concentrated, for example, in electricity, gas and water supply (37%)(GeoStat)

To evaluate the role of SMEs in Georgian economy we have to assess their contribution into the main macroeconomic indicators such as GDP, national income, employment, etc. Unfortunately, there is no special statistics on the share of GDP added by SMEs, other indicators – turnover, output, value added, and incomes – might be analyzed.

In 2003-2006 the share of medium and small enterprises in turnover was around 1/5 of total turnover and it declined in following years (Quarterly bulletin, 2011. III; p.32). In particular, as Figure 2 shows, since 2008 the share of SMEs in total turnover was about 16-17 percent or, in other words, large enterprises contributed 83 percent and more of total turnover.

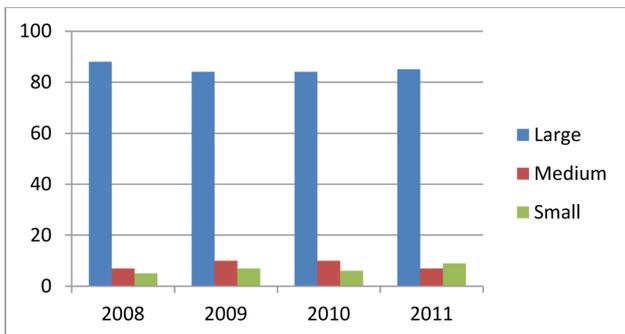


Figure 2. Turnover by enterprises size, as percent of total

*9 months of 2011

Source: GeoStat

As far as turnover by selected economic activities, in 2011 SMEs prevailed just in some kinds of economic activities, for example, in real estate and renting (53%), in fishing (60%), and in education (56%) (GeoStat).

The similar situation exists in output creation. While in 2004-2005 medium and small enterprises produced around 1/5 of country output, in the following years including 2011 their share declined to 18-14 percent (Figure 3). In other words, most part of output, 82 percent and more, has been produced by large enterprises. As for output by kinds of economic activities, in 2011 large enterprises produced most part of output of leading sectors of Georgian economy, for example, 72% in agriculture, 89 % in manufacturing, 73% in construction, 68% in hotel and restaurants business while small and medium enterprises produce most part of output in fishing (74%), real estate and renting (53%), education (55%), etc.

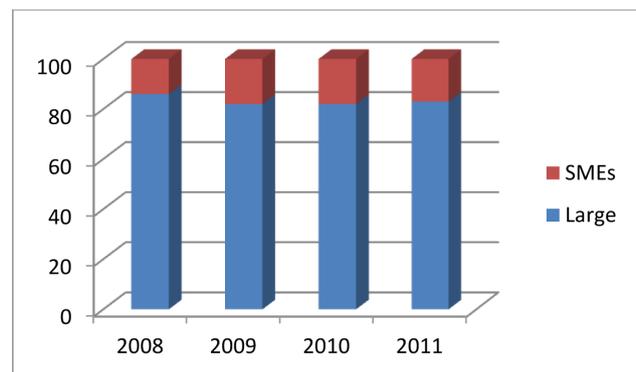


Figure 3. Output by size of enterprises, as percent of total.

*9 months of 2011

Source: GeoStat

Another important indicator of economic activity is value added. Since 2006 most part of value added (80% and more) has been produced by large firms (Figure 4). Specifically, in 2010 small and medium enterprises produced 46,6% of value added in agriculture, 15,1% in manufacturing, 29,5% in construction, etc.

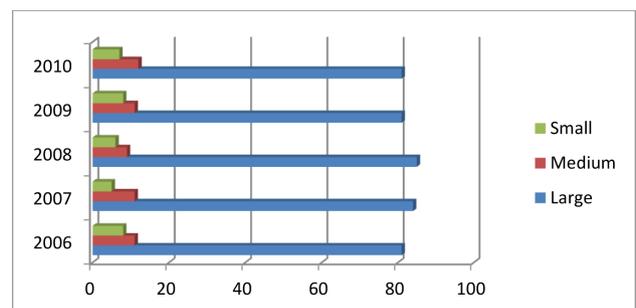


Figure 4. Value added by size of enterprises, as percent of total.

Source: GeoStat

Despite their multiplicity, SMEs contribution into national income is not significant. In particular, in 2010 small business share in total tax revenues was 0-10%, while medium business share was 10-25% and large business more than 70% (Tax Reforms, 2011; p.26).

An important indicator of economic efficiency is labor

productivity per employed person. As Table 1 indicates, in 2008-2011 productivity of labor of employed person of large enterprises was higher than that in average in the country, while productivity of labor of employed person of small and medium enterprises was significantly lower. For instance, in 2010 productivity of labor of employed person of medium enterprises was more than two times lower and of small enterprises about three times lower than that in average in the country.

