Entrepreneurship and SME Development in Transition Economies:  
*The Case of Georgia*

Master thesis within Business Administration  
Author: Lela Putkaradze  
         Irine Abramishvili  
Tutor:  Friederike Welter  
Jönköping  June, 2009
Acknowledgements

We would like to express our sincere gratitude to our tutor Professor Friederike Welter for her beneficial guidance and fruitful tutoring during writing this thesis. We would also like to thank our families who supported us during this entire period. Moreover, special thanks go to all our respondents, who took their time, participated in the study, and contributed to this thesis.

Irine Abramishvili

Lela Putkaradze
Abbreviations

ADA Agribusiness Development Activity
CEE Central and Eastern Europe
EBRD European Bank for Reconstruction and Development
FSU Former Soviet Union
GoG Government of Georgia
GCCCI Georgian Chamber of Commerce and Industry
GEL Georgian Lari
GNI Gross National Income
GNIA Georgian National Investment Agency
IFC International Finance Corporation
ICC-Georgia International Chamber of Commerce-Georgia
IMF International Monetary Fund
LLC Limited Liability Company
NGO Non-Governmental Organization
OECD Organization for Economic Co-operation and Development
SME Small and Medium-Sized Enterprise
UNDP United Nations Development Programme
USAID United States Agency for International Development
WB World Bank
Abstract

Master Thesis within Business Administration

Title: Entrepreneurship and SME Development in Transition Economies: The Case of Georgia.

Authors: Abramishvili Irine
Putkaradze Lela

Tutor: Friederike Welter

Date: Jönköping, June 2009

Key Words: Entrepreneurship, SMEs, transition economies, Georgia.

Introduction
Entrepreneurship and SME development play a crucial role in speeding up the economic development of transition economies. Although entrepreneurship exists in all environments it flourishes in the conditions where it is supported. Transition economies, as well as Georgia, are characterized by inefficient framework conditions that present barriers to productive entrepreneurship and SMEs to develop and benefit the economies in their full potential.

Purpose
The Thesis aimed at answering the following research questions:

1) To what extent the framework conditions necessary for promoting productive entrepreneurship and SME development exist in Georgia?

2) What are the perceived barriers to entrepreneurship and SME development in Georgia?

3) In what ways is entrepreneurship and SME development encouraged and supported in Georgia?

Method
The thesis consists of theoretical data such as literature review, secondary data presented by previous studies, and primary data collected by conducting interviews with Georgian entrepreneurs and representatives of governmental bodies and NGOs engaged in improving a business climate in the country.

Conclusions
The study revealed that basic framework conditions for developing entrepreneurship are present in Georgia. Although inefficiencies and institutional gaps give rise to a number of barriers to entrepreneurship and SME development. They are mostly presented by inefficient tax system and financial framework. Despite their efforts towards fostering favourable business environment, GoG, as well as NOGs could do a better job in improving an indirect support in terms of abolishing imperfections in the taxation system, as well as directly providing finance, training and efectual information flow to existing and potential businesses.
# Table of Contents

## 1 INTRODUCTION

1.1 Background 7  
1.2 Problem 7  
1.3 Purpose 7  
1.4 Perspective 8  
1.5 Delimitation 8  

## 2 METHODOLOGY

2.1 Research Paradigm 9  
2.1.1 Epistemological Assumption 9  
2.1.2 Ontological Assumption 10  
2.1.3 Axiological Assumption 10  
2.1.4 Rhetorical Assumption 10  
2.2 Methodological Assumption 10  
2.3 Purpose of the Research 11  
2.4 Data Collection 11  
2.4.1 Exploring Secondary Data 11  
2.4.2 Collecting Primary Data through Interviews 12  
2.4.3 Designing Interview Questions 12  
2.4.4 Selecting a Sample 13  
2.4.5 Qualitative Analysis of the Data 13  
2.5 Trustworthiness of the Thesis 15  
2.5.1 Reliability 15  
2.5.2 Validity 15  
2.5.3 Generalisability 15  

## 3 FRAME OF REFERENCE

3.1 Entrepreneurship and SMEs in Transition Context 16  
3.1.1 Determinants and Different types of Entrepreneurship 16  
3.1.2 Definition of transition 17  
3.1.3 Reforms in transition process 17  
3.1.4 Classification of transition stages 18  
3.1.5 Entrepreneurship and SMEs in Transitional Environment 19  
3.2 Institutional Theory: The Role of Formal and Informal Institutions 21  
3.2.1 Northean Institutional Theory 22  
3.3 Barriers to Entrepreneurship and SME Development 23  
3.3.1 External Barriers to Entrepreneurship and SME Development 24  
3.3.2 Internal Barriers to Entrepreneurship and SME Development 25  
3.4 Fostering Entrepreneurship and SME development 26  
3.5 Summary of the Frame of Reference 32
4 RESULTS

4.1 Secondary Data (Previous Studies) on Georgia
  4.1.1 Entrepreneurship and SMEs in Georgia
  4.1.2 Business Environment in Georgia
  4.1.3 Governmental reforms towards Fostering Entrepreneurship
  4.1.4 Existing Barriers to Entrepreneurship and SMEs in Georgia

4.2 Primary Data
  4.2.1 Interviewee Profiles
    4.2.1.1 Entrepreneurs
    4.2.1.2 Governmental and non-governmental sector Representatives
  4.2.2 Entrepreneur’s Interviews
    4.2.2.1 Internal Factors
    4.2.2.2 External Factors
    4.2.2.3 State and Other Support
  4.2.3 Governmental and non-Governmental Representatives
    4.2.3.1 External Environment
    4.2.3.2 Direct and indirect governmental and other support

5 ANALYSIS

5.1 Introduction

5.2 Existence of Framework Conditions in Georgia

5.3 Perceived Barriers to Entrepreneurship and SMEs in Georgia
  5.3.1 External Barriers
  5.3.2 Internal Barriers

5.4 Fostering Entrepreneurship and SME development in Georgia

5.5 Conclusions

6 REFLECTIONS

6.1 Contributions

6.2 Limitations

6.3 Propositions for Further Research

REFERENCES

APPENDICES
  A. Interview Questions for Entrepreneurs
  B. Interview Questions for government agents, private organization representatives

Figure 1 Methodological Assumption of the Main Paradigms

Figure 2 Components of Data Analysis Interactive Model

Figure 3 A model for Entrepreneurship in Transition Economies
Figure 4 Entrepreneurship Policies in Transition Context

Figure 5 Transition Indicators 2008

Figure 6 Number of SMEs per 1,000 People in Georgia

Figure 8 Ease of Doing Business in Georgia as compared to Global rankings

Figure 7 SME membership in Business Associations in Georgia

Figure 9 Ease of Doing business rankings in Different aspects in Georgia

Figure 10 Processes SMEs in Georgia considered “Rather Difficult” and “Very Problematic”

Figure 11 Central Government Role in Business Development in Georgia

Figure 12 Obstacles to Business Development as viewed by the entrepreneurs in Georgia

Figure 13 SMEs rating of government processes as obstacles in Georgia

Figure 14 Businesses Identify Problematic Areas

Figure 15 Corruption Problem

Figure 16 Tax Perception

Figure 17 Access to Finance

Table 1 Perceived Barriers to Entrepreneurship and SME development in transition economies ......... 26

Table 2 Perceived Barriers to Entrepreneurship and SME development in Georgia................................ 57

Table 3 Barriers and Policies directed towards abolishing them......................................................... 59
1 Introduction

In this chapter we present the topic of the thesis. The chapter starts with presenting a short background to the importance of entrepreneurship and SME development, and continues with the problem discussion. Purpose of the thesis and research questions follows afterwards, and the chapter is finalized by giving the perspective accepted for the study, as well as the delimitation of the thesis.

1.1 Background

Entrepreneurship and small and medium-sized enterprise (SME) development play a crucial role in countries’ economic growth in market as well as in transition economies. However, entrepreneurship in transition economies has gained higher importance due to its contribution to the transition process by speeding the economic development of those countries. Significantly, SMEs are regarded as change agents in transforming economies (Aidis, 2003a; Aidis, 2003b; Smallbone & Walter, 2009), and are seen as vehicles for economic and social development (Kirby and Watson, 2003). Despite this fact, policymakers in transition countries did not realize, or ignored, the importance of entrepreneurship and SME development, putting a higher emphasis on restructuring and privatization of state enterprises; thus resulting in less resources and attention being paid to the needs of SME development and encouragement of entrepreneurship (Aidis, 2003b; Aidis & Sauka, 2005). On the other hand, entrepreneurship, despite its presence in all environments, flourishes in the environments where it is strongly supported. In addition, transition economies, contrasted to market economies, endure institutional weaknesses and historic legacies which in turn impede productive entrepreneurship and SME development (Aidis, 2003a; Welter & Smallbone, 2003). For that reason, it becomes critical to research and study entrepreneurship and SME development in transition economies in isolation from market economies and view the issue in a broader context, embracing external environment in terms of framework conditions and institutions (such as governments), that stimulate entrepreneurship through creation and development of SMEs.

It is worth mentioning that most of the research done on entrepreneurship and SMEs are characterized by using the examples of SMEs and entrepreneurs in the United States and Europe. At the same time, results gathered from developed countries cannot be applied in the similar manner to the countries in the transition process (Bruton, Ahlstrom & Obloj, 2008). Furthermore, even though countries in the transition economies go through very similar development paths, differences among them still exist (Muller & Goic, 2002; Aidis, 2003b). Nevertheless, studies cannot be generalized due to existing differences in cultural and historical dimensions (Bruton et al. 2008). As North (1990, 1994) argues, imposing same formal rules and/or constitutions on different countries produces different economic performance due to different informal rules and their enforcement. For that reason, studying entrepreneurship and SME development in a particular transition country deserves a careful investigation in separation from other transition economies.

1.2 Problem

Since the fall of the communism, transition process has been very different in various countries of former Soviet Union (FSU). All of the transition countries have taken very different steps in the transformation process despite the similarity in the extent and level of changes in their socioeconomic, political and macroeconomic environments (Smallbone & Welter, 2009). Some countries have been quite successful in the process, whilst others are still in the process of transformation, and struggle poverty (Boettke, Coyne & Leeson, 2008). From our point of view, Georgia is one of those countries that are still struggling with the transition process. Even though researches undertaken on Georgia by international organizations, such as International Monetary Fund (IMF) and European Bank for Reconstruction and Development (EBRD), assert the completion of transition process in the country, institutional weaknesses still persist. This in turn produces
barriers to entrepreneurship and SME development resulting in less contribution of SMEs to speeding up the transition process. On the other hand, we believe that entrepreneurial climate and enhanced entrepreneurial activities can be one of the contributing factors in escalating the economic development in Georgia. However, the role of entrepreneurship and SME development cannot be fully realized without the existence of basic framework conditions, and further support institutions in the country (Smallbone & Welter, 2009). At the same time, inadequate institutional environment may serve as a barrier to productive entrepreneurship and SME development (Welter and Smallbone, 2003). Even though entrepreneurship might exist at some level in any environment, alertness to opportunities, as well as the future path that the entrepreneurial activities take, largely depends on the existing settings and institutional framework (Boettke et al. 2008), on which governments have a reasonably huge influence (Smallbone & Welter, 2009).

1.3 Purpose

In line with the above mentioned, the purpose of our study is to analyze the extent of the existence of framework conditions (protection of property rights, liberalization of markets, creation of market-oriented institutions and others), barriers to entrepreneurship and SME development, and how entrepreneurship is fostered in Georgia. In order to fulfill the purpose of this thesis following research questions shall be answered:

1) To what extent the framework conditions necessary for promoting productive entrepreneurship and SME development exist in Georgia?

2) What are the perceived barriers to entrepreneurship and SME development in Georgia?

3) In what ways is entrepreneurship and SME development encouraged and supported in Georgia?

1.4 Perspective

In order for the findings of this research to be objective and reasonably free of a possible bias, we look at the topic from various perspectives: through the eyes of entrepreneurs, government agents, and private organizations. As a result, we will be able to fulfill the purpose by providing a complete picture of the matter with the help of different actors.

1.5 Delimitation

In the process of this study we shall not be able to measure the level of entrepreneurship and its effect on the economic development in Georgia. Moreover, according to OECD, it is not practically possible to measure entrepreneurship since there are no universally agreed indicators of doing so (Audretsch, Grilo & Thurik, 2007).
2 Methodology

In this Chapter we present our scientific approach and the method that we used while working with this thesis. The first section includes scientific assumptions, and the second part comprises of theoretical and empirical data of the thesis. The Chapter ends with a part concerning a critical view of the study.

2.1 Research Paradigm

Understanding personal research paradigm determines the course of research. Paradigm refers to “the progress of scientific practice based on people’s philosophies and assumptions about the world and the nature of knowledge” (Hussey & Hussey, 1997, p.47). Therefore, researchers’ personal beliefs and assumptions about the world are usually reflected in the way they conduct their research and collect data (Hussey & Hussey, 1997; Saunders, Lewis & Thornhill, 2007). There are different types of assumptions that a researcher has to make before conducting a research study; in this chapter we are going to make our own assumptions based on the research purpose and research questions at hand.

2.1.1 Epistemological Assumption

Epistemology is concerned with what constitutes an acceptable, valid knowledge in a specific field of study (Hussey & Hussey, 1997; Saunders et al. 2007). This in its turn involves investigation of the relationship between the researcher and the subject matter of the research. Based on the epistemological assumptions researchers can either reflect the principles of positivist or phenomenologist, this two assumptions can be viewed as extremes of one continuum. On the one end of the continuum we have positivists who consider that the only observable and measurable data is regarded as a valid knowledge (Hussey & Hussey, 1997). As Saunders et al (2007) states, positivists believe that “only phenomena that you can observe will lead to the production of credible data” (p.103). Under this assumption the researcher does not affect nor is affected by the collected data, since the data collection is merely based on facts and figures. Positivist assumption is based on the fact that social reality and individuals exist independent of each other, at the same time they believe that natural sciences and human behavior is close enough to be studied in the same way (Hussey & Hussey, 1997).

On the other end of the continuum of epistemology we have phenomenological or interpretivism assumptions that highlight the necessity to differentiate between conducting research among people and other objects (Saunders et al. 2007). Therefore, phenomenological paradigm is “concerned with understanding human behavior from the participant’s own frame of reference” (Hussey & Hussey, p.52). According to phenomenologist’s view, social reality does not exist without us, it is within us (ibid.). We, humans should try and understand this world and make sense out of it, thus we “interpret the actions of others with whom we interact and this interpretation leads to adjustment of our own meanings and actions”(Saunders et al. 2007, p.107).

From the above-mentioned, we infer to the phenomenological paradigm of viewing reality. Phenomenology as the science of phenomena is concerned with understanding human behavior from the author’s own frame of reference. Furthermore, the process of investigating reality has an effect on that reality. This paradigm is a qualitative approach to research strategy and emphasizes on the human activity by focusing on the meaning rather than the measurement of a social phenomena (Hussey & Hussey, 1997). Since in this research our aim is to find a meaning rather than the measurement of the reality and show a pattern of this social phenomenon, phenomenological paradigm seems to be relevant.
2.1.2 Ontological Assumption

Ontology is concerned “with nature of knowledge” (Saunders et al. 2007, p. 108). The researcher should decide if he or she considers the world to be objective and external to the researcher - objectivism portrays this position; or if it is “socially constructed and only understood by examining the perceptions of the human actors” which is regarded as a subjectivist view (Hussey & Hussey, 1997, p.49). To put it simply this assumption is concerned with the way the world operates (Saunders et al. 2007). Phenomenological (interpretivism) assumption highlights the necessity to explore subjective means that are motivating social actors in their actions, in order for the researcher to understand these actions (ibid.). In this research we infer to subjectivism position, since outcomes of the research are based on the different ways that the social actors interpret the situations they find themselves in. Therefore, respondents of this research are most likely to perceive situations differently based on their own view of the world and the reality that surrounds them.

2.1.3 Axiological Assumption

Axiological assumptions are concerned with values. Positivists consider that the objects of their research are value-free, i.e. they believe that the objects of their studies are not affected by the research they are conducting. On the other hand, phenomenologist approach asserts that researchers have their own values that affect the way they conduct research and the way they interpret collected facts (Hussey & Hussey, 1997). Heron (1996), states that values guide human action, thus researchers’ values have a great influence on the way they make judgments and pursue research (as cited in Saunders et al. 2007). In this research we assume that our values will affect the way we interpret the collected data and draw conclusions from it.

2.1.4 Rhetorical Assumption

Rhetorical assumption is concerned with the style of writing and the language of the research; it comprises choices such as using first or second person, active or passive voice, present or past tense (Hussey & Hussey, 1997). This thesis is mostly written in the first person plural, using active voice. Furthermore, present indefinite tense is predominant in the report.

2.2 Methodological Assumption

After determining the paradigm, methodological assumption should be made. In this case methodological assumption means the overall approach to the research process. The type of methodology that a researcher chooses should reflect his/her research paradigm (fig. 1)

<table>
<thead>
<tr>
<th>Positivistic</th>
<th>Approach to social sciences</th>
<th>Phenomenological</th>
</tr>
</thead>
<tbody>
<tr>
<td>Associated methodologies:</td>
<td>Associated methodologies:</td>
<td>Action research</td>
</tr>
<tr>
<td>Cross-sectional studies</td>
<td>Case studies</td>
<td>Ethnography</td>
</tr>
<tr>
<td>Experimental studies</td>
<td>Feminist Perspective</td>
<td>Grounded theory</td>
</tr>
<tr>
<td>Longitudinal studies</td>
<td></td>
<td>Hermeneutics</td>
</tr>
<tr>
<td>Surveys</td>
<td></td>
<td>Participative enquiry</td>
</tr>
</tbody>
</table>

Figure 1 Methodological Assumption of the Main Paradigms
(Source: Hussey & Hussey 1997, p.59)
As identified in the above figure, a researcher should choose a methodology based on the social science approach that he/she chooses. Therefore, since we abide with the phenomenological assumption, we examined the methodologies on the right hand side, in order to find the most appropriate one for fulfilling the purpose of this thesis. Two methodologies were identified: hermeneutics and participative enquiry. Hermeneutics is a type of phenomenological methodology that highlights the importance of the social and historical context when interpreting the text. Thus, hermeneutics involves interpreting the research whilst continually referring to its context (Hussey & Hussey, 1997). We believe this methodological assumption is the right one for our research purpose, since we are focused on collecting data in a specific historical and social context, i.e. Georgia, and for the purpose of interpreting the data a reference should be given to this context as well. At the same time, participative enquiry is another type of phenomenological methodology which is a research with people, when participants are fully involved in the research (Hussey & Hussey, 1997). We infer to using this methodology since the parties that we are going to interview and gather the data from shall direct and determine the progress of the research, and thus influence it highly.

2.3 Purpose of the Research

Research questions of the study shall result in descriptive, explanatory or exploratory answers. We believe our research questions fit best with the exploratory studies, since these are means for finding out what is going on regarding the topic and seeing the phenomena from a new angle, whilst at the same time referring to the existing literature in the field (Hussey & Hussey, 1997; Saunders et al. 2007). Furthermore, this type of research is suitable when the study aims at showing the patterns and ideas rather than testing or confirming a hypothesis (Hussey & Hussey, 1997). This thesis does not aim at testing hypothesis against the collected empirical evidence, since the sample size of the study is very small for fulfilling this purpose. For the same reason, the thesis shall not have the possibility to conclude answers to problems; it will rather give guidance and serve as a building block for a further research in the area. Since exploratory approach is further recommended for gathering a wide range of data and impressions as defined by Hussey and Hussey (1997), we believe this type of research purpose to be the right one for us.

