Chapter 2. Pillar A – Responsive government

A comprehensive and coherent policy and institutional and regulatory framework, simple and low-cost administrative procedures, and efficient insolvency systems are core elements of a sound SME policy. Pillar A assesses the Eastern Partner governments’ responsiveness to SME needs, focusing on the institutional and regulatory framework for SME policy making, the operational environment, and bankruptcy and second chances procedures.

Since the 2016 assessment, all EaP countries have made significant progress in the institutional and regulatory framework dimension by improving their SME definition, establishing multi-year SME development strategies, and setting up SME development agencies. The performance in the operational environment dimension was already high in 2016, and countries have continued to make progress in the licenses and permits area and in e-government services. On the other hand, insolvency frameworks remain one of the weakest areas of the EaP region’s business environment, and countries have experienced only modest progress in this area.

The EaP countries are invited to systematically apply RIAs, invest in IT skills and requirements to ensure entrepreneurs can benefit from e-government services, and assess the impact of simplified tax regimes. Governments should also implement early-warning systems for a systematic detection of insolvency, streamline judicial proceedings, and adopt co-ordinated and proactive second-chance strategies.
Entrepreneurs in both developed and emerging economies must navigate a complex structure of government regulations, interventions and institutions. As a result, SMEs often view government as a source of bureaucracy and of often complex and heavy-handed regulation. Government regulation and institutions, though necessary to the proper functioning of a complex market economy, can indeed hinder entrepreneurship and discourage individuals from engaging in entrepreneurial activity.

Laws and regulations set the “rules of the game” that constrain and encourage economic actors (North, 1990[1]; Schmid, 2008[2]; Williamson, 2000[3]), while institutions define and guide the operational framework. An effective institutional and regulatory environment, which provides clear and universal rules, is essential for promoting risk-taking, encouraging investment, and reducing both informality and corruption (OECD, 2017[4]).

SMEs contribute significantly to employment and value added generation, but their views and needs are often neglected in day-to-day policy making. Moreover, SMEs are typically more dependent than large companies on the surrounding business ecosystem and, due to their limited resources, more vulnerable to market failures, policy inefficiencies and inconsistencies. In efficient markets, the exit of inefficient or unviable firms is a natural part of the competitive process, yet this exit must take place in an orderly manner, so to protect the interests of both debtors and creditors. Moreover, exit and restructuring of failed companies ensure that productive assets remain in use and scarce resources are allocated efficiently.

In order to achieve SME policy objectives such as increasing value added and employment and promoting innovation and competitiveness, the government as a whole – not just the institutions directly in charge of SME policy – need to be suitably attentive to SMEs’ needs.

Conducting an effective SME policy is a complex task, due to the highly-diversified nature of the SME population and the fact that SME policy cuts across many different policy areas. Governments need to set clear strategic guidelines for SME policy, secure business sector support and build a broad consensus involving the SME community, including NGOs, experts, and international organisations.

An effective institutional and regulatory environment that provides clear and universal rules is essential for promoting risk-taking, which will encourage investment and in turn promote innovation. In particular, a strong legal framework reduces the transaction costs of economic activities and ensures that economic gains from starting and growing businesses are not expropriated and can be devoted to the generation and diffusion of innovations.

Furthermore, a strong institutional and regulatory framework plays a fundamental role in reducing informality and corruption, which is essential for a healthy public procurement sector and for ensuring a level playing field. Indeed, corruption in procurement can hinder economic development and distort market mechanisms.

This pillar investigates recent EaP reforms in these areas with an assessment of three policy dimensions: 1) the institutional and regulatory framework for SME policy, 2) the operational environment for SMEs, and 3) bankruptcy and second chance.

As illustrated in Figure 2.1, significant improvements in the institutional and regulatory framework have been made in the region since 2016. The regional average score for the
Bankruptcy and second chance dimension has increased, while the result for the Operational environment one remains high, yet slightly lower than in 2016.

Figure 2.1 SME Policy Index scores for Pillar A: Responsive government

Regional scores, 2020 vs. 2016

![Graph showing SME Policy Index scores for Pillar A: Responsive government.](http://dx.doi.org/10.1787/888934086717)

Table 2.1. Country scores by dimension and sub-dimension, 2020

<table>
<thead>
<tr>
<th>Dimension and sub-dimension</th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average 2020</th>
<th>EaP average 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional and regulatory framework for SME policy</td>
<td>3.76</td>
<td>3.53</td>
<td>3.51</td>
<td>4.20</td>
<td>3.92</td>
<td>3.50</td>
<td>3.74</td>
<td>2.95</td>
</tr>
<tr>
<td>Institutional setting</td>
<td>3.76</td>
<td>4.00</td>
<td>3.52</td>
<td>4.53</td>
<td>4.05</td>
<td>3.32</td>
<td>3.86</td>
<td>3.27</td>
</tr>
<tr>
<td>Legislative simplification and RIA</td>
<td>3.49</td>
<td>3.37</td>
<td>3.25</td>
<td>3.92</td>
<td>3.94</td>
<td>3.71</td>
<td>3.61</td>
<td>2.47</td>
</tr>
<tr>
<td>Public-private consultations</td>
<td>4.05</td>
<td>3.08</td>
<td>3.75</td>
<td>4.04</td>
<td>3.72</td>
<td>3.53</td>
<td>3.69</td>
<td>3.00</td>
</tr>
<tr>
<td>Operational environment</td>
<td>3.55</td>
<td>4.20</td>
<td>4.12</td>
<td>4.36</td>
<td>3.76</td>
<td>3.55</td>
<td>3.92</td>
<td>4.01</td>
</tr>
<tr>
<td>Digital government for SMEs</td>
<td>3.14</td>
<td>4.14</td>
<td>3.84</td>
<td>4.17</td>
<td>3.43</td>
<td>3.52</td>
<td>3.71</td>
<td>3.82</td>
</tr>
<tr>
<td>Business licensing*</td>
<td>2.94</td>
<td>3.21</td>
<td>3.68</td>
<td>4.82</td>
<td>4.52</td>
<td>3.88</td>
<td>3.84</td>
<td>-</td>
</tr>
<tr>
<td>Company registration</td>
<td>4.58</td>
<td>4.58</td>
<td>4.49</td>
<td>4.85</td>
<td>3.97</td>
<td>3.81</td>
<td>4.38</td>
<td>4.17</td>
</tr>
<tr>
<td>Tax compliance procedures for SMEs*</td>
<td>3.14</td>
<td>4.26</td>
<td>4.34</td>
<td>3.80</td>
<td>3.70</td>
<td>3.06</td>
<td>3.72</td>
<td>-</td>
</tr>
<tr>
<td>Bankruptcy and second chance</td>
<td>2.40</td>
<td>2.97</td>
<td>3.34</td>
<td>3.03</td>
<td>2.79</td>
<td>2.56</td>
<td>2.85</td>
<td>2.71</td>
</tr>
<tr>
<td>Preventive measures*</td>
<td>1.29</td>
<td>2.43</td>
<td>3.76</td>
<td>2.71</td>
<td>2.90</td>
<td>2.71</td>
<td>2.63</td>
<td>-</td>
</tr>
</tbody>
</table>
### Survival and bankruptcy procedures

<table>
<thead>
<tr>
<th>Country</th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average 2020</th>
<th>EaP average 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARM</td>
<td>3.84</td>
<td>3.87</td>
<td>3.85</td>
<td>3.67</td>
<td>3.01</td>
<td>3.15</td>
<td>3.56</td>
<td>2.96</td>
</tr>
<tr>
<td>Promoting second chance</td>
<td>1.17</td>
<td>2.00</td>
<td>1.92</td>
<td>2.25</td>
<td>2.25</td>
<td>1.33</td>
<td>1.82</td>
<td>2.25</td>
</tr>
</tbody>
</table>

*Note: The dimension score is the weighted average of the sub-dimension scores (see Overview of key findings chapter and Annex A). The following methodological changes have been introduced in the 2020 assessment, which should be taken into account when observing trends in SME Policy Index scores: Operational environment (new sub-dimensions: Business licensing and Tax compliance procedures for SMEs), Bankruptcy and second chance (new sub-dimensions: Preventive measures).*  
*These sub-dimensions have been introduced in 2020 and were not covered in previous assessments.*

## Institutional and regulatory framework for SME policy

The institutional and regulatory framework for SME policy shapes the scope and the efficiency of SME policy interventions. It includes elements such as the definition of an SME; the institutions in charge of elaborating, implementing, monitoring and evaluating SME policy at the central government level; and the mechanisms for policy dialogue and co-ordination.

Giving SME needs full consideration at an early stage of policy development requires governments to devise comprehensive SME strategies, including a clear and consistent SME definition, data collection goals and an autonomous SME policy implementation agency. Such a strategy should be co-ordinated among all stakeholder ministries, agencies and departments involved in SME-related policy making. The application of the “Think Small First” principle, as presented in the EU Small Business Act and which instructs policy makers to give priority consideration to the impact of policy decisions on small businesses, should be derived from specific country and local contexts. Action plans, as well as prioritised and sequenced reforms, need to be grounded in broader socio-economic or development strategies and to reflect the main local business constraints – such as, in many contexts, the incidence of informal activity.

*Ex ante* and *ex post* regulatory impact analysis (RIA) has great potential to ensure the promotion of better laws with less uncertainty. Evaluating the costs, benefits and social impact of regulation for SMEs (the so-called “SME test”) enables policy makers to adapt regulations to smaller firms’ needs. Implementing comprehensive public-private consultations including SMEs is key also for the implementation of the “Think Small First” principle.

### Assessment framework

The framework for the *institutional and regulatory framework for SME policy* dimension assesses three sub-dimensions: 1) the institutional framework, 2) legislative simplification and RIA, and 3) public-private consultations (Figure 2.2).
2. PILLAR A – RESPONSIVE GOVERNMENT

Figure 2.2. Assessment framework – Institutional and regulatory framework for SME policy making

Institutional framework

The first sub-dimension covers the main building blocks of a proactive SME policy. It starts with a review of the current SME definition, its applicability across the country’s public administration, and the efforts made to collect timely and accurate SME data. A set of indicators focuses on the institutions in charge of coordinating and conducting interventions towards the SME sector, looking at the assignment of the policy mandate, the relations between institutions charged with policy elaboration and policy implementation and the inter-ministerial and inter-agency co-ordination mechanisms. Indicators cover the entire policy cycle, starting with policy design, implementation, monitoring and evaluation. Specific attention is devoted to the presence and the structure of a multi-year SME development strategy, a key instrument for organising and linking policy interventions around a set of pre-agreed objectives. Finally, a number of indicators look at the quality and the timely availability of SME data, while a final set of indicators capture the policy actions conducted to fight informality among the SME population, as a high incidence of enterprise and labour informality may distort SME development and significantly reduce the impact of policy interventions.

