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• Besim Ćulahocić, Ph.D
Distinguished ERENET Members and Friends,

We are at the end of the year and still chilly wind is blowing from Brussels from the household of the European Commission. The whole year came to an end without eliminating the EURO crisis. The Eurozone business activity hit a nice-month high in December without solving the smallest problems. What is more pity, that the European Union morally is loosing its face and identity? Belgium banned a popular Christmas Tree because the local Muslim population found it “offensive”. The “electronic winter tree” put on the place of the traditional Christmas Tree and Nativity scene is an outrage our European human feeling and slap in the face of the majority religious and nonreligious Europeans. The tail is wagging the dog. To whom does Europe belong? We, members of many EU countries feel ourselves totally discriminated because of the Brussels City Administration. Dear Freddy Thielemans, Major of the City of Brussels, do you believe that the majority has to suffer because of a few Muslim emigrants? Why those minorities are not trying to accept our cultural heritage? The word seems to be turned upside down.

As far as the ERENET network is concern, we had a very busy quarter behind us. First we assisted in organizing the BSEC-KAS Workshop on “Innovative Entrepreneurship and Sustainable Development for SMEs” held in Tbilisi (Georgia). The major statements and papers of this Workshop you will find in the current issue of the ERENET PROFILE. Secondly we co-organized the Annual European SPES Conference on “Sustainability and Spirituality” jointly with the Business Ethic Center of the Corvinus University of Budapest. This event was held in Visegrád (Hungary). The papers and presentations under the Session “New Path to Entrepreneurship” will be published in the next ERENET PROFILE early 2013. As far as our last event is concern, I would like to mention the very successful and fruitful Workshop on “Youth Entrepreneurship” held jointly with the Institute for Entrepreneurship – IFE – at the Fachhochschule Frankfurt am Main (Germany).

It is my deep sorrow to inform our dear ERENET Members and Readers of the ERENET PROFILE, that we recently got the sad news about the dead of our Bosnia and Herzegovina member: Associate professor Besim Cuhalovic. We keep him in our memory. Besim, rest in peace.

Last but not least I wish you all Marry Christmas and a happy and Prosperous New Year!

Dr. Szabó Antal
Scientific Director of ERENET
OPENING STATEMENT AT THE WORKSHOP ON
“INNOVATIVE ENTREPRENEURSHIP AND SUSTAINABLE DEVELOPMENT FOR SMEs”

ABSTRACT

The Deputy Secretary General of the BSEC PERMIS addressed the participants of the Workshop on "Innovative Entrepreneurship and Sustainable Development for SMEs" held on 12-14 September 2012 in Tbilisi (Georgia). The Deputy Secretary General expressed his appreciating to Konrad Adenauer Stiftung and ERENET Network for long-standing support and cooperation.

JEL Code: F14, F15, L21, L26, O1

Your Excellency First Deputy Minister,
Distinguished Dr. Dürkop,
Distinguished Participants,

It is a great honour and privilege to address you today on behalf of the Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation.

I would begin by expressing our thanks and appreciation to Konrad Adenauer Stiftung (KAS) for co-organizing this Workshop which allows us to exchange views and hopefully formulate recommendations on the future and potential activities of SMEs at a crucial time for them in the current economic context.

I would like to express also our deep gratitude to the Government of Georgia for the warm hospitality and for the excellent working conditions offered to the organizers and to the participants in the Workshop allowing them to proceed to productive exchanges and discussions.

Our Workshop is dedicated to a specific topic – Innovative Entrepreneurship and Sustainable Development for SMEs. It aims at contributing to the endeavours undertaken by governments and non-governmental organisations, nationally and through international cooperation, to support the development of the SMEs sectors of their economies, which are in fact the greatest creators of jobs everywhere.

We focus on innovative entrepreneurship, which was perfectly described by the great Austrian economist Joseph Schumpeter as an entrepreneurship that places emphasis on innovation such as:
- new products;
- new production methods;
- new markets; and/or
- new forms of organization.

In fact, in the entrepreneurial economy, SMEs are playing an ever-increasing role in innovation, driven by changes in technologies and markets. The problem is that a great part of the SMEs are not capitalising on their advantages and – as studies and researches show – they are on average less involved in collaboration for innovation activities. Our exchanges these two days may bring about ideas and suggestions regarding how government policies and action in international organizations, like BSEC, can boost innovation by improving the environment for entrepreneurship and the development of SMEs and increasing the innovative capacities of enterprises. I hope that through our discussions we will arrive at policy findings and recommendations that could help embedding SMEs in knowledge flows, developing entrepreneurship and social entrepreneurship.
One of the first lines of action for governments is to secure a simple and straightforward access to finance for SMEs by providing enough liquidity and simplifying as much as possible the procedures for their access to financial resources. In addition to access to finance, which is a traditional concern for the SMEs, the statistics show that a major obstacle for them is lack of suitably qualified personnel, both scientific and managerial.

Distinguished Participants,

The very existence of the BSEC Working Group on SMEs is an acknowledgement by the BSEC Member States of the important and significant role the SMEs play in their economic, social and political development. This awareness, through the joint work conducted in the framework of BSEC, is translated into effective policies and concrete measures to support the sustainable development of the SME sector in our region.

In this context, the Workshops we organise regularly together with the Konrad-Adenauer-Stiftung (KAS) in Turkey – more than 40 workshops over the years – have made major contributions. I would only mention that, following the instruction of the Council of Ministers of Foreign Affairs held in Moscow on 16 December 2011, the Working Group considered the Summary Proceedings prepared by BSEC PERMIS and the report published by the Konrad-Adenauer-Stiftung (KAS) on the outcome of the BSEC-KAS Workshop “Entrepreneurship and SME Policy Development in the BSEC Region in the Time of Emerging from Economic Crises” held in Istanbul, at the BSEC Headquarters, on 21-22 July 2011. The Working Group expressed the view that the outcome of the Workshop could be taken into account in the process of implementation of the governmental policies on SMEs in the BSEC Member States.

In the area of SMEs, BSEC has been focusing on high technology, innovation, technology parks and incubators with the objective to encourage innovative ideas, products, services and procedures. Our Organization is also endeavouring to bring together and link businesses, academics, business incubators and financial and state institutions from the BSEC Member States with the purpose of developing a culture of cooperation through networking. BSEC is also supporting the collaboration of SME’s with large companies, promoting measures to improve production efficiency.