2.4 Data Collection

2.4.1 Exploring Secondary Data

In order to understand the phenomena in question we have conducted a literature study of journals, publications and books from Jönköping University Library, as well as the previous studies and reports on Georgia carried out by international organizations. The previous studies are also important for the reader to understand the overall situation in Georgia, as well as for investigating some general historical facts that the reader might not know. Another form of secondary research that we used included investigating the web-pages of the governmental and non-governmental (NGO) bodies that are in charge of fostering entrepreneurial activities and improving a business climate in the country. In this manner, we created a knowledge base regarding the topic, got acquainted with the activities that are being undertaken in the direction of fostering entrepreneurship; thus, we prepared ourselves for forming the questions for interviews. According to Gnauthi and Gronhaug (2005), literature study helps the researcher explain and understand the research problem. It is even possible to answer some of the research questions based on secondary data and at the same time, this type of research broadens horizons of the researchers and gives them a possibility to bring up scientific conclusions from the research. In case of reports of the international organizations, and studies done by them, in the analysis part we shall compare and contrast our empirical findings against these secondary data. Furthermore, literature study provided us with
suggestions about the suitable research method for the research problem at hand; it also provided us with an instrument that helped us in interpreting and understanding our primary data.

2.4.2 Collecting Primary Data through Interviews

As we have already discussed, the purpose of this research is an exploratory study, i.e. we are trying to find out what is happening and assess the phenomena in a new way. We are not interested in collecting numerical data; therefore we choose qualitative techniques for collecting data that generated non-numerical data (Saunders et al. 2007). Qualitative research findings are not based on statistical methods and other procedures of quantification; therefore it is common to use observations and interviews as common means for collecting qualitative data (Ghauri & Gronhaug, 2005). Furthermore, “interviews are often considered the best data collection method” (ibid. p.132).

Interviews can be structured, unstructured and semi-structured. We believe that using semi-structured interviews for this purpose will be a reasonable choice. Since, semi-structured interviews are usually analyzed qualitatively; at the same time, they are used when a researcher is not only interested in “what” and “how”, but also in “why” questions (Saunders et al. 2007). Semi-structured or in-depth interviews are especially useful in the following circumstances:

- When the order and logic of the questions needs to be varied (Saunders et al. 2007);
- When the questions are open-ended and complex in nature (Hussey & Hussey, 1997; Saunders et al. 2007);
- When the researcher wants that the respondents share as much information as possible regarding a phenomenon that is to develop the understanding of the interviewees “world” (Hussey & Hussey 1997, p. 156; Cooper & Schindler, 2001).

These above-mentioned points are the circumstances found in our study. Furthermore, semi-structured interviews are especially helpful when conducting an exploratory study (Saunders et al. 2007). During semi-structured interviews, the researcher has a list of themes of questions, although the specific questions differ from interview to interview, therefore it is possible to omit or add some questions whenever a researcher sees it suitable. At the same time, in case of semi-structured interviews topics and issues to be covered, sample sizes, people to be interviewed are determined beforehand (Ghauri & Gronhaug, 2005).

Semi-structured interviews shall give us a flexibility to ask interviewees to further explain their points, give specific examples, this in turn is important when adopting a phenomenological (interpretivist) epistemology, when the concern is given to the way respondents understand and ascribe meanings to a phenomenon (Saunders et al. 2007). We shall have an opportunity to get a more in depth and significant data, while probing on the meanings and ideas presented by interviewees. This might even lead to some points that have not been considered beforehand, and that will further contribute to successfully fulfilling the research purpose.

2.4.3 Designing Interview Questions

Interview questions that we designed were open-ended, since they allow participants to describe a situation or an event in an extensive and in-depth way (Saunders et al. 2007). Two types of open ended questions were designed, one was specifically meant for entrepreneurs and the other for governmental and non-governmental organizations’ representatives. Questions meant for governmental and NGO representatives were adopted accordingly to fit the functions of the organizations respectively.

Interviews can be face-to-face, voice-to-voice, and screen-to-screen conducted with one individual or a group of individuals (Hussey & Hussey, 1997). Non-standardized interviews mostly occur face-to-face, although they may also be conducted via telephone, or electronically (Saunders et al. 2007). Since the thesis writing takes place in Sweden and our respondents are located in Georgia,
we chose to conduct electronic interviews, which refer to interviews that are held in a real time using intranet, as well as those conducted offline. Thus, electronic interviews are classified as synchronous or asynchronous depending on whether they are taken in real time of offline. We chose to conduct electronic asynchronous interviews, such as e-mail interviews. E-mail interview is a type of asynchronous electronic interview, when a number of e-mails each consisting of a small number of questions are sent to the respondent (ibid.). Therefore, after contacting our respondents, introducing ourselves to them, and making an agreement with them to participate, we sent several e-mails containing a small number of questions. Later on, we responded to these ideas, asked further questions for clarification, and in some cases made a follow-up call. According to Morgan and Symon (2004), since these types of interviews take several weeks to complete, they are advantageous since they allow the interviewer and the interviewee to further reflect upon the questions and responses before providing a thought out answer (as cited in Saunders et al. 2007). We further believe that these type of interviews were convenient for the respondents since they had a flexibility of answering the questions during the suitable for them time.

2.4.4 Selecting a Sample

Sampling issues are particularly important when conducting a quantitative study, when statistically valid conclusions are to be made. On the other hand, in a qualitative research the purpose of the study is not concerned with arriving at a statistically valid conclusion, the purpose is usually to understand, gain insight in the phenomena and create explanations (Ghauri & Gronhaug, 2005). However, it is still important to formulate and justify the choice of respondents. In our case, we chose owners and founders of SMEs and representatives of governmental as well as NGOs that are in charge of fostering and shaping business environment in the country. In both cases snowball sampling was identified to be the most convenient way to proceed. According to Saunders et al. (2007), snowball sampling is used in the situations when it is difficult or impossible to identify the members of the desired population. This is the case in our research, due to the fact that Georgia has a very poor or practically non-existent electronic database where one can find the list of entrepreneurs. Although it is considered that snowball sampling leads to biased results, we considered this type of sampling method to be the only option for us. Initial contact was made with a friend entrepreneur who later on directed us and helped us make contact with other cases in the population. As far as the representatives of governmental and non-governmental organizations are concerned, initial contact was made with the Ministry of Economic Development of Georgia, in particular the Department for Economic Policy Development that later on led us to other organizations that are also involved in the issue of fostering business environment in the country.

2.4.5 Qualitative Analysis of the Data

After collecting the data it needs to be processed in order to become useful and convey information (Saunders et al. 2007). The collected data can be analyzed in a quantitative or qualitative way. In this research we have chosen to analyze the data qualitatively, since we believe that the phenomena at hand is based on meanings expressed in words rather than numbers, moreover, the data is non-standardized and thus needs to be classified in different categories. To further justify our choice of qualitatively analyzing the data, we would like to refer back to specifications of the phenomenological paradigm that we infer to, this paradigm itself is a qualitative approach to research strategy and emphasizes on the meaning rather than the measurement of the phenomena (Hussey & Hussey, 1997). Furthermore, according to Robson (2002), qualitative data is used with the concepts that are rich and full in nature, and gives the opportunity to explore the subject in a real time manner (as cited in Saunders et al. 2007). At the same time, according to Cooper and Schindler (2001), the objective for exploratory study, that is the purpose of this research, can be achieved with various techniques; they can be both qualitative and quantitative, although exploration is more associated with qualitative techniques.
Analyzing the collected data is a process of bringing order to the mass amount of data that is collected, especially in case of qualitative data when the amount of information is very wide (Ghauri & Gronhaug, 2005). The key to analysis is being able to break down and divide the complex data into separate components. In this thesis we chose to follow the process described by Miles and Huberman (1994) who distinguish three processes in analyzing qualitative data (fig. 2):

![Diagram](image)

**Figure 2 Components of Data Analysis Interactive Model**


- Data reduction, categorizing the data to be compatible with the frame of reference (focusing, simplifying and selecting relevant information);
- Data display to show the information (assembling the information);
- Conclusion and verification (as cited in Ghauri & Gronhaug, 2005).

Therefore, we first reduced the data by simplifying the information and finding the focus and classifying the data into meaningful categories in order for the data to be relevant to our research. To further ease our task, we have given subheadings to the interview questions. In this manner we have connected these questions with different categories relevant to the frame of reference. As Saunders et al. (2007) notes, these categories provide a structure that is linked to the research topic. In some cases we had to omit the information that was not relevant to the purpose of the study. Afterwards, we assembled the information and displayed it in results using quotations from respondents. According to Miles and Huberman (1994) displaying the data helps in recognizing patterns of the data, and at the same time, serves as good means for drawing conclusions and verifications (as cited in Saunders et al. 2007). We have chosen to display the data in a separate results section were the reader has the possibility to view the data in a raw form, the way it was gathered. In the results section authors’ interpretation of the data is not given and the section is strictly objective, concentrated on presenting just the facts. This might further give a possibility to the reader to interpret the results in a different form and even contradict with the authors’ views. Further, Results section helps the thesis to be less biased towards viewing the results in the way that the authors of the thesis see it fit. This argument is especially important since as we have argued, while making axiological assumption, our values affect the way we interpret the gathered data. This is why a separate results section is of relevance for this study. At the same time, for presenting authors’ views the analysis section is presented, where the data is given a connection to the frame of reference and the authors’ view is explicitly stated. Finally, we drew conclusions from the analysis part that basically presented conclusions for each of the three research questions.
2.5 Trustworthiness of the Thesis

2.5.1 Reliability

Due to the lack of standardization in the semi-structured interviews the issue of reliability arises. Reliability is concerned with whether or not if similar research yields similar results if conducted by a different researcher (Saunders et al. 2007). According to Hussey and Hussey (1997), this is more of an issue when we are taking into account a positivistic paradigm, and not so much of an importance in the phenomenological paradigm. Further, Saunders et al. (2007), argue that non-standardized research methods are not meant to be replicated since they usually reflect reality at the particular time when they are collected and might be subject to change later on. Therefore, we conclude that the data collected as a result of this research shall reflect reality of that particular time and place and will be subject to change.

2.5.2 Validity

Validity is concerned with the extent to which the research is presenting what is happening in reality, i.e. the accuracy of the data of the research. Issues like researchers errors, poorly chosen samples, wrong research procedures may lower validity of a study. Since phenomenological paradigm captures the essence of phenomena as opposed to just measuring it, validity is high in such a paradigm (Hussey & Hussey, 1997). Furthermore, validity was relatively high in this research due to the fact that there was no language barrier present, both researchers and respondents communicated in the language native for both parties, i.e. Georgian language. Furthermore, interviewed entrepreneurs represented the capital of Georgia, as well as its regions. Validity might be lowered by the fact that the authors of the thesis do not have much experience in conducting interviews and their skills in this aspect might not be enough.

2.5.3 Generalisability

Generalization is concerned with “the application of research results to cases or situations beyond those examined in the study”; this means drawing conclusions about one thing based on the information from another thing (Hussey & Hussey, 1997 p. 58). Although in case of qualitative studies it is possible to relate the findings to the existing theory and thus give a broader theoretical significance to the work. This relationship allows us to examine the applicability of the existing theory to the new settings (Saunders et al. 2007); in our case this will be a new geographical location and a new context. In this research we do not mean to generalize the findings to a broader context that is not covered by the empirical material presented hereof, these findings can only serve as a starting point for a further research.
3 Frame of Reference

In this Chapter we define the terms entrepreneurship and SMEs in transitional environment. For a better understanding of the study information regarding transition process and institutional theory is provided. Finally, major barriers to entrepreneurship and SME development, as well as policies for overcoming these barriers in transitional context are presented. The Chapter ends with a summary of the theoretical framework by presenting a model constructed by the authors.

3.1 Entrepreneurship and SMEs in Transition Context

3.1.1 Determinants and Different types of Entrepreneurship

Entrepreneurship is a multi-dimensional concept; its research is characterized by little consistency and no concrete theory (Aidis, 2003a). The concept can be associated with a whole range of spectrums, such as application of innovative ideas, growth in a market economy, and most importantly, creation of new organizations. Determinants of entrepreneurship also involve different interrelated factors and forces, such as legal, institutional and social (Audretsch & Thurik, 2008). Furthermore, entrepreneurship can be analyzed at different levels such as individual, firm and aggregate, whilst taking into account the external environment, since entrepreneurship is a combination of interactions between those parts. Thus, the context in which entrepreneurship operates should not be underestimated, since it is a crucial factor (Smallbone & Welter, 2009).

Although it has been said that entrepreneurship exists in all environments, it still thrives in the conditions where it is supported. As Baumol states, entrepreneurs are present in all contexts but the external environment is the one that shapes their future manifestation (Baumol, 2008). Thus, entrepreneurship should be viewed in a broad context comprising many institutions that support emergence of entrepreneurs and entrepreneurial activities (Stevenson & Lundstrom, 2007). At the same time, decentralized economy allows potential entrepreneurs to act upon entrepreneurial opportunities, thus free market environment is more conducive to entrepreneurial development (Boettke et al. 2008). When entrepreneurs take advantage of profit opportunities, they create new entrepreneurial opportunities that others can act upon. Therefore, entrepreneurship creates an environment that makes more entrepreneurship possible. It is widely accepted that in a society characterized by well-defined and enforceable property rights, economic freedom, and the rule of law, productive entrepreneurs tend to allocate resources towards their highest-valued use (Boettke et al. 2008).

Although not all types of entrepreneurial activities are contributing to the progress of the country’s economy, according to Baumol (2008) there is a distinction between productive, unproductive and even disruptive entrepreneurial activities. The author states that productive entrepreneurial activity is the one that contributes directly or indirectly to net output of the economy, it should yield positive marginal product through a direct or an indirect route (ibid.). According to Wennekers and Thurik (1999), productive entrepreneurship manifests the innovative spirit that takes place when individual, social, legal, political and economic conditions are in place. On the other hand, an unproductive entrepreneur might engage in an innovative activity but not make any real contribution to the economy. It can take many forms and include rent seeking, through such activities as litigation and takeovers, tax avoidance that presents a potential threat to productive entrepreneurship (Baumol, 2008). Therefore, the rules of the game that are present in the specific environment and determine payoffs of entrepreneurial activities play a major role in determining the future fate of the entrepreneurship whether it will take a productive or an unproductive path (ibid.). The rules of the game are what we call the framework conditions for entrepreneurship that is all the social, legal, political and economic conditions that affect the development patterns of entrepreneurship. Unlike Western democracies, where productive entrepreneur-
ship is taken for granted, transition economies are suffering from institutional weaknesses, and
historic legacies (Aidis, 2003a; Welter & Smallbone, 2003). Thus, it is of importance to highlight
the role and importance of developing a productive entrepreneurship in transition economies to-
gether with an institutional system that supports its well-functioning. Before moving towards de-
fining and investigating entrepreneurship and SMEs in transitional environment, as well as the
institutional systems, we believe it is of relevance to first define the transition process as such, i.e.
present major characteristics and reforms that take place in the countries of economic transition,
as well as the stages that those countries pass during the process of transformation.

3.1.2 Definition of transition

Transition process is defined as a shift from centrally planned economy towards a free well-
functioning market oriented system. According to EBRD, transition process involves institutional
change (such as economic, social, financial and legal), change of private sector as well as transfor-
mation of the state role (Aidis & Sauka 2005). In addition, institutional arrangements for goods
allocation and generation, since ownership and reward structures that these institutions comprise
are different between market and centrally planned economies (Aidis & Sauka 2005). Transition
is a historic process of various changes that leads a centrally-planned economy that is based on
bureaucratic coordination and state property to transform into an open economy and the domi-
nance of private property. Although, only developing a private sector is far from sufficient to suc-
cessfully implement a transformation process (Kolodko, 2003). However, Smallbone and Welter
(2009), assert that transiting to market economy may not be the goal of all FSU countries.

Therefore, the major factor that characterizes transition countries is the transformation from a
centrally planned to a market oriented system (Aidis, 2003a). This transformation in turn is
extraordinarily radical in nature and scale, hence involving political, judiciary and cultural dimen-
sions along with economic reforms (Van de Mortel, 2002). A centrally planned economy is domi-
nated by large firms, producing few consumer goods, i.e. SME sector is basically non-existent,
whilst in the market economy they present a major part of the economy (McMillan & Woodruff,
2002; Uvalic, 2003). Moreover, all of the transition countries have taken very different steps in
the transformation process, although all of them underwent series of dramatic changes in their so-
cio-economic, political and macroeconomic environments.

3.1.3 Reforms in transition process

The most important reforms that the governments have been mainly focused on in the transition
process were the privatization processes, liberalization of markets, and achievement of the ma-
croeconomic stability (OECD, 1997; Hull, 1999). Only after these three processes are fulfilled
successfully can a country move on to the next stage and start reforming policies, building institu-
tions and behaviors that can further accelerate economic growth. The very last stage includes fur-
ther privatization, enterprise performance improvement through reconstruction, further market
liberalization, development of necessary infrastructure and reforming financial institutions (Aidis
& Sauka, 2005).

Transformation processes affected the environment in which private enterprises operated, the
population was given access to new range of opportunities, private initiatives were possible,
enormous profit opportunities were created (OECD, 1997; McMillan & Woodruff, 2002). The
most important role that the transition process has played is the emergence and growth of small
businesses that accelerate economic growth (Hull, 1999), since the role of SMEs is socially and
economically crucial (Aidis, 2003b).

There has been a controversy around the subject of how should these reforms be done. Should
the government take an active part in the transformation process or should the country’s econo-
my adjust by itself. In the beginning of the 1990s the common view was supporting the second
3.1.4 Classification of transition stages

Transition stages are classified in various ways, this classification helps in determining at which stage a particular transition country is placed. Several authors and organizations have presented their own ways of classifying the transition phases.

According to EBRD, the transition process is divided into two major phases an initial phase and the next phase. During the initial phase assets are privatized, markets liberalized and macroeconomic stability is achieved. These processes include small scale privatization efforts, liberalizing prices and trade. After these preliminary stage policies are developed, institutions and behaviors are adopted. These processes comprise of larger scale privatization efforts, restructuring infrastructures, reforming banking and non-banking financial institutions, liberalizing the interest rate (Aidis & Sauka, 2005).

Van de Mortel (2002) presents yet another classification of the transition process. According to this classification, the transition process starts from either the country’s willingness to transforming the economy, or when it is forced to do so. The author considers that when there is a free will of transforming, the process is usually short and successful. On the other hand, those countries that are forced to transform, may find themselves in a total vacuum after the collapse of existing institutional framework. At this stage of development countries should try and develop their own transition strategy that is relevant for that particular context; countries with strong constitutional institutions are successful at this process. During this early stage of transformation it is too early to demand property rights and privatization efforts; this stage is concluded once the decision-making process regarding new laws and regulations is initiated. The second stage of transition according to Van de Mortel (2002) is presented by formal institutional reforms, i.e. new legal framework is presented, rules and laws are revised including introduction of new types of laws such as banking, private property, competition, bankruptcy. The third stage of transition starts after completion of the legal framework. This phase is the process of adaption to the new formal institutional framework that should be accepted by the people. Probably this stage lasts the longest time, since this is when formal and informal institutions should be put together and harmonized, without this harmonization process they are deemed to failure (ibid.). Significantly, the author highlights the importance of development path, where "the transition process which individual countries go through is determined not only by events during the process, but also by the characteristics of these countries (the culture of people, geographical position, domestic resources) before the start of the process" (Van de Mortel, 2002, p. 26).