Legislative and regulatory simplification and RIA application to SME policy

The second sub-dimension looks at the actions taken by the government to reduce the administrative burden on SMEs. Horizontal policies aimed at improving the business climate and the operational conditions for all enterprises are a major component of SME policy, and they have been actively pursued by all the EaP countries. The focus is on the process of legislative and regulatory simplification and the application of RIA, including the introduction of a SME test to evaluate the impact of new legislative and regulatory acts on small enterprises.
Public-private consultations

The third-sub-dimension concerns the frequency, transparency, inclusiveness and formal influence of public-private consultations. The presence of effective channels of consultations and the capacity to conduct a constructive dialogue with the private sector are essential to the development of a well-structured and broadly supported SME policy. Small firms tend to be less organised than larger companies and have a limited capacity to come up with policy proposals. Governments must therefore take specific initiatives to ensure that the voice of the small enterprises is properly heard and that all categories of enterprises are represented in the consultation process. A good example of an effective public-private consultation initiative can be found in Korea, where the government launched the Public-Private Joint Regulation Advancement Initiative (PPJRAI) initiative (see Box 2.1 for more information).

Box 2.1. Public-private consultations on regulatory reforms in Korea

In 2013, the Korean government launched the Public-Private Joint Regulation Advancement Initiative (PPJRAI) to improve and advance its regulatory framework, with a particular focus on the conditions under which SMEs operate. It operates as a task force of the Office of Government Policy Coordination (OGPC) and is composed of 26 members – half being experts from each of the regulating government ministries, and half representing private sector organisations such as the Korea Chamber of Commerce & Industry (KCCI) and the Korea Federation of SMEs (KBIZ). The PPJRAI includes a team in charge of addressing the regulatory obstacles of SMEs and microenterprises. Its overarching objective is to identify on-site regulations which appear overly onerous for SMEs, improve them, and monitor their implementation in direct consultations with the pertinent regulating government ministry.

The task force works on a case-by-case basis, and each case analysis can take up to two weeks. It identifies pertinent regulations in need of reform through its function as a forum for stakeholders and the public to submit petitions for review of regulations via its monthly town hall meetings, through its website, or by phone. Pertinent submissions are then allocated to the national or local levels for review and drafting suggestions for improvement. Finally, consultations with the relevant ministries decide whether to accept or reject proposed amendments. PPJRAI is also responsible for conducting retrospective reviews to quantify the impact of the introduced changes on Korea’s economy (OECD, 2017[5]).

The PPJRAI’s success with regulatory reform stems from three factors (Pérez, 2015[6]):

- A high level of political support from the President, who is directly involved in the PPJRAI;
- Engagement with highly technical and institutional experts who can propose reforms while identifying first-hand the limits and advantages of each effort;
- A public-private partnership that strongly engages the community and signals the desire for market-oriented regulatory reforms.

**Analysis**

Effective institutional and regulatory frameworks are crucial for the success of all other SME support initiatives. This dimension measures progress towards developing 1) a functional institutional and regulatory framework for SME policy making (including elements such as the definition of an SME), 2) the institutions in charge of elaborating, implementing, monitoring and evaluating SME policy at the central government level, and 3) mechanisms designed to promote policy dialogue and coordination.

All the EaP countries have made significant progress in this area since the completion of the last assessment in 2016. The progress was stronger in countries which in 2016 were lagging behind, such as Belarus and Ukraine. As shown in Figure 2.3, the overall average score for the dimension has reached the level of 3.74, an increase of 0.79 points over the average score for 2016, indicating that a relatively well-structured institutional and regulatory framework is now mostly in place across all EaP countries. Most EaP countries improved their SME definition, which is now based on multiple criteria and includes stratification breakdowns by micro, small and medium-sized enterprises. The EaP countries have made significant efforts to organise SME policy interventions around multi-year SME development strategies, albeit with significant across-country variation in structure. Nearly all EaP countries have now established SME development agencies. The availability of SME data has also improved, especially in Armenia, Georgia and Ukraine. The above-mentioned progress is also reflected in the regional average score increase in the *institutional framework* sub-dimension (+0.59). Regarding regulatory impact assessment (RIA), Moldova is currently the only country among the EaP where RIA is systematically applied at the moment. However, a strong regional average increase can be seen in the value of the *legislative simplification and RIA application* sub-dimension (+1.14). All EaP countries showed incremental progress towards a more systematic and institutionalised *public-private consultation* process, with Armenia, Georgia and Moldova leading the way. In fact, the regional average score in this sub-dimension has increased by 0.69 points with respect to the 2016 assessment.

**Figure 2.3.** Scores for the *Institutional and regulatory framework* dimension compared to 2016

![Figure 2.3. Scores for the Institutional and regulatory framework dimension compared to 2016](http://dx.doi.org/10.1787/888934086736)
Institutional framework

The institutional framework sub-dimension assesses the level of development of the institutional framework – which includes the systems of formal laws, regulations and procedures – as well as the functioning of government institutions that regulate socio-economic activity.

Over the last four years, all EaP countries have worked to improve the institutional framework for SME policy. The 2016 assessment noted that efforts have been made to strengthen the institutional framework in all the EaP countries, but there were still gaps in terms of institutional building and strategic elaboration. The 2020 assessment shows that most of those gaps have been filled and most of the main building blocks of a proactive SME policy are now established across the region. Georgia performs particularly well in this sub-dimension, achieving a remarkably high score (4.75) in monitoring and evaluation (see Table 2.2).

Table 2.2. Scores for the Institutional framework sub-dimension

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning &amp; design</td>
<td>3.20</td>
<td>4.37</td>
<td>3.50</td>
<td>4.30</td>
<td>4.13</td>
<td>3.66</td>
<td>3.86</td>
</tr>
<tr>
<td>Implementation</td>
<td>3.93</td>
<td>3.93</td>
<td>3.40</td>
<td>4.60</td>
<td>3.93</td>
<td>2.73</td>
<td>3.76</td>
</tr>
<tr>
<td>Monitoring &amp; evaluation</td>
<td>4.33</td>
<td>3.50</td>
<td>3.83</td>
<td>4.75</td>
<td>4.19</td>
<td>4.08</td>
<td>4.11</td>
</tr>
<tr>
<td>Weighted average</td>
<td>3.76</td>
<td>4.00</td>
<td>3.52</td>
<td>4.53</td>
<td>4.05</td>
<td>3.32</td>
<td>3.83</td>
</tr>
</tbody>
</table>

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

The main SME policy building blocks include: 1) a comprehensive SME definition, widely adopted throughout the public administration, defining the SME policy scope; 2) a clear assignment of the mandate over the elaboration and supervision of the SME policy to a central government ministry, as well as establishment of effective policy co-ordination mechanisms; 3) the delegation of policy implementation to a specialised SME development agency or a group of executive agencies, responding to the central ministry but benefitting from a good level of operational autonomy; and 4) the presence of a multi-year SME development strategy or a similar strategic document that clearly indicates the main policy objectives and priorities as well as qualitative and quantitative targets, key performance indicators, and the monitoring and evaluation mechanisms. The strategy should be complemented by detailed yearly or bi-annual action plans.

Five of the six EaP countries currently have in place an SME definition based on multiple parameters; Belarus is the sole exception, as its definition is based on the employment parameter alone. All definitions include stratification breakdowns by micro, small and medium-sized enterprises – with the partial exception of Ukraine, which uses an indirect definition of the medium-size enterprise segment, and Belarus, which has a separate breakdown for individual entrepreneurs. The country definitions, established either through a legislative act or a government decree, are modelled on the EU definition (even if the thresholds related to turnover and balance sheet assets differ) and they are generally widely applied across the public administration (see Table 2.3).
Table 2.3. EaP and EU SME definitions

<table>
<thead>
<tr>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>&lt;10 employees ≤ EUR 2 million turnover or ≤ 2 million balance sheet</td>
<td>&lt;50 employees ≤ EUR 10 million turnover or ≤ 10 million balance sheet</td>
<td>&lt;250 employees ≤ EUR 50 million turnover or ≤ 43 million balance sheet</td>
</tr>
<tr>
<td>Armenia</td>
<td>&lt; 10 employees ≤ AMD 100 million (EUR 185 980) turnover ≤ AMD 100 million (EUR 185 980) balance sheet</td>
<td>&lt; 50 employees ≤ AMD 500 million (EUR 927 900) turnover ≤ AMD 500 million (EUR 927 900) balance sheet</td>
<td>&lt; 250 employees ≤ AMD 1 500 million (EUR 2 783 700) turnover ≤ AMD 1 500 million (EUR 2 041 380) balance sheet</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>&lt; 10 employees ≤ AMD 200 000 (EUR 104 000) turnover</td>
<td>&lt; 50 employees ≤ 3 000 000 AZN (EUR 1 056 000)</td>
<td>&lt; 250 employees ≤ 3 000 000 AZN (EUR 15 690 000)</td>
</tr>
<tr>
<td>Belarus</td>
<td>&lt; 15 employees (individual entrepreneurs &lt; 4 employees) &lt;100 employees</td>
<td>&lt; 250 employees</td>
<td>Law of the Republic of Belarus of 1 July 2010, No. 148-31, On State Support for Small and Medium Entrepreneurship</td>
</tr>
<tr>
<td>Georgia</td>
<td>Not defined ≤ 50 employees ≤ GEL 12 million (EUR 3.6 million) ≤ 250 employees ≤ GEL 60 million (EUR 19.5 million)</td>
<td></td>
<td>Geostat</td>
</tr>
<tr>
<td>Moldova</td>
<td>&lt; 10 employees ≤ MDL 9 million (EUR 0.46 million)</td>
<td>&lt; 50 employees ≤ MDL 25 million (EUR 1.28 million)</td>
<td>&lt; 250 employees ≤ MDL 50 million (EUR 2.56 million)</td>
</tr>
<tr>
<td>Ukraine</td>
<td>≤ 10 employees ≤ EUR 2 million</td>
<td>≤ 50 employees ≤ EUR 10 million</td>
<td>All enterprises that do not fall into the category of small or large enterprises (large: &gt; 250 employees; &gt; EUR 50 million)</td>
</tr>
</tbody>
</table>


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


In all the EaP countries, with the exception of Armenia, the SME policy mandate is clearly assigned to the economy ministry and there have not been significant changes in the configuration of the mandate since 2016. In Armenia, the Ministry of Economy and Investments, in charge of SME development, has been merged with the Ministry of Agriculture in 2019. The newly enlarged ministry has gone through an internal reorganisation, which entailed the redefinition of the competences of the General Directorate in charge of SME policy and the implementation agencies operating under the Ministry.