Under the guidance of the Republic of Turkey, as the Country-Coordinator of the BSEC Working Group on SMEs since the beginning of this year, for a two year term, in April this year the Working Group adopted a new Plan of Action, with the specific objectives to increase technological and economical collaboration amongst the institutions and SMEs in the Member States in the concept of energy efficiency and to strengthen their institutional capacity for determining and adopting of shared policies. To this effect, the Plan of Action envisages, inter alia:

- organizing knowledge and experience sharing activities;
- developing and implementing projects on green growth;
- launching a BSEC SME Expert Exchange Project;
- organizing technology park and incubator visits and seminars for technology oriented SMEs among the BSEC Member States;
- extending and updating the “BSEC Innovation Data Bank”;
- preparing an electronic “Best Practice Booklet” that will collect best practices of the BSEC Member States under the coordination of BSEC PERMIS.

Support for the sustainable development of the SME sector is one of the goals of the “BSEC Economic Agenda: Towards an Enhanced BSEC Partnership”, adopted by the Council of Ministers of Foreign Affairs and endorsed by the BSEC Summit held in Istanbul on 26 June 2012. It sets out also a framework of action to achieve this goal, out of which I would highlight:

- Increasing the competitiveness of the SMEs by creating fair conditions at both national and regional levels and undertaking regular surveys on SMEs’ needs, priorities and problems in the BSEC Region.
- Developing BSEC programs aimed at promoting favourable conditions for local businesses and foreign investments; facilitating networking, exchange of experiences and know-how; organizing training for young entrepreneurs.
- Improving the access of SMEs from the BSEC Member States to other markets, in particular by stimulating the export capacity of SMEs and promoting cross-border cooperation and business partnership with neighbouring countries.
- Developing a support system for innovation and technology at BSEC region, with the view to promoting cooperation among SMEs and the university environment, or research and development institutions.

- Promoting the E-business system in the BSEC Region and the use of the BSEC Innovation Data Bank.

Our major objective is to contribute, through our activities in the BSEC framework, to stimulating the SMEs from the BSEC region to improve their quality performance and to allowing them to approach the level of excellence of the advanced European companies.

**Distinguished Participants,**

In concluding my remarks, I wish to underline that BSEC will continue to promote SMEs in the Black Sea region. In this process, we will maintain our traditional cooperation with Konrad Adenauer Stiftung, and will develop our cooperation with other regional organizations and initiatives as well as with international organizations and institutions.

I look forward to listening to evaluations and visions of policy makers, academics and practitioners attending this Workshop on lines of conduct and action to be taken in the BSEC Member States in supporting SMEs, which is essential for their economic growth.

I wish all of us fruitful discussions.

**REFERENCES**


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Dr. Canan Atilgan, Head of the Regional Program “Political Dialogue South Caucasus” of the Konrad Adenauer Foundation (KAS), Ambassador Traian Chebeleu, Deputy Secretary General of the BSEC PERMIS, Irakli Matkava, First Deputy Minister of Economy and Sustainable Development of Georgia, Dr. Colin Dürkop, Head of Office of the KAS in Turkey and Giorgi Pertaina, Deputy Director of the National Investment Agency of Georgia (from left to right)
OPENING STATEMENT AT THE WORKSHOP ON 
“INNOVATIVE ENTREPRENEURSHIP AND SUSTAINABLE DEVELOPMENT FOR SMEs”

ABSTRACT

The Head of the Konrad Adenauer Stiftung in Turkey welcomed the participants of the Workshop on “Innovative Entrepreneurship and Sustainable Development for SMEs” held on 12-14 September 2012 in Tbilisi (Georgia). Colin Dürkop expressed his appreciating to the Georgian Ministry for Economy and Sustainable Development, the other Georgian institutions and ERENET Network for long-standing support and cooperation.

JEL Code: F14, F15, L21, L26, O1

Your Excellency Deputy Minister Matkava, 
Dr. Canan Atilgan, 
Deputy Secretary General Ambassador Traian Chebeleu, 
Ladies and Gentlemen,

Good evening to all of you and it is with great pleasure and honour alike to welcome you all, on behalf of the Konrad Adenauer Stiftung (KAS), to the opening session of the International Workshop on „Innovative Entrepreneurship and Sustainable Development for SMEs” in the Black Sea Region.

Thank you all for attending today's opening session here in Tbilisi. We are glad to be honoured by the presence of the First Deputy Minister Irakli Matkava from the Ministry of Economy and Sustainable Development of Georgia. This is an indicator of the significance and priority attached by the Georgian Government to this event and to the important topic of this international workshop i.e. strengthening entrepreneurship in the BSEC Region.

I would also like to welcome all the participants who came from abroad to represent the public sector and the SMEs from almost all BSEC Member Countries.

These types of international workshop on SMEs are organized once or twice a year jointly by the Konrad Adenauer Stiftung and the Permanent International Secretariat (PERMIS) of the Organisation of BSEC in any one of the BSEC Member Countries. 2012 we have chosen Georgia as the hosting country of this KAS-BSEC event.

This year happens to be the 20th anniversary of the signing of the Bosporus Statement in Istanbul and the founding of the Black Sea Economic Cooperation. Over the past two decades I believe that we have been concluding some 40 workshops already with a view to support small and medium sized enterprises in the region. As usual, these events are jointly coordinated by the Office of the KAS in Turkey together with the PERMIS of BSEC in Istanbul.

Ladies and Gentlemen,

The KAS has thus been working with the Organization of BSEC for over 15 years already. Actually, shortly after the foundation of the Secretariat, the KAS began its contacts with and I am proud that I was at time heading the Turkey desk at our headquarters in Bonn and thereby was able to conduct the initial
negotiations with the BSEC Secretariat which later on led to the successful cooperation between the two organizations.

With these workshop series we aim at strengthening the dialogue at the political level between the stake holders and decision-makers for SME-policies in the different BSEC countries, the exchange of experiences and information between the SMEs and other NGOs themselves thereby contributing to a better understanding between entrepreneurs and state institutions.

Last year in July, we jointly organized an Expert Meeting in Istanbul to elaborate on the topic of Strategies of the Development of Emerging Entrepreneurship and the SME Sector in the BSEC Region after the Economic Crises. The relating publication, compiling the papers fro the Workshop with contributions from all BSEC Members Countries is now available and is in front of you.

In the coming two days, we would like to examine the following issues:

Innovative entrepreneurship and sustainable development has become a central concern for policy makers in the BSEC Region as is the case for most modern Governments. It is a prerequisite for economic growth and social well-being. This international workshop brings together experts from Governments, civil society and academia coming from the BSEC countries and Germany to discuss ways and means of how to promote innovative entrepreneurship in the Region. They will most probably also examine what are the possible obstacles that hinder a healthy growth of SMEs and at the end of the workshop come up with some findings, conclusions and recommendations to this effect.

