

**Speech**  
**Mr. Stephen HAYKIN, Mission Director, USAID/Caucasus**  
**“Developing Small and Medium Sized Enterprises”**  
**“Fostering Economic Cooperation and Stability in the OSCE Region”**  
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Honorable guests, ladies and gentlemen:

Today I am going to speak about small and medium sized firms or SMEs and how their development relates to security and economic growth drawing on our last two decades of experience in Europe and Eurasia. I will discuss some of the types of activities that have proven successful for the United States Agency for International Development, USAID, and point out the implications for parliamentarians, such as yourselves, and other policy makers.

In general, we can say that economic growth usually promotes stability in a country. And, vice versa, stability – both political and economic – is necessary for economic growth. They are mutually reinforcing. I would add that the more inclusive economic growth can be, the more it tends to promote stability. Inclusive economic growth is supported by buy-in from all classes and regions of a country. Inclusive economic growth promotes stability domestically and may help to guard against inter-state conflict associated with break-away regions, thus promoting regional and international stability as well.

But if economic growth promotes stability, does any one firm size – small, medium or large – as a category promote more or less economic growth than the other? More specifically, do SMEs create more growth than large firms? The answer is probably, “It depends.” At various times and in different places, growth may relate to the size category of firms. However, in most times and in most places it may be more useful to get firms to cooperate together to meet the demands of the marketplace rather than favoring one category over another.

If we are looking for drivers of economic growth, it may be more useful to look at entrepreneurial activity across the economy. Entrepreneurial activity is the ability to start and build successful enterprises. Entrepreneurial activity – creating more enterprises and expanding (successful) enterprises – is then a fundamental driver of economic growth.

It is easier to make the case that growth is caused by entrepreneurial activity across the economy than by a particular category of firm size.

However, it may also be easier to argue that entrepreneurial activity may at times be more prevalent in small and medium size firms than in large firms. This could be true for a number of reasons: SMEs are closer to the needs and tastes of their customers. SMEs are less bureaucratic and can innovate more rapidly than larger firms. Numerically more entrepreneurs come from SMEs than large firms.

Consequently, the real question is how to promote entrepreneurial activity to create more successful enterprises in all size categories of firms. As policy-makers our attitude should be that we will take growth from whatever sized firm we can get it.

Competition is one way to promote entrepreneurial activity and economic growth. In a market economy, enterprises compete against each other for market share. Those that are successful in this competition grow, and those that are unsuccessful stagnate or fail. As an aside, letting unsuccessful firms fail (or go bankrupt) also promotes entrepreneurial activity. This is because entrepreneurs who have had previously unsuccessful business start-ups generally have a higher success rate than entrepreneurs engaged in first starts.

Competition should be encouraged both within domestic markets and between countries that have open international markets. Firms who can successfully compete against each other for market share we call “competitive” firms.

When countries open up their domestic markets, as in the transitional economies, they frequently need assistance to compete in the global marketplace. USAID has invested a lot of resources to try to increase firm and country competitiveness.

Being competitive in the global marketplace is rarely or easily achieved by a single firm. Meeting the demand for quantity, quality, and timeliness of the global marketplace is not easy. An important aspect of USAID assistance has been to focus on value chain development.

Here is a diagram of a value chain. It consists of groups of firms that add value to a product. It begins with the supply of raw materials to delivery of the final product to the end consumer. Value chains require the cooperation of both large firms and smaller firms.

At the enterprise level, competitiveness is a function of two types of factors, which I call internal and external: Internal factors are those that are largely within the control of management including production processes, quality, style, reliability, and other factors inside the firm. External factors are those that are largely outside of the control of management, including macroeconomic stability, tax policy, customs/trade policies, education, infrastructure, and related factors.

USAID tries to find which of these factors are most relevant and most constraining in the local economy, and then to focus development efforts on those constraints:

Basic market intelligence addresses those productive areas in which countries have the best chances of having a comparative advantage. For example, Georgia probably has as many different areas of agricultural production as the United States. USAID-financed competitiveness assessments and value chain assessments provide basic market information to identify in which areas it may potentially become competitive. As a result of these assessments, over 60 small Georgian farmers are exporting the first container of Mandarin oranges to the EU. If the Mandarins can meet the EU food safety standards, it could lead to a sustainable trade breakthrough to a much more lucrative market that could create a better income for thousands of farmers as well as other firms.

Business enabling environment projects to address external factors that constraint the economy. In Montenegro, USAID supported the creation of the Montenegro Business Alliance (MBA) that has provided the business community with a strong voice to interact at every level of government. The member firms represent 30% of the annual GDP of Montenegro. The Alliance

has deliberated on eight key laws including accounting, privatization, corporate tax, enterprise registration, securities licensing and energy.

Firm/industry/value chain projects focus more on internal factors, and the external factors that are unique to specific industries. In Georgia, for instance, hazelnuts are produced predominantly by small-holder farmers and small- and medium-size processors. The international market can buy as many hazelnuts as Georgia can produce. USAID has partnered with Ferrero to form an alliance with a global confectionary company and leverage resources to increase competitiveness of the hazelnut sector. This example shows that when value chains begin to take shape and start cooperating we frequently see large firms assisting SMEs with finance, technical assistance and training.