SME policy co-ordination mechanisms vary significantly across EaP countries, but overall, they remain relatively weak, as SME policy cross- ministerial coordination mandate is not clearly defined and assigned to a dedicated body in charge of supervising and coordinating
the actions of the different line ministries dealing with SME policy issues (Economy, Trade, Finance, Employment, Education and Science and Technology). However, Georgia and Azerbaijan have made progress towards a more effective inter-ministerial and inter-agency coordination. Georgia has established a high-level Steering Group, chaired by the Minister of Economy and Sustainable Development and composed by all the relevant line ministries, to monitor and co-ordinate the implementation of the country’s SME development strategy. In Azerbaijan, the Center for Analysis of Economic Reforms and Communications (CAERC) is in charge of monitoring and co-ordinating the implementation of the country’s Strategic Road Maps, including the one covering the SME sector.

The EaP countries have made significant efforts to organise SME policy interventions around multi-year SME development strategies, fulfilling one of the key recommendations of the 2016 assessment formulated under the institutional and regulatory framework dimension. Such strategic documents are now in place or are at an advanced stage of elaboration in all EaP countries. The structure of the SME development strategy varies significantly across the EaP countries. Azerbaijan, Georgia, Moldova and Ukraine have adopted well-structured documents containing quantitative and qualitative targets and sections on monitoring and evaluation. On the other side, Armenia and more recently Belarus, have adopted documents that indicate the general strategic guidelines, but often lack clear indications about qualitative and quantitative targets, and do not contain sections on monitoring and quantitative targets, and do not contain sections on monitoring and evaluation (see Table 2.4).

The strategic documents adopted by all the EaP countries emphasise the improvement of the business climate for SMEs, legislative and regulatory simplification, access to finance, and entrepreneurship promotion, but are less specific about the segments of the population and sectors targeted for policy intervention. Across the region, SME policy is still viewed mostly as a horizontal policy supporting entrepreneurship and small enterprises, placing a significant emphasis on the social role played by SMEs, rather than a policy supporting the country’s productive transformation and integration into the global economy.
<table>
<thead>
<tr>
<th></th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Belarus</th>
<th>Georgia</th>
<th>Moldova</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of strategic directions (SDs)/actions</strong></td>
<td>7 SDs/ not clear</td>
<td>5SDs/ 72 actions</td>
<td>9SDs/ not specified</td>
<td>5SDs/33 actions</td>
<td>6 SDs</td>
<td>6 SDs/31 actions</td>
</tr>
<tr>
<td><strong>Targets for the whole strategy</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>KPIs for every SD</strong></td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes/partially</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>KPIs for every action</strong></td>
<td>Ministry of Economy, SME DNC</td>
<td>Ministry of Economy</td>
<td>Ministry of Economy</td>
<td>MoESD, Enterprise Georgia, GITA</td>
<td>Ministry of Economy and Infrastructure/ODIMM</td>
<td>Ministry for Development of Economy, Trade and, SME Development office</td>
</tr>
<tr>
<td><strong>Reporting (e.g., quarterly, yearly)</strong></td>
<td>Not specified</td>
<td>Quarterly</td>
<td>Yearly (on relevant SME state support programmes)</td>
<td>Yearly</td>
<td>Quarterly</td>
<td>Quarterly</td>
</tr>
<tr>
<td><strong>Coordination mechanism (e.g., inter-ministerial meetings; dedicated councils)</strong></td>
<td>Not specified</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Partially specified</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Impact evaluation (external assessment)</strong></td>
<td>Yes, carried out by Advise group, October 2018</td>
<td>Forseen for 2020</td>
<td>Forseen for 2020, to be informally carried out by research institute</td>
<td>Yes, informally carried out by research institute, January 2018</td>
<td>No</td>
<td>Forseen for 2020</td>
</tr>
<tr>
<td><strong>Costing carried out</strong></td>
<td>No</td>
<td>Partially</td>
<td>Mostly state funds (not specified)</td>
<td>State funds (amount specified in relevant SME state support programmes)</td>
<td>Combination of donor and state funds (not specified)</td>
<td>Combination of important donor funds and state funds</td>
</tr>
<tr>
<td><strong>Budget allocated for implementation</strong></td>
<td>(For 2016, AMD 152 600 000) Mostly state funds with some donor funding</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Another area where there have been significant improvements over the last four years is related to the establishment of national SME development agencies (see Box 2.2).

Until 2016, only Moldova and Armenia had operational SME development agencies. Since then, Enterprise Georgia has become fully operational while the Small Business Development Agency (SBDA) of Azerbaijan, although still in the early operational phase, it is expected to be fully staffed by 2020. As of this writing (mid-2019), Belarus is in the process of creating an SME agency; while Ukraine, which currently does not have an independent national SME agency, will in 2020/21 evaluate the performance of the SME Development Office (SMEDO), which at the moment operates as an advisory and co-ordination body associated with the Ministry of Economic Development, Trade and Agriculture (MEDTA). It will be decided in 2021 whether to transform SMEDO into a national agency playing a more active role in managing SME development programmes, or to maintain SMEDO’s current functions.
Box 2.2. SME agencies across the EaP region

As part of the SBA assessment, a survey of SME agencies in EaP countries was conducted in June-July 2019. All countries responded except for Belarus, which is in the process of establishing its SME agency. The table below presents a summary of the information collected.

Table 2.5. Detailed information on SME agencies in EaP countries

<table>
<thead>
<tr>
<th></th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Georgia</th>
<th>Moldova</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME Agency</td>
<td>SME Development National Centre</td>
<td>Small and Medium Business Development Agency</td>
<td>Enterprise Georgia</td>
<td>ODIMM</td>
<td>SME Development Office</td>
</tr>
<tr>
<td>Year of establishment</td>
<td>2002</td>
<td>2017</td>
<td>2014</td>
<td>2007</td>
<td>2018</td>
</tr>
<tr>
<td>Reporting to</td>
<td>Ministry of Economy</td>
<td>Ministry of Economy</td>
<td>Ministry of Economy and Sustainable Development</td>
<td>Ministry of Economy and Infrastructure</td>
<td>Ministry of Economic Development and Trade</td>
</tr>
<tr>
<td>Areas of support</td>
<td>SMEs, innovation, export, investment, regional development</td>
<td>SMEs, innovation, export, access to finance, investment, regional development</td>
<td>Business support, export, Investment</td>
<td>Incubation, training, internationalisation, greening, women/youth/migrant entrepreneurship</td>
<td>Entrepreneurship, access to finance, information on EU support</td>
</tr>
<tr>
<td>Nr. of staff</td>
<td>36</td>
<td>117</td>
<td>60</td>
<td>53</td>
<td>10</td>
</tr>
<tr>
<td>Yearly budget,(^1) mln EUR (operations)</td>
<td>1</td>
<td>5.2</td>
<td>1.2</td>
<td>0.56</td>
<td>n.a</td>
</tr>
<tr>
<td>Yearly budget,(^*) mln EUR (financial support)</td>
<td>4 (guarantee fund)</td>
<td>n.a.</td>
<td>15</td>
<td>4</td>
<td>n.a</td>
</tr>
<tr>
<td>Nr of beneficiaries (per year)</td>
<td>8000 – 10000 (all forms of support)</td>
<td>3770 (all forms of support)</td>
<td>1 387 (financial support)</td>
<td>670 (financial support) 2058 (non-financial support)</td>
<td>n.a.</td>
</tr>
<tr>
<td>Territorial presence</td>
<td>Yes (10 offices)</td>
<td>Yes (14 offices)</td>
<td>Yes (1 office)</td>
<td>Yes (11 incubators)</td>
<td>No</td>
</tr>
</tbody>
</table>

\* 2018 for Armenia, Azerbaijan and Moldova. 2019 for Georgia.

Source: Survey completed by national SME development agencies.

In relation to the establishment of a dedicated public agency in charge of SME development, the EaP countries could be divided in three sub-groups:

- Armenia and Moldova were the first countries to establish SME development agencies (SME DNC in Armenia in 2002 and ODIMM in Moldova in 2007), adopting a model already tested in the other transition countries, from Eastern Europe to the Western Balkans. Those two agencies were established when the
countries were introducing more direct tools of SME support, but well before the elaboration of a multi-year SME Development Strategy. Both SME DNC and ODIMM, in addition to providing standard training, market information and consultancy services, run a credit guarantee facility.

- Azerbaijan and Georgia established dedicated agencies at a later stage, as a result of the adoption of a more proactive SME policy approach. Enterprise Georgia has a clear implementation mandate and benefits from relatively extensive autonomy in the planning of support programmes and related budget allocation. The SMBDA in Azerbaijan has a wider mandate: in addition to training, market information and consultancy activities, it is also in charge of developing RIA and formulating regulatory reforms inputs. While Enterprise Georgia is supported by a mix of budget and donor funds, the SMBDA can count on a relatively large state budget allocation.

- Belarus and Ukraine had a more de-centralised approach to SME policy, with most support programmes designed and implemented at the local level, SME support being seen as a component of local development policy. SMEDO in Ukraine operates as an advisory body to the Ministry of Economic Development, Trade and Agriculture (MEDTA) and performs an important co-ordination function, with the potential to evolve into a centrally managed agency. The decision is expected in 2020-2021 after an evaluation of the first phase of SMEDO’s activity. Belarus is planning to establish an SME agency, but the structure and the mandate of the new agency is still to be decided.

Over the last four years, there have been also significant improvements in the availability of SME data, creating better conditions for evidence-based policy making. For instance, Armenia and Ukraine have produced, in co-operation with the OECD (Compendium of Enterprise Statistics, Armenia and Ukraine, OECD 2018), compendiums of SME statistics, compiled according to international standards. The Georgian national statistical agency, Geostat, has further improved its coverage of the SME statistics and published enterprise demography data, and it has been put in charge of monitoring the quantitative indicators listed in the country’s SME Development Strategy.

Compared with other middle-income economies, the EaP countries have a generally more contained informal sector. Within the region, enterprise and labour informality is relatively high in Moldova and Ukraine but limited in Armenia, Belarus and Georgia. In Azerbaijan, according to official estimates, informality is relatively limited, while independent researchers claim that the data tend to underestimate the real incidence of informality. No EaP country has a dedicated strategy to reduce informality. In all the EaP countries, the issue is mainly addressed through the reduction of administrative burdens, in particular highly simplified company registration procedures, and through the introduction of favourable tax regimes for auto-entrepreneurs and microenterprises, the two types of enterprises most likely to operate informally.

**Legislative and regulatory simplification and RIA application**

The legislative and regulatory simplification and RIA application sub-dimension assesses the mechanisms for legislative simplification and regulatory impact analysis to ensure that the impact of new laws and regulations on SMEs is properly measured and mitigated.