For sure a holistic approach will have to be considered creating the right framework conditions or a favourable environment such as

- increase international cooperation and education, promoting and organizing R&D,
- free flow of goods, people and information,
- putting in place a reliable judicial system and the like.

Just to give you some facts that highlight the importance of European SMEs fro economic transformation and the development of sustainable competitive economy.

The development of European SMEs is a cornerstone of the Lisbon Strategy, launched by the European Council in March 2000 with the goal of making the European Union eventually the world's most competitive economy. Although it did not reach all its targets, the SME-related provisions of the Lisbon Strategy did trigger growth of SMEs in the European Union whereby the number of SMEs rose by 13 percent (i.e. 2.4 million new companies) against a five percent increase in large enterprises in job creation during this period, registering annual employment gains of 1.9 percent (versus 0.8 percent in the large enterprise sector). Also the productivity gap has narrowed, illustrating SMEs increased use of advanced process technologies that permits cost-effective production in small lot sizes. The wage gap between large and small firms has similarly narrowed, signalling SMEs upward trend in the international value chain demanding highly skilled workers.

In Germany, the so called MITTELSTAND (or family owned small and medium enterprises) remains the linchpin of the country's export sector, producing advanced equipment and precision engineered components fro e.g. automobile, power transmission, renewable energy and other global industries. The achievements of Germany's mid-sized export world champions (“Exportweltmeister”) may probably provide interesting examples for SMEs based in other countries which purpose growth opportunities outside their sluggish home markets.

To conclude, I would like to extend my thanks to a number of people:

(i) to the Georgian Ministry for Economy and Sustainable Development and the National Investment Agency represented by Giorgi Pertaina for the excellent cooperation and the support for the organization of this workshop in Tbilisi;
(ii) to my colleagues Dr. Canan Atülgün and her co-workers from the KAS Office in Tbilisi likewise;
(iii) to Dr. Antal Szabó and his ERENET for his intellectual input in conceptualizing this workshop and his invaluable networking abilities and capabilities; and
(iv) last but certainly not least also like to thank our long-term partner, the PERMIS of the Organization of BSEC, and its distinguished Deputy Secretary General, Ambassador Traian Chebeleu, in particular, for the close and successful cooperation.

With further ado, let me wish all the participants an interesting and fruitful Workshop session.
BE INNOVATIVE IN THE LINE OF THE EUROPE 2020 STRATEGY - EU PRACTICE IN SUPPORT INNOVATIVE SMEs

ABSTRACT

The paper presents the dual impact of globalization on SMEs, describes the EU innovation policies. SMEs must feel the innovation environment and public administration should play an important role in creation of a favourable environment for innovation. The author highlights the reasons while the Lisbon strategy failed. Following this he outlines the main feature of the EU 2020 strategy including the Europe Flagship Initiative: Innovation Union.

Keywords: Globalization, SMEs, innovation policy, failures of the Lisbon strategy, EU 2020 strategy

JEL Code: E20, E61, F6, L26, O31

INTRODUCTION

The issue of globalization and its consequence to the SMEs is a hot topic in economic development policies since the Bangkok Declaration on Global Dialogues and Dynamic Engagement held in February 2000 and organized by the United Nations Conference on Trade and Development.

"Globalization is an ongoing process that presents opportunities; as well as risks and challenges. It has expanded the prospect for technological advances and for effective integration into the international economy. It has increased prosperity and the potential for countries to benefit. However, globalization also raises the risk of marginalization of countries, in particular the poorest countries, and the most vulnerable groups everywhere. Income gaps within and among countries remain wide, and the number of people living in poverty has increased. Asymmetries and imbalances in the international economy have intensified. Instability in the international financial system continues to be a serious problem and requires urgent attention." [1]

Kofi Annan, UN Secretary General, in his opening address in Bangkok expressed his hope to launch very soon a new round of trade negotiations, which would be called the Development Round, because it would at least deliver to the developing countries the benefits they have so often been promised from freer trade. The protectionism of the industrialized countries was blocked in Seattle by the peoples of the world gathering together in the streets against "a group of faceless international bureaucrats who wanted to force them all to eat the same genetically modified food. In other words, there was a kind of global grassroots uprising against globalization".

The conclusions of the International Ministerial Conference on “Enhancing the Competitiveness of SMEs in Global Economy” organized by the OECD and the Italian Ministry of Industry on 13-15 June 2000 in Bologna (Italy) and summarized in the “Bologna Charter”, have emphasized a significant contribution of a dynamic SME sector and entrepreneurship to restructuring of economies and alleviation of poverty. The Ministers agreed that globalization, enhancement of technological changes and innovation create new challenges for SMEs although they may also contribute to increased costs of transition. Globalization should be considered as an important process impacting the development of individual economies thus contributing to a higher standard of living for all actors involved. To this end, globalization, opportunities and benefits

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1 Prepared for the Workshop on “Innovative Entrepreneurship and Sustainable Development for SMEs” held on 11-13 September 2012 in Tbilisi/Georgia
should be accessible to everyone. The Ministers have also recognized the role of international institutions in fostering the development of SMEs and have, therefore, recommended further multilateral exchange of experience and good practice in order to strengthen partnerships and co-operation between countries.

Certainly these optimistic views are of ones of the most advanced market economies. In reality the globalization of economic activity has a dual impact on SMEs. For some it provides new opportunities for expansion and growth by taking advantage of international market possibilities. These are able to adapt and become internationally competitive. For the majority, however, growing economic globalization is increasing the competition with foreign enterprises and it is an inward process that brings competitive challenges and threats. For those SMEs globalization brings risks that they unlikely survive in their present form without improving quality, cost competitiveness and management practices.

SMEs are deeply affected by the globalization of the markets, which is forcing all firms to act and think more globally. The world economy, the liberalization, the increasing globalization, the internal market of the EU, e-commerce, and other institutional changes are gradually shifting the behavioural pattern of the SMEs. In remarkable short time, economic globalization changed the world's economic order with new challenges and opportunities.

As far as the SME sector is concerned, there is a logo for the 3rd Millennium: THINK GLOBAL - ACT LOCAL. The majority of the SMEs are working within the framework of a local environment. Their consumers are their neighbours and in the vicinity of their village/city/county/region. This is their strength and opportunity. However, they have to act taking into consideration the influence and external factors of the globalization, the particular stage of internationalization including challenges of the competitive market players, environment concerns, sustainable economic growth, international standards, and information technology.