Table 1. Labor productivity per employed person, GEL¹

	2008	2009	2010
Total	29344	28398	33443
Large	41910	40193	48404
Medium	12622	14726	15895
Small	8080	10237	12055

Analysis of employment by enterprises size shows that in 2003-2008 SMEs employed about half of total labor force, dividing approximately equally between small and medium

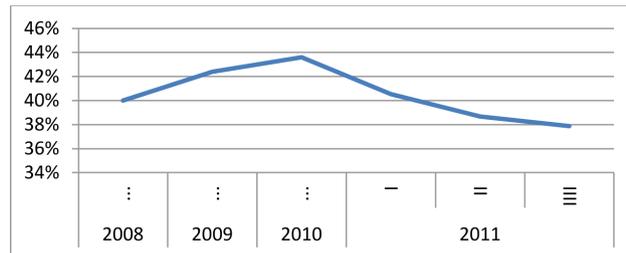


Figure 5. Employed persons by SMEs *9 months of 2011

Source: GeoStat

enterprises. It should be also noted that in 2008 employment shrank significantly in large as well as small and medium enterprises (by 6.4, 15.6 and 11.8 percent, respectively) because of global financial crisis but from 2009 economic situation has improved and in 2010 number of employed increased in large enterprises (by 4,5%) as well as in medium and small ones by 17,3% and 29,5%, respectively (Quarterly bulletin, 2010. II; p.33). In 2011 SMEs employed about 40% of labor force.

3. Survey and data collection

To complete our study we carried out a survey. The survey was conducted among 191 firms from Tbilisi, Kutaisi, Batumi, and Rustavi in September –November of 2010. Respondents were selected through convenience sampling. 300 questionnaires were distributed and 191 of them returned; response rate is 63 percent. Response rate

is reasonable, because the researchers expected a lower response rate. It is known that overall a “typical” response rate is about 50 percent; a “good” one is 60 - 70 percent. Therefore, a “drop-off, pick-up” method of survey administration was found very suitable for the purpose of this study and it was adopted.

One of the central questions of the survey was about the existing barriers to the development of the small business in Georgia. Two groups of factors were included into the questionnaire: macro factors (aggregated and connected to the government policy) and micro factors. Figures 6-A, 6-B, and 6-C present the results.

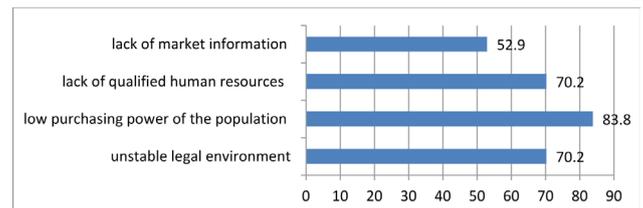


Figure 6-A. Macro factors: General (aggregate), (in percent)

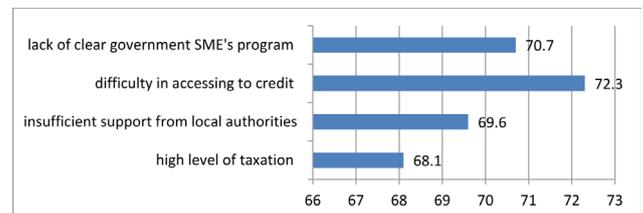


Figure 6-B. Macro factors: Related to the government policy, (in percent)

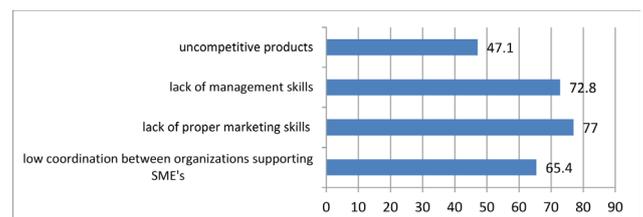


Figure 6-C. Micro factors, (in percent)

Based on the received results, it can be concluded that general or aggregated macroeconomic factors (Figure 6-A) such as unstable legal environment, low purchasing power of the population, lack of qualified human resources, lack of market information, etc. still brake the development of SME sector in Georgia. On another side, it is clear that these obstacles are transition period heritage and their effects are decreasing in the process of country’s development. Moreover, most of these barriers are common to transition and developing countries².

As for the second group of factors related to the government policy (Figure 6-B), high level of taxation may be classified as traditional and common claim of businessmen all over the world if tax rate is higher than zero! It’s a fact that operating new Georgian Tax Code is one of the most

liberal because in the course of 2004 - 2011 the number of taxes sharply decreased (from 22 to 6) as well as their rates. Namely, instead of differentiated income tax (12-20 percent), a unified 12 percent rate has been established, the social tax rate went down from 33 to 20 percent and VAT from 20 to 18 percent. Besides, there is no payroll tax or social insurance tax; no capital gains tax; no wealth tax. According to 2009 Tax Misery & Reform Index, release by Forbes Business & Financial News, Georgia is the fourth least tax burden country after Qatar, UAE and Hong Kong (Tax Reforms, 2011; p.5, 37).

The survey identifies a lack of clear government SME's program as a key concern of SME sector development in Georgian. Indeed, all others macro barriers such as insufficient support from local authorities and/or difficulty in accessing to credit as well as micro barriers such as low coordination between organizations supporting SME's, lack of proper marketing and managerial skills, uncompetitive products, the like are the consequences of the lack of sound government strategy toward SME sector.