Legislative and regulatory simplifications remain a key priority for all EaP countries, as also highlighted by the relevance given to this topic in the different countries’ SME
development strategies. The results achieved across the region come from the application of a number of tools, such as the introduction of a regulatory guillotine in Armenia and Moldova, the establishment of dedicated task forces in Azerbaijan and Belarus, the implementation of regulatory reform action plan in Ukraine and the transition towards a one-stop public service centre in Georgia.

Table 2.6. Scores for the Legislative simplification and RIA sub-dimension

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning &amp; design</td>
<td>4.20</td>
<td>3.80</td>
<td>3.27</td>
<td>4.47</td>
<td>4.38</td>
<td>4.20</td>
<td>4.05</td>
</tr>
<tr>
<td>Implementation</td>
<td>3.16</td>
<td>2.81</td>
<td>3.85</td>
<td>3.91</td>
<td>3.76</td>
<td>3.70</td>
<td>3.53</td>
</tr>
<tr>
<td>Monitoring &amp; evaluation</td>
<td>3.00</td>
<td>3.89</td>
<td>1.89</td>
<td>3.00</td>
<td>3.56</td>
<td>2.87</td>
<td>3.03</td>
</tr>
<tr>
<td>Weighted average</td>
<td>3.49</td>
<td>3.37</td>
<td>3.25</td>
<td>3.92</td>
<td>3.94</td>
<td>3.71</td>
<td>3.61</td>
</tr>
</tbody>
</table>

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

While progress on revision and simplification of existing laws and regulation is well advanced in most of the EaP countries, the systematic application of RIA is less advanced (see Table 2.6), although incremental progress has been recorded over the last four years.

RIA is systematically applied in Moldova, although quality standards are not always respected, due to a high level of turnover of public officials in charge of RIA application. In Armenia, the only EaP country where RIA was systematically applied until 2018, the government has currently put on hold new application, pending a review of the RIA procedures. In Georgia, where RIA has been adopted on ad hoc basis, the government has taken a commitment to systematically apply RIA to all new business-related legislative acts. Ukraine has also taken steps to apply RIA in a more systematic way and it has upgraded the country’s RIA methodological guidelines. In Belarus, the government is systematically applying cost-benefit analysis to new laws and regulations, but the evaluation is not yet conducted in accordance with standard RIA guidelines. Azerbaijan is at an early phase of RIA introduction, the mandate to apply RIA for laws and regulations on the SME sector having been assigned to the SMBDA.

Public-private consultations

The Public-private consultations sub-dimension assesses the frequency, transparency, inclusiveness and formal influence of public-private consultations.

Over the last four years there has been, on average, incremental progress towards a more systematic and institutionalised consultation process in the EaP region, although there are significant variations in terms of country experiences and performance, with Armenia, Georgia and Moldova leading the way. Georgia in particular performs well in the private sector involvement thematic block (see Table 2.7).
In terms of institutional development, Georgia and Belarus have established private sector or entrepreneurship advisory councils which are directly engaged in the policy elaboration process and include representatives of the main SME and business organisations. Particularly, in Georgia, in addition to the Private Sector Development Advisory Council, a number of public-private bodies – such as the Investors Council, the DCFTA Advisory Council and the Sub-council for the Promotion of Women Entrepreneurship – also involve SME associations. In Armenia, public-private consultations are co-ordinated by the Business Support Office operating directly under the Prime Minister and established in 2007. In Moldova, there are regular consultations co-ordinated by the Ministry of Economy and Infrastructure.

In Ukraine, every ministry has established a Public Council, with an advisory and consultative function. The Public Council associated with the Ministry of Economic Development, Trade and Agriculture (MEDTA) is composed of 56 members, 70% of whom represent private sector organisations. In Azerbaijan, the policy-making process is still dominated by a top-down approach; however, efforts have been made to involve the private sector more closely.

**The way forward**

- The first generation of SME Development strategies adopted by Georgia, Moldova, Azerbaijan and Ukraine placed high importance on improving the business environment and reducing administrative barriers. Several of those have already come to an end or will do in 2020. The next set of SME strategies should include clearly defined objectives, quantitative targets and key performance indicators, building on the initial set of aggregated quantitative targets already included in the current strategies elaborated by Azerbaijan, Georgia, Moldova and Ukraine. Armenia and Belarus, which do not have yet introduced quantitative targets, should identify key measurable targets and set in place a data collection system. When productive transformation is a priority objective, as in the case of Azerbaijan, the strategy should also identify the targeted SME population segments and the sectors driving the transformation.

- The relations between implementation agencies and the supervisory ministries should be clearly defined. Agencies in all EaP countries should have 1) the necessary operational autonomy, in defining the best tools and sequence for reaching assigned objectives and targets related to SME development and in selecting their staff and experts; and 2) human and financial resources proportionate to their objectives and targets.

- Focus should progressively shift from the review of the existing stock of laws and regulations to the assessment of the impact of new legal and regulatory...
acts, so as to avoid falling back into a highly-regulated economy. The systematic application of RIA should be therefore a crucial element in the regulatory reform strategy of all EaP countries.

- **Public-private consultations should be more open** and, given the ongoing changes in the structure of the SME population, **efforts should be made to involve new categories** (such as innovative start-ups, self-entrepreneurs and social enterprises) in the public-private dialogue.

**Operational environment for SMEs**

A strong legal framework reduces the transaction costs of economic activities and ensures that economic gains from starting and growing businesses are not expropriated, providing the incentives for individuals to maximise profits. Thus, strong property rights and contract enforcement are foundations for the development of the SME sector (Āidis, Estrin and Mickiewicz, 2010[7]; Verheul et al., 2002[8]). Besides, within the operational life of firms, registration and interaction with authorities are potential sources of administrative burden. Principle 4 of the European Union’s Small Business Act seeks to “make public administrations responsive to SME needs, making life as simple as possible for SMEs” (Commission of the European Communities, 2008[9]).

Reducing the burden of procedures for starting and managing businesses, as well as interacting with public authorities, enables SMEs to free crucial resources for innovation or job creation (Parker and Kirkpatrick, 2012[10]). The literature also suggests that reducing barriers and delays in business registration can lead to more dynamic market entry and efficiency gains for entrepreneurs. Conversely, lengthy and costly registration procedures disproportionately affect micro- and small enterprises and act as a deterrent to entrepreneurial activities. Fewer legally registered firms can also contribute to a bigger informal sector, a smaller tax base and more corruption. (Dickinson, 2008[11]; European Commission, 2009[12]; Klapper et al., 2010[13]).

The adoption of ICT – notably through the use of e-services – improves the reach and efficiency of government services and plays an important role in reducing corruption and informal economic activity given the increased transparency, objectiveness and enforceability of decisions. The move to a one-stop, automated, web-enabled registry capable of delivering online products and services with authenticated users and documents represents global best practice. Further measures can include the application of the silence-is-consent principle as well as unification of identification numbers and enhanced data exchange across all government agencies. SMEs can also benefit from streamlined and tailored tax schemes as simplification provisions encourage business creation and reduce the burden of tax compliance, while also reducing tax collection costs.

*Assessment framework*

The assessment framework related to the operational environment for SMEs includes four sub-dimensions: 1) digital government for SMEs, 2) business licencing, 3) company registration and, 4) tax compliance procedures for SMEs (Figure 2.4).
E-government services

The provision of government services through digital platforms provides an opportunity to simplify administrative procedures, to improve the dissemination of information on administrative requirements, and to cut significantly the time required to perform administrative functions. All this should help to reduce the administrative burden imposed on the business sector. In particular, SMEs should greatly benefit from the provision of e-government services because they have generally more limited resources for dealing with administrative procedures, provided they also have a good IT connection, the right IT equipment and appropriate ICT skills. The sub-dimension includes indicators covering the government strategy towards the provision of e-services, the range of services provided, the level of interoperability among the different data banks run by the public administration, and the action taken to implement an open-data approach.

Business licenses and permits

Some of the most complex administrative procedures are related to the issue of licenses and permits. All six EaP countries formerly had highly-regulated economies, and firms had to deal with large numbers of license and permit requirements. Traditionally, in all enterprise surveys, the high number of administrative and fiscal inspections is mentioned as among the most severe impediments to doing business. This sub-dimension analyses the actions taken by governments to reduce the number of required business licenses and permits and to improve the business license allocation systems, through better coordination among the licensing institutions.
Company registration

The first contact most new entrepreneurs have with the public administration is during the company registration phase. Complex, costly and lengthy procedures may discourage new entrepreneurial activities and push new enterprises towards informality, thus protecting incumbent enterprises by reducing competition from new business entrants. The sub-dimension includes indicators looking at the presence of one-stop shops, at the introduction of a single company identification numbers, in addition to a number of indicators taken from the “Starting a Business” section of the World Bank’s 2020 Doing Business report (World Bank, 2019[14]).

Tax compliance procedures for SMEs

The sub-dimension includes a set of indicators related to the tax regime applied to SMEs, looking at the presence of special tax regimes and tax incentives for small enterprises as well as indicators related to the procedures for tax filing. This second section is largely based the “Ease of Filing Taxes” indicator from the Doing Business report.

Analysis

Clear and straightforward regulations, low administrative costs and simple procedures for starting and operating a business are all fundamental aspects of ensuring that economic gains from starting and growing businesses are not expropriated. The operational environment dimension assesses the extent to which public administrations have simplified regulations and reduced costs and procedures to slim administrative burden on SMEs.

Since 2016, EaP countries have recorded only incremental progress in the operational environment for SMEs. The results of the assessment, presented in Figure 2.5, show incremental improvements in all EaP countries, with a regional average score of 3.92.6

In particular, Georgia performs well across all sub-dimensions, while Azerbaijan and Belarus have further improved their company registration procedures and made additional progress concerning SME interaction with digital government services. For instance, as a result of the State Programme for the development of ICT and the establishment of the E-Gov Development Centre, Azerbaijan launched a new single-entry portal for all e-government services in 2018. However, none of the EaP countries have yet fully reached the high level of inter-operability needed to move forward in the transition to full digitalisation. In addition, in order to benefit from the provision of e-government services, the digital divide within the SME population must be reduced and small enterprises, particularly those operating in the traditional service sectors, must be assisted in upgrading their ICT skills and their IT technology use. Armenia is the only country whose dimension’s score has fallen, mainly due to the fact that the implementation of regulatory reforms was put on hold during the 2018-19 political transition. In the licenses and permits area, Moldova and Ukraine have made substantive progress.

Since 2016, several countries amended their tax codes to introduce new tax incentives and simplify tax regimes for SMEs. Both Azerbaijan and Armenia have introduced some form of tax exemption for 1) small, innovative start-ups and SMEs operating within approved clusters and 2) individual entrepreneurs and small businesses. Most EaP countries have also introduced a set of thresholds below which enterprises are exempted from keeping a VAT account and have made efforts to speed up tax refund payments.
Figure 2.5. Scores for the Operational environment dimension compared to 2016

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

StatLink http://dx.doi.org/10.1787/888934086755

E-government services

The E-government sub-dimension assesses the development stage of online services designed to improve the efficiency of interactions between SMEs and the public administration.