EU INNOVATION STRATEGY

The European Commission's Green Paper on Innovation states that “Innovation is at the heart of the spirit of enterprise and thus companies must constantly innovate, even if only gradually.” In the context of this document, innovation is taken as being a synonym for the successful production, assimilation and exploitation of novelty in the economic and social spheres. It offers new solutions to problems and thus is synonymous with change. An innovative enterprise is one which responds the challenges, makes it possible to meet the needs of both the individual and society. [2]

Innovation accepts change, undertakes new actions, develops new products and offers more efficient and user-friendly services, provides higher quality. Innovation goes beyond the technological advancement, because this alone does not guarantee the future survival of a company. Innovation aims to anticipate market needs and offers higher quality products and services.

While innovation process is a complicated task for large companies, for SMEs it represents a real challenge. In most cases it is nearly impossible for them to tackle alone. According to an EU study on Innovation Management “small companies often ignore that true meaning of innovation. Very frequently, SMEs feel disconcerted when it comes to innovation. Many sense that they should change the way they run the companies, recognizing that they should add new technologies to increase their competitiveness, and feeling that their internal organization is not optimum for competing in current market conditions.” [3]

SMEs must feel the innovative environment, in other words, the request that something is changing and they have to change, too. In all respects, public administrations dealing with innovation promotion and all organization dealing with R&D development should play an important role in creation of a favourable environment for innovation and continuously extend it.

NEW TASKS FOR ENTREPRENEURSHIP

European Commission Vice President Antonio Tajani, responsible for entrepreneurship and industry, said: "Europe lags behind its competitors in entrepreneurial attitudes. Yet at the same time we know that SMEs are the biggest source of new jobs and related growth. Therefore, it is crucial that Europe increases its appetite for entrepreneurship and then
supports its would-be and new entrepreneurs in creating new businesses. A European Entrepreneurship Action Plan is needed to unleash entrepreneurial potential. Please let us know your ideas - we count on them."

In terms of entrepreneurship Europe lags behind the United States. While in Europe only 45% of citizens prefer to be self-employed, this proportion in the US is 55%. The situation is even worse, because only 11% of the European citizens are entrepreneurs. The difference in entrepreneurial spirit is not because European are less entrepreneur, rather than because the administrative, structural and cultural factors are different. At the same time SMEs are the biggest source of new jobs and wealth creation. An updated European Entrepreneurship Action Plan is needed to address this issue. In order to overcome the difficulties the Commission this year has been launched a consultation in receiving ideas how to:

- unleash entrepreneurial potential;
- remove obstacles to entrepreneurial activities;
- support entrepreneurs in business starting up; and
- help entrepreneurs to face challenges, particularly during the first year of life of the business.

The consultation started on 9 July 2012 and will be terminated on 1 October 2012. All citizens and organizations are welcome to contribute to this consultation. Contributions are particularly sought from public administrations and private sector organizations and individuals who support entrepreneurs in starting up businesses and in helping them face challenges, particularly during the first years of life of the business, individual entrepreneurs and businesses. [4]

EUROPE 2020 STRATEGY [5]

The economic crises hit back Europe and has exposed fundamental issues and unsustainable trends that Europe cannot ignore any longer. Europe has a growth deficit.

According to Lisbon Declaration as of 24 March 2010, “The Union has today set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.” When the Heads of States and Governments unanimously endorsed this strategy, the aim was uncontroversial. The EU was lagging behind the USA in most technical and scientific field. Europe under-invests in knowledge base, spending every year 0.8% of GDP less than the US and 1.5% less than Japan in R&D - with major gaps in business R&D, venture capital investments and the education system needs reform. Private sector R&D is increasingly outsourced to emerging economies and thousands of our best researchers and innovators have moved to countries where conditions are more favourable.

Too many people were jobless and therefore do not produced any value added. A decade later the mission of the Lisbon strategy failed, its mission has not been accomplished. Failure resulted in a “lost decade” of relative decline, permanently damaged growth and structurally high level of unemployment. The former Lisbon strategy felt because of many failures, the most important five are the following:

- The aim of the ambitious project to develop monetary union and common single European currency – EURO - based rather on political than on justified economic and fiscal decision making;
- The majority of the old EU countries were undisciplined and did not fulfilled the Maastricht criteria; [2]

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[2] There are five criteria set out in the Treaty of Maastricht that must be met by European countries if they wish to adopt the European Union's single currency, the EURO. They are: 1) inflation of no more than 1.5 percentage points above the average rate of the three EU member states with the lowest inflation over the previous year. 2) A national budget deficit at or below 3 percent of gross domestic product (GDP). 3) National public debt not exceeding 60 percent of gross domestic product. A country with a higher level of debt can still adopt the euro provided its debt level is falling steadily. 4) Long-term interest rates should be no more than two percentage points above the rate in the three EU countries with the lowest inflation over the previous year. 5) The national currency is required to enter the ERM 2 exchange rate mechanism two years prior to entry.
Great Power countries – Germany, France, Italy and United Kingdom – preferred to compete with each other instead of dealing with real job creation. The national interests prevent a creation of a unified research space in Europe;

The European countries support large bureaucracies;

The old EU countries used the newcomers from Central and Eastern-European countries rather as a place to outsource their secondhand and outdated products. Hereby, they contributed to the creation of a two-speed Europe with developed Western and less developed Central-and-Eastern ones. Concerning the free movement of workers a certain brain-drain is taking place by sucking out the high intellectual potential – especially in the field of engineering, medicine, R+D – from these countries for strengthening the institutions in the advanced market economies.

Europe need to build a new economic model based on knowledge, high employment levels and low-carbon economy. The Europe 2020 Strategy sets out a new vision for Europe’s social market economy and rests on three interlocking and mutually reinforcing priority areas:

(i) **Smart growth**, developing an economy based on knowledge and innovation;
(ii) **Sustainable growth**, promoting a low-carbon, resource-efficient and competitive economy; and
(iii) **Inclusive growth**, fostering a high employment economy delivering social and territorial cohesion.

Progress towards these objectives will be measured against five representative headline EU-level targets, which Member States will be asked to translate into national targets reflecting starting points:

- 75% of the population aged 20-64 should be employed.
- 3% of the EU’s GDP should be invested in R&D.
- The EU’s energy and climate targets for the year 2020: "20/20/20" climate/energy targets should be met. That means a 20% reduction in greenhouse gas emissions, a 20% improvement in energy efficiency, and a 20% share for renewables in the EU energy mix.
- The share of early school leavers should be under 10% and at least 40% of the younger generation should have a degree or diploma.
- 20 million less people should be at risk of poverty. [6]

Concretely, the Union has set five ambitious objectives - on employment, innovation, education, social inclusion and climate/energy – to be reached by 2020. Each Member State has adopted its own national targets in each of these areas. Concrete actions at EU and national levels underpin the strategy.

Europe has identified new engines to boost growth and jobs. These called as flagship initiatives. Within each initiative, both EU and national authorities have to coordinate their efforts so they are mutually reinforcing.