Furthermore, Smallbone and Welter (2009) present three main aspects of transition process. According to their research transition involves three steps:
(1) *A shift from public to private ownership* - this process is characterized by the privatization of the formerly state owned enterprises or creation of the new private startups. Thus, transformation not only involves privatization of the existing enterprises but equally important is the promotion of new startups and creation of favorable conditions for them (Hull, 1999). Newly established private firms usually perform better, thus making them agents of growth in those countries. New firms are also more adaptable to the transformation from the planned to free market economy and its conditions (Aidis, 2003b). The first stage is therefore characterized by privatization of land and capital, since private ownership of the factors of production encourage investments. At this stage the necessity of protecting private property rights, for example intellectual property comes into play. Intellectual property rights protection gives possibility to the entrepreneurs to reap the gains from developing new products and services, thus creating strong incentives to innovate and pursue entrepreneurial opportunities;

(2) *Market and price liberalization* - this process involves the increase in market opportunities and in the level of competition, at this stage scarcity is determining the price and it is not set by the state, there is a freedom of trade. Here it is important to open up to foreign trade, unify exchange rate and abolish trade restrictions. This gives possibility to the country to enjoy advantages of foreign direct investment (FDI) in forms of supply of capital, technology, knowledge transfer, employment generation, and enterprise development.

(3) *Creation of market institutions in order to establish the framework conditions for the free economy* - These institutions consist of banks and financial institutions, training support services, state organizations such as regulatory bodies. The extent and success of these reforms have a great influence on the future development of the private sector and its future success.

### 3.1.5 Entrepreneurship and SMEs in Transitional Environment

In the transition context specifically, Dallago (1997) distinguishes between two types of entrepreneurs: economic and systemic ones. Economic entrepreneurs are those that transform the structure and the system through applying innovation and who solve specific problems. Moreover, economic entrepreneurs can engage in productive as well as unproductive activities. On the other hand, systemic entrepreneurs do not change the environment they work within the system and fulfill specific interests. Most importantly, these types of entrepreneurs were predominant in FSU countries. While systemic entrepreneurs are a part of transition economies, economic entrepreneurs are found in both market and transition economies (ibid.).

On the other hand, Scase (2000) presents a differentiation between entrepreneurs and proprietors. According to this view, entrepreneurship refers to person’s commitment to create wealth, and grow the business; entrepreneur is willing to sacrifice some part of the direct consumption for the sake of expanding the business. Whereas, proprietors are more directed towards consuming the profits gained from the business and maintaining high standards of living, they are not determined to reinvest the funds back into the business. Thus, entrepreneurs, unlike proprietors, are concentrated on long term commitment and capital accumulation, and are willing to forgo short-term benefits. Applying to the transition context, Scase (2000) strongly asserts that proprietorship would best explain the rapid increase in small business traders in transition countries and draws attention to policy implications. Scase (2000) concludes that entrepreneurship seen in transition economies is similar to ‘booty capitalism’, where owners of new ventures are motivated by short-term financial profit rather than long-term growth. Therefore, it might be optimistic to regard that as “a force of indigenous economic transformation” (Scase, 2000, p.9). This in turn draws attention to policy implication, stating that resources should be devoted properly in order to produce business growth among entrepreneurs rather than among proprietors. But, how to separate entrepreneurs from proprietors for policy purposes remains vague.
On the contrary, Smallbone and Welter (2009) claim that Scase’s argument on the existence and the role of entrepreneurship in transition economies is not specific to transition. Therefore, SMEs in mature market economies also exhibit varying degrees of interest in long-term growth. Moreover, the authors claim that few business owners can be regarded as pure Schumpeterians (innovators) or pure shopkeepers and factors such as learning and environmental change may cause change in their orientation overtime (ibid. p. 45). Most importantly, while discussing the role of entrepreneurship in economic development in transition economies, emphasis on characteristics of external environment and the pace of change within it should be made, since they influence the scope of entrepreneurship as well the forms it takes (ibid. p. 39). As a result, “it may be misleading to use simple distinctions between opportunity- and necessity-driven entrepreneurs in order to discuss entrepreneurship and its wider implications to economic development” (ibid. p. 47). That is why, in this thesis first of all we look at the framework conditions that are present in Georgia, i.e. the external environment and the pace of change that took place over the past years for building a free market economy. According to OECD reports, framework conditions include the following: initial administrative as well as legal reforms, (which allows private enterprises to function within the law); private property rights; market based institutions; functioning banking system; business law, business ethics code, competition law, bankruptcy laws; simplified licensing procedures; transparent tax regime and stable legislation (Smallbone & Welter, 2009). Absence of these major framework conditions will distract development of productive entrepreneurship by all means (ibid.).

Furthermore, for the purpose of this study solely productive entrepreneurship that results in business creation is of relevance. This is due to the fact, that as we have already mentioned only productive entrepreneurship results in a positive effect on the national economy, thus we are not interested in entrepreneurial activities that do not affect the national economy or the ones that affects it negatively. We further believe that only productive entrepreneurship contributes to the successful transition process. At the same time, since entrepreneurship takes different forms starting from innovation to entrepreneurship within existing companies it is quite difficult to measure those types of activities. Thus, for the purpose of this study we only look at the productive entrepreneurial activities that result in the creation of new organizations; or simply we look at registered SMEs. Furthermore, considering the views of Dallago (1997), Baumol (2008), Aidis (2003b), Smallbone and Welter (2009) external environment is shaping entrepreneurial activities in transition economies. Therefore, our definition should highlight the influence of the ‘rules of the game’ or the framework conditions, and the obstacles that are created due to non-existence or inefficient existence of these conditions. Consequently, we decided to adopt a definition of entrepreneurship presented by Aidis (2003b).

“Productive entrepreneurship is the manifest ability and willingness of individuals to (a) perceive and create new economic opportunities through innovative activity (new products, new production methods, new organizational schemes, and new production-market combinations) and to (b) introduce their ideas in the market in the face of uncertainty and other obstacles; and (c) their efforts result in a viable business that contributes to national economic growth and personal livelihood” (Aidis, 2003b, p. 51).

However, a further distinction should be made between the notions of entrepreneurship and SMEs. As Wennekers and Thurik state, they are not synonymous terms, rather “small firms are an outstanding vehicle by which individuals can materialize their entrepreneurial ambitions” (1999 p.26). To put it differently, SMEs are vehicles in which “entrepreneurship thrives” (ibid. p.4). Similar thought is presented by Mateev (2003) who considers that entrepreneurship is a tool for starting up SMEs. At the same time, our definition of entrepreneurship already illustrates that entrepreneurship results in SME creation. Therefore, we share the distinction made by Wennekers and Thurik (1999).
Furthermore, referring to Aidis and Sauka (2005), it is important to highlight the roles that SMEs play in transition countries, understanding the role of SMEs in this context is important for understanding the essence of the study. The crucial role of SMEs is the reason why governments of transition economies should strive towards creating a favorable business environment. First of all, SMEs have a potential to offer benefits in terms of experimentation, learning and adaptability that are especially important in transforming economies. In addition, SME sector importance and development in transition economies was ignored due to high emphasis on restructuring and privatization of state enterprises, thus resulting in less resources and attention being paid to the needs of SME development (ibid.). International organizations such as EBRD and WB, particularly working with transition countries, affirm in their reports that small firms are ‘central to a successful transition’ (Bartlett & Bukvic, 2002). Moreover, entrepreneurship is regarded as significant player in transition countries because it has a high potential in facilitating the shift from a centrally planned towards a market-based system (Welter & Smallbone, 2003, p. 95). Supported by Smallbone and Welter (2009) SME sector “can contribute to the development of a more diversified economic structure, as an economy moves away from central planning” (p. 27).

In this chapter we talked about the transition process that is associated with institutional changes and with building a new institutional framework. In line with this argument we believe it is appropriate to dedicate a separate section to the institutional theory that comprises of the role of formal and informal institutions in a country. This section is crucial in understanding the process that takes place during the transformation.

3.2 Institutional Theory: The Role of Formal and Informal Institutions

Institutional theory is a most widely used theoretical framework for analyzing entrepreneurship in a transition context. Scholars researching entrepreneurship and SME development in transition economies such as Van de Mortel (2002), Welter and Smallbone (2003), and Aidis (2003b), mainly utilize institutional perspectives such as North’s concept of formal and informal institutions and institutional change for analyzing transition economies. Welter and Smallbone (2003) state that North’s institutional theory highlights the external political, economical and societal influences on individual activities, hence classifying them as formal and informal institutions. Importantly, external environment is the major element affecting the pace and nature of entrepreneurship in transition countries (Peng & Heath, 1996). Referring to Chavance (2008) unique relations between formal and informal institutional change explains the variety of transformation paths taken and outcomes achieved by various transition countries. In addition, Van de Mortel (2002) supports the notion that transition economies are characterized with wide range of fundamental institutional changes involving not only economic reforms, but also political, judiciary and cultural dimensions. For that reason, neo-classical approaches are not suited for analyzing transition countries, since they focus on economic issues within a specified institutional environment, whereas transition involves extreme uncertainty and needs to be analyzed as a process (ibid.). Besides, North (1994) assert the inability of neoclassical theory to grasp the development of economies stating that “it is concerned with the operation of markets, not with how markets develop” and its unsuitability while prescribing policies (North, 1994, p. 359). Therefore, Van de Mortel (2002) draws attention to theory’s treatment of uncertainty, specifically framework uncertainty that results from the collapse of the formal institutional framework in transition countries and hence, need to form new institutions. Significantly, the author considers North’s theory of institutions and institutional change as “the best-known example of an institutional theory capable of treating institutional change of an economic, political and judiciary nature” (ibid. p. 18). On the other hand, Chavance (2008) believes that shift from market-centered analysis to institutional approach was the result of an important role played by informal institutions in a systemic change.
3.2.1 Northean Institutional Theory

“Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction” (North, 1990, p. 3). Moreover, North (1990) asserts that institutions diminish uncertainty, define and limit the variety of choices existing for individuals. Institutions if not existent, may be formed or may develop eventually. However, we need to distinguish institutions from organizations to better understand North’s institutional theory. North classifies organizations as political, economic, social and educational bodies, whereas institutions as formal institutions (political and judicial rules, economic rules and contracts) and informal institutions (customs, traditions and codes of behavior). Emergence and evolvement of organizations are influenced by the institutional framework, which in turn is influenced by organizations and their entrepreneurs. Therefore, North considers organizations as ‘agents of institutional change’ (1990, p. 5). Due to the fact that institutions determine the opportunities in a society, existence of formal and informal institutions along with the enforcement plays a crucial role for low-cost transacting and hence, for economic performance.

According to Aidis (2003b), institutional theory plays a huge role in explaining the roles of institutions and their effect on economic performance especially in transition countries since in an advanced market economy, where market institutions are present and functioning, impact of institutions deserve less attention. According to Aidis (2003b), entrepreneurship is influenced on two different levels: environmental (such as macro and micro environment and the state role), and cultural and personal (including norms, values, personal characteristics, skills). These two levels can be regarded as formal and informal institutions. External environment is largely affected by the existing formal institutions, whereas the so-called cultural and personal dimensions are what North calls the informal institutions. Therefore, interactions of these two factors influence entrepreneur’s individual decisions to pursue productive or unproductive entrepreneurship.

Furthermore, North (1990, 1994) gives higher emphasis to informal constraints and argues that imposing same formal rules and/or constitutions on different countries produces different economic performance due to different informal rules and enforcement. Moreover, the author highlights the importance of realizing difficulty in changing or reshaping informal institutions. Even if formal institutions are changed overnight by political and judicial parties, informal constraints may not even be influenced by that change and “when there is a radical change in the formal constraints that makes them inconsistent with the existing informal constraints, there is an unresolved tension between them that will lead to long-run political instability” (ibid. p.140). Referring to Van de Mortel (2002), extensive or radical institutional change occurs rarely, mostly during a revolution, but recognizes the limit of overall changes when old informal institutions conflict with newly introduced formal institutions. However, formal and informal institutions may also interact in a way that produces harmony not only conflict, explaining the different kind of influence they have on each other. Further supported by Welter and Smallbone (2003), both formal and informal institutions are highly dependent on each other, particularly when new or modified institutional structure is to be introduced and implemented. Moreover, inadequate performance of formal institutions may lead to institutional distrust given the fact that informal institutions change slowly. Exploring informal institutions is out of the scope of this study, due to the fact that investigating informal institutions is a time-consuming process that is connected with observing and identifying cultural norms and codes of behavior of a nation. Therefore, this thesis will only concentrate on the general framework conditions that result from the existence of formal institutions.

North (1990) claims that institutions determine the performance of economies, and overall institutional framework affects the extent of trial encouragement, experimentation and innovation by society and economy. Aidis (2003b) considers North’s framework of formal and informal institutions relevant for transition context, since the evidence from the transition process in Central and Eastern European (CEE) countries show that institutions matter for economic development.
Moreover, North writes: “If the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities than organizations and firms will come into existence to engage in productive activities” (North, 1994, p. 361). This illustrates how nature of the institutional framework influences the nature of the activities of organizations such as firms (Mortel, 2002). Besides, North underlines the importance of path dependence that describes the ‘strong influence of the past on the present and future’ (1994, p. 364) and regards history as ‘an incremental story of institutional evolution’ (1990, p. 118). As a result, institutions are “the key to understanding the interrelationship between polity and the economy and the consequences of that interrelationship for economic growth” (North, 1990, p.118). Consequently, North (1994) acknowledges the importance of polity for country’s economic growth since they describe and impose economic rules. However, without developing informal institutions that will support and legitimize new formal rules, polities will tend to be unstable (ibid. p. 366). This in turn, does not exclude lengthiness of the process.

Even though Van de Mortel (2002) recognizes the capability of North’s institutional theory to treat institutional change of an economic, political and judiciary nature in transition countries, the author argues for the need to extend North’s theory. Mainly, North (1990) focuses on evolutionary change while transition economies experience a revolutionary change. This has also been the case in Soviet Union, where all the countries experienced revolutionary changes in the socio-economic environment after the collapse of the regime. In that case, as already illustrated, it might take long before new formal institutions are introduced and put into place, thus prolonging the time for ascertaining the harmony between formal and informal institutions. Hence, “a prolonged period of disharmony between the two kinds of institutions can have a profound influence on the transition process” (Mortel, 2002, p. 24). Despite the suitability of institutional approach to transition context, Van de Mortel (2002, p. 219) lists its limitations: (a) hard to draw general conclusions based on analysis of each individual country, (b) focuses on many dimensions simultaneously, and (c) has a qualitative overtone.

In cases when the above mentioned processes of institutional building are not completed successfully, inefficient framework conditions are created, i.e. unfavorable external environment that presents obstacles to the normal functioning process of potential as well as existing entrepreneurs. “Inadequate institutional environment in countries, where market reforms have been slow or only partially installed, can play a major role in constraining small business development” (Smallbone & Welte, 2009, p.18). In this case, specific emerged barriers limit the potential of entrepreneurship and SME development in the country. In this upcoming section we are going to have a closer look at the barriers to entrepreneurship and SME development, and more particularly in the transition context.

### 3.3 Barriers to Entrepreneurship and SME Development

Barriers to entrepreneurship and SME development are all those factors that make it difficult for entrepreneurs to either enter the market or to grow the already existing business, not including the fact when entrepreneurs are not willing to grow the business. Most of the market economies are characterized by significant barriers to business start-ups and growth. However, transition economies suffer from severe barriers to entry and growth of SMEs. These barriers, if not overcome, present a slowdown in the transition process to a competitive market, and in the worst cases can stagnate this transition all together. The process of transition may be delayed when there is a blockage in reallocation of resources towards a private sector. In this case barriers to growth of the existing firms and barriers to entry of new firms arise (Bartlett & Bulovic, 2002). SMEs in CEE countries face different types of barriers at different stages of their transformation process (Welter, 1997). Due to this fact, SMEs do not grow sufficiently and rapidly enough to prevent unemployment and fulfill their role as engines of economic growth. Barriers imposed by the ruling political elite can cause a misdirection of entrepreneurs from a productive into unproductive
forms of activities (Bartlett & Bukvic, 2002). Therefore, so called rules of the game presented by Baumol (2008) can make a big difference.

As we have mentioned, in an inadequate institutional environment when market reforms are slow or not completely installed SME development is highly constrained. Inefficient formal and informal institutions might decrease the SME role and its contribution to the country’s social and economic development (Welter & Smallbone, 2003). In this case, whenever the institutional reforms are slow, legal and financial infrastructure is the major drawback for SME and entrepreneurship development. Legal framework includes laws on property, bankruptcy, contracts, commercial activities, taxes, creation of this framework and these laws is fundamental for promoting SME development (Welter & Smallbone, 2003). All of the transition economies have made efforts in building up the legal framework, although some were more successful than others. However, establishing new laws is not enough for the legal framework to be efficient, most of the problems occur in the implementation stage (Welter, 1997; Hull, 1999; Catoiu & Veghes, 2003; Kuzmina, 2003; Mateev, 2003). In the transition economies there are institutional deficiencies for enforcing these laws; at the same time, frequent changes in regulations cause further confusion among business owners and government officials (Smallbone & Welter, 2009). Transition economies are usually characterized by lack of educated personnel and correct enforcement mechanisms. “This factors in turn will enforce SME’s reluctant or reserved attitude towards government and official regulations which is a rather common attitude during the beginning period of transition because of unfamiliar regulations as well as because of lacking confidence in state bureaucracy” (Welter, 1997, p.9).

Yet another major drawback for transition countries with slow institutional reforms is the financial infrastructure, inadequate banking system that lacks willingness and experience to finance small businesses. In such situations of inefficient framework conditions entrepreneurship remains restricted, and SME contribution to the country’s economic growth is limited (Smallbone & Welter, 2009).

In this study we differentiate between internal and external obstacles to entrepreneurship and SME development as presented by Welter (1997). External barriers include the entire external environment in which an enterprise operates, such as macro economic situation and institutional infrastructure, therefore this presents a formal institutional framework. On the other hand, internal barriers include obstacles found within an individual enterprise, such as entrepreneurs’ skills, as well as their, mindsets, mentalities, behaviors which present informal institutions and are out of the scope for this study; although, we shall briefly touch upon this issue and make own assumptions based on the collected data. For the purpose of this study we look at these two types of obstacles that will help us identify the existing barriers after conducting the primary and secondary data collection.