Over the last four years, all EaP countries have made significant efforts to build integrated platforms for providing e-government services to enterprises and citizens, and the introduction of e-government services today is at an advanced implementation stage. All the EaP countries have elaborated multi-year strategies and shorter-term action plans for dealing with structural constraints and promoting the deployment of digital services. Azerbaijan, Georgia and Ukraine have also established a public agency in charge of directing and co-ordinating the digitalisation process. Armenia had a similar agency, the Armenia Digital Foundation, but it was dissolved in 2018, pending a review of the government digital strategy. In Belarus and Moldova, the coordination role is exercised respectively by the Ministry of Communications and Informatisation and by the State Chancellery. The best performers in this sub-dimension are Azerbaijan and Georgia, the only two countries to score above 4 (see Table 2.8).
Table 2.8. Scores for the *E-government services* sub-dimension

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy, planning &amp; design</td>
<td>1.96</td>
<td>4.22</td>
<td>4.44</td>
<td>4.33</td>
<td>3.67</td>
<td>2.89</td>
<td>3.59</td>
</tr>
<tr>
<td>Implementation</td>
<td>4.07</td>
<td>4.48</td>
<td>3.63</td>
<td>4.78</td>
<td>3.67</td>
<td>4.46</td>
<td>4.18</td>
</tr>
<tr>
<td>Monitoring &amp; evaluation</td>
<td>3.08</td>
<td>3.25</td>
<td>3.25</td>
<td>2.50</td>
<td>2.50</td>
<td>2.50</td>
<td>2.85</td>
</tr>
<tr>
<td>Weighted average</td>
<td>3.14</td>
<td>4.14</td>
<td>3.84</td>
<td>4.17</td>
<td>3.43</td>
<td>3.52</td>
<td>3.71</td>
</tr>
</tbody>
</table>

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

While overall progress across the region has been remarkable, UN data on the development of e-government services (Figure 2.6) suggest that EaP countries, with an exception of Belarus, are still distant from the best global performers, such as Estonia (Box 2.3).

**Figure 2.6. UN E-Government Development Index, 2018**

Note: The assessment covered 193 countries. Index value ranges from 0 (minimum) to 1 (maximum).


*StatLink*  [http://dx.doi.org/10.1787/888934086774](http://dx.doi.org/10.1787/888934086774)
Since 2013, Estonia has repeatedly outperformed European Union member countries in terms of its scores on the "responsive administration" principle of the Small Business Act for Europe. Entrepreneurs in Estonia complain significantly less about burdensome legislation or complex administrative procedures as problems for doing business, and enjoy the fastest tax payment procedures in Europe. Estonia’s public infrastructure relies on ubiquitous internet coverage and delivers most public services online.

E-government services of particular interest to businesses include:

- **e-Tax**: the electronic tax filing system set up by the Estonian Tax and Customs Board. Currently, 98% of tax declarations are filed online every year;
- **e-Business Register**: a secure, one-stop platform for carrying out most business administration requirements. Entrepreneurs can register a new business online, change data in the business register, file yearly reports, and inquire about other enterprises, without the involvement of a third party. Since 2011, 98% of new companies have been established online and the process has been significantly shortened to less than three hours.

Alongside, there are e-Banking, an online public procurement register, and an online system for reporting statistics. The online infrastructure relies on a safe ecosystem of online services such as digital signatures, digital ID cards and e-Residency, and facial recognition.


The case of Azerbaijan is illustrative of how EaP countries have managed to build well-designed e-government systems, compared to those in place in several OECD countries, in a relatively short period.

Azerbaijan has launched the “National ICT Strategy of the Republic of Azerbaijan 2014-2020”, which is aimed at removing legal obstacles to the introduction of digital services. In March 2018, a Presidential Decree established the E-Gov Development Centre, placed under the supervision of the State Agency for Public Service and Social Innovation, with the mandate of co-ordinating the introduction of the e-government services, enhancing the management of public information, and increasing the awareness of the e-service availability. As a result of those combined efforts, Azerbaijan in 2018 launched a new single-entry portal for all e-government services ([www.digital.gov.az](http://www.digital.gov.az)) with over 440 different digital services currently available to the entire population for both legal and physical persons.

Similar approaches have been adopted by other EaP countries in their efforts to speed up the implementation of an e-government system, as part of a wider process of reform of the public administration.

The main actions taken since 2016 in the other EaP countries are as follows: Armenia and Georgia have updated their respective e-government strategies, setting a number of intermediary targets and made further progress in their implementation, with Georgia also establishing a co-ordinating body, the Data Exchange Agency. Belarus and the Republic of Moldova have further extended the range of e-government services and facilitated access to e-services through the use of electronic signatures. Belarus has also introduced an m-
signature system. Ukraine has launched an E-Governance Action Plan (2018-2020) and enhanced the implementation role of the State Agency for e-governance.

**Business licenses and permits**

This sub-dimension assesses the extent to which governments have succeeded in streamlining administrative procedures related to the issuance of licenses and permits.

Since 2016, several EaP countries have taken steps to reduce the number of business licenses and permits requirements, simplifying the issuance procedures, and increasing transparency. Armenia still has much room for improvement, especially in the *Monitoring and streamlining of licence systems* thematic block; by contrast, in the same block, Georgia achieved the best possible performance, obtaining a score of 5 (see Table 2.9).

**Table 2.9. Scores for the Business licenses and permits sub-dimension**

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licence procedures</td>
<td>3.22</td>
<td>2.78</td>
<td>4.33</td>
<td>4.56</td>
<td>4.56</td>
<td>4.70</td>
<td>4.02</td>
</tr>
<tr>
<td>Monitoring and streamlining of licence systems</td>
<td>2.75</td>
<td>3.50</td>
<td>3.25</td>
<td>5.00</td>
<td>4.50</td>
<td>3.33</td>
<td>3.72</td>
</tr>
<tr>
<td>Weighted average</td>
<td>2.94</td>
<td>3.21</td>
<td>3.88</td>
<td>4.82</td>
<td>4.52</td>
<td>3.88</td>
<td>3.84</td>
</tr>
</tbody>
</table>

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

In Georgia, the number of business licenses has been reduced by 85% since 2016, according to the questionnaire provided by the government as part of the SBA assessment, and the “silence is consent” principle is generally applied. The procedure for allocating the few remaining compulsory business licences is conducted entirely online and it is based on an e-auction system that excludes any direct intervention by public officials to avoid any opportunity for discretion and corrupt practices.

In 2017, Moldova significantly cut the list of business licenses and permits, eliminating 18 business licenses and 122 permits. In Ukraine, the government launched two Deregulation Actions Plans (2015-16 and 2016-17). Although the implementation of the two plans has been relatively slow (only 58% of the actions included in the 2016-17 plan had been completed by the end of 2018), the plans led to a reduction of the required business licenses from 56 to 33 since 2016, while the number of required permits was reduced from 143 to 85 by the end of 2018.

In Armenia, the government has acted to improve the transparency of business licenses requirements by establishing a dedicated website accessible through the government general portal (www.e-gov.am). In Azerbaijan the government has amended its licenses and permits system through a new Law on Licences and Permits approved in June 2016, which reduces the number of licensing requirements and simplifies the application procedures.

**Company Registration**

The *Company registration* sub-dimension analyses the reforms undertaken by the EaP governments to make it simpler to start a business.

Since 2016, the EaP countries have made further progress in reducing the number of procedures, the time and the costs associated with company registration, and the overall process of starting a business. The regional average score for the sub-dimension covering
company registration has increased from 4.17 in 2016 to 4.38, indicating a good level of effective implementation. Georgia obtained the maximum possible score of 5 in the Design and implementation thematic block, while all the countries except for Moldova and Ukraine, obtained it in the Monitoring & evaluation thematic block (see Table 2.10).

Table 2.10. Scores for the Company registration sub-dimension

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design and implementation</td>
<td>4.67</td>
<td>4.67</td>
<td>4.83</td>
<td>5.00</td>
<td>4.33</td>
<td>4.00</td>
<td>4.58</td>
</tr>
<tr>
<td>Performance</td>
<td>4.33</td>
<td>4.33</td>
<td>4.00</td>
<td>4.67</td>
<td>3.83</td>
<td>4.33</td>
<td>4.25</td>
</tr>
<tr>
<td>Monitoring &amp; evaluation</td>
<td>5.00</td>
<td>5.00</td>
<td>5.00</td>
<td>5.00</td>
<td>3.66</td>
<td>2.32</td>
<td>4.33</td>
</tr>
<tr>
<td>Weighted average</td>
<td>4.58</td>
<td>4.58</td>
<td>4.49</td>
<td>4.85</td>
<td>3.97</td>
<td>3.81</td>
<td>4.38</td>
</tr>
</tbody>
</table>

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

Furthermore, data from the Doing Business 2020 report (World Bank, 2019[14]), related to the Starting a Business sections, provide a clear indication of the progress achieved by a single country, in relation to the other EaP countries and to the global level. According to the Doing Business 2020 report, the region includes three countries – Georgia (2), Azerbaijan (9) and Armenia (10) – that are positioned at the global frontier and have put in place effective procedures for starting a business. Ukraine is the only significant outlier, as its global rank on the “starting a business” indicator fell from 30th in 2017 to 61st in 2020. In part, this reflects improvements elsewhere, during a period when the Ukrainian government was focused primarily on macro-economic stabilisation and managing the conflict in the Donbass region.

The positive scores recorded at the regional level in this sub-dimension are the results of the continued efforts made by most of the EaP countries to improve the institutional and regulatory setting, develop online registration applications, and further reduce the number of procedures and time required to complete the notification procedures.

Four EaP countries (Azerbaijan, Belarus, Georgia and Ukraine) have now adopted a single company registry, and all the EaP countries have established one-stop shops. In Armenia, Belarus and Georgia it is possible to conduct the full registration process on line, while in Azerbaijan, Moldova and Ukraine, only the loading of the documents can be performed on line, but to obtain the company registration document, personal interaction with the company registration authority is required.

Among all the EaP countries Georgia stands-out for its state-of-the-art company registration process. Further significant improvements compared with 2016 have been recorded, due to the work conducted by the National Agency for Public Registry. In 2018, the process of starting a business was reduced to a single procedure that can be completed in a matter of minutes, either online or in one of the Public Services Halls located across the country.

Tax compliance procedures for SMEs

This sub-dimension investigates the presence of simplified tax regimes and tax incentives for small enterprises, and assesses the procedures for tax filing.

All EaP countries apply simplified tax regimes for small enterprises and individual entrepreneurs, and they have made significant efforts to simplify tax administration and increase the transparency and effectiveness of tax inspection systems. More needs to be
done in terms of *monitoring and evaluation*, especially in Armenia and Ukraine, which scored respectively 2.78 and 2.33 in the relevant thematic block (see Table 2.11).