**Smart growth**

- **A digital agenda for Europe** - delivering sustainable economic and social benefits from a Digital Single Market based on ultra fast internet. All Europeans should have access to high speed internet by 2013.
- **Innovation union** - re-focussing R&D and innovation policy on major challenges, while closing the gap between science and market to turn inventions into products. As an example, the Community Patent could save companies 289€ million each year.
- **Youth on the move** - enhancing the quality and international attractiveness of Europe’s higher education system by promoting student and young professional mobility. As a concrete action, vacancies in all Member States should be more accessible through out Europe and professional qualifications and experience properly recognised.

**Sustainable growth**
Resource-efficient Europe - supporting the shift towards a resource efficient and low-carbon economy. Europe should stick to its 2020 targets in terms of energy production, efficiency and consumption. This would result in €60 billion less in oil and gas imports by 2020.

An industrial policy for green growth – helping the EU's industrial base to be competitive in the post-crisis world, promoting entrepreneurship and developing new skills. This would create millions of new jobs;

Inclusive growth

An agenda for new skills and jobs – creating the conditions for modernising labour markets, with a view to raising employment levels and ensuring the sustainability of our social models, while baby-boomers retire; and

European platform against poverty - ensuring economic, social and territorial cohesion by helping the poor and socially excluded and enabling them to play an active part in society.

EUROPE FLAGSHIP INITIATIVE: INNOVATION UNION

At the time of public budget constraints, major demographic changes and increasing global competition, Europe's competitiveness, our capacity to create millions of new jobs to replace those lost in the crisis and the future standard of living depends on the ability to manage innovation, create new products and services and improve the existing business and social models. Innovation is also the best means of successfully tackling major societal challenges, such as climate change, energy and resource scarcity, health and ageing, which are becoming more urgent by the day. The Innovation Union has been developed alongside the flagship initiative on an Industrial Policy for the Globalisation Era, which aims to ensure a strong, competitive, and diversified manufacturing value chain, with particular emphasis on Small and Medium Sized Enterprises. It complements other flagship initiatives, such as the Digital Agenda, Youth on the Move and the Agenda for New Skills and Jobs.

According to the European Commission's document on the Innovation Union, Europe intends to spend 3% of EU GDP on R&D by 2020, which could create 3.7 million jobs and increase annual GDP by close to €800 billion by 2025. [7] In spite of the fact, that the EU market is the largest in the world, it remains fragmented and insufficiently innovation friendly. Although the European services sector accounts for 70% of the economy, the knowledge intensive services are still under-developed.

In a global environment Europe must develop its own distinctive approach on innovation by

- **Focusing on innovation that address the major societal challenges identified in Europe 2020 Strategy**, strengthening the leadership in key technologies, reaping the potential these markets offer for innovative businesses, and enhancing EU competitiveness.

- **Pursuing a broad concept of innovation**, both research-driven innovation and innovation in business models, design, branding and services that add value for users and where Europe has unique talents. The creativity and diversity of our people and the strength of European creative industries, offer huge potential for new growth and jobs through innovation, especially for SMEs.

- **Involving all actors and all regions in the innovation cycle**: not only major companies but also SMEs in all sectors, including the public sector, the social economy and citizens; not only a few high-tech areas, but all regions in Europe and every Member State, each focusing on its own strengths ("smart specialisation") with Europe, Member States and regions acting in partnership.

In the current post-crisis world, Europe must move away the model «business as usual» and make innovation as one of the leading political initiative and policy objective. What is needed to transform the European economy into a genuine Innovation Union?

The European Union should commit to creating a true "Innovation Union" by 2020 by:

- **Taking collective responsibility for a strategic, inclusive and business-oriented research and innovation policy**, to tackle major societal challenges, raise competitiveness and generate new jobs.
The Commission will reflect this strategic approach to innovation in all its policies and invites the other EU institutions to do likewise.

– Prioritising and protecting investments in our knowledge base, reducing costly fragmentation and making Europe a more rewarding place for innovation and for bringing ideas to market. A deadline of 2014 should be set for delivering the European Research Area.

– Agreeing to launch European innovation partnerships, the first on active and healthy ageing, to pool resources and expertise to find solutions to societal challenges and to build competitive advantage in key markets.

The European Commission provides support for innovation through a series of initiatives and actions aimed at providing financial support to innovators, as well as better innovation support services for SMEs, notably start-ups, by developing and testing new forms of business support and facilitating transnational cooperation with a view to mobilizing more resources for the creation of a European Innovation Space.

Current programmes are financed within the Competitiveness and Innovation Framework Programme (CIP) [8]. With small and medium-sized enterprises (SMEs) as its main target, the CIP supports innovation activities (including eco-innovation), provides better access to finance and delivers business support services in the regions. It encourages a better take-up and use of information and communication technologies (ICT) and helps to develop the information society. It also promotes the increased use of renewable energies and energy efficiency. The CIP runs from 2007 to 2013 with an overall budget of € 3621 million.

The CIP is divided into three operational programmes. Each programme has its specific objectives, aimed at contributing to the competitiveness of enterprises and their innovative capacity in their own areas, such as ICT or sustainable energy:

- The Entrepreneurship and Innovation Programme (EIP)
- The Information Communication Technologies Policy Support Programme (ICT-PSP)
- The Intelligent Energy Europe Programme (IEE)

The financial instruments under CIP, but also under some operational programmes of the Structural Funds, mainly provide venture capital and loan guarantees for business innovation activities through financial intermediaries. As support for SMEs is a central objective of the CIP, an SME funding portal has been set up.

More information on the financial support being provided within the Member States can be found on the Access2finance website. [9].

- Grants for market replication projects for proof of economic concept and investment readiness under the CIP, can be provided in the field of sustainable energy, eco-innovation and ICT. Besides grants, the CIP is also used for service contracts mainly for the provision of analytical services;
- Research and development projects in a number of fields can be funded from the FP7;
- Structural Funds supply funding in a large number of national, regional and inter-regional operational programmes for a range of innovation-related activities, including research cooperation, technology transfer, ICT take-up, human resource development and support of start-ups and entrepreneurship.

The Practical guide to EU funding opportunities for research and innovation provides information on how the FP7, CIP and Structural Funds may be combined, and contains a checklist with 6 steps that allows potential beneficiaries to identify under which programme they might be able to obtain EU funding for their research or innovation activities. [10].

The draft and main target of the Competitiveness of Enterprises and SMEs (COSME) for 2014-2020 with a planned budget of € 2.5 bn is already exhibited on the European Commission web-site [11].

By implementing the COSME programme, the Commission expects

- easier access to finance for entrepreneurs and small businesses;
- more prominent role for self-employment and business development as important sources of growth and job creation; and
in individual EU countries: a more competitive industry, more entrepreneurs and higher employment rates.