### 3.3.1 External Barriers to Entrepreneurship and SME Development

External barriers to entrepreneurship and SME development in transition countries include a wide range of factors such as: unsteady tax legislation and high taxes for businesses (Bartlett & Bukvic, 2002; Catoiu & Veghes 2003; Kuzmina, 2003; Mateev, 2003), as well as government’s intervention in the economy. At the same time, laws and regulations are regarded as a major drawback, which includes policy instability, frequent changes in legislations, non-transparent implementation of laws, poorly functioning state, inadequate accounting standards and business registration methods. Furthermore, business inspections present a heavy burden, together with high social security payments. Transition economies are also characterized by lack of state support, i.e. non-existence of business infrastructure and business supporting services. An important part of the formal barrier is an inefficient financial structure (Aidis, 2003b; Aidis & Sauka, 2005). Difficulties in financing that are due to restricted and underdeveloped financial markets, inefficient
banking system, high interest rates, collateral requirements, and moral hazard problems, makes it nearly impossible to finance a business. A number of reforms were taken to shift the banks’ role from a pure accounting agency towards a market oriented banking system. However, we see that banks in the transition economies do not compete their major responsibility of providing capital investments to private enterprises (Welter, 1997; Welter & Smallbone, 2003). This further leads to the lack of financial resources and inefficient credit policy in transition economies (Hull, 1999; Bartlett & Bukvic, 2002; Catoiu & Veghes 2003; Kuzmina, 2003; Mateev, 2003). These hindering factors are once again due to imperfect legal framework and less effective law application, which in its turn is due to the codes of behavior that are still to be developed through long years of experience (Chilosi 2001; Aidis, 2003b; Aidis & Sauka, 2005).

At the same time, motivation of the workforce tends to be low and bureaucracy is present everywhere; rent-seeking behavior of inspections, which results in a poor implementation of business regulations. As far as the economic barriers are concerned they are characterized mainly by macroeconomic instability and high inflation, the physical infrastructure in these countries is old, businesses suffer from lack of qualified workers and managers. Moreover, businesses find themselves in a very tough domestic and foreign competition, whilst the general demand is low due to low standards of living (Aidis, 2003b; Aidis & Sauka, 2005).

Investments can be seen as a key to economic stability. Therefore, an economy with high entry barriers in terms of investments is more probably to stagnate (Welter, 1997). One important aspect that deters investment and therefore entrepreneurship development is presented by McMillan and Woodruff (2002), this factor is corruption. Illegitimate takings aside and new regulations or policies make it extremely costly to start-up a business. When it comes to transition economies, not only is the corruption present during the start-up phase, but also in every day economic transactions (Welter & Smallbone, 2003). Moreover, a social barrier identified by Chilosi (2001) is worth mentioning, transition countries are characterized by left over attitudes from the previous regime, a case of this is the fact that entrepreneurs are still regarded as exploiters in FSU countries, and this decreases the appeal of becoming one.

### 3.3.2 Internal Barriers to Entrepreneurship and SME Development

As far as the internal barriers to entrepreneurship and SME development are concerned, entrepreneurs in CEE countries usually lack special knowledge and techniques to manage enterprises in the conditions of market economy (Welter, 1997). Entrepreneurs in transition economies do not possess business skills, experience and knowledge about how the market economy works (Catoiu & Veghes 2003; Kuzmina, 2003; Mateev, 2003). Although, most of the time entrepreneurs are reluctant to admit this fact and blame external barriers as causes of all their problems. This might be due to the fact that external barriers are easier to spot rather than internal ones, which are mostly related to management practices, and could be an implication of entrepreneurial weakness (Welter, 1997). At the same time, the author states that the external environment is still the most relevant factor for the entrepreneurs in transition economies. It is quite natural that entrepreneurs in transition economies have difficulties in managing the enterprises in new market economy conditions, since the management techniques were totally different during the centrally planned economy. Entrepreneurs are given an opportunity to actually decide autonomously, a factor that has been non-existent before. This in turn results in internal barriers presented by the mentalities and mindsets that are aligned with the old formal institutions that were present under the previous Soviet regime.

To sum up, table 1 presents an overview of the major external and internal barriers to entrepreneurship and SME development in the transition context. At the same time, in the following session we are going to present and discuss different policies for overcoming these barriers and fostering entrepreneurial climate in a country.
<table>
<thead>
<tr>
<th>External Barriers</th>
<th>Internal Barriers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic Conditions</strong></td>
<td></td>
</tr>
<tr>
<td>- Macroeconomic instability</td>
<td></td>
</tr>
<tr>
<td>- High inflation</td>
<td></td>
</tr>
<tr>
<td>- Tough competition</td>
<td></td>
</tr>
<tr>
<td>- Low demand</td>
<td></td>
</tr>
<tr>
<td><strong>Legal Framework</strong></td>
<td></td>
</tr>
<tr>
<td>- Unsteady and changing legislation</td>
<td></td>
</tr>
<tr>
<td>- High taxes</td>
<td></td>
</tr>
<tr>
<td>- Non-transparent and inadequate enforcement mechanisms</td>
<td></td>
</tr>
<tr>
<td><strong>Financial Framework</strong></td>
<td></td>
</tr>
<tr>
<td>- Inefficient banking system</td>
<td></td>
</tr>
<tr>
<td>- High interest rates</td>
<td></td>
</tr>
<tr>
<td>- High collateral requirements</td>
<td></td>
</tr>
<tr>
<td>- Underdeveloped financial markets</td>
<td></td>
</tr>
<tr>
<td>- Inefficient credit policy</td>
<td></td>
</tr>
<tr>
<td><strong>State Support</strong></td>
<td></td>
</tr>
<tr>
<td>- Non-existing physical infrastructure</td>
<td></td>
</tr>
<tr>
<td>- Lack of business support services</td>
<td></td>
</tr>
<tr>
<td>- Corruption</td>
<td></td>
</tr>
<tr>
<td><strong>Social Conditions</strong></td>
<td></td>
</tr>
<tr>
<td>- Low motivation of workforce</td>
<td></td>
</tr>
<tr>
<td>- Lack of qualified workers</td>
<td></td>
</tr>
<tr>
<td>- High levels of bureaucracy</td>
<td></td>
</tr>
<tr>
<td>- Negative perceptions about entrepreneurs</td>
<td></td>
</tr>
<tr>
<td>- Lack of knowledge and management techniques</td>
<td></td>
</tr>
<tr>
<td>- Lack of experience and skills</td>
<td></td>
</tr>
<tr>
<td>- Entrepreneurs’ mentalities and mind-sets</td>
<td></td>
</tr>
</tbody>
</table>

Table 1 Perceived Barriers to Entrepreneurship and SME development in transition economies
(Source: Own table)

### 3.4 Fostering Entrepreneurship and SME development

In order to positively affect and foster entrepreneurship it is crucial to know the factors that influence entrepreneurial activities and the process as a whole. As we have already mentioned above, Aidis (2003b) believes that entrepreneurship is influenced on two different levels: environmental (such as macro and micro environment and the state role) and cultural and personal (including norms, values, personal characteristics, skills). We have further classified them as formal and informal institutions are presented by North (1994). These are the factors that influence entrepreneur’s individual decisions to pursue productive or unproductive entrepreneurship. At the same time, government policy and programmes play a key role in these four factors that influence the development of legitimate or illegitimate entrepreneurship. Although personal characteristics are the most difficult to change, correctly designed training programmes can still change individual norms and values (fig. 3).
The author identifies the following factors that influence entrepreneurship in transition economies (Aidis, 2003b):

**Environment** - the main characteristic of all transition countries is the switch from a centrally planned to a free market economy. There is a lack of entrepreneurship traditions and business infrastructure in those countries. Furthermore, lack of financing serves as a main barrier for private businesses to succeed.

**Role of the state** – Preliminary policy of the state in transition countries was non-intervention in the economy. Most of the mistakes were made in totally new spheres, such as business tax system and legislation. Later on governments of transition economies changed their policy and started over regulating and interfering with private business activities. This in its turn led to the problem of corruption.

**Business owner characteristics** – In the environment where business infrastructure is lacking private business owners usually depend heavily on support services. At the same time, most of them have skeptical views about the national government. Since business owners in transition economies lack experience in dealing with taxes and business legislations this creates further difficulties for them. Short term orientation characterizes many business owners in FSU countries. They mainly focus on strategies for getting rich soon that are not long term in nature. Further, most of the business owners in FSU engage in trade activities which are generic in nature.

Entrepreneurship policy is a mechanism for stimulating growth, employment, and competitiveness on a market. It consists of measures taken to stimulate more entrepreneurial behavior in a region or a county, they are the measures intended to directly influence the level of entrepreneurship vitality in a country or region. In advanced countries, the main goal is to promote the spillover knowledge from universities for commercialization that will foster innovation and ultimately economic growth. Different countries use different instruments for constructing their entre-
preneurial policy based on specific economic, social, political, cultural and other contexts (Stevenson & Lundstrom, 2007). Storey (2008) presents a view on entrepreneurial policy, presenting the most common elements that are crucial. Some of these factors include reducing red-tape, access to microloans, information and support, education, as well as facilitating network services. Moreover, governments have to promote policies in order to increase welfare for its citizens. These policies include: lowering barriers to start-up, lowering barriers to expansion and growth, providing advice, support and finance from public funds (Stel, Storey & Thurik, 2008). According to Link (2007) public policy can enrich environments in which individuals grasp knowledge that otherwise can go unexploited. He presents some of the factors that should be taken into account for fostering entrepreneurship, which are tax incentives, direct support of innovation activity, collaborative research programmes and technology infrastructures.

Entrepreneurship policy makers seeking to increase rates of new firm formation and subsequent wealth creation in the country are faced with two choices: low regulation – starting business to take place as quickly and cheaply as possible (mainly present in U.S.) and high support – decreasing number and severity or regulations upon those businesses that are on the market (common in Europe). The latter is done through providing information, advice, training, or finance to new firms or existing small firms. Significantly, countries with burdensome business regulations are most likely to be undemocratic, characterized with corruption, large unofficial economies, and lower levels of wealth. This fact in turn triggered introduction of legislation in many countries for lowering “barriers” to new business creation (Stel et al. 2008).

During the last years governments of the transition economies have presented various policies that aimed at fostering entrepreneurship through SME development (Hull, 1999; Aidis & Sauka, 2005). Therefore, governments in these countries see the necessity to promote entrepreneurial climate by creating the support institutions for the development of the SME sector (OECD, 1997). Thus, role of the government is to set a platform for entrepreneurs for pursuing productive activities (Catoiu & Veghes, 2003; Kuzmina, 2003; Mateev, 2003). It is crucial for the existing firms and the new entrants to have support agencies, associations, and networks to advance their success (ibid.). Government policy matters a lot even at the level of the small start-ups, since business environment should be somewhat stable to create incentives for business creation (McMillan & Woodruff, 2002). Although policy does not influence entrepreneurial supply, it by all means influences its effective allocation, since private enterprises are biased towards profits rather than innovation. Entrepreneurs are always present; however, they take different directions that sometimes can even be detrimental for the economy. That is why, adjustment of rules of the game is so important. At the same time, at least one of the prime determinants of entrepreneurial behavior is ‘the rules of the game’ that govern the payoff between one entrepreneurial activity over another (Baumol, 2008).

Furthermore, as already discussed, the potential role of entrepreneurship and SMEs to economic development of transition economies is substantial but the extent to which it has actually achieved remains restricted. Small businesses necessitate support to be able to realize their potential in terms of job creation and economic growth (Hull 1999; Kirby & Watson, 2003). Smallbone and Welter (2001a; 2001b; 2009) argue the influence of the state’s policy on the level of SMEs contribution to the process of economic transformation.

Policy issues start from institutional arrangements that are established gradually by the government and results are monitored. In case institutional arrangements are not given a priority and are left to spontaneous processes, there is a case when a “system vacuum” arises and “informal institutionalization” takes place spreading corruption and organized crime (Kolodko, 2003, p.167). Another point is establishment of legal framework such as laws, tax codes, market regulations, and private property rights. At the same time, functions should be delegated to local government from central government, this deregulation is necessary to facilitate SME growth. Although in-
equality is unavoidable during the preliminary stages of transition, governments should try and
through social, income and fiscal policies manage income diffusion. Globalization and integration
with the world economy, regional integration and cooperation shall further facilitate SME develop-
ment and growth (ibid.).

Therefore, “government is one of the key influences on the external environment in which business de-
velop in any economy, acting as enabling and/or a constraining force, particularly in relation to institu-
tional change and development” (Smallbone & Welter, 2009, p. 31). Government measures taken
towards creating basic framework conditions for entrepreneurship help overcome the external
barriers to productive entrepreneurship and SME development. For that reason, the authors high-
light the importance of variety of ways that government can influence the nature and the level of
entrepreneurship in transition countries. There are other types of policies that influence entrepre-
neurship and SME development directly, these measures can be governmental or non-
governmental and comprise of programmes, trainings and direct support mechanisms directed
mostly towards abolishing internal barriers and some of the external ones as well (such as financial
assistance that provides accessible credits for entrepreneurs).

Most importantly, it should be realized that direct support has restricted impact if those frame-
work conditions are not created and developed. As a result, Smallbone and Welter (2001b) sug-
gest five types of policies through which government may influence the nature and the extent of
entrepreneurship in transition countries, i.e. indirectly affecting entrepreneurship development
through creating framework conditions, or directly - by providing information, finance or advice:

(1) Through the influence of government on the macro-economic environment in which business is
conducted. Even in mature market economies, factors such as levels of aggregate demand, interest
rates and taxation are considered to be directly affecting the development of businesses. Especially
in transition countries, early years of transition was characterized by high inflation, which discour-
daged individuals to engage in entrepreneurial activities rather than engage in trading and specula-
tive activity (Smallbone & Welter, 2009). Significantly, “stability in macroeconomic environment
management is a key requirement for SMEs since a stable external environment makes it easier for
firms to plan, especially with respect to the timing of investment, expansion and taking on new initia-
tives” (Smallbone, 1995, p. 16). In addition, low GDP level further discourages entrepreneurial
activity during transition. However, the authors argue the ability of governments in transition
countries to establish stable macro-economic environment without the support from internation-
al organizations.

(2) Through the impact of government legislation and regulations, that may have a differential impact
on firms of different sizes. Government policies may have different effects on large and small busi-
nesses. According to North (1990), businesses face two kinds of costs: direct (costs of employee’s
social security contribution) and compliance (understanding the legal requirements of legislation,
to deal with the paperwork, etc.) costs. Moreover, due to the size and resource constraints of
smaller firms, they face higher costs than large companies. Applying to the transition context, fre-
cquent changes of legislation and its complexity necessitated hiring of specialist to deal with the
paperwork and requirements imposed. Also, introducing laws that are difficult to implement
leads to corruption. In addition, factors such as tax burden and frequent changes in tax rules and
regulations have negative effects thus encouraging entrepreneurs to move to informal sector
(Smallbone & Welter, 2001b). Therefore, “the level of regulations imposed on small firms may need
to be examined in such circumstances to ensure that is compatible with the encouragement of enterprise
in the formal economy, and not placing too many burdens on emergent entrepreneurs” (Smallbone,

(3) Through direct support measures and programmes that are designed to assist small firms in over-
coming size-related disadvantages. As previously argued small firms face size-related difficulties and
need external support. This would be categorized as direct support such as providing financial support, advice/consultancy and business training.

(4) **Through its influence on the development of those institutions that are a necessary part of a market economy, such as banks and other financial intermediaries; business courts; training; business services organizations.** Referring to the authors, dynamic growth of entrepreneurship in many transition countries stipulate for institutional change involving legal infrastructure, creation of legal framework and the creation of commodity, capital and labor markets for facilitation of entrepreneurship development. Moreover, non-existence of above frameworks leads to informal activities, thus illustrating significance of its existence and development early on in transition process. Despite, creation of an effective business services infrastructure is another element of institutional change that is necessary for supporting SMEs. However, these issues should also be considered at the local level to avoid confusion among entrepreneurs.

(5) **Through its influence on the value placed on enterprise and entrepreneurship within the wider society.** This might be considered as long-term influence of government policy on entrepreneurship and SME development, but is regarded as crucial role for government especially in FSU countries. Hull (1999) calls it ‘the wisest policy’ when governments make efforts in encouraging entrepreneurial culture. First of all, entrepreneurship education should be encouraged at all levels of education. Moreover, politicians and government officials’ behaviors should reflect the courage and support for people wanting to start their own businesses. However, Smallbone (1995) argues that high expectations should not be placed on the ability of government to influence values placed on entrepreneurship in the short-run.

Furthermore, different policies presented by various authors can be divided according to the barriers that they directly aim to abolish:

**External Barriers:**

**Financial Framework**

Obstacles for flow of investments for financing existing businesses and startups should be reduced; this can be implemented through creating competitive and transparent banking and financial systems together with institutional infrastructures. At the same time, for those entrepreneurs who are unable to present collateral for receiving a loan, publicly supported funds should be put in place. In this way valuable entrepreneurs will be able to manifest themselves (Chilosi, 2001).

**Legal Framework**

Great importance should be given to the legal climate of the country, when entrepreneurs will be subject to law and their property rights shall be protected (Chilosi, 2001).

**State Support**

According to Hubner (1996) there are different types of support institutions for SMEs, they are roughly divided into financial (such as state banks, private, co-operative banks, insurance institutions) and non-financial ones (such as regional development agencies, centers for innovation and entrepreneurship, advisory, information and training institutions, economic chambers and associations, promotion and commercial institutions). For the SMEs to fully utilize this assistance measures, a mixture of both financial and non-financial institutions should be present (Huber, 1996).

Referring to Smallbone (1995), policies should be directed towards raising new business start-up rates as well as improving the survivability of young SMEs to allow them contribute to wider
process of restructuring and hence, to economic development. In addition, various types of support infrastructure should be applied to the stage of SME development since SMEs during start-up stage require business advice and information at the local level, whereas as they develop further, support needs tend to be more specific (Smallbone, 1995; Komsa & Merkulov, 1997).

It is important to abolish entry barriers for new businesses such as various types of licensing and registration procedures. In order to promote effective entrepreneurship, importance should be given to information exchange among entrepreneurs and with authorities, in this way public and private initiatives should be coordinated (Chilioti, 2001; Kuzmina, 2003; Catoiu & Veghes, 2003; Mateev, 2003; Hull, 1999). Careless subsidies should be avoided since they might promote only short lives incentives and do not have long term orientation. Corruption is another important topic to address for transition economies, together with making tax rates and regulations reasonable. Moreover, not only is it enough to set measures but their quality is related to the implementation processes, thus to public authorities who enforce them.

**Internal barriers:**

**Entrepreneurs’ knowledge and skills**

Fostering entrepreneurial education by increasing resources in this area is especially useful for promoting entrepreneurial capabilities (Chilioti, 2001; Mateev, 2003). Since business development begins with the reform in educational system, almost all of the transition countries are reforming educational system at different levels (Gibb, 1996). Furthermore, promoting presence of foreign entrepreneurship might lead to knowledge/technological spillovers, provide training to local entrepreneurs, and change the business culture (Chilioti, 2001).