Trade/investment projects tend to address external factors that are specific to international trade and FDI promotion. For example, USAID assistance is enabling SMEs in the Georgian hazelnut processing industry achieve efficiencies and better meet the quality and quantity needs of the global market, currently representing an annual export of around \$130 million hazelnuts (2011). Improved farming practices in pruning, pest prevention, soil tilling, and post-harvest management can result in 30 percent increase in production.

Workforce development projects strive to increase overall labor productivity either throughout the economy, or more targeted on specific industries. Once a country has identified the areas in which it has a comparative advantage, it can train its human resource to meet the skill required by the marketplace. As a practical example, now in Georgia apparel workers are trained on identical equipment as used by a majority of apparel manufacturers.

So what does this mean for Parliamentarians and other policy-makers? We can sum up the implementations for policy-makers in three sets of actions: The first effort for policy-makers is to get government out of the way of the private sector. The second important effort is to build the institutional capacity for effective, equitable and predictable regulation of the private sector. The third action area is to promote a high quality of policy dialogue on economic issues.

These efforts are not easy but they are possible and necessary. The first effort consists of a negative list of things government should not be doing. Policymakers need to get government out of competition with private enterprise, eliminate bureaucratic red tape, and eliminate gate-keeper positions (corruption), among other measures.

The second effort is more difficult. It consists of an affirmative list of things government should be doing to support and regulate businesses because businesses cannot do these things for themselves. Policy makers need to build an effective judiciary for commercial activities to ensure enforcement of contracts and resolution of disputes. They need to ensure the systematic and consistent enforcement of rule of law. They need to manage natural resources and public utilities to keep basic inputs such as energy, transportation and other input costs low. For example, throughout the transitional economies, USAID has financed activities to promote central bank regulation.

The third set of actions is to engage deliberative, consultative mechanisms that promote a dialogue between the public and private sectors. All governments face the challenge of how to implement good policies and to stop bad ones. When vigorous debate is absent it increases

political vulnerabilities to policy mistakes. Successful countries create an environment where all ideas – good and bad – are exposed to review and vigorous debate. This debate, to be most effective, should not be limited to government, but should also include think tanks, academia, press, independent review commissions, and others.

In conclusion, economic growth and stability go hand-in-hand. Take advantage of periods of relative stability to promote economic growth. Firm size is not as important to economic growth as entrepreneurial activity: the ability of the economy to create more enterprises and more successful enterprises. In comparison to the size and demands of the global marketplace, almost all firms are “small.” Firms need to work together effectively and efficiently in value chains to increase market share in their commodity areas. In identifying and removing the constraints in value chains, policy-makers should engage in three sets of actions: First, stay out of the way of the private sector so it can detect and respond to market signals. Second, build and maintain a policy environment that regulates the private sector and effectively address constraints which the private sector is unable to address itself. And third, promote vigorous public-private policy dialogue to minimize policy mistakes through a broad-based consensus on major policy issues.

Thank you.

### **Selected Examples of USAID Activities**

#### **Supporting Small and Medium Sized Enterprises and Value Chain Development**

**Importance of Rule of Law:** In Bulgaria, USAID supported public-private dialog and public outreach to advocate for the advantages of adopting a private judgment enforcement mechanism. USAID assisted the Parliament members to draft legislation to create a private enforcement system (predominant in Europe) and reform collection procedures in a manner that protects the interests of creditors, debtors and third parties. Following passage of the legislation, USAID worked to support the development of a new profession through extensive training of the agents and institutional development of a governing professional association. The new profession dramatically improved collection performance in Bulgaria, which had a significant impact on improving World Bank Doing Business Enforcement of Contracts Indicator.

**SME advocacy:** In Montenegro, USAID supported the creation of Montenegro Business Alliance (MBA) that has provided the business community with a strong voice at every level of government. MBA is now an effective advocacy coalition of Montenegrin SMEs, entrepreneurs, business associations and international companies, with membership representing over 30% of GDP in Montenegro. Through the Alliance, 8 Key Laws were passed in accounting, privatization, corporate tax, enterprise registration, securities, licensing and energy that contribute to SME development.

**Financial literacy:** When the global financial crisis in October 2008 jeopardized the financial gains made by middle-class citizens, USAID in Serbia designed and launched a financial literacy campaign. The goal of this campaign was seeking to equip SMEs and entrepreneurs with the financial knowledge needed to protect the economic gains they have achieved in recent years and foster economic security.