**Table 2.11. Scores for the Tax compliance procedures for SMEs sub-dimension**

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP average</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME tax compliance &amp; simplification procedures</td>
<td>2.78</td>
<td>4.78</td>
<td>4.56</td>
<td>3.67</td>
<td>3.22</td>
<td>2.78</td>
<td>3.63</td>
</tr>
<tr>
<td>Monitoring &amp; evaluation</td>
<td>2.78</td>
<td>3.40</td>
<td>4.56</td>
<td>3.22</td>
<td>3.67</td>
<td>2.33</td>
<td>3.33</td>
</tr>
<tr>
<td>Weighted average</td>
<td>3.14</td>
<td>4.26</td>
<td>4.34</td>
<td>3.80</td>
<td>3.70</td>
<td>3.06</td>
<td>3.72</td>
</tr>
</tbody>
</table>

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

Since 2016, several countries have amended their tax codes to introduce new tax incentives and improve tax regimes for SMEs. Azerbaijan has introduced a three-year corporate tax exemption for small innovative start-ups and a seven-year exemption on corporate tax, property tax and VAT on qualified machinery imports for SMEs operating within approved clusters. Similarly, Armenia has introduced a profit tax exemption for individual entrepreneurs and small businesses with a turnover of up to AMD 9 million (EUR 16 630) and family run enterprises with a turnover of up to AMD 18 million (EUR 32 265). Georgia has introduced a similar tax exemption for small enterprises with a turnover not exceeding GEL 30 000 (EUR 9 840) and a reduced profit tax rate equal to 1% of the taxable income for enterprises with a turnover below GEL 500 000 (EUR 164 040). However, the impact of those measures on enterprise growth and entrepreneurship promotion is not generally evaluated. In Belarus and Moldova, no significant changes in the tax regime applicable to SMEs have taken place since 2016, while in Ukraine a new electronic administration system (EAS) for VAT was introduced since July 2016. (The new system has helped improve the VAT collection rate, but it is seen by most of the enterprises as non-user friendly.)

Most EaP countries have also introduced a set of thresholds below which enterprises are exempted from registering for and collecting VAT and have made efforts to speed-up VAT refund payments. Table 2.12 provides an overview of the tax compliance procedures for SMEs in the EaP countries.

**Table 2.12. Tax compliance procedures for SMEs in EaP countries**

Overview of the tax compliance procedures for SMEs in the EaP region.

<table>
<thead>
<tr>
<th></th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Belarus</th>
<th>Georgia</th>
<th>Moldova</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is it possible to complete tax filing procedures online?</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Yes.</td>
</tr>
<tr>
<td>No. of tax payments per year</td>
<td>15</td>
<td>9</td>
<td>7</td>
<td>5</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Hours required to complete tax compliance procedures per year</td>
<td>264</td>
<td>159</td>
<td>170</td>
<td>216</td>
<td>183</td>
<td>328</td>
</tr>
<tr>
<td>Post-filing index1</td>
<td>79.4</td>
<td>83.8</td>
<td>50.0</td>
<td>85.9</td>
<td>90.8</td>
<td>86.0</td>
</tr>
</tbody>
</table>

*1 Maximum value is 100.*

*Source: SME Policy Index 2020, Doing Business 2020*

**The way forward**

The EaP countries should consider the following actions to improve the overall operational environment for SMEs:
• **Upgrade the IT skills and IT equipment of small enterprises and individual entrepreneurs in all EaP countries**, so that they can optimise benefits from the introduction of e-government services. While the introduction of e-government services has moved at relatively rapid pace, no specific actions have been taken to promote the upgrading of IT skills and IT equipment in small enterprises and in particular micro-enterprises. If no remedies are taken, there is a risk of developing a new digital divide and limiting the benefits generated by the development of an e-government system.

• **Expand the role of the company registration agencies**, placing them at the centre of an enterprise data collection and management system. Company registers, once fully digitalised, are in the position to collect and disseminate valuable data on enterprise structure and performance to the public administration and, subject to privacy conditions for sensitive data, to the financial and business sector. Now that the “starting a business” processes in all the EaP countries (with the partial exception of Ukraine) are becoming more efficient, governments should actively consider the additional value-added that well-managed company registers may provide to the improvement of the overall business climate.

• **All EaP countries (except for Belarus) that still need to simplify their tax regimes should assess the impact of such a simplification** on business development and SME performance, and ensure that tax exemptions do not discourage SMEs with growth potential from engaging in activities that may lead to further expansion of their turnover and profitability or encourage businesses to operate informally, even if this may result in being subject to less favourable tax regimes.

**Bankruptcy and second chance**

Business failure, like business creation, is part of a dynamic, healthy market. Exit (liquidation) and restructuring of failed companies, or “fresh start” for honest entrepreneurs, ensure that productive assets remain in use and scarce resources are allocated efficiently. On the other hand, inefficient, lengthy and burdensome proceedings cause opportunity and procedural costs for both creditors and debtors, while diminishing prospects of a successful company reorganisation or asset recoveries by creditors. Principle 2 of the European Union’s Small Business Act hence seeks to “ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance” (Commission of the European Communities, 2008[9]).

Moreover, insolvency reforms are often difficult to implement given the complex nature of insolvency frameworks and their spillovers. In high-income countries, encouraging debtors to take actions early in financial distress is often considered as the best option to maintain the activity of insolvent businesses and save the value of the estate. Early warning systems (such as self-tests, call centres and training courses for entrepreneurs that fear failure) and preventive measures (such as restructuring proceedings) can avoid bankruptcy altogether by identifying distressed companies and striking the right balance between financial support contingent on business viability, training and assistance. EaP countries might also want to consider out-of-court settlement mechanisms, such as mediation and arbitration, associated with reduced bankruptcy rates (European Commission, 2011[15]; European Commission, 2014[16]). EaP countries, however, also benefit from legal features facilitating
the development of a sound and active credit market, such as stronger creditor rights (Succurro, 2012[17]).

Government campaigns mitigating the negative attitude towards failed businesses can pave the way for a second chance for honest entrepreneurs. Re-started businesses grow faster and create more jobs and turnover than start-ups (Stam, Audretsch and Meijaard, 2008[18]). In many countries, successful entrepreneurs often succeed only at the second or third attempt – after they have learned from failure. If failed entrepreneurs are less likely to enter the field again, then more entrepreneurs will be first-timers, making first-time mistakes (Ucbasaran, D., P. Westhead and M. Wright, 2011[19]), and little learning will occur. This contrasts with the experience of places like Silicon Valley, where the motto of “fail fast, fail cheap, and move on” is often quoted (Lee, S.-H. et al., 2011[20]). Hence, measures to reduce stigma, such as setting a reasonable maximum debt-discharge period or eliminating discriminatory provisions against re-starters, would allow entrepreneurs to benefit from their first entrepreneurial experience, even though failed, and efficiently plan the start of a new firm.

**Assessment framework**

The framework for the bankruptcy and second-chance dimension assesses three sub-dimensions: 1) preventive measures, 2) survival and bankruptcy procedures and 3) promotion of second chance (Figure 2.7). A major change since the 2016 assessment has been the introduction of the preventive measures sub-dimension to account for policies that promote the early detection and rescue of financially distressed entrepreneurs.

**Figure 2.7. Assessment framework – Bankruptcy and second chance**

**Preventive measures**

This sub-dimension captures the measures in place to prevent insolvency. Early detection and resolution of financial distress can reduce the bankruptcy rate, maximise the value of assets recovered by creditors, and allow for the quick reallocation of assets and resources of distressed firms to more productive uses (Garrido, 2012[21]; European Commission, 2011[15]). The lack of preventive measures can push viable firms with temporary financial distress into bankruptcy.

A first set of investigated measures comprises business services (e.g. financial and debt counselling) and information tools (e.g. self-test websites, call centres and training courses) provided by public or private institutions to entrepreneurs fearing failure. The existence of
early-warning systems – such as financial reviews of tax declarations or mandatory alert of early-insolvency signs from managers to creditors – is also taken into consideration, given that they allow for a systematic detection of financially distressed businesses before filing for bankruptcy. The sub-dimension finally looks at pre-insolvency schemes providing protection from creditors and allowing time to restructure debts while continuing operations.

**Survival and bankruptcy procedures**

Well-designed and performant insolvency regimes are at the core of the dimension. This sub-dimension specifically measures the alignment of laws, procedures and institutions of the insolvency regime with international standards, but also captures the actual performances of insolvency proceedings and related institutions.

The sub-dimension primarily assesses the design and implementation of the insolvency regime. A first factor is the clear distinction between honest and fraudulent bankruptcies, which is crucial for giving honest entrepreneurs a second chance. The sub-dimension then assesses the consistency of in-court procedures with international standards. This includes 1) transparency of procedures, 2) neutrality of courts, 3) formal discharge from bankruptcy, 4) strength of restructuring procedures as an alternative to liquidation, 5) sufficient protection of creditors’ rights, and 6) strength of the legal framework governing secured transactions. The existence of alternatives to in-court bankruptcy processes is also explored in the sub-dimension, including out-of-court-settlements and the availability of independent legal and accounting services to provide advice on the recovery plan.

In addition, this sub-dimension takes into account the performance, monitoring and evaluation of the insolvency regime. The average time required for typical insolvency proceedings and to obtain discharge, and the related costs (as a percentage of the estate) and recovery rates (cents on the dollar), are important measured factors. The sub-dimension finally assesses the scope and structure of the monitoring and evaluation system, as well as the existence of registries to collect data on bankruptcy.

**Promoting second chance**

This sub-dimension assesses the extent to which insolvency regimes promote a “fresh start” for honest entrepreneurs going bankrupt and reduce the stigma associated with a failing business. Second chance can be assimilated to the treatment of failed entrepreneurs, once the bankruptcy procedures are completed. The promotion of second chance creates incentives for entrepreneurship and experimentation by increasing firms entry and by allowing entrepreneurs to apply their experience and lessons learnt to new businesses (OECD, 2018[22]).

This assessment first measures the degree of promotion of second chance through co-ordinated policies at the national or local level or through information campaigns (through training or online tools). Governments can play an active role in fostering market re-entry by promoting the idea that failing a business is not a “life sentence” and ultimately translates into valuable experience in fresh starts. Another element measured by the sub-dimension is the extent to which insolvency regimes “punish” honest entrepreneurs. While effective measures should be taken to prosecute fraudulent entrepreneurs who are going bankrupt, the restrictions imposed on the civil and economic rights of debtors (e.g. restrictions to getting credit or being involved in the management of a firm; incarceration or restrictions to travel; loss of the right to vote or hold elected office) limit honest entrepreneurs’ ability to start new businesses following a failure.
Analysis

Given their limited resources compared to larger firms, SMEs (as both debtors and creditors) especially benefit from cost-effective, streamlined bankruptcy systems. This dimension assesses the extent to which EaP countries have facilitated market exit and re-entry by adopting effective and efficient insolvency frameworks.