4. Learning European experience

SMEs play a significant role in virtually every economy and represent a large segment of the private sector. In low-income countries with GDP per capita between \$100 and \$500, SMEs account for over 60% of GDP and 70% of total employment; in middle-income countries they produce close to 70% of GDP and 95% of total employment. Even in OECD countries, SMEs comprise the majority of firms and contribute over 55 percent of GDP and 65 percent of total employment (Promoting small; p.2).

According to the Europe figures, SMEs make up 99.8 percent of the estimated 20.2 million non-financial business enterprises within the EU-27. SMEs (with fewer than 250 employees), generated 56.9 percent of the value added and employed 67.4 percent of the workforce in the non-financial business economy. Micro enterprises (those with less than 10 persons employed) played a particularly important role, providing employment to nearly as many persons as large enterprises (Europe in figures, 2010; p.356-357).

EU policy towards SME includes a wide-ranging set of pro-enterprise measures designed to alleviate administrative burdens, facilitate SMEs' access to finance and support SMEs' access to markets. Particularly, in June 2008, the European Commission launched the Small Business Act (SBA) for Europe that reflects the political will to recognize the central role of SMEs in the EU's economy and, for the first time, puts into place a comprehensive SME policy framework for the EU and its Member States (SBA Review: SBA, 2011). The Small Business Act is a comprehensive plan that seeks to promote entrepreneurship and anchor the "Think Small First" principle in law and policy

making. It should be specially stressed that since January 2009, the European Commission has applied a compulsory 'SME Test' to check whether new EU policies and laws will have an impact on small businesses (SBA Review: What, 2011; p.5). This approach creates a solid framework to SME sector development as a central player of the EU's economy.

To give new impetus to the SBA and to ensure a full and timely delivery of all its actions, since 2008 both the Commission and the Member States have focused on implementing actions. They have overviewed this process and carefully monitored and controlled of the progress achieved in implementing the SBA, and set out new actions to respond to challenges resulting from the economic crisis of 2008 (SBA Review: What, 2011; SBA Review: SBA, 2011).

5. Conclusion

In European countries SMEs are currently economically significant and politically popular as employment vehicles while larger firms are frequently popular for industrial planning or as engine of advanced economy. In Georgia the SME sector development trend is mistakable and complex.

The done short statistical review has shown that, despite SMEs make a considerable number of business enterprises in Georgia, an inadequate growing of SMEs quality relevant to SMEs number, should be emphasized specially. In other words, SMEs have occupied insignificant segment of Georgian economy according to their contribution into the main macroeconomic indicators - turnover, output, value added, national income, etc. Even a share of employed persons in small and medium business in Georgia is less than that in European countries - around 40 percent compare to 60-70 percent, respectively.

As our survey shows, there is a set of macro factors (for example, unstable legal environment, low purchasing power of the population, lack of qualified human resources, lack of market information, etc.) and micro factors (such as low coordination between organizations supporting SME's, lack of proper marketing and managerial skills, uncompetitive products, the like) that still brake the development of SME sector in Georgia.

The survey identifies a lack of clear government SME's program as a key concern of SME sector development in Georgian. On one side, SME sector development directly depends on national legislation. Unfortunately, the situation is closed to be described as a "legislative vacuum". The Law of Georgia on "Entrepreneurs" (1999) has not determined the SMEs. The SMEs definition was given in the Law of Georgia on "Small and Medium Enterprise Support" of July 1999 (clause 1 article 2), but was abolished by the Georgian government in 2006, and was never replaced.

In September 2010, Parliament approved a new Tax Code which entered into force in January 2011. The new Tax Code stipulates a new specification of businesses in Georgia: micro-, small, medium and large based on workforce and annual turnover output (Tax Code of Georgia; p. 115-117). In particular,

- Micro business is an entity with income less than to 30,000GEL and no employees.
- Small business is entity with income less than 100,000 GEL.

A different tax regime is applied to individuals and companies involved in businesses. Thus, national legislation on SMEs is not specific and regulates mostly taxation.

On another side, the Georgian government has a very clear role as an economic regulator: facilitate the training of SME representatives in these areas – both quantitative and qualitative – that will allow them to either have or to be as close to having the skills necessary to act on their ideas. Generalizing, Georgian government role must begin with providing meaningful tools for financing, marketing and technological support of SMEs.

It is clear that the promotion of widespread entrepreneurship through the setting up and intensive support of SMEs should be crucial for the full and definitive transformation of Georgian economy to a market-oriented and European style economy and to the further democratization of society. Within this strategy, micro and small-enterprises are of special importance. Therefore, despite the fact that much has been done but more still needs to be done in creation of the framework to SME sector development as a competitive player of Georgian economy.

1. GEL is Georgian lari that is national currency of Georgia

2. See, for example, (Small businesses, job creation; n/d, p.3-4)

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