Despite the lack of resources and adequate institutional frameworks, not all transition countries’ governments show commitment and do not possess ability to implement market reforms (Smallbone & Welte, 2001b; Smallbone & Welte, 2009) leading to slow progress of the countries’ economies. As a result, “government may be seen as one of the barriers to the development of small private firms, with a reluctant and often hostile attitude, which adds a political dimension to an already unstable economic environment” (Smallbone & Welte, 2001b, p. 74). Significantly, a lack of clarity with respect to responsibilities, a lack of accountability for actions along with lack of transparency in procedures contribute to unimplemented state policies (Smallbone & Welte, 2009). However, one of the challenges faced in creation of a favorable environment for entrepreneurship and SMEs is the inexperience of governments in being a regulator of business activities. In addition, governments face challenge in utilizing cooperation strategies instead of ruling by force, which they experienced in past. On the other hand, participation of all levels of government in the process of transformation and encouragement of entrepreneurship and SME development is another requirement to promote co-ordination and avoid bureaucracy (ibid. p. 36). Therefore, the most important part of the transformation process is to establish proper policing and control of the introduced institutions, so that people who administer someone else’s wealth are not stealing it in any form (Chilioti, 2001). At the same time, Kuzmina, 2003; Catoiu and Veghes, 2003, and Mateev, 2003 stress the importance of establishing statistical monitoring of entrepreneurial development. However, the policy tasks of transition are quite complex and need concurrent expansion of the scope of markets as well as creating the array of institutions, both formal and informal (McIntyre, 2003). Most importantly, “connecting citizens to the process of change for gaining support of informal institutions for new rules” is of high relevance, but should be realized that it takes time (Aidis, 2003b, p. 210). Finally, due to distinctiveness of countries from each other, ‘one-size-fits all’ policy should not be utilized (Boettke et al. 2008).
3.5 Summary of the Frame of Reference

As we have argued above, although policies do not influence the entrepreneurial supply as such, they by all means influence its effective allocation, in terms of giving incentives for the entrepreneurs to take a path of productive entrepreneurship; this in its turn results in economic development of the country. This brings us to Baumol’s rules of the game or framework conditions that govern the payoff between the different entrepreneurial activities (2008).

We have stated above, that governmental policies affect entrepreneurship and SME development indirectly through influencing framework conditions (rules of the game) that result in creating a conducive environment; at the same time, if the framework conditions are inefficient they serve as barriers to entrepreneurship, and result in its ineffective allocation and creation of unproductive entrepreneurship (fig. 4). Together with the indirect measures, government or other organizations such as NGOs or international organizations, can directly influence entrepreneurship and SME development by providing financing, training, or support services for them. Although as mentioned, without the efficient framework conditions in place, these direct measures shall have a little positive influence, if any.

Figure 4 Entrepreneurship Policies in Transition Context
(Source: Authors’ Own Model)

The figure above encompasses the three research questions that the thesis aims to answer. The upper part of the figure labeled as framework conditions reflects the extent to which framework conditions conducive for productive entrepreneurship and SME development exist in Georgia. On the other hand, the second question represents identification of major barriers to development of the productive entrepreneurship in the country. The final question embodies state and other support policies aimed at fostering entrepreneurship in the country through direct or indirect policies.
4 Results

In this chapter we present results of the secondary data, as well as the results from the empirical study conducted by us. The secondary study presented hereof comprises of the previous studies conducted in the field, mostly by international organizations. These data shall be used for comparing and contrasting results gathered from our empirical findings. The primary data was collected by interviewing 8 entrepreneurs who are founders and managers of SMEs in Georgia, and 6 representatives of Governmental and non-governmental bodies.

4.1 Secondary Data (Previous Studies) on Georgia

4.1.1 Entrepreneurship and SMEs in Georgia

Georgia is a small transition economy situated in South Caucasus with a population of 4.5 million people and gross national income (GNI) per capita of 2.090 USD. Capital of Georgia is Tbilisi. Georgia regained its independence in 1991 after collapse of the Soviet Union and had the worst decline in the economy suffered by any transition economy (www.worldbank.org). Independence was followed by an economic transition of the country. According to various EBRD reports Georgia has completed the primary stage of transition process during 1989-1994, followed by a secondary stage in 1995-1999, and finally advanced stage was carried out during 2000-2004 (Aidis & Sauka, 2005). Currently, according to EBRD indicators (2008) transition process in Georgia is ranked quite high 3.07 (fig. 5) (from the scale of 1 to 4.33). At an initial step the government of Georgia (GoG), with the assistance of IMF, WB, EBRD, USAID, IFC and other international financial organizations and institutions passed reforms directed towards liberalization of prices, privatization of state property. Privatization of SMEs, the so-called mass privatization, was complete by the year of 2001. Furthermore, steps were taken towards building a new legal and institutional infrastructure for speeding up the transition process (Guruli, Abutidze & Khurtsidze, 2001).

![Transition indicators, 2008](image-url)

Figure 5 Transition Indicators 2008

(Source EBRD data retrieved from www.ebrd.com)
Strong post advanced transition reforms that took place between 2004-2008 generated rapid economic growth for the country. Reforms were mostly directed towards strengthening public finances, improving the business environment, and upgrading infrastructures (EBRD, 2008). GoG introduced reform programmes directed towards the following: simplifying licensing, eliminating red tape, simplifying tax and customs code, improving tax administration and enforcement, significantly reducing corruption (Ministry of Economic Development of Georgia, 2008). During the past years the government has achieved quite positive results in creating a better business climate (EBRD, 2008). Although, this growth has been hampered by the recent Georgia-Russia war in August 2008 (www.worldbank.org). After the August war in 2008, the banking system is suffering from serious problems in liquidity and exchange rate stability, they have stopped giving out loans, and currently credits are still given out in a restricted manner. Currently the banking system is still quite inefficient due to lack of finances and the means of its regulation despite the fact, that the banking system of the country has improved considerably during the past years, and the agency for Financial control has been created that is in charge of controlling all aspects of financial system (banks, insurance companies) (IFC, 2006). At this point, the most important fact is to regain trust among investors and keep on further reforms for creating a favorable business environment (EBRD, 2008).

According to official statistics private sector has grown considerably in Georgia during the recent years. The taxation department has 83 400 operating entities registered in 2005, that grew to 122 000 in 2006 (OECD, 2007), and 259 988 in 2008 (www.statistic.ge). Since Georgian firms are not tracked by size it is not possible to determine how many of these are SMEs and how do they contribute to production and employment growth in the country. Georgian Law defines small enterprise as having annual turnover of maximum 500 000 Georgian Lari (GEL) (1 GEL = 0.47 EUROs as of 2009-04-24) and up to 20 employees. On the other hand, a medium enterprise should not exceed 100 employees and annual turnover of 1 500 000 GEL (OECD, 2007).

4.1.2 Business Environment in Georgia

GoG recognized high costs of doing business in the country by committing itself to improving the business environment. This was done by reducing costs for establishing and operating businesses and improving the participation of the private sector in policy-making. GoG also recognized that anticorruption reforms and regulation of the informal economy were country’s main priorities. According to Transparency International Report 2008, Georgia ranks as 67th among 180 countries when it comes to corruption perception index (Ministry of Economic Development of Georgia, 2008). In 2004 a significant step was taken towards fostering entrepreneurship and business development in the country by reducing tax rates and the number of taxes. Despite all this changes according to the data from 2004 the number of SMEs per one thousand people in Georgia is still lower compared to other countries (fig. 6) (IFC, 2004).

---

Figure 6 Number of SMEs per 1,000 People in Georgia

---

54
Putkaradze & Abramishvili, 2009


At the same time, it is worth mentioning that SME owners in the country lack trust in business associations and majority of them are not members of any of them, it is mainly because of the fact that they do not see any benefits from this membership, or that they are not aware of their existence altogether (fig. 7).

Figure 7 SME membership in Business Associations in Georgia

Due to further governmental reforms that took place in Georgia after 2004, currently it is easier to operate a business, and the country is ranked quite high on the doing business 2009 rating of the World Bank (EBRD, 2008). According to the international rankings Georgia has quite a favorable environment for starting up and operating a business. It is ranked 15th (out of 181 economies) on Ease of Doing Business (fig. 8) (Doing Business, 2009).

Figure 8 Ease of Doing Business in Georgia as compared to Global rankings
(Source www.doingbusiness.org, 2008).
When it comes to actually starting up a business Georgia’s ranking is even better, it is ranked as number 4 (out of 181 economies) (fig. 9). This is mainly due to the reduction of the number of procedures from ten to three; as a result of these changes, the country advanced 6 places within a year. Now it takes three days, three procedures and 4.05% of GNI per capita to start a business. The procedures are: (1) paying the registration fee; (2) registering a company with the entrepreneurial register and obtaining the identification number and certificate for state and tax registration; (3) opening a corporate account in the bank. It is of interest to look at Georgian indicators when it comes to other variables such as dealing with permits, registering property, getting a credit, paying taxes and enforcing contracts. From the information we can see that taxation system remains as one of the major challenges for the country, in this sphere the ranking is not so appealing, out of 181 economies Georgia occupies 110th place (Doing Business, 2009).

<table>
<thead>
<tr>
<th>Rank</th>
<th>Ease of Doing Business</th>
<th>Starting a Business</th>
<th>Dealing with Construction Permits</th>
<th>Employing Workers</th>
<th>Registering Property</th>
<th>Getting Credit</th>
<th>Protecting Investors</th>
<th>Paying Taxes</th>
<th>Trading Across Borders</th>
<th>Enforcing Contracts</th>
<th>Closing a Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>110</td>
<td></td>
<td>81</td>
<td>92</td>
</tr>
</tbody>
</table>

Figure 9 Ease of Doing business rankings in Different aspects in Georgia
(Source www.doingbusiness.org, 2008).

4.1.3 Governmental reforms towards Fostering Entrepreneurship

The joint report of World Bank and IFC “Doing business in 2007: How to Reform” rated Georgia as number one reformer. Furthermore, according to Business Environment and Enterprise Performance Survey, during the years of 2002-2005, Georgia had the largest reduction in the level of corruption among other transition economies. All these indicators show Georgian government’s attempts of transforming a country into a hospitable place for businesses and investors to operate in (IFC, 2006). Steps have been taken to achieve this in reality as well. In the following paragraphs we are going to mention major reforms that took place within the recent years.

The government has taken actions for improving the situation in the years of 2004-2007. Special attention was given to reducing the licenses and permits that improved SME operating environment. Out of total 909 licenses only 145 remain currently. Although according to IMF, there is no secondary legislation that would make these processes clear and more transparent (OECD, 2007). Moreover, majority of inspections that take place do not have well-defined procedures
that are clearly documented or established officially. Although there is a law against unauthorized inspections, tax authorities that account for 70% of all inspections, are among those that are exempt from the scope of this law. At the same time, inspection authorities are in the need of qualified personnel (IFC, 2006).

In order to fight with the informal economy the government has initiated a programme under which newly created businesses have the ability to postpone payment of taxes during the first ten years for existence. Overall, due to the improvement of business climate in the country in 2007, flow of FDI amounted to 1.5 billion USD (EBRD, 2008).

Governmental Reforms were mostly directed towards taxation system and business regulations.

**Tax reform (Legal Framework)**

In 2005 Georgian government introduced a new tax code that brought significant changes to the taxation system. Income tax has been changed from 12-20 % progressive rate to a flat 12% rate. Social tax has been reduced to 20% instead of existing 33% and VAT is now 18% instead of 20% (IFC, 2006). The profit tax has been reduced from 20% to 15% (Ministry of Economic Development of Georgia, 2008). Moreover, the taxation reform continued in the following years and is considering a reduction of income tax from 20 to 15 %, whilst abolishing the social tax altogether. Together with the changes made in the tax legislation, starting from 2008 tax declaration can now be done electronically (EBRD, 2008). Furthermore, as an incentive for small businesses, self-employed proprietors that do not employ any work force and have annual turnover up to 100,000 GEL are not liable to pay income and social taxes (IFC, 2006). All these reforms in the taxation legislation are directed towards facilitating economic growth, establishing a stable and attractive investment environment by setting up a solid legal framework and introducing liberal economic principles, supporting legal business by using flexible administrative mechanisms, and ensuring an increased culture of taxpaying through simplified procedures and taxpayer support. In total out of 21 taxes under the old tax code only 6 exist today (Ministry of Economic Development of Georgia, 2008).

On the other hand, tax legislation is very unstable and is characterized by frequent changes. Since its introduction in 2005, tax code has been amended 17 times. This makes it difficult to do tax planning and accounting for businesses. In line with this, tax code is claimed to be ambiguous and complicated by the entrepreneurs. To make matters even worse, general attitude towards businesses is considered to be unfriendly. Financial police is considered to conduct audits and inspections of businesses without involving the tax authorities. This government agency is supposed to prevent and fight financial crime, although if an entrepreneur wants to appeal against the inspection results, he/she finds that resolutions are poorly supported by factual evidence, thus it is difficult to defend the cause. Thus, taxation system is very much penalty-oriented and results in fines that are unreasonably high; whilst, tax appeal process is ineffective due to the fact that tax officer’s decisions are not overturned by higher fiscal instances or courts, this discourages business owners from appealing against tax authorities (IFC, 2006).

**Business regulations**

After the amendments in Georgian Company legislation in 2005, Georgia is one of the easiest countries for starting up a business activity. Now it only takes one day to register a sole proprietorship and three days for a Limited Liability Company (LLC). A new online business registry makes it easier to register private property, this reform reduced number of procedures for registration (IFC, 2006).
Reforms continued in later years, in total 4 reforms have taken place during the year of 2008 they include: a positive reform in starting a business, registering a property, getting credit, and one towards improvement of taxation procedures (Doing Business, 2009).

4.1.4 Existing Barriers to Entrepreneurship and SMEs in Georgia

Despite the positive steps taken by the government, a survey conducted in 2004 shows that SME owners still consider a number of external factors to be difficult and problematic in operating their businesses (fig. 10). As can be seen from the chart taxation is identified as a major problem to the SME owners. It should be mentioned that a similar study conducted for USAID Caucasus in 2004 also highlighted that tax system was identified as a major problem inhibiting business operations, due to its ambiguity and unpredictability (USAID, 2004). At the same time, frequent changes to tax legislation presents an obstacle to business development. In the year of 2004 alone around 60 changes were made to the tax laws. Inspections also rank quite high on the scale, although number of inspections has been reduced, it is still difficult to follow the requirements, since inspector’s functions are not clearly defined. The problem is that some bodies do not perform checks or do so in an unprofessional manner. In most of the cases these inspections end up with unofficial payments done by SME owners. Unofficial actions of the inspectors are not challenged to the inefficient court system and the fear that this might cause possible negative consequences to the business. Obtaining permits is another problematic case for the SME owners; this is mainly due to the red tape in the system and the large number of documentations that are required. As for the registration of a business, the reforms passed by the government that reduced the number of procedures have for sure brought a positive result, since business registration is not ranked as high as other problems (IFC, 2004).

<table>
<thead>
<tr>
<th>Processes SMEs Considered “Rather Difficult” and “Very Problematic”</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>83%</td>
</tr>
<tr>
<td>Export-Import</td>
<td>71%</td>
</tr>
<tr>
<td>Inspections</td>
<td>58%</td>
</tr>
<tr>
<td>Obtaining permits and approvals</td>
<td>43%</td>
</tr>
<tr>
<td>Licensing</td>
<td>43%</td>
</tr>
<tr>
<td>Certification and standardization</td>
<td>40%</td>
</tr>
<tr>
<td>Registration</td>
<td>38%</td>
</tr>
</tbody>
</table>

Figure 10 Processes SMEs in Georgia considered “Rather Difficult” and “Very Problematic”  

When it comes to supporting business environment, SMEs are quite skeptical about the authorities that they come directly in contact with during their business activities, especially this concerns the state tax inspectors (fig. 11).
As we have already mentioned, since 2003 Georgian government has passed a number of reforms for creating a more hospitable environment for businesses. A similar study was conducted in 2005 to compare the results with the previous years and in a way measure the effects of those reforms. From the chart below (fig. 12), it is clearly shown that at this point Georgian entrepreneurs feel more vulnerable to global environment and its factors rather than some specific regulatory processes that are administered by the state; since microeconomic stability presents a major hurdle in conducting a business in 2005 (IFC, 2006).

Figure 11 Central Government Role in Business Development in Georgia

Figure 12 Obstacles to Business Development as viewed by the entrepreneurs in Georgia

Although this shows an improvement in reform policies in the country, it is clear that many of the issues are still problematic for entrepreneurs – these include tax administration, unstable legislation, judicial system, corruption, all these factors are also closely linked with the government regulations their quality and the personnel that is enforcing them (fig. 13).

<table>
<thead>
<tr>
<th>Services</th>
<th>2003</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>Taxation</td>
<td>59%</td>
<td>80%</td>
</tr>
<tr>
<td>Inspections</td>
<td>32%</td>
<td>58%</td>
</tr>
<tr>
<td>Licences / Permits</td>
<td>30%</td>
<td>42%</td>
</tr>
</tbody>
</table>

Figure 13 SMEs rating of government processes as obstacles in Georgia
(Source: IFC, 2006 retrieved from www.ifc.org)

Further to the above-mentioned it will be of interest to see Georgia’s positioning in comparison with other countries in the Eastern Europe and Central Asia. The below presented figure (14) presents areas that businesses in the region identify as problematic. It is seen that Georgian enterprises are more concerned with financial assistance and political stability in the country compared to the region as a whole. They are less concerned with tax rates and existence of informal sector, as well as corruption and inadequately educated workforce. Aforementioned is believed to present a larger problem in the other countries of Eastern Europe and Central Asia.
Figure 14 Businesses Identify Problematic Areas  
(Source: IFC, 2008 retrieved from www.georgia.gov.ge)

Although corruption is a problem that GoG is constantly working on, and it presents one of the problematic areas in conducting a business, percentage of firms that identify corruption as a major problem are lower in Georgia as compared to the region. The same can be said about taxation rates and the tax administration mechanisms. On the other hand, when it comes to financing a business, it presents a larger challenge in Georgia as compared to the other countries in the region (fig. 15, 16, 17).

Figure 15 Corruption Problem  
Figure 16 Tax Perception  
Figure 17 Access to Finance

(Source: IFC, 2008 retrieved from www.georgia.gov.ge)

To sum up, Georgian business environment has suffered from systemic problems for a long time. According to OECD (2007), currently the most important issues that can be highlighted are the following:

- **Inefficient laws and their enforcement** — law compliance and its monitoring has been reduced to collecting fines, that in its turn is linked to the poor trained officials, court employees, judges and results in laws interpreted. Moreover, judiciary system is believed to
be corrupted. These settings forced may entrepreneurs to operate informally, i.e. pursuing unproductive entrepreneurship that does not contribute to country’s economic development.

- **Unstable governmental institutions** – government officials in the country are switching posts very often, thus are given no possibility to implement the policy or develop working relationships and cooperate with governmental or other actors. This permanent reshuffling results in the unstable political and legal environment in the country that in its turn negatively influenced business environment for investments that affects SMEs in particular.

- **SMEs’ short term orientation and poor access to finance** – In general SMEs in Georgia are focusing on immediate profits, i.e. SME owners are proprietors who do not reinvest in the business and reap the profits. Reasons for this could be an immature business culture, operating informally to avoid regulations, and overly secured loans.

- **Lack of skills** – although Georgian population is well educated, the educational system does not supply them with the skills that are necessary in the modern economy.

- **There is an asymmetric access to information and poor communication with authorities** – SMEs do not have possibility to voice their concerns, at the same time they have poor access to information, they usually do not coordinate with one another, and are isolated which makes it harder to influence policies or laws.
4.2 Primary Data

As we have mentioned in chapter 2 of this thesis, primary data was collected by using asynchronous electronic interviews, i.e. e-mail interviews.