Insolvency frameworks remain one of the weakest areas of the EaP region’s business environment and countries have experienced only modest progress in this area. The results of the assessment show that the scores on average increased by only 5% in EaP countries with a regional average score of 2.85. Even though Belarus, Georgia, Moldova and Ukraine have developed a range of tools to detect and prevent insolvency at early stages of financial distress, or to promote a culture of sound business management and business rescue, those tools often lack visibility and accessibility. The development of early-warning systems is at nascent stages in all EaP countries, with the exception of Belarus, where a comprehensive system based on tax declarations has been implemented. (Belarus’s system provides for the monitoring of tax declarations, and firms showing signs of financial distress are invited to explain the reasons for their situation; unsatisfactory explanations may be followed by further investigations from the authorities.) Azerbaijan and Georgia have amended their insolvency legislations and Ukraine has introduced a new Bankruptcy Code. The insolvency framework is also expected to improve in Armenia, Belarus and Moldova, where reforms are planned for 2020. Proactive policies and initiatives promoting second chance for honest re-starters are at very early stages in EaP countries and entrepreneurs seeking a fresh start still face some form of discrimination (e.g. in Ukraine and Belarus). Only in Moldova are awareness campaigns, training and restructuring services provided in the context of the DanubeChance2.0 project to support honest re-starters.

Despite recent improvements, measures to promote business rescue and second chance are still lacking

EaP countries have experienced modest progress in the bankruptcy and second-chance dimension, especially when compared to other dimensions of Pillar A, Responsive government. Insolvency frameworks remain one of the weakest areas of the region’s business environment. This is due not only to the complexity of reforming insolvency legislation – i.e. striking a right balance between restructuring and liquidation, or maintaining a healthy credit market – but also to the lack of proactive policies promoting business rescue and second chance.

The average score for EaP countries remains below 3 in this dimension, whereas their scores in other Pillar A dimensions are closer to 4 (Figure 2.8). EaP countries show significant progress in the sub-dimension on bankruptcy and survival measures, driven by recent reforms in insolvency legislation (notably in Azerbaijan, Georgia and Ukraine); however, the only modest or weak policy progress with respect to preventive measures and promotion of second chance tend to rebalance the scores downwards. Belarus and Georgia stand at the forefront, although for different reasons. Georgia is carried by strong formal frameworks, while Belarus shows efforts to prevent insolvency and increase the efficiency of procedures. Armenia, Azerbaijan, Moldova and Ukraine lag behind because of the sub-par efficiency of bankruptcy procedures and low emphasis on prevention, restructuring and second chance.

It is critical to note that the introduction of the preventive measures sub-dimension has lowered the scores compared to the previous methodology, despite the improvements
introduced in EaP legislation. This is particularly the case for Armenia, which experienced a decrease in its bankruptcy and second chance score partly due to weak preventive measures.

Figure 2.8. Scores for the Bankruptcy and second chance dimension compared to 2016

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

StatLink http://dx.doi.org/10.1787/888934086793

Figure 2.9. Performance of insolvency frameworks in EaP and OECD countries

Note: EU-13 Member States – Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

StatLink http://dx.doi.org/10.1787/888934086812
Implementing more comprehensive and systematic preventive measures

This sub-dimension assesses the measures in place to prevent insolvency – measures that are essential to reducing the bankruptcy rate, maximising the value of assets recovered by creditors and allowing for the quick reallocation of assets and resources of distressed firms.

Belarus, Georgia, Moldova and Ukraine have developed a range of tools to detect and prevent insolvency at the early stages of financial distress, or to promote a culture of sound business management and business rescue:

- In Belarus, private companies have access to pre-insolvency services provided by the Ministry of Economy (self-test and advice website) and by business support centres (training courses, consulting services, e.g. by the Republican Confederation of Entrepreneurs). An early-warning system has been implemented by the Ministry of Taxes and Duties – based on the review of tax declarations – and by Commissions on Preventing Economic Insolvency, created and operated under the control of state bodies. Firms showing signs of financial distress are invited to explain the reasons for their situation: unsatisfactory explanations may be followed by further investigations from the authorities. As a result of these policies, Belarus obtained a score of 3.76, which is the highest score in this sub-dimension (see Table 2.13).

- In Georgia, Moldova and Ukraine, business support organisations (e.g. Chambers of Commerce in Georgia and Moldova and the Start-Up Ukraine seminar in Ukraine) provide SMEs with a range of consulting services and basic pre-insolvency information. In Moldova and Ukraine, a self-test website is available before starting a business. It is also mandatory for the debtor’s manager to alert stakeholders and the owner of the property about any sign of insolvency in Ukraine.

However, a closer look at the preventive measures and early-warning tools reveals that they often lack visibility and accessibility. Even though business support organisations provide useful consultancy advice or training, they are often concentrated in economic centres and do not advertise their services properly to SMEs. In Belarus, for instance, few business support organisations have appropriate websites describing the services they provide, especially in peripheral regions. Best practices in this regard can be derived from the Early Warning project implemented in several EU countries (Box 2.4).

In addition, the development of systemic early-warning systems is at a very early stage in the EaP countries. As described earlier, only Belarus has a solid early-warning system based on tax declaration (although the investigations following the signs of financial distress often focus on the manager’s responsibility instead of promoting a rescue-oriented dialogue). Repeatedly exceeding borrowing limits, receiving frequent demands for payment from creditors, or concentrating on risky and late-paying clients are all early signs of insolvency risks. Implementing systemic detection mechanisms is an efficient way to lower the risks of insolvency.

<table>
<thead>
<tr>
<th>Preventive measures</th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.29</td>
<td>2.43</td>
<td>3.76</td>
<td>2.71</td>
<td>2.90</td>
<td>2.71</td>
<td>2.63</td>
</tr>
</tbody>
</table>

Note: see Annex A for information on the assessment methodology.
Box 2.4. Early warning systems: building on EU best practices

The Early Warning Europe project has provided advice and support to distressed entrepreneurs since 2017. Its objective is to establish 1) an early warning system based on a data-driven method to identify companies in distress and 2) an organisation supporting entrepreneurs and contributing to the policy debate to promote preventive measures and promotion of second chance. The project has so far implemented early warning mechanisms in Belgium, Denmark, Germany, Greece, Italy, Poland and Spain. Additionally, Croatia, Finland, Lithuania and Slovenia have completed the Early Warning Europe Training Academy and are preparing to set up the Early Warning mechanism.

Early Warning Europe notably derives best practices from the following:

- **Early Warning, Denmark.** Since 2007, the programme has provided over 5,500 Danish SMEs with tailor-made assessments of financial distress and services to avoid bankruptcy and promote second chance. At the request of distressed entrepreneurs, a team of consultants, lawyers and voluntary entrepreneurs undertake economic assessments and support the turn-around of the company if it can be saved, and the restructuring or the bankruptcy otherwise. The group of voluntary advisors accompanying financially distressed companies is a key success factor of this early warning system.

- **Team U, Germany.** Started in 2007 as a self-help group to empower entrepreneurs fearing failure, Team U provides financially distressed businesses with a hotline, peer-to-peer support, self-help groups, online services and consulting by a team of experienced practitioners. The focus on entrepreneurs’ well-being and emotional issues, in addition to the focus on financial issues, is key to helping entrepreneurs overcome insolvency.

- **Dyzo, Belgium.** Established in 2015, this institution provides advice and support to self-employed people in financial distress. Dyzo provides entrepreneurs with a hotline, an informative website, a legal helpdesk, seminars and consulting services. The institution keeps in close contact with the authorities to follow legal changes and enhance the efficiency of legal assistance.


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**Insolvency laws and procedures have improved, but more can be done to encourage restructuring**

The *Survival and bankruptcy procedures* sub-dimension measures the sophistication level of bankruptcy laws and procedures and their alignment with international standards.

Since the last SBA assessment, the EaP countries have undertaken a significant number of reforms to align the main provisions of their insolvency legislation with international standards:

- Azerbaijan has enacted over 50 amendments to its insolvency legislation. Also, the new Law on Secured Transactions with Movable Property has since 2016 strengthened the protection of creditors’ rights, extended the obligations for insolvency administrators, and introduced the notion of a recovery plan. As a result,
the country achieved a score of 3.78 in the Implementation thematic block (see Table 2.14).

- Georgia has amended its insolvency legislation to expedite reorganisation and liquidation proceedings, strengthen secured and unsecured creditors rights through better participation in the decision-making process, introduce an electronic system for insolvency proceedings and regulate the appointment of bankruptcy trustees. Georgia now plans to further reform its insolvency legislation with the support of donors (e.g. GIZ and USAID).

- In 2019, Ukraine introduced a new Bankruptcy Code to replace the previous insolvency legislation. The reform introduces the notion of personal bankruptcy for individuals, strengthens the protection of creditors’ rights, and simplifies and expedites bankruptcy procedures, while also reducing the scope for appeal and introducing transparent sales procedures through e-platforms.

In addition, although no major improvements to the insolvency framework have been introduced in Armenia, Belarus and Moldova, reforms are planned in all three countries. Moreover, Armenia performs particularly well in the implementation thematic block, achieving a score of 4.20.

<table>
<thead>
<tr>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementation</td>
<td>4.20</td>
<td>3.78</td>
<td>3.62</td>
<td>3.47</td>
<td>3.34</td>
<td>3.97</td>
</tr>
<tr>
<td>Performance</td>
<td>3.60</td>
<td>3.93</td>
<td>4.00</td>
<td>3.80</td>
<td>2.80</td>
<td>2.60</td>
</tr>
<tr>
<td>Weighted average</td>
<td>3.84</td>
<td>3.87</td>
<td>3.85</td>
<td>3.67</td>
<td>3.01</td>
<td>3.15</td>
</tr>
</tbody>
</table>

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

Persistent challenges remain, however, in the design and performance of insolvency legislation. First, the majority of insolvency cases in EaP countries are resolved through liquidation, which lowers the potential value of recovered assets. This largely reflects the generally weak restructuring and mediation frameworks. In Armenia, for instance, debtors cannot file for restructuring proceedings at an early stage of financial distress. In Azerbaijan, although mediation procedures were recently introduced, they have not yet been implemented. In Moldova, the procedure for accelerated restructuring does not provide sufficient protection from creditors. Such liquidation and credit-driven orientation of insolvency regimes in EaP countries contrasts with the recent re-orientation of the EU insolvency frameworks towards the preservation of debtors’ assets through the harmonisation of restructuring procedures in Member States (Box 2.5). Hence, strengthening restructuring procedures and striking the right balance of opportunities for debtors to file for restructuring or liquidation procedures is a key practice EaP countries should consider in order to lower the predominance of liquidation in their frameworks.