**Adoption of international best practices by SMEs:** In Georgia, USAID, through its Economic Prosperity Initiative (EPI), has partnered with Ferrero to form an alliance with a global confectionary company and leverage resources to increase competitiveness of the hazelnut sector, dominated by small-holder farmers and small- and medium-size processors. The initiative implemented by EPI and Ferrero partners will have helped more than 2,000 hazelnut producers apply modern agricultural technologies and practices to achieve immediate improvements in yields and the quality of their crops. Alongside EPI's support to Georgian laboratories to obtain international accreditation which will facilitate the processors' access to internationally recognized testing and verification services for their hazelnuts, USAID assistance is enabling SMEs in the hazelnut processing industry achieve efficiencies and better meet the quality and quantity needs of the global market, currently representing an annual export of around \$130 million hazelnuts (2011).

**Access to finance:** In Bosnia, USAID provided direct funds to rebuild the Bosnian SME sector and increase employment. Through building the capacity of the commercial banking sector to commence lending to SMEs, USAID established a full set of credit risk management processes with full back office support, comprehensive credit administration, and problem loan management capabilities, and most importantly, training of 100 local bankers on SME lending who extended over \$125 million in loan funds to SMEs.

Across the whole region, USAID has established loan portfolio guarantee programs with commercial banks to guarantee up to half of their portfolio when lending to micro, small and medium sized enterprises, with specific focus on business expansion, medium- and long-term loans, or different sectors in the economy, such as agriculture.

In Macedonia, Bosnia and now replicated in Georgia, USAID is supporting the development of financial advisory professions with advisors helping SMEs formulate growth strategies and present them to financial institutions to access finance. Over a period of 2 years in Macedonia, through this program, USAID was able to help 130 companies access around \$57 million in loans and other financial products.

In Georgia, USAID's current assistance to development of crop insurance products and tailored training programs for insurance industry on agricultural insurance has increased the number of crop insurance policies purchased by small-holder farmers from 153 to 1,225 during 2011, or an incremental increase of approximately USD 4 million in the insured value. Of this amount, an estimated USD 3 million in loan amount has been mobilized through the crop insurance.

In Georgia, USAID supported the Parliament of Georgia adopt proposed leasing related amendments to the Tax and Civil Code, Law on Commercial Banks and Law on Bankruptcy. Working with a broad group of stakeholders, these changes have jump-started the leasing industry in Georgia. On the heels of this break-through reform, as well as targeted technical assistance to Georgia's three leasing companies, the leasing companies reported an increase by approximately USD 13 million in their leasing portfolios in one year alone that has been dedicated to SMEs.

**Labor environment:** To create a more flexible labor market, reduce the burden of the labor inspection regime, and encourage small firms to enter the formal economy, USAID in Bosnia provided assistance to streamline the process for registering employees with tax and social insurance funds and to streamline labor inspections. USAID revolutionized the approach of the

Labor Inspectorates by changing their focus from a checklist-based approach to labor inspection to a more innovative, comprehensive, and streamlined process that combines three inspectors (health, safety, and labor relations) into one. USAID activities also broadened the number of workers covered by the social insurance system, thereby diminishing the impact of the grey economy, increasing collections, and setting the stage for reductions in contribution rates. A key lesson learned was the importance of public-private dialogue and changing mindsets inherited from the prior regime on the part of both trade unions and employer associations to collaboratively improve the business environment for the benefit of all, especially micro and small businesses.

**Business services:** Under the USAID Micro Enterprise Development Initiative (MEDI) project in Armenia, USAID assisted developed survey tools to assess SME demand for and supply of business development services (BDS). Training curriculum was adapted to the Armenian context, translated into Armenian, and training of trainers workshops were conducted, which built the capacity of local service providers to offer relevant, market-driven training. Service providers were also offered courses on how to strengthen and grow their own consulting firms through improved marketing, project management and operational management skills.

**Kosovo Infrastructure Development:** In Kosovo, USAID has been supporting SME development in several ways -- by overhauling and simplifying the business registration legal framework to ease business formation and remove uncertainties in the registration process, and by supporting local infrastructure development through public private partnerships at the municipal and national levels. With USAID help, Pristina is dramatically expanding its international airport with local business participation, and Kosovo's municipalities are renovating outdated public transportation systems, building modern waste collection and management systems, and designing new public parking facilities.

**Promoting Regional Entrepreneurship:** USAID has provided support to establish Centers for Entrepreneurship and Executive Development (CEED) across the region. With operations in Slovenia, Bulgaria, Romania, Serbia, Montenegro, Macedonia, and Kosovo, Albania and Armenia, CEED is an SME 'business accelerator' – a place where entrepreneurs in Southeast and Eastern Europe can go to find practical business-building knowledge, connections to new markets, and access to finance they need to take their businesses to the next level. More than 10,000 entrepreneurs are members of the CEED network across the region, regularly meeting in regional B2B matchmaking events that achieve tangible business results for these SMEs.

**Competitiveness Council:** USAID has been promoting effective public private partnerships between numerous stakeholders to drive economic agenda and policy framework. For example, Competitiveness Councils in Croatia and in Serbia were established with participation of government agencies, universities, NGOs, business associations and think tanks who have jointly identified their country economic priorities and are now working together to implement relevant economic policies to increase country competitiveness.