Questions asked to the entrepreneurs broadly covered the following categories:

1) *Internal Factors* – entrepreneur’s experience in managing a business, his/her educational background, and entrepreneur’s management style such as reinvestment habits, usage of outside consultations.

2) *External Environment* – perceived external barriers that hamper normal operation of a business, general business and economic environment in the country, such as views regarding stability and competition patterns. Views regarding legal framework in the country, legislations and frequency of inspections. Efficiency level and existing barriers in the financial system. Difficulty of finding a qualified personnel, and societal views on entrepreneurship.

3) *State and other Support* – participation and awareness of support programmes. At the same time, view regarding government institutions, red tape and corruption perception level.

All questions were open-ended, referred to the frame of reference and allowed flexibility of views. Complete list of the questions can be found in Appendix A.

Questions asked to the governmental and non-governmental representatives who are actively involved in improving a business climate in the country, or are in some way involved in shaping a business environment, covered the following areas:

1) *External Environment* – measures taken to ensure economic stability in the country, views regarding legislation simplicity, frequency of changes, enforcement mechanisms. Existence of financing means for SMEs, flow of investments. Encouragement of entrepreneurship among the population.

2) *State and Other Support* – support measures provided to SMEs, incentives for this sector of business, measurement mechanisms of the existing programmes, trainings. Control measures of corruption, transparency level, qualification of the staff.

All questions asked were open-ended, and once again referred to the frame of reference; complete list of the questions can be found in Appendix B.

4.2.1 Interviewee Profiles

4.2.1.1 Entrepreneurs

For confidentiality reasons names of the entrepreneurs shall not be mentioned. Although we shall briefly describe the business sectors that they represented, as well as some background information about the entrepreneurs.

**Entrepreneur 1** – Services (household repairing works). The company was established a year ago, currently employs 20 people; and the average annual turnover amounts to 130.000 GEL (1 GEL = 0.47 EUROs as of 2009-04-24). Primary investment was gained through winning a tender announced by the Ministry of Finance of Georgia.

**Entrepreneur 2** – Services (legal consultancy). The company was established about year and a half ago, currently employs 12 people; average annual turnover amounts to 900.000 GEL. Primary
investment in the business was done through a loan given by a company’s partner that currently holds a share in the business.

Entrepreneur 3 – Services (bar-restaurant), Trade (convenience stores). The major business, i.e. a bar-restaurant was established in 2006, it currently employees 25 people, with average annual turnover of 800.000 GEL. Primary investment was done through personal funds and a bank credit.

Entrepreneur 4 – Construction Company. Established in 2006, although the entrepreneur has been pursuing business activities for 20 years. Currently the construction company employees 22 people, average annual turnover is 1 500 000 GEL. Primary investment was done through personal savings and a bank credit.

Entrepreneur 5 – Production of construction materials (such as tiles). Established in 2003. Currently employees 35 people, with average annual turnover of 1 500 000 GEL. Primary investment was done through a bank loan.

Entrepreneur 6 – Trade Sector. Established in 1994. Employees 5 people with an average annual turnover of 120 000 GEL. Primary investment was done through personal savings.

Entrepreneur 7 – Production sector (Oxygen production). Established in 1990, employees 8 people, with average annual turnover of 230.000 GEL. Primary investment was done through personal savings.

Entrepreneur 8 – Services (IT services). Established in November 2008, currently employs 13 people, average turnover so far amounted to 20.000 GEL. Primary investment was done through personal savings of several friends.

4.2.1.2 Governmental and non-governmental sector Representatives

The following Governmental and non-governmental organizations’ representatives were interviewed:

Ministry of Economic Development of Georgia - Representatives from Economic Policy Department, and International Economic Relations and Foreign Trade Department (decided to stay anonymous). Ministry of Economic Development of Georgia is responsible for liberalization of entrepreneurship activities, creation of favorable, transparent and stable legislation for private entrepreneurship and attractive business and investment climate in the country (www.economy.ge).

Irakli Kipshidze Deputy Director General of Georgian Chamber of Commerce and Industry (GCCI) – the chamber is a non-governmental independent organization. Objective of the Chamber is presentation and protection of interests of its members in Georgia. It takes part in the development of economic drafts, legislative and other acts. The Chamber leads systematic negotiations with its members, elaborates common opinion of business society and submits it to the management of the country, its ministries and organizations (www.gcci.ge).

Tamuia Liluashvili – former Director of Georgian National Investment Agency (GNIA). GNIA is an agency under the Ministry of Economic Development of Georgia, responsible for facilitation and promotion of investments in the country. Together with supporting FDI, the agency is also fostering public-private dialogue for building a hospitable environment for private sector development in the country. This governmental body provides with up to date information regarding starting up a business in Georgia. (www.investinggeorgia.org).

Fady Asly – Chairman of International Chamber of Commerce-Georgia (ICC-Georgia), founding member of the American Chamber of Commerce in Georgia. ICC-Georgia unites leading
companies and business associations in the country. It establishes a dialogue between the government and other stakeholders in the economy for ensuring a business-friendly environment in the country, therefore ICC-Georgia: “voices the views of the local business community to affect change in policy”. (www.icc.ge).

Gia Bibileishvili – Representative from the Project: Agribusiness Development Activity (ADA) financed by Millennium Challenge Fund. The project is involved in financing mostly existing enterprises and entrepreneurs in the agrarian sector. Financing takes place on the basis of presenting a project proposal that in case of approval is financed within the project. The project also finances start-ups if the business plan is well constructed and appealing.

4.2.2 Entrepreneur’s Interviews

4.2.2.1 Internal Factors

*Educational Background* - All of the respondents have higher education, although in different spheres, such as economics, law, finance, engineering, ecology. At the beginning of their businesses they were not specifically familiar with business management, although gained insights in the field through practical experience. Furthermore, entrepreneur 8 believes that this inexperience in management is a major barrier when operating a business. All of the respondents use some type of external consultation mostly in the fields of accounting, and law; advices on friendly or more formal basis.

*Reasons for starting a business* - Reasons for starting a business are mostly the desire to have a higher income, and interest in the business sector that was caused by changes that took place the country, such as creation of possibility to legally and openly operate a business.

*Reinvestment habits* - It is worth mentioning that service companies do not see the necessity to reinvest in the business, since they believe that service industry does not need reinvestment. Although, when it comes to construction companies and production of construction material business, as well as the bar-restaurant enterprise they do reinvest from the gained profit. Reinvestment varies and ranges from 10-80%.

4.2.2.2 External Factors

Commonly mentioned external barriers were the following: non-efficient taxation system, high taxes, corruption, involvement and control coming from non-competent governmental authorities in the private sector (e.g. police), unofficial inspections, economic instability, forceful extraction of unofficial sums, artificial barriers caused by the government such as unqualified staff, difficulty of getting things done without connections.

We are going to tackle most commonly mentioned barriers separately and present quotes of respondent entrepreneurs to further visualize the issue.

*Taxation system* – taxes are very high, according to some respondents; this hampers business development and growth; although as entrepreneur number 2 states: “of course it will be better if taxes were lower, but we should also take into account the fact that tax rates are quite low in Georgia, compared to other countries.” Mostly entrepreneurs prefer if taxes were lowered. “Tax legislation is inefficient, profit tax and VAT should be reduced. At the same time it is difficult to get a bank loan, interest rate is very high annual 35%.” (Entrepreneur 5). “Although taxes are claimed to be reduced, in reality they have increased and this is how; before the change, income tax was 12% and social tax was 20%. Social tax was paid by legal entities and income tax by individuals from their salaries and other incomes. After the change, social tax was abolished, whilst income tax became 20%. This is supposed an advantage for legal entities, although, in reality, individuals end up paying more.” (Entrepreneur 1)

45
Furthermore, entrepreneurs consider the Tax Code to be ambiguous and some of the parts are believed to be difficult to interpret without a help from the professional. At the same time, getting formal documentation and all sorts of paperwork done requires quite some time. This documentation mostly regards getting taxation papers done.

**Corruption** – different views were given regarding the corruption issue, some confirmed its importance in managing a business, one even confessed to having given a bribe. On the other hand, others did not admit the existence of corruption in the business sector.

“Corruption is a necessary factor for getting things done, I have bribed governmental officials and I have also heard others doing so” (Entrepreneur 1). “Corruption plays a major role in pursuing business activities; with its help any procedure is quick and easy”. (Entrepreneur 4). “Corruption plays a big role, although I have never given a bribe.” (Entrepreneur 6).

“Corruption is out of question” (Entrepreneur 5). “Corruption is a crime and is punished severely in Georgia” (Entrepreneur 2) “I believe that so-called “connections” institute plays a larger role in Georgia than corruption. It might be the case in all countries, but in Georgia it is more severe, such as hiring employees through connections, making business deals through connections, etc.” (Entrepreneur 8).

**Economic Stability** - Lack of economic and political stability makes it difficult to do any type of planning for all respondents. At the same time, recent crisis has affected negatively through the fact that demand fell among population, and their purchasing power is lower.

**Personnel at Governmental bodies** - “Personnel working for the governmental bodies are not responsible enough, they also lack relevant qualifications” (Entrepreneur 1). “Whenever the situation is not ordinary, and requires some extra knowledge, governmental bodies have big difficulties solving a problem” (Entrepreneur 2)

**Views regarding Property Rights** - Property rights are not effectively protected, mostly this concerns privatization issues regarding state property. “I have difficulty in registering land that I have bought from the state” (Entrepreneur 1). “Property rights are protected, but in some cases there are misunderstandings” (Entrepreneur 5). “Property rights present a problem in the country, although has not affected me in any way.” (Entrepreneur 8).

**Inspections** - Entrepreneur 1 has mentioned the unofficial inspections to present a barrier for him, although number of inspections are satisfactory for other respondents; some respondents do not remember the last time that governmental inspections were conducted. In some cases inspections have not been conducted at all.

**Legal framework** – respondents claim to be informed about existing laws, furthermore, most of the entrepreneurs use formal contacts and believe that they present a strong guarantee.

**Financial System** - Inefficient banking system is presented by the difficulty of getting credit from banks and high interest rates. Although for entrepreneur 3 it is not a problem, since: “I am using connections that I have in the bank, so I do not have problems related to the banking sector”.

**Social Factors** - Public has a positive opinion regarding entrepreneurs and their activities. Although some people consider that entrepreneurs get rich without deserving it. “Some people do not realize that stable development of entrepreneurship creates work places and income for them.” (Entrepreneur 4). As to hiring employees, this factor did not seem to present a problem, since eventually it is possible to hire the employee that one is looking for.

### 4.2.2.3 State and Other Support

Most of the respondents have heard of some support programmes such as micro-loans, grants from international organizations. Although, for one reason or another, respondents do not seem
to be taking part in any of the programmes, or using any of the support measures. As entrepreneur 3 puts it: “I have heard of some government programmes directed towards SME support, although I haven’t seen them in reality”. None of the respondents are member of any business association, since they do not see any benefits from this membership. General attitude towards governmental programmes is: “Government does not help entrepreneurs” (Entrepreneur 5). “Government has a totally loyal attitude, although experience in other countries has shown that it is necessary for the government to intervene and provide support measures, such as tax exemptions as well as business incubators” (Entrepreneur 8).

4.2.3 Governmental and non-Governmental Representatives

4.2.3.1 External Environment

Economic Stability - Government of Georgia undertakes various reforms to insure a continuous and sustainable macroeconomic development in the country. “The macroeconomic policies pursued by the government have produced positive results as evidenced by strong economic growth trends in the past few years” (GNIA). Ensuring external stability in the country presents government’s one of the top priorities, together with making the country attractive for foreign investors.

“Government’s role is crucial since macro-economic environment depends on the economic and business legislation as well as on the Central Bank Policy; considering the challenges that resulted from the global economic crisis and thanks to a wise Government Policy and cautious Central Bank policies, Georgia’s economy is weathering the storm much better than many countries.” (ICC-Georgia).

Legislation (Taxation, protection of private property) - All necessary measures are taken to protect property rights, as in every democratic country. Furthermore, there are monitoring groups to ensure the process. Private property is protected by a special legislation, as well as independent judicial system. “Private property in the country is protected on the constitutional level, by article 2” (Representative of the Economic Policy Department from the Ministry of Economic development of Georgia). Most of the information regarding recent changes in taxation, regulations and legislation can be found on the web-pages of the Ministry of Economic Development, as well as the National Investment Agency (listed above). At the same time, so-called “hot lines” exist for interested individuals to obtain information.

There is no special legislation for SMEs in the country, they share a common legislation with all types of enterprises; this is the Georgian Law on “Entrepreneurs”, at the same time, notion of SMEs is presented in the Georgian Law on “National Investment Agency”. It is worth mentioning the laws that determine the encouragement of investment flows on the legislative level. These are the Law on “Investment Support and Guarantees” as well as the Law on “State Support of Investments”. Although, in order to create an incentive for SMEs they are exempted from VAT if their income is below 100,000 GEL and if they are sole proprietors.

Changes in legislation are done according to demand, from the practical experience that was gained after the law has been in force. These changes are targeted towards simplifying and improving the legislation. GoG is trying to ensure easiness of legislation through acquiring international experience and practical experience of entrepreneurs. Recent changes in legislation have considerably improved the legislation through decreasing the number of taxes and their amount. Furthermore, the government if fighting corruption through transparency in its actions; all types of information is disseminated through web-pages, as well as in printed media. In this manner, all citizens have an access to governmental information (Ministry of Economic Development of Georgia). Although the Ministry does not provide entrepreneurs with direct support measures, NGOs are involved in different directions by providing support for SMEs in the areas such as: business planning, market research, financial planning, accounting, taxation, marketing, etc.
Barriers to Business - According to ICC-Georgia representative a major barrier that Georgian businesses face is the mistrust towards the judiciary system, although independence of the judiciary system seems to have improved a lot. Another challenge is access and the cost of credits for businesses. Due to the financial crisis local banks are borrowing at a high price and since their confidence in the private sector has dropped, they are not keen on lending money. Furthermore, instability and lack of visibility is another challenge for Georgian business sector. “Georgian Political parties have to understand that the permanent destabilization and the tarnishing of Georgia’s image will ultimately lead to a loss of investor’s confidence and the loss of jobs.” (ICC-Georgia). Despite, the government is very active in drafting proper legislations to create a business friendly environment in the country. ICC-Georgia is further involved in promoting Georgia among world investors in order to attract FDI.

4.2.3.2 Direct and indirect governmental and other support

According to the Ministry of Economic Development of Georgia, support provided to SMEs can be classified in three directions: procedural (simplifying business regulation procedures), financial and consultancy. Great attention is given to simplification of business procedures, lessening bureaucratic barriers, easing taxation burden. All these factors encourage business start-ups “these procedures seem to be fruitful, since during the recent years the number of registered enterprises has increased drastically” (representative from the Ministry of Economic Development of Georgia). Financial assistance is presented by a number of governmental programmes. These programmes are for example: “Agro 100” – creation of 100 agricultural enterprises; aim of this programme is development of new agricultural enterprises in the regions, since agricultural sector is a priority for the country. This programme is implemented by the Ministry of Agriculture and the Ministry of Economic Development of Georgia and so far has created a number of enterprises that employed local population. Yet another programme is the “Cheap Credit” programme that is also directed towards giving affordable credits to the agricultural sector, for those who already have an agricultural enterprise or wish to start a new one. As to business consultancy, NGOs are mainly engaged in this sector. These organizations are; “Young Economists’ Association of Georgia”; “Centre for Business and Economic Development” that provides all sorts of consultations for SMEs such as: business consultations, business trainings, accounting and audit, taxation and law consultations, support in sales, marketing and PR services; “Business Consultation Network of Georgia” that is concentrated towards SME sector development and has 6 offices across Georgia. Their activities mainly involve business consultations, training courses and market research (The Ministry of Economic Development of Georgia). Further, a consultation in business and law, as well as organizing business forums and fairs is GCCI’s competence. The Chamber is involved in training personnel for businesses. For this reason, a professional training centre exists were interested parties get training in the following fields: office management, hotel and tourism management, administrative management, marketing management (GCC).

The government provides special direct support measures for SMEs such as low percentage loans, information sessions and trainings mostly conducted by USAID and United Nations Development Programme (UNDP), as well as chambers of commerce. At the same time, many non-governmental agencies provide special trainings for SMEs. “Government conducts informational sessions with entrepreneurs, such as creating special agencies that are concentrated on helping and assisting beginner entrepreneurs in creation of businesses. Ministry of Economic Development has issued many “cheap loans” to SMEs to help them get started” (GNIA). “At the information centre of the Ministry of Economic Development of Georgia, all interested individuals can get necessary information. Advice will be provided by the competent employees of relevant departments” (Representative of the Economic Policy Department of the Ministry of Economic Development of Georgia). Furthermore, GCCI is directly involved in providing information to businesses in spheres of their interest. At the same time, these direct support programmes are constantly improved with the help of international organizations and by sharing experiences of other countries.
Simplified procedures for starting up a business are very appealing for new companies. Especially in the trading sector, since Georgia enjoys no quantitative restrictions on trade, at the same time after having streamlined border clearance procedures and preferential trade regimes with major partners. Furthermore, as a result of changes in Tax Code and Law on Entrepreneurs in 2005 and 2006 it only takes three days to register a legal entity and one day for sole proprietors. “Unified state and tax registration of companies is now carried out by tax inspectorates under one single procedure.” (GNIA). “ Licensing and permits have been dramatically decreased out of existing 555 types of licenses only 107 are left, as to the permits out of existing 423 only 50 are left today” (Representative of the Economic Policy Department of the Ministry of Economic Development of Georgia). With the simplification of licensing and registration procedures, and inflow of foreign capital, entrepreneurship is becoming very popular in Georgia. Government does its best to foster public-private dialogue for building a more hospitable and prosperous business climate. Public sector is involved in financial assistance, whereas private sector is involved in business consultations.

The government is encouraging private sector such as banks for initiating micro credits and special loans directed towards SMEs in particular. “National Bank of Georgia is supervising commercial banks and provides them with action plans”. (Representative of the Ministry of Economic Development of Georgia). The low percentage loan that the Ministry of Economic Development provides is directed towards the agricultural sector only. At the same time, government has passed many legislations helping different private sectors in Georgia. “In 2007 FDI in Georgia was close to 2 billion USD” (GNIA). The Ministry of Economic Development, GNIA, ICC Georgia, and GCCI are involved in helping investors and SMEs to network. Last year Georgia received 1300 million USD investments that mostly were directed towards SME sector development. Through having simplified registration procedures and relevant investment environment Georgia is also attracting foreign entrepreneurs (Ministry of Economic Development of Georgia).

 Mostly the Ministry of Economic Development helps entrepreneurs in the agricultural and tourism sectors. Direct support measures are in the form of machinery, fuel, chemicals (for agricultural sector), and creation of touristic zones and infrastructure for the entrepreneurs involved in tourism sector. At the same time, for all types of entrepreneurs the government provides benefits to support business development. Government programmes are disseminated on regional and local levels; programmes are monitored by government representatives. Great importance is given to entrepreneurs on the regional level. UNDP is implementing a special project called “Inclusive Financial Systems in Georgia” that is directed towards providing micro loans to entrepreneurs living in the different regions of Georgia. Major barriers that arise during the implementation phase are unqualified entrepreneurs who do not have relevant knowledge of a particular subject. For this reason international organizations are providing trainings for increasing awareness and qualification of entrepreneurs (Representatives from the Ministry of Economic Development of Georgia).