In order to strengthen the European innovation a series of programs and initiatives have to be strengthened. Among the numerous initiatives below please find some interesting ones:

1. Since the number of researchers in Europe as a share of the population is well below that of the US, Japan and other countries, the EU will need at least one million new research jobs if it is to reach the R&D target of 3%. The number of researchers required is significantly higher, as many researchers will retire over the next decade. The EU and its Member States should strengthen their capacity to attract and train young people to become researchers and offer internationally competitive research careers to keep them in Europe and attract the best from abroad. In this respect, the **Marie Curie Actions – Research Fellowships Programme** is playing an important role to strengthen the skills development, mobility and careers of researchers across borders. [12]

2. More broadly, more needs to be done to address innovation skills shortages and to implement **European e-skills for the 21st century agenda** [13]. This is crucial to accelerate the development and the adoption of innovative business models by European enterprises, especially SMEs.

3. Businesses should also be more involved in curricula development and doctoral training so that skills better match industry needs building for instance on the University Business Forum There are good examples of inter-disciplinary approaches in universities bringing together skills ranging from research to financial and business skills and from creativity and design to intercultural skills. [14]

**LITERATURE**


OBSERVATIONS AND RECOMMENDATIONS ON INNOVATION REQUIREMENTS ON BEHALF OF SMALL BUSINESS MANAGEMENT

ABSTRACT

The paper summarises the modalities and measures what the small and medium-sized companies are doing while innovating their products, services or organizational behaviours. It also describes innovation policies and prerequisites to succeed without failures. The author presents the „seven I-s obligations” as guiding the innovation process. Finally the paper highlights the policy and programmes of the Federal Ministry of Economics and Technology in Germany in supporting and promoting innovation for SMEs.

Keywords: innovation management, SMEs, German government policy and program to support innovation for SMEs

JEL Code: F14, F15, L21, L26, O1

The following remarks intend to enliven reasoning whether and how the current course of applied business methods must be reconsidered in order to avoid or at least to minimize presumable overheads if consumers hesitate to maintain their relations because of price increase, quality deficiencies of the ordered product or prolonged time of delivery. A way out from such defiles has been made possible again and again by innovation efforts.

Regarding the SMEs it is oft attested that they are the innovation heralds, the avant-garde of novelties. Indeed, studies support the assumption that the smaller companies are more likely than the bigger ones to generate faster both cost-cutting and market-suitable innovations in manufacturing and service systems. It is well known especially among younger, competently educated entrepreneurs – in so far they are goal-oriented company founders – that innovation initiatives are life elixir of economy.

The observation of everyday facts reflects that not only technology-based establishments are innovators. Non-technological innovation plays a striking role in boosting economic commercial performance. It is a matter of organizational improvement of processes enabling and facilitating productivity enhancement. Readjustment makes possible i.e. saving of working stocks, energy consumption, and avoidance of pollution or rise of safety (prevention of accidents, engine trouble, and personal state of health).

Small business innovation is generally slow and a step-wise occurrence, although it relates to cost-effective reforms to the reduction of storage, to more proper room and square using, to speeding up delivery times by shortening of computerised operation times, to alter transportation systems etc. These renovation cases reflect that innovation is not a concept that addresses only to novel products. It also incorporates changes in the way companies are doing things. And innovations are not exclusively the consequence of new ideas but as well they deal with the removal of old ideas that are not any longer of benefit to the enterprise.

When thinking about and even dealing with innovation measures it is indispensable to turn out from the consciousness that innovation programmes comprise much more than the mere introduction of expenditure and capital intensive re-engineering of business procedures. The leading of small firms in the direction to profitable long-term survival is determined by the open-minded ability of entrepreneurs and work-fellows to translate their imagination in praying application.

The vital factor of business development is the respective company's legal constitution at hand including corporate liability obligations as well as the expectation of consumers and perhaps bank demands. Asking a responsible entrepreneur how he judges the contribution of his surroundings, especially on the part
of politicians, that answer reads mostly: less bureaucratization hindrances and frictionless access to public financial support.

The advance of converting an idea into a new product or a renewed process that someone is ready to acquire is a rather complex procedure of many-sided flows of information and results of research among people, institutions and also competitors. A now-a-days globalized and knowledge-based world can let recognized experience by opposite ends of the earth.

SMEs, whatever sector they are in, have perceived at the latest that their advantage in business relies on being able to offer something new or different, in conditions of innovation, that make them stand-out from their market-partners. What is remarkable today is that the competitors are increasingly not in firms next door, but companies many miles away in countries with lower labour costs which produce a growing range of goods at price below average.

In order to operate productively the up-to-date SME can not but to raise its performance. It must do so through having smart and quickly developed altered offerings, better technology, efficient admission to markets – also abroad -, engaged skilled workforce that function better when improved organizational and human resources are well established.

It is understandable that in particular a small firm can not introduce all the desirable innovation on its own. Therefore SMEs often depend mainly on advice of consultants, business associations, larger companies, banks, public authorities, universities, trade fairs, exhibitions or expert meetings. Innovative solutions can accrue from co-operation with comparable business.

Innovation policies have to be diverse, on the one hand, and tailored to the actual in-house situation, on the other hand. Prerequisite to succeed without failures implies a realistic business planning in the long run combined with sustainable strategic management attitudes. Indeed, innovation projects are intermingled with numerous factors. Conventional methods of going on with a pretentious work are never a safe basis for handling innovation intentions either in factories or in offices. Ideal leadership's primary employment is to steer and to nurture the necessary alteration of business operation in an integrated procedure.

In order to master the no stable conditions of the environment it is imperative that company leaders are enabled to cope with the various fields of entrepreneurial challenges. It must be investigated permanently the state and outlook of the awaited activity results. Incessantly questions have to be clarifies what is i.e. about the firms commission, its size, age, image, location (urban or rural), number of qualifies workforce (blue and white collars), its furnishing and equipment, its industrial sector, suppliers, customers, financial position, expansion thoughts, political role.

Creating and orchestrating innovation is usually being moved with dissatisfaction of the current disposition in vies of manufacturing bottlenecks. SMEs, however, have mostly just poor insight how to realise innovations. They mainly start unprepared when impelled by decline of income, by external socio-economic pressures, by bad burden on account of the expenditure at energy and material purchase, by new regulations about work conditions, by wage rises, by import growth rate of cheaper products from developing countries. Many innovation objects are not sufficiently discussed because of mental resistance. Fear is widespread to lose jobs. That is why it is reasonable to turn first of all in-house “barriers to change” into optimistic “levers for innovation”.