In all EaP countries, many SMEs prefer not to engage in formal insolvency because they wish to avoid lengthy and costly insolvency procedures. Instead, debtors tend to sell their assets at early stage of financial distress, often at low prices, or to continue operating even though the firm is effectively insolvent. In addition, SME insolvency may lead to personal insolvency of owners in the case of family businesses, in which families pledge their personal assets for loans. Simplified or pre-packaged in-court procedures specifically
targeting SMEs are key provisions to address this issue and encourage SMEs to engage in formal procedures.

**Box 2.5. Giving entrepreneurs a second chance in the EU**

In June 2019 the Council of the European Union for the first time harmonised restructuring procedures and adopted the promotion of second chance for troubled businesses. It formally adopted a directive on preventive restructuring frameworks, second chance, and measures to increase the efficiency of restructuring, insolvency and discharge procedures. Member States will implement the new provisions within two years.

The objective of the directive is to reduce the barriers to cross-border investments arising from the differences in Member States’ insolvency framework. The promotion of restructuring procedures and second chance for honest entrepreneurs aims at reducing the amount of non-performing loans and increase the recovery rate of creditors within the EU.

Key features of the reform include:

- **Core elements of preventive restructuring frameworks.** Debtors have access to preventive restructuring procedures with facilitated negotiations. Debtors may also benefit from protection from individual enforcement actions and a suspension of insolvency proceedings during the negotiations (up to four months). New financing and interim financing are protected under specific conditions to support the restructuring process.

- **Enhanced second chance for entrepreneurs.** Honest entrepreneurs have access to a full debt discharge after a maximum of three years. Restrictions to become a member of a board of a firm (disqualification order) are time-limited and should end with the discharge period.

- **Enhanced efficiency of insolvency, restructuring and discharge procedures.** The directive frames the specialisation of courts, as well as the qualifications, supervision and remuneration of insolvency practitioners. The digitalisation of proceedings is also encouraged.

- **Minimum rules on monitoring and evaluation.** Member States have to collect key statistics on insolvency – such as the number of preventive restructuring procedures and the length of insolvency procedures – and communicate the data to the Commission.


*Promoting second chance for honest entrepreneurs*

The Second chance sub-dimension assesses the measures in place to facilitate a second chance for entrepreneurs and to reduce the stigma associated to a failed business.

Proactive policies and initiatives promoting second chance for honest re-starters are at very early stages in EaP countries, as reflected in the relatively low scores presented in Table 2.15. All legislations now include provisions to distinguish honest from dishonest bankrupt
entrepreneurs, which are important to avoid unnecessary costs and the stigma of insolvency. However, economic or civic disabilities – such as preventing failed entrepreneurs from applying to public support programmes for SMEs – still worsen the treatment of failed entrepreneurs in some EaP countries. For instance, in Ukraine, entrepreneurs seeking a fresh start cannot apply for a bank loan for three years or file for bankruptcy for five, while in Belarus they are allowed to register a new business entity only one year after their exclusion from official registries.

Table 2.15. Scores for the Promoting second chance sub-dimension

<table>
<thead>
<tr>
<th></th>
<th>ARM</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>MDA</th>
<th>UKR</th>
<th>EaP Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promoting second chance</td>
<td>1.17</td>
<td>2.00</td>
<td>1.92</td>
<td>2.25</td>
<td>2.25</td>
<td>1.33</td>
<td>1.82</td>
</tr>
</tbody>
</table>

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

Five of the six EaP countries do not implement informational campaigns and targeted support and training for honest re-starters. Moldova has been the exception since ODIMM recently got involved in the DanubeChance2.0 project, giving formally bankrupt entrepreneurs a second chance in the Danube Region though awareness campaigns, training, and restructuring services. ODIMM and the Ministry of Economy and Infrastructure also held a first event in 2018 on “Embracing failure to facilitate second-chance entrepreneurship in the Danube region”.

The way forward

The following key policies and initiatives should be considered by EaP countries to promote business rescue and fresh start for entrepreneurs:

- **Armenia and Azerbaijan could increase support to financially distressed entrepreneurs** by fostering the implementation of training and debt counselling by practitioners at the local level for private companies with financial difficulties, with appropriate visibility and accessibility for SMEs (i.e. through a hotline or website).

- **Armenia, Azerbaijan, Georgia, and Moldova should implement early-warning systems for a systematic detection of insolvency**, either from inside (from managers and accountants, e.g. first steps implemented in Ukraine, such as self-test websites) or outside the company (from tax declarations, e.g. in Belarus, or from creditors). All EaP countries should give preventive measures and early-warning tools more visibility and accessibility.

- **Continue reforming insolvency legislation**, notably regarding restructuring procedures (Armenia, Azerbaijan). Sound restructuring tools generally allow 1) creditors to initiate restructuring and to take decisions by the majority (“cramming-down” on dissenting creditors), 2) for continuity of operations (automatic stay on assets\(^1\)), 3) for new or interim financing or 4) for incumbent managers to stay in office (OECD, 2018\(^{22}\)). Azerbaijan should institute specialised courts for insolvency cases and credit reporting institutions, while Belarus could align more with international standards, introducing a clear definition of discharge from bankruptcy and a maximum time of discharge, and covering secured transactions for companies filing for bankruptcy in the insolvency framework. Georgian insolvency legislation could also be further improved to reach international standards.
• Introduce simplified or pre-packaged in-court proceedings specifically targeting SMEs (Georgia) or give SMEs the option to pay expenses related to insolvency procedures in instalments (Azerbaijan). Alternatives to in-court procedures could also be introduced and encouraged in both countries.

• All EaP countries should collect more comprehensive and systematic data on insolvency and efficiency of procedures, such as survival rate of new businesses, size of firms going bankrupt or number and outcome of insolvency procedures.

• All EaP countries should adopt co-ordinated and proactive second chance strategies. Key features of second-chance promotion in EaP countries could include 1) facilitated access to finance after bankruptcy, 2) guidelines or training for re-starters, and 3) awareness raising campaigns.

Policy instruments – Responsive Government

Table 2.16. Dimension challenges and policy instruments – Pillar A

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Challenges / Opportunities</th>
<th>Policy instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institutional and regulatory framework</strong></td>
<td>Lack of focus on SMEs. Despite the significant contribution of SMEs to the economy, policies often do not fully acknowledge them, leading to higher compliance costs and market failures.</td>
<td>Tailor policy objectives to SMEs. Adopt a definition of SMEs that encompasses the different enterprise categories; then promote its adoption to enhance policy focus. Strategies should include clearly defined, consensus-based objectives, quantitative targets and key performance indicators.</td>
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<tr>
<td><strong>Operational environment</strong></td>
<td>Administrative impediments and poor IT skills. Complex, costly and lengthy administrative procedures might discourage entrepreneurship and push SMEs to the informal sector and hamper competition in the markets. E-government could help SMEs cope with the procedures, but only if the digital divide within the SME population is reduced.</td>
<td>Enhance the efficacy of e-government. Upgrade IT connection, equipment and ICT skills of SMEs to enable them to take advantage of e-government and reduce the administrative burden imposed on them. Integrate databases run by public institutions to ensure a comprehensive range of e-government services.</td>
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<tr>
<td><strong>Inefficient tax regime.</strong></td>
<td>The current simplified tax regime present in most EaP countries offers tax simplification measures and incentives for SMEs, on one hand; on the other hand, one should keep in mind the unintended consequences of such manoeuvres, as SMEs might prefer remaining “small” in order to keep the tax incentives they are entitled to by size.</td>
<td>Improve the tax regime. Assess the impact of the current simplified tax regimes and redesign them to ensure sustainability of SME growth.</td>
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<td>Bankruptcy and second chance</td>
<td>Late detection of failing businesses. Because support services are not specifically targeted at SMEs and because early-warning systems are not well co-ordinated, businesses filing for bankruptcy cannot be rescued on time.</td>
<td>Enhance visibility and accessibility of preventive measures. Increase training and debt counselling services for SMEs, and enhance their accessibility (e.g. through hotline or website).</td>
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<td></td>
<td>Detect failing firms early. Implement early-warning system, acting internally (e.g. accountants) or externally (e.g. tax declarations) to systematically detect financially distressed firms before bankruptcy.</td>
<td>Introduce simplified or pre-packaged in court proceedings targeting SMEs, or allow for instalments for the expenses in insolvency procedures.</td>
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<tr>
<td>Weak insolvency frameworks. The complexity, the lack of proactive policies promoting business rescue and second chance, and the associated costs result in a very few SMEs engaging with formal insolvency procedures, with dire consequences for the financial stability of the entrepreneurs.</td>
<td>Adopt co-ordinated and proactive second-chance strategies. For instance, facilitate access to finance after bankruptcy, provide training, and launch awareness-raising campaigns.</td>
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</table>

References


Notes

1 The “think small first principle” requires public authorities to consider SMEs’ interests early on in the policy-making process. A comprehensive and coherent policy and institutional and regulatory framework is therefore necessary to ensure that laws and regulations are SME-friendly and that public initiatives address the needs of SMEs effectively. This dimension assesses three interrelated aspects of the SME policy process: the institutional framework; the adoption of legislative simplification and regulatory impact analysis tools for SMEs; and the existence of participatory platforms for public-private consultations on SME-related topics.

2 In the EU, the SME Test analyses the possible effects of EU legislative proposals on SMEs. By assessing the costs and benefits of policy options, it helps implement the ‘Think Small Principle’ and improve the business environment. See https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/sme-test_en.


5 The low estimates of the informal sector provided by GEOstat (around 10% of GDP) are not in line with estimations from the IMF, according to which Georgia figures among the largest shadow economies (with a size of 64.9% of GDP). Such discrepancy may be due to differences in the methodology used. For more on this, see (Medina and Schneider, 2018[26]).

6 According to new methodology.

7 2020 World Bank Doing Business assessed 190 countries.
However, the point should not be pushed too far: Ucbasaran, Westhead and Wright (2011) cite data suggesting that this is not necessarily true of some “serial entrepreneurs”, who often fail not just once but repeatedly, owing to an optimistic bias in their decision making and a failure.

Promotion of second chance should hence be distinguished from restructuring/survival measures for financially distressed businesses.

New 2020 methodology

Planned improvements and reforms, such as draft laws pending in Parliament, are not reflected in the sub-dimension score.

An automatic stay on asset temporarily prevents creditors from pursuing the debtors for amounts owned – i.e. starting or continuing court proceedings against the debtor, moving to foreclose on a debtor’s property, creating, perfecting or enforcing a lien against a debtor’s property and attempting to repossess collateral. An automatic stay goes into effect the moment a debtor files for bankruptcy.