Furthermore, GoG is trying to promote entrepreneurship, although society has different viewpoints regarding entrepreneurship in general. “Entrepreneurship is slowly but surely developing in Georgia in a more organized way; considering the ease of doing business more and more SMEs are being created; Although Government does not have a specific legislation for SMEs, it is trying to encourage their development in the regions through encouraging large businesses to delocalize from Tbilisi to the regions.” (ICC-Georgia).

Further direct support for agricultural sector is presented by the project financed by Millennium Challenge Georgia Fund. The project is based on co-financing principle; i.e. from the required sum, the entrepreneur has to finance at least 50% of it. The project comprises all agricultural sectors, a necessary component is that it should be outside the capital and has to employee more people. The project is popularized with the help of regional government offices and meetings with farmers. Project proposals are received quarterly and the number of proposals ranges from
150-200. This project contributes to the business sector by providing short and long term assets and financing. Effects are monitored by the employees of the project, as well as representatives of the Millennium Challenge Georgia Fund. “The biggest challenge is working with the farmers, they find it difficult sometimes to realize and fulfil the necessary obligations” (ADA project).

Another non-governmental body ICC-Georgia serves as an intermediary body between the businesses and government. “Through several commissions ICC-Georgia put together businesses, Government and specialists to work on drafted legislations or to tackle precise problems related to the questionable implementation of already existing legislation. We were involved in changes in the Tax and Customs Codes” (ICC-Georgia). Currently ICC-Georgia is negotiating the establishment of an ICC Court of Arbitration in Tbilisi; this will dramatically improve the confidence of foreign investors according to the representative of ICC-Georgia. Furthermore, Georgian government tends to be very friendly to the business community and interacts very constructively on all types of existing problems. Government officials are very responsible in their duties and always ready to listen to the complains and overcome the difficulties (ICC-Georgia).
5 Analysis

In this section we present a phenomenological analysis of two different views: entrepreneurs’ perspective, and governmental/non-governmental representatives’ views regarding entrepreneurship and SME development in Georgia. At the same time, observed pattern derived from empirical research shall be compared to the views presented in the frame of reference, as well as with the information given in Chapter 4. Furthermore, authors’ personal opinion shall be presented.

5.1 Introduction

In the beginning of the thesis we have presented our purpose that comprised of analyzing the extent of the existence of framework conditions (protection of property rights, liberalization of markets, creation of market-oriented institutions and others), barriers to entrepreneurship and SME development, and how entrepreneurship is fostered in Georgia. For fulfilling the purpose, our study aims at answering the following research questions:

1) To what extent the framework conditions necessary for promoting productive entrepreneurship and SME development exist in Georgia?

2) What are the perceived barriers to entrepreneurship and SME development in Georgia?

3) In what ways is entrepreneurship and SME development encouraged and supported in Georgia?

Furthermore, these three research questions were visualized in figure 4. Based on the results and the frame of reference given in the study, each area of the research questions shall be analyzed below and authors’ opinion shall be explicitly highlighted.

5.2 Existence of Framework Conditions in Georgia

According to Baumol (2008) the rules of the game or framework conditions of the specific environment determine the future fate of entrepreneurship, i.e. whether it will take a productive or an unproductive path. As we have argued in chapter three, these framework conditions are all the social, legal, political and economic conditions that have an effect upon entrepreneurship in a country. Further, according to OECD reports these conditions include initial administrative as well as legal reforms, protection of private property, banking system, business laws, simplifying licensing procedures, transparent tax regime and stable legislation (Smallbone & Welter, 2009). Since until 1991 Georgia was under Soviet regime, the country operated under a centrally planned economy, and did not have any of the above-mentioned conditions necessary for a free market economy. Therefore, institutions or the rules of the game as North (1990) calls them were adjusted to the functioning of a centrally planned rather than a free market economy.

After regaining independence in 1991 Georgia experienced what Van de Mortel (2002) calls an extensive and radical institutional change due to the collapse of the existing institutions. In this case formal and informal institutions are highly dependent on each other as supported by Welter and Smallbone (2003). According to Van de Mortel (2002), when there is a free will of transforming, the process is usually short and successful. On the other hand, those countries that are forced to transform, may find themselves in a total vacuum after the collapse of existing institutional framework. In line with this argument, it is quite difficult to say whether Georgia was forced to transform or whether there was a free will to do so. Although there has always been the desire to gain independence, we believe that the country was quite unprepared to meet these radical changes and did at some point find itself in a vacuum as Van de Mortel (2002) puts it. This argument can be further strengthened by the fact that international organizations played a major
role in bringing out the country from this vacuum, by undertaking various reforms in this direction.

From 1991 with the help of international organizations Georgia started building the new formal institutions, which took a quite rapid phase. As we have mentioned above, Georgia has completed the primary stage of transition process during 1989-1994 which was characterized by the following processes: decisions were made for initiating new laws and regulations, small scale privatization started, prices were liberalized. This stage was followed by a secondary stage in 1995-1999 when introduction of new legal framework, rules, and laws related to protection of private property and bankruptcy took place. At the same time, larger scale privatization was implemented, and banks as well as other non-financial institutions were reformed. Advanced stage (2000-2004) was characterized by a so-called mass privatization, and further reforms and development of institutions. According to Guruli, et al (2001) mass privatization was complete by the year of 2001. This stage was followed by a phase which from our point of view still goes on in Georgia; this is the phase when adaptation should happen with the new formal institutional framework, i.e. it should be accepted by the people. According to Van de Mortel (2002), whilst formal institutions can change overnight, the harmonization of formal and informal institutions is what takes quite some time. This is the process when the population changes its behaviors and becomes adjusted to the new way of life, thus course of this action takes the longest time. Moreover, as highlighted by Welter and Smallbone (2003) inadequate performance of formal institutions may lead to institutional distrust given the fact that informal institutions change slowly. The institutional distrust is also revealed by distrust towards the government in general that is present in Georgia; SME owners are skeptical towards the governmental authorities that they directly come in contact with; figure (11) further proves the point. At the same time, Aids (2003b) further asserts this argument when states that entrepreneurs in transition economies are skeptical towards their national governments.

Despite the above-mentioned, we cannot prove whether informal institutions are harmonized with formal institutions or not. As we have stated, investigation is a lengthy process and takes an extensive research of mentalities and behaviors of the people. Despite, we shall still make some assumptions regarding informal institutions, since they are an indispensable part of the formal institutions. This study is more concentrated on observing the extent to which these formal institutions exist in the country. The reason is that formal institutions, as stated by North (1990), determine the performance of economies, and the nature of institutional framework influences the nature of the activities of organizations and firms. Furthermore, it is confirmed that transition economies tend to suffer from institutional weaknesses, which cause distractions in the development of productive entrepreneurship. This is due to the revolutionary nature of changes that the transition economies face (Mortel, 2002); this argument is also true for FSU countries that faced a profound socio/economic transformations. That is why, it is so important to develop an institutional system or external environment, as referred by Peng and Heath (1996), supporting a well-functioning entrepreneurial environment.

In line with the adaptation process, according to EBRD (2008), GoG continued strong post advanced transition reforms that took place from 2004 till 2008 and generated rapid economic growth in the country. These reforms were mostly directed towards strengthening public finances, improving the business environment, and upgrading the infrastructure. At the same time, the courses of transition processes are ranked quite high by EBRD (fig.5). From the above mentioned, it can be concluded that the basic framework conditions for operating a business are in place in Georgia. Further supported by the primary data, all necessary measures are taken for protecting property rights which is protected on the constitutional level and an independent judicial system, as asserted by the representatives of the Ministry of Economic Development of Georgia. In order to further ease the burden for entrepreneurs and foster business climate, legislation is based on international experience. Currently, there are a number of legislations protecting SME
Perceived Barriers to Entrepreneurship and SMEs in Georgia

5.3.1 External Barriers

As we have mentioned, Welter and Smallbone (2003) argue that with slow institutional reforms two major infrastructures that present drawbacks for development of entrepreneurship and SMEs in a country are legal and financial. If we have a look at the previous studies (fig. 10, 13), as well as answers of our entrepreneur respondents we can see that these two frameworks present a major barrier for Georgian entrepreneurs at the moment. As presented, Georgia adopted new laws and legislations by sharing experiences of other mature market economies. However, as presented in chapter three, various authors consider that establishing new laws is not enough for the legal framework to be efficient and most of the inefficiencies occur during the implementation stage which is the case in Georgia as well. According to Smallbone and Welter (2009), there are institutional deficiencies for enforcing these laws. At the same time, frequent changes cause further confusion among entrepreneurs and government officials. According to IFC (2004), around 60 changes were made to the tax laws in 2004, followed by 17 amendments in 2005 in Georgia (IFC, 2006). According to Welter (1997), transition economies are also characterized by lack of educated personnel; this point was mentioned by our respondents who identified that due to lack of qualifications, government officials have difficulties when solving a non-ordinary case. In line with this argument, tax code was claimed to be ambiguous and difficult to interpret by our respondents. Furthermore, according to various authors, as presented in chapter three, high taxes for businesses is a hurdle to entrepreneurship and SME development in transition countries. Although taxes have been reduced in Georgia due to a number of reforms, according to entrepreneurs taxes still remain high and they present an obstacle in the productive development of the business. This fact might be due to the penalty-oriented tax administration in the country and a general unfriendly attitude towards businesses that come from the taxation officials as presented by IFC (2006) report. However, it is worth mentioning that in comparison to other Eastern Europe and Central Asian countries, tax rates are lower in Georgia, and tax administration presents less constraint to businesses in Georgia (fig. 14, 16) (IFC, 2008).
At the same time, due to the low motivation of workforce in transition economies, bureaucracy is present everywhere and inspectors are characterized by rent-seeking behavior, which results in a poor implementation of business regulations (Aidis, 2003b; Aidis & Sauka, 2005). Furthermore, according to IFC (2006), taxation system as a whole in Georgia is penalty-oriented and if violated, is subject to fines that are very high. This might be the reason for entrepreneurs to consider taxes high; they might consider fines to present a burden rather than high taxes. This issue is worth looking at in case of a further research done on the subject. Moreover, unauthorized audits are being conducted for imposing these fines. As one of our respondents has stated, these unauthorized inspections result in unlawful extraction of sums from businesses. At the same time, as representative of ICC-Georgia has mentioned, entrepreneurs do not have trust in the judicial system which further discourages them from appealing against these illegal actions.

Moreover, taxation system is believed to be ambiguous and difficult for entrepreneurs to interpret without a help of a professional. Inefficient laws and their enforcement were further mentioned as a major barrier in the country by OECD (2007) report that further identifies the problem of poor trained government officials who interpret the law falsely. In line with the taxation system, entrepreneurs feel that getting paperwork done and solving the formal documentations takes quite a lot of time. This issue leads to corruption with the help of which most of the procedures can be shortened and quickened. Corruption deters investment and therefore entrepreneurship development according to McMillan and Woodruff (2002). Furthermore, illegitimate takings aside, in transition economies, not only make it difficult to start-up a business, but they are also costly in every day economictransactions (Welter & Smallbone, 2003). Although most of the entrepreneurs have highlighted the importance and presence of corruption in the business sector, just one of them has admitted to have actually given a bribe. It is worth mentioning that corruption level is lower in Georgia in comparison with the region’s indicator (fig. 14, 15) (IFC, 2008). Since this issue is very delicate it is difficult to rely on the gathered data, reality might be different, because naturally, entrepreneurs are not keen on discussing this issue. That is why, the corruption indicator is always an estimate rather than a definite percentage.

An important part of the formal barrier in transition economies is an inefficient financial structure (Aidis, 2003b; Aidis & Sauka, 2005). Difficulties in financing that are due to restricted and underdeveloped financial markets, inefficient banking system, high interest rates, collateral requirements, and moral hazard problems, makes it nearly impossible to finance a business. This further leads to lack of financial resources and inefficient credit policy in transition economies as we have mentioned in Chapter 3. We see that this is also the case in Georgia, although according to IFC (2006), Georgian banks underwent a number of reforms, receiving a credit is still very restricted. Banks in the transition economies do not complete their major responsibility of providing capital investments to private enterprises (Welter, 1997; Welter & Smallbone, 2003). According to the ICC-Georgia representative, the financial crisis further deepened the problem of getting a loan from banks, since now local banks are borrowing at a high price and at the same time, their confidence in the private sector has dropped and they are not keen on lending money. All of the respondents have complained about the difficulty of getting a loan from the bank as well as the high interest rates that further deepen the problem of financing. Furthermore, according to IFC (2008), difficulty related to access to finance for businesses presents a larger problem in Georgia as compared to the region of Eastern Europe and Central Asia (fig. 14, 17).

Protection of property rights presents yet another barrier. Although not all of the respondents have had a case when their private property right has been violated, most of them believe that this presents an issue in the country. Mostly this fact concerns privatization and registration of the state property. At the same time, problems regarding private property protection do not rank as a top problematic area in the international reports done on the subject. This means that it is not regarded as a major burden; more importance is given to other areas.
Transition economies are also characterized by lack of state support, i.e. non-existence of business infrastructure and business support services (Chilosi 2001; Aidis, 2003b; Aidis & Sauka, 2005). In the environment where business infrastructure is lacking, private business owners usually depend heavily on support services; although as we have stated above, entrepreneurs are usually skeptical towards their national government. In line with this argument, most of our respondents felt that GoG is capable of doing more than it is doing currently. Some entrepreneurs have heard of governmental programmes, although none of them have participated in any type of support measures. This can be related back to OECD report (2007) that identified that SMEs have a poor access to information, they are usually isolated and do not coordinate with one another, thus making it harder to voice their concerns. This isolation mostly results from the fact that entrepreneurs do not tend to be members of any business associations as reported in IFC (2004) (fig. 7). Furthermore, none of our respondents were members of any business association either, due to lack of trust or a belief that this membership does not bring any benefits. Of course when we talk about participation in the support programmes we refer to the direct support measures, i.e. when it comes to indirect support measures, entrepreneurs enjoy those measures whether they realize it or not. Since indirect support measures are presented by creation of existing formal framework conditions in which businesses operate.

Yet more importance was dedicated to the economic and political instability in the country, which makes it impossible for entrepreneurs to plan their businesses. This point was further mentioned in the report done by IFC (fig. 12); moreover, this factor is given more importance in Georgia in comparison with other countries in the region (fig.14). It is quite understandable due to the recent war that devastated the country. Moreover, businesses in transition economies find themselves in a very tough domestic and foreign competition, whilst the general demand is low due to low standards of living (Aidis, 2003b; Aidis & Sauka, 2005). Our respondents do find themselves in the environment of fierce competition, although they believe that low living standards of the population and therefore a low purchasing power present a heavier burden. Interestingly enough, the opposite is presented in the IFC report (2006) (fig. 13), where import is a major hurdle for businesses. The interpretation of the point is that due to abolishment of all trade barriers, competition coming from abroad presents a serious problem for national businesses. Although, it is obvious that this argument does not concern the service sector, and our respondents mainly presented this sector. Furthermore, the representatives from the Ministry of Economic Development of Georgia, believe that trade liberalization is a big step taken ahead for a better development of the business sector.

Moreover, as identified by Chilosi (2001), FSU countries suffer from a social barrier, since they have left over attitudes from the old regime that decreases the appeal to become an entrepreneur. Our respondents have not felt negative attitudes coming from the public. Although as one the entrepreneur stated, some people do not consider that entrepreneurs work hard enough to get so rich. This means that society might not yet realize the importance of entrepreneurship in economic development of the country as a whole.

5.3.2 Internal Barriers

As far as the internal barriers to entrepreneurship and SME development are concerned, CEE countries usually lack special knowledge and techniques to manage enterprises in the conditions of market economy (Welter, 1997). This is due to the fact that business education is a new field of study for the FSU countries. According to OECD (2007), although Georgian population is well-educated, education system in the country is not yet directed towards supplying them with skills that are necessary in the modern economy. Our respondent entrepreneurs once again showed this trend, i.e. all of them have a higher education although none of them have business education in management fields, or more specifically entrepreneurship. Their educational backgrounds are from different fields such as law, finance, economics, ecology, engineering, etc. Most
of them studied management through experience gained after managing their own businesses. That is why, all of them use some sort of external consultation or hire external help in different fields, especially this concerns accounting sector. As we have discussed in chapter three, entrepreneurs in transition economies do not possess business skills, experience and knowledge about how the market economy works. Furthermore, according to Welter (1997) entrepreneurs are usually reluctant to admit this fact and blame external barriers in the problems related to business management. Just one entrepreneur believed that Georgian businesses suffered from inexperience in management, which according to him presents a major barrier in operating a business efficiently. Although, Welter (1997) still believes that external environment is a more relevant factor for the entrepreneurs in transition economies.

At the same time, according to Aidis (2003b) business owners in FSU countries mainly focus on short-term gains and do not reinvest heavily in the business. That is she believes that entrepreneurs in FSU countries are proprietors without interest in long-term growth. This argument might represent entrepreneurs’ mentalities and attitudes, since we believe that Georgia is in the process when formal and informal institutions are not yet harmonized, these informal institutions, i.e. mentalities and attitudes might still be representing the old regime. Furthermore, according to OECD report (2007), in general SMEs in Georgia tend to be short-term oriented focusing on immediate profits. We found it very difficult to find a trend in this direction from our respondents. We observed, that service companies do not believe it is necessary to reinvest in the business, whilst construction and other companies stated that they reinvested parts of their profits back into the business, for encouraging future growth. Aidis (2003b) further states that entrepreneurs in transition countries are concentrated on getting rich soon and that was the main reason for starting a business. This might be the case among our entrepreneurs as well, since largest majority stated that the reason for starting their own business was a desire to get a higher income.

On the contrary to Aidis (2003b), Smallbone and Welter (2009) believe that Scase’s (2000) argument on the existence and the role of proprietorship in transition economies is not specific to transition only; this trend could also be observed in mature economies, where a number of entrepreneurs could also have a short-term orientation. For that reason, it might not be possible to generalize the trend of proprietorship specifically to the transition context and hence, in Georgia.

According to IFC (2004), number of SMEs in Georgia per 1.000 people is relatively low in comparison with other countries (fig. 6). To a great extent, this might stem from the above discussed barriers (table 2) to entrepreneurship and SME development in Georgia.
5.4 Fostering Entrepreneurship and SME development in Georgia

Accordingly, the role of government and other institutions in abolishing those barriers, and thus, encouraging entrepreneurship and SME development in the country becomes critical. Therefore, in the next section we shall analyze different support mechanisms that GoG and NGOs direct towards fostering entrepreneurship and SME development.