Because of their throughout existing transparency small businesses have an internal agreement advantage over large firms where division of labour prevails and where each employee's sphere of competence and responsibility is relatively limited. Fixed hierarchies hinder innovation initiatives since the decision ways are too long.

Small company staff, in comparison, comprehending faster of what is going on, are more able to contribute to innovation necessities. In SMEs the benefits of improvement proposals are greater, and suggestions of change have far more chances of acceptance. Anyway, recommendable are working groups whose authority feeds on the inset of the individual participants, but not on the size of a company.

The systematic search to find business handling improvements as an ongoing curiosity remains always essential to match the future. For that purpose several measures can help to realize and to cut down defects at present: such as i.e. brainstorming, employee suggestion schemes or value analysis.
Sometimes SMEs are looked at to be less talented and less prepared to carry out innovation projects as a chain from the brilliant idea – the invention – to its money making commercialization. If there exists hindrances then at most the difficulties are related to financial shortcomings and insufficient public assistance funds although the smaller businesses have proved that they can innovate at lower expenditure that the big ones.

Innovation management, which contributes to a welcomed share of enhanced productivity, must be reviewed daily and adequately positioned within the available capabilities and know-how. Typically risky handicaps must be cut down well-timed. To them belong:

- inadequacy of real objectives;
- lack of strategies;
- inefficiency of information and controlling systems;
- shortage of investment capital;
- overestimation of the readiness of new products and services from the marketplace;
- low awareness of customer interest;
- failures of in-house organization.

Small companies are characterized by a highly centralized structure: the boss determines and decides willingly alone. SMEs often described as “resource poor” in terms of skilled human, sure financially and sound material consumption. They are repeatedly confronted with modest insight into external influence factors. The small firm's responsiveness-cycle and time attention is predominantly short-term displayed with a rather reactive than a pro-active behaviour. There can also be observed some slight use of formal management techniques like budgeting, work responsibility, inventory control, maintenance precaution, source of supply tests or costs analysis. Intuition replaces solid calculation.

Innovation on behalf of small firms happens many times by accident, because executives are too preoccupies with the daily work that they simply have to time to devote to the tasks required for innovation installation. It is not so much a question of research activities that are firms concerned about in order to develop new or improved products, but the engagement of company leaders to take care of smoother manufacturing processes and as well of organizational up-dating.

Sustainable innovation management as a multi-disciplinary function has to take into account a variety of significant measures, such as

- monitoring innovation trends outside the own company: analysis of competitors behaviours;
- team-based examination, assessment and planning of in-house innovation possibilities; directive thinking needs frankness, an optimal innovation climate does not originate only during working time;
- initiating internal mobility;
- making use of advanced training fro management members and staff in consideration of their education experiences, age, duration of employment and health;
- establishing co-operate partnership with corresponding enterprises i.e. licensee or subcontractor of big business;
- checking of future deployment of computers in manufacturing processes, in visibleness of quality circles and in service dimensions; and
- protecting the firm's intellectual property.

The preparation of far-reaching future-oriented “novelties” is becoming all over the leading part of managerial duties. SMEs must not be frightened because they have submitted remarkable examples as progressive purveyors of innovation. Surveys demonstrate persuasive evidence that also SMEs are fully aware of innovation as a major component in stabilizing long-term profitability. It is said in Germany some 110,000 small firms appear annually with new products and improved processes.

Doubtless, innovation is a must in order to survive in an intensified competitive and cross-border laid our free market economy. Matching with such a challenge is less a matter of reengineering, of purely mechanical hardware preference, of one-sided high tech orientation in a business: it is primarily the indispensable task of the mastery of software.
If innovative backwardness prevails it can not be eliminated immediately because of the reserved behaviour of entrepreneurs. On the other hand, business leaders have been constantly motivated to create order from chaos.

During considerations everybody has to remain conscious that innovation introduction can not be limited to the settlement of a single task: a series of activities must be executed, namely as already summarized in 1985 under seven “I” obligations as a Guideline by Kienbaum Management Consultants in Germany, such as:

(1) Innovation needs INITIATIVE;
(2) Innovation needs IDEAS;
(3) Innovation need: IDENTITY;
(4) Innovation need: INFORMATION;
(5) Innovation need: INVESTMENT;
(6) Innovation needs: INSTRUMENTS; and
(7) Innovation need: IMPLEMENTATION.

That implies, that

(i) Innovation without initiatives, without a kick-off, without recommendation from the floor, from external commercial resources will never occur successfully.

(ii) Innovation without ideas will not cause any move ahead whether it is about improvement in products lines, in manufacturing procedures, in the fields of marketing, service to the customer, sales including export, purchase, finances, office organization, workroom equipment, personnel upgrading and so forth.

(iii) Innovation without entrepreneurial identity of the acting business as a grown organism since years, qualified for a special individual image and having an external acknowledgement, will not happen.

(iv) Innovation without a sound information basis about the strengths of a firm and about the real market interests in new problems solutions will expansively stiffen in a hazardous game that produces neither a reliable company cash flow nor a profitable return on investment.

(v) Innovation without precautionary financial assurance will remain inefficacious.

(vi) Innovation without instruments of evaluation schemes, of recurrent planning, of adapted in-house organization, of time schedules etc., what means altogether a well rounded off project management, will go astray.

(vii) And finally, innovation without implementation will merely demonstrate an extravagance, a nonsensical waste of brain, money and time.

SMEs are admirable. They master again and again to move aside from an endless array of difficulties. In vies of the nowadays everywhere influential digital age courageous dealing instead of “wait and see” is of utmost significance.

Attentive business people, who always strive for marketable achievements, deserve unrestricted respect because they are incessantly anxious to ensure companies benefits, to raise a profitable income, to expand the market share, to preserve carefully the service to the customers, to guarantee the independence of the establishment, to widen the firm's prestige and to take care of additional places of employment.

In Germany – already for long – lasts an extensive supply of assistance in order to promote innovation efforts either by companies in action or start-ups. For all that many institutions are involved. Beyond it series of guide books, case studies and technical magazines are available. Constant conferences, workshops and information meetings are hold. Often awards are presented to above-average busy entrepreneurs.
Apart from a variety of support initiatives on behalf of local, regional or national economic advancement bodies, the Federal Ministry of Economic and Technology – Bundesministerium für Wirtschaft und Technologie, BMWi – has introduced four years ago the Central Innovation Programme for SMEs – Zentrales Innovationsprogram Mittelstand, ZIM. The financial amount runs up in 2012 to EURO 500 million, mainly facilitating in-house technological research endeavours. Inquiries report that only 25% of SMEs apply for financial assistance whilst 45% of big businesses utilize public means.