Table 2 Perceived Barriers to Entrepreneurship and SME development in Georgia
(Source: Own table)

<table>
<thead>
<tr>
<th>External Barriers</th>
<th>Internal Barriers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic</strong></td>
<td>- Lack of management/entrepreneurship education</td>
</tr>
<tr>
<td>- Macroeconomic instability</td>
<td>- Lack of business skills and knowledge</td>
</tr>
<tr>
<td>- Fierce competition</td>
<td>- Mentalities and attitudes representing the old regime</td>
</tr>
<tr>
<td>- Low demand</td>
<td>- Inefficient and unsteady laws</td>
</tr>
<tr>
<td>- Legal</td>
<td>- Frequent changes to laws</td>
</tr>
<tr>
<td>- Ineffective judicial system</td>
<td>- High taxes</td>
</tr>
<tr>
<td>- Non-transparent and inadequate enforcement mechanisms</td>
<td>- Penalty-oriented taxation system</td>
</tr>
<tr>
<td><strong>Financial</strong></td>
<td>- High interest rates</td>
</tr>
<tr>
<td>- Inefficient banking system/difficult access to finance</td>
<td>- High collateral requirements</td>
</tr>
<tr>
<td>- High interest rates</td>
<td>- Inefficient credit policy</td>
</tr>
<tr>
<td>- High collateral requirements</td>
<td><strong>Governmental</strong></td>
</tr>
<tr>
<td>- Inefficient credit policy</td>
<td>- Lack of educated personnel in government entities</td>
</tr>
<tr>
<td><strong>Social</strong></td>
<td>- Poor access to information on state programmes</td>
</tr>
<tr>
<td>- Distrust of entrepreneurs towards government</td>
<td>- Corruption</td>
</tr>
<tr>
<td>- High levels of bureaucracy</td>
<td></td>
</tr>
</tbody>
</table>

As we have mentioned in chapter 3, government has a crucial role in setting up an efficient platform for entrepreneurs to pursue productive activities. In recent years governments in transition economies realized the importance of SME sector and have presented various policies aimed at fostering entrepreneurship through SME development (OECD, 1997; Hull, 1999; Aidis & Sauka, 2005). GoG has also recognized the high cost of doing business in the country and committed itself to improving the business environment.

As we have presented in figure 4, there are two types of policies for fostering entrepreneurship, one that influences entrepreneurship indirectly through influencing framework conditions that results in creation of a conducive environment for entrepreneurship and SME development. On the other hand, direct policies can be both governmental and non-governmental; they directly affect
entrepreneurship through providing financing, training, and consultancy services to existing or potential businesses. To put it differently, indirect policies mostly affect external barriers to entrepreneurship, whereas direct ones are more related to abolishing internal barriers (ex. through advice and consultancy). For that reason, we shall have a closer look at these two policies by analyzing their importance and the extent to which they exist in Georgia.

As presented, Smallbone and Welter (2009) enumerate five types of policies that governments can undertake to directly and indirectly influence entrepreneurship through creating efficient framework conditions. Below we shall once again look at those policies and try to determine if and how they are met in Georgia.

(1) The first important policy is how the government influences and ensures macro-economic stability in the country. According to the authors, stable external environment is essential for SMEs to plan, expand and take new initiatives. In line with the representatives of the Ministry of Economic Development of Georgia, GoG undertakes various reforms to ensure a sustainable macroeconomic development in the country, furthermore external stability presents country’s one of the top priorities. At the same time, our respondent from ICC-Georgia believes that it is due to these wise policies that the country manages to maintain stability during the conditions of global economic crisis.

(2) The second policy concerns governmental impact on legislation and regulations, i.e. government should try and guarantee that the level of regulations does not discourage the small firms from pursuing entrepreneurial activities, and does not present a too heavy burden on them. According to the Ministry of Economic Development of Georgia, there is no special legislation for SMEs in the country, thus they are sharing a common Georgian Law on Entrepreneurs with other enterprises. Although as an incentive, sole proprietors with annual income below 100,000 GEL are exempt from VAT. At the same time, changes in the legislation are targeted towards further improvement and simplification of the system. GoG is trying to ensure easiness of legislation through acquiring international experience and practical experience of entrepreneurs. Recent changes in legislation considerably decreased the tax burden for all entrepreneurs. Due to these changes, doing business in Georgia 2009 indicator is very impressive, country ranks 14th out of 181 economies (fig. 8). Furthermore, due to easiness of registration procedures for starting up a business, country ranks 4th out of 181 economies in starting a business indicator (fig. 9).

(3) The third policy presents a direct support mechanism for SMEs and entrepreneurs through initiation of various measures and programmes, such as financial assistance and consultations. According to the representatives of the Ministry of Economic Development of Georgia, financial assistance is presented by two programmes that are being implemented currently. These are “Agro 100” and “Cheap Credit”; both of these programmes are directed towards providing financial assistance to potential and existing entrepreneurs in the agricultural sector. Furthermore, government is encouraging private sector, such as banks, to initiate micro credits and special loans for SMEs. At the same time, last year Georgia has received 1300 million USD investment directed towards financing and developing SME sector. Further support for agricultural sector is presented by the project financed by Millennium Challenge Georgia Fund. The project is based on co-financing principle; i.e. from the required sum, the entrepreneur has to finance at least 50% of the budget. The project comprises of all agricultural sectors, a necessary component is that it should be outside the capital and has to employee more people. As to business consultancy NGOs and international organizations are involved in this field, they provide business consultations, and business trainings in the following fields: accounting and audit, taxation and law consultations, support in sales, marketing, and PR services.

(4) The fourth policy concerns development of necessary institutions for market economy, such as banks and other financial intermediaries, as well as business courts. According to the Ministry of Economic
Development of Georgia, National Bank of Georgia is setting procedures and guidelines to other commercial banks in order to guarantee easier access to finances for entrepreneurs. Furthermore, ICC-Georgia and GCCI, serve as intermediary bodied between the businesses and the government. These NGOs helps voice entrepreneurs’ concerns and draft legislation changes to the GoG. Currently, ICC-Georgia is negotiating the establishment of an ICC court of Arbitration Tbilisi, which will dramatically improve the confidence of foreign investors according to ICC-Georgia. Furthermore, the Ministry of Economic Development builds necessary infrastructures necessary for developing sectors that are of priority for the GoG, these are agriculture and tourism.

(5) The fifth policy should be directed towards popularization of entrepreneurship in the society by influencing the value that is placed on entrepreneurial activates. According to Hull (1999) it is actually one of the smartest policies from the government’s side. Representatives of the Ministry of Economic Development of Georgia claimed that the government is promoting entrepreneurial activities among the population. This popularization is mainly presented by decreasing the number of procedures necessary for starting up a business. According to ICC-Georgia, entrepreneurship is slowly developing in Georgia through formation of a business culture in the country. This view is further supported by the statistics that show a drastic increase in the registered enterprises in the country.

Furthermore, as we have presented in chapter 3, different policies can be also divided according to the barriers that they aim to abolish. We shall present these barriers and the corresponding policies in a separate table (3).

<table>
<thead>
<tr>
<th>Types of Barriers</th>
<th>Types of Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>External Barriers</strong></td>
<td><strong>Financial Framework</strong> (access to finance)</td>
</tr>
<tr>
<td></td>
<td>- Government ensures flow of investments;</td>
</tr>
<tr>
<td></td>
<td>- “Agro 100”, “Cheap Credit” Programmes</td>
</tr>
<tr>
<td></td>
<td>- UNDP programme</td>
</tr>
<tr>
<td></td>
<td>- Millennium Challenge fund</td>
</tr>
<tr>
<td><strong>Legal Framework</strong></td>
<td>- Continuous improvement of Legislation</td>
</tr>
<tr>
<td></td>
<td>- Reducing Tax burden</td>
</tr>
<tr>
<td></td>
<td>- Reducing number of licenses, permits</td>
</tr>
<tr>
<td><strong>State Support</strong></td>
<td>- Ease of registering a business</td>
</tr>
<tr>
<td></td>
<td>- Ensuring Transparency of actions, abolishing corruption</td>
</tr>
<tr>
<td><strong>Internal Barriers</strong></td>
<td><strong>Entrepreneurs knowledge and skills</strong></td>
</tr>
<tr>
<td></td>
<td>- Consulting, support services of NGOs, international organizations</td>
</tr>
<tr>
<td></td>
<td>- Trainings at GCCI</td>
</tr>
</tbody>
</table>

Table 3 Barriers and Policies directed towards abolishing them

Source (Authors’ own Table)
Most importantly, implementation gap of the policies presents a problem in transition economies due to lack of transparency in procedures. Furthermore, importance should be given to engaging all levels of government in the process to achieve coordination and decrease the level of bureaucracy (Smallbone & Welter, 2009). Furthermore, as argued by Aidis (2003b) support from informal institutions which comes from citizens is of high importance; they should be connected and be a part of the change that takes place in formal institutions. We see from the results that our respondent entrepreneurs are not part of this change. They lack trust in government sector and, hence do not participate or do not have relevant information regarding the ongoing programmes and support mechanisms undertaken by the government. Even though Welter (1997) regards reserved attitudes of entrepreneurs towards government and official regulations as a common attitude during the beginning period of transition, our study reveals same type of attitudes of interviewed entrepreneurs during post advance transition period in Georgia. Furthermore, since the government has changed in 2003 and a new wave of reforms followed in 2004, we believed it was of relevance to ask the entrepreneurs if some of the barriers have been abolished. Although, all of the entrepreneurs claimed that the situation has not changed in any way so far.

To sum up the discussion regarding policies on fostering entrepreneurship and SME development in Georgia, it can be argued that the country is adopting the so-called U.S. model of support, i.e. as discussed in chapter three, this model implies low regulations for business, so that business registration can take place as quickly and cheaply as possible (Stel et al. 2008). On the other hand, this model is also characterized by the lack of support for existing businesses, especially in forms of financing training, and information.

### 5.5 Conclusions

This study aimed at developing a better understanding of entrepreneurship and SME development in the transition economies, more specifically in Georgia. After careful investigation of the existing literature on the subject and the previous studies, and after collecting the primary data on the subject, we have probed three research questions:

a. To what extent the framework conditions necessary for promoting productive entrepreneurship and SME development exist in Georgia?

b. What are the perceived barriers to entrepreneurship and SME development in Georgia?

c. In what ways is entrepreneurship and SME development encouraged and supported in Georgia?

Below we shall present a short conclusion that touches upon each of the research questions.

After the collapse of the Soviet Union in 1991, Georgia pursued a wide range of reforms for building new formal institutions, and therefore creating framework conditions for a well-functioning market-oriented economy. Recent reforms were mostly directed towards creating a hospitable business environment and fostering productive entrepreneurship in the country. Our study reveals that basic framework conditions such as laws related to private property, licensing and the registration of enterprises as well as laws for bankruptcy, contracts and taxes exist in Georgia to the extent that forms favorable environment for businesses to operate in, especially SMEs.

Although, institutional weaknesses and inefficient framework conditions that are present in transition economies, as well as in Georgia, caused emergence of a number of barriers to entrepreneurship and SME development in the country. Due to these obstacles which are mainly represented by difficulty of financing a business, as well as inefficiencies in taxation system and legislat-
tion enforcement mechanisms, also most importantly, due to existing economic and political instability, the potential of entrepreneurship and SME development in Georgia is limited. Moreover, Georgian entrepreneurs are characterized by inexperience in managing a business, since this is a relatively new field in the country that is in transition from a centrally planned to a market economy.

As for the third question, governmental policies and support, along with the programmes implemented by NGOs, reflect encouragement of entrepreneurship and SME development in the country. Indirect support measures are mostly taken towards making it easier to register and start a business procedurally, although when it comes to direct support for the existing businesses in the forms of finance, training, and information, it is clearly lacking. Further indirect policies should be directed towards overcoming the problems related to taxation system. Furthermore, direct support policies provided by the government in the form of financial aid such as accessible credits, mainly are directed towards agricultural and tourism sectors only. This might indicate that the government does not fully realize the importance of entrepreneurship and SME development as such, since development of productive entrepreneurship in any sector is a driving force of the economy. Furthermore, direct support measures undertaken by NGOs (such as business associations) lack the ability to gain trust among entrepreneurs and persuade them in benefits of participation. At the same time, information asymmetry presents a problem since entrepreneurs do not seem to be informed about the ongoing support measures and mechanisms available for them. Due to this fact membership and participation rate from the entrepreneurs’ side is quite low in the business associations and NGOs working in the direction of fostering entrepreneurship and SME development in Georgia.
6 Reflections

6.1 Contributions

In our opinion this study can benefit three major groups: policy makers, representatives of the non-governmental organizations, and future researchers in the field.

For the first group the thesis presents a good overview of what has been done so far and which aspects can be further improved. The study shall show them general gaps that exist in the framework conditions, as well as perceptions of the entrepreneurs. This study gives an implication for policy makers that direct support measures are especially lacking for existing or potential businesses in the country. As to the representatives of NGOs, the thesis shall show them in which direction should their efforts towards fostering entrepreneurship and SME development in Georgia be continued. This mainly involves understanding the fact that a better promotion is needed for their activities, since entrepreneurs do not seem to be aware of their existence. Lastly, this thesis might also be of interest to future researchers who investigate the phenomenon of entrepreneurship and SMEs in transition economies of FSU, or more specifically Georgia.

6.2 Limitations

We are aware of several limitations of this study. Firstly, due to lack of resources only 8 entrepreneurs and 6 representatives of governmental and NGOs have been interviewed. This might not have given us the possibility to fully understand the subject at hand. Although the study can present a good starting point for further researchers in the field.

Furthermore, the qualitative, phenomenological nature of the study might be a reason for a subjective nature of the study (Hussey & Hussey, 1997). Although as mentioned in the methodology chapter since the research deals with people, their actions and behaviors we felt the phenomenological approach to be more appropriate.

At the same time, the sampling method used, i.e. snowball sampling might be a further cause of a possible bias (Saunders et al. 2005). Although due to the fact that it was impossible or hard to identify the members of the desired population, we believed that was the only way to proceed with the study.

Lastly, all of the respondent entrepreneurs were men; it might be the case that female entrepreneurs face somewhat different perceptions and views regarding the phenomenon. Furthermore, most of the entrepreneurs presented the service sector; interviewing entrepreneurs in the manufacturing sector might have given different insights in the study.

6.3 Propositions for Further Research

This study can be further developed in order for it to be more valuable and representative than it is now. For this purpose, informal institutions could be researched, as possible means for creation of unfavourable framework conditions in the country. At the same time, since governmental policies are mostly directed towards agricultural and tourism sectors it might be a good idea to include entrepreneurs from those sectors in the research. Lastly, due to lack of time resources it was not possible to include business associations, as well as a wider range of NGOs in the study, which can be done in the later studies.
References


**Internet Sources**


Georgian Chamber of Commerce and Industry. Homepage. [www.gcci.ge](http://www.gcci.ge)


International Chamber of Commerce in Georgia. Homepage. [www.icc.ge](http://www.icc.ge)


Ministry of Economic Development of Georgia. Homepage. [www.economy.ge](http://www.economy.ge)

Putkadze & Abramishvili, 2009


Appendices

A. Interview Questions for Entrepreneurs

1) When did you start your business? (In case of several businesses, the major one)
2) How did you finance your business? /How did you obtain preliminary investment?
3) Is this the first business for you? If not, when did you start your entrepreneurial activities?
   What type of businesses did you have? Do these businesses still exist? Do you still manage them? If not, why did they close?
4) How many employees do you have?
5) What is your annual turnover? (approximately)
6) Besides the fact that you are the business creator, do you also manage this business?

Internal Factors

7) Do you think your experience is enough for running a business? Do you use external consultations/help?
8) What type of business do you have? Which sector do you operate in?
9) Did your business grow since its creation? By how many percent did it grow? If not, are you planning on growing your business in the near future?
10) How many percent of your profit do you reinvest in the business?
11) Is the business your only means of income?
12) Who is your direct customer?
13) What is your educational background? Do you have any education/trainings/courses in business?
14) What influenced you to start your own business?
15) How did you choose a business sector?
16) Are you a member of any business association?

External Environment

17) Which barriers (i.e. any factor that hampers you in conducting business activities, in reaching certain goals) would you identify as the most crucial ones while doing business? Would you mention concrete examples related to these barriers?
18) Since you have started your business:
   - Which new barriers have appeared?
   - Which barriers have been abolished?
19) Do you think there is an economic stability in Georgia? Does this have any impact on the way you plan for the business?
20) Do you think that the competition is a major problem for you?
21) In your opinion are the tax levels reasonable? Please motivate your answer.
22) Do you think your property rights are protected? Did you have problems in this sphere? In what way?
23) Have you heard of the bankruptcy law? Does it exist in Georgia?
24) How often do you use formal/written contracts? Do you think it is a strong guarantee?
25) Do you think the taxation legislation is easily understandable?
26) Does the government often conduct inspections in your business?
27) Do you think the banking system is efficient? What type of changes would you like in it? What is the biggest barrier for you in this system?
28) Have you ever had a case when you wanted to hire an employee and could not find a qualified one? What qualification were you looking for?
29) What do you think about the opinion of the people regarding entrepreneurship and entrepreneurs?

State Support

30) Have you heard of government programmes that are directed towards supporting entrepreneurs? If yes, what types of programmes are out there? What type of support do they involve?

31) Have you heard of and taken part in any programmes, trainings? Who were the organizers of them?

32) Do you often cooperate with government institutions? Do you think they fulfill their duties with high sense of responsibility?

33) Does it take a long time to get the paperwork done; is the process connected with a lot of procedures?

34) In your opinion what is the role of corruption while doing business? Is it necessary? Why do you think so? Have you ever given a bribe?
B. Interview Questions for government agents, private organization representatives

External Environment

1. How do you influence the macro-economic environment (level of aggregate demand, interest rates and taxation) in which businesses operate?
2. What measures do you undertake to ensure stability of the external environment?
3. How protected are property rights of entrepreneurs? What do you do for ensuring that?
4. Do you have special legislations and regulations tailored to SMEs or do they share the same legislations and regulations with large companies?
5. How frequently do you make changes in legislation?
6. How do you ensure simplicity of taxation, regulations and legislations for SMEs?
7. What kind of financial support exists for SMEs and what does it include?
8. How is government involved in the development of banking system?
9. How can you assess the flow of investments and loan options for SMEs?
10. Are there venture capitalists in the country and how does the government arrange networking between them and potential entrepreneurs?
11. Does Georgia have foreign entrepreneurs and how does the government promote FDI?
12. How is entrepreneurship viewed by society and does the government try to promote entrepreneurship in the country?

State Support

13. Do you have information centers, where entrepreneurs can get information about recent changes to taxation, regulations, legislation, and available programmes?
14. What kind of support do you provide for SMEs?
15. Does government provide advice/consultancy and if yes, what kind and who are the advisors?
16. Are there business trainings for entrepreneurs and in which spheres? What are the terms of participation?
17. How does the government encourage potential entrepreneurs to proceed to firm creation?
18. Are there certain incentives for start-ups?
19. How do you assess the entry procedures for start-ups? (types of licensing & registration procedures)
20. Who is involved in creation of policies targeted to encouraging start-ups and supporting SME growth?
21. When designing the policies, do you consider the stage of SME development or are programmes tailored to all SMEs?
22. How are the policies and programmes disseminated at the local and regional levels?
23. Do you undertake monitoring of the programmes and who is monitoring them?
24. Do you encourage private sector organizations to be involved in the promotion of entrepreneurship and SME development? How are those private organizations involved?
25. How do you measure the effects of the policies designed and what are up-to-date contributions? (concrete examples)
26. What are the barriers/challenges you meet during implementation of certain programmes?
   How do you assess the qualification of staff and how do you control/abolish corruption?
27. What is the level of transparency in those procedures?
28. How do you ensure continuous improvement in the policies and support measures?