In addition to ZIM, stands the nationwide Consultation Programme “go-Inno” with EURO 14 million backing up SMEs in the field of product or process innovation or aiming at the reduction of expenses for (raw)material purchases.

Businesses with less than 100 employees or maximum turnover of EURO 20 million can receive grants on the basis on “Innovation Credit Notes” (Innovations-Gutscheine). Thereby the Federal Ministry of Economy and Technology stimulates innovation activities with 50% of the costs of external consulting achievements by professional consultants, authorized by the Ministry. The individual notes covering 10 days potential analysis and 25 days realization conception pay up to EURO 13,751 per case.

Finally the Ministry organizes Annual Innovation Day in order to animate the exchange of experience. These conferences serve for presentation of marketable research results and the illustration of the breath of the ministerial promotion. In 2012, 190 companies and 120 research institutes have notified their publicity supported innovation exertions.

Nino Elizbarashvili, Founder and President of the Georgian Association Women in Business, Prof. Dr. Hans-Jürgen Weissbach, Department of Economy and Law at the Fachhochschule Frankfurt University of Applied Sciences and Dieter Ibielski, Presidential Counselor of the Union of SMEs (UMU, Germany) At the Opening Session of the BSEC-KAS Workshop on Innovative Entrepreneurship and Sustainable Development for SMEs” held in Tbilisi (from left to right)
INNOVATIVE SMALL AND MEDIUM SIZED ENTERPRISES IN THE REPUBLIC OF MOLDOVA

ABSTRACT

The article elucidates the activity of innovative SMEs in Republic of Moldova presented at the Workshop on “Innovative Entrepreneurship and Sustainable Development for SMEs”, organized by BSEC and Konrad-Adenauer-Stiftung (KAS) on September 12 - 15 2012 in Tbilisi, Georgia.

The article is designed to share experience by presenting an overview of issues related to the innovation activity of small and medium-sized enterprises, to the promotion of measures to increase the creativity and competitiveness of SMEs (Albania, Armenia, Azerbaijan, Bulgaria, Hellenic Republic, Moldova, Romania, Russia, Serbia, Turkey, Ukraine).

Major headlines cover:
- The innovation development in the national economy with special focus on the SME sector in the Republic of Moldova.
- Regulatory framework and support infrastructure in the development of innovations and technology transfer.
- Institutional actors, their strategies, policies and initiatives.
- Present good practices of innovative SMEs in the Republic of Moldova.
- Defining the problems faced by SMEs in innovation and technological development and the measures to support innovative, technology-oriented, high-tech and environmental-friendly SMEs.

Keywords: small and medium-sized enterprises, innovative activity, innovative incubators, governmental strategy, competitiveness.

JEL Code: F14, F15, L21, L26, O1

THE INNOVATION DEVELOPMENT IN THE NATIONAL ECONOMY WITH SPECIAL FOCUS ON THE SME SECTOR IN THE REPUBLIC OF MOLDOVA.

The Innovative sector in Moldova is in its formation and restructuring process, and is transitioning to meet the ever changing market demands and to adjust to technological developments at international level.

Are there opportunities for innovation in Moldova? Are there inventions that could turn into innovation? Does the Republic of Moldova have the research results that could be marketed?

To answer these questions I will have to present some data.

In accordance with the results, applied into the Register of Eurasian Innovation Patent, Moldovan scientists have received 268 patents back in 2007, 250 patents in 2008, 78 patents in 2009 and 61 patents in 2011 (see Figure 1).

Only in 2010, inventions of Moldovan scientists have been mentioned more than 100 times at various exhibitions.

Based on the presented figures, the overall vision of innovative projects development and technology transfer can be structured from 5 in 2005 to 25 in 2011 (see Figure 2). Given the fact that their funding varies from year to year, a constant increase in the number of projects cannot be noticed.

This circumstance also reveals the potential for research and innovation activities in the Republic of Moldova, and the need to create favorable conditions for its effective usage.
Note that the largest volume of innovation is oriented to improve the unique quality of products and services delivered on the market and they became important arguments in the fight for the consumer. Thus there are opportunities for local innovation but they need to be explored.

In-house innovative enterprises can be defined as companies launching products or processes that are:
- new for the company;
- new to business associations.

In most cases, the innovative activity conducted in Moldova by in-house SMEs also means autonomous activity. Thus, about 74% of SMEs launch new or significantly improved products and services within their companies.

In Moldova, this activity is carried out by 30.2% of all Small and Medium Enterprises (see Figure 3), which in comparison to the indicia in other countries is a good figure: in Romania - 16.66%, in Hungary - 12.6%. At the same time the same indicia for Germany constitutes a relatively high figure – 46.03%.

In regard to applying innovative products, services and processes, Moldova is a little step behind, though, as only 22.9% SMEs are up-taking the innovations (see Figure 4), while in countries like Germany, Austria or Greece this level is relatively high - between 37.31% and to 53.61%.

The success of innovative activity of the enterprises, which is often associated with significant economic and financial performance, is implied mostly in the introduction of new products onto the market. One fifth of all SMEs (44.1%), having introduced a new product or service onto the market, consist of mainly urban enterprises, of them the majority being located in the capital (see Figure 5).

In this respect, the situation is quite business - favorable for enterprises located in the Southern region of the country.

In the category of companies, having launched innovations onto one the existing markets, app. 27.9% were companies launching new products and app. 30.4% (see Table 1) were companies launching new services.

### Table 1 - SMEs that introduced a new products or services on the market, regarding the development area

<table>
<thead>
<tr>
<th>Nr.</th>
<th>Types of innovation</th>
<th>Number of enterprises</th>
<th>Share of enterprises in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>New products</td>
<td>314</td>
<td>27.9</td>
</tr>
<tr>
<td></td>
<td>inclusive by regions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- north</td>
<td>40</td>
<td>21.78</td>
</tr>
<tr>
<td></td>
<td>- center</td>
<td>40</td>
<td>20.18</td>
</tr>
<tr>
<td></td>
<td>- south</td>
<td>61</td>
<td>27.64</td>
</tr>
<tr>
<td>2.</td>
<td>New services</td>
<td>342</td>
<td>30.4</td>
</tr>
<tr>
<td></td>
<td>inclusive by regions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- north</td>
<td>24</td>
<td>12.87</td>
</tr>
<tr>
<td></td>
<td>- center</td>
<td>34</td>
<td>17.43</td>
</tr>
<tr>
<td></td>
<td>- south</td>
<td>112</td>
<td>51.22</td>
</tr>
</tbody>
</table>

Source: (Agency for Innovation and Technology Transfer internal reports 2011)

Another form of innovation is the innovative process, an activity undertaken by approximately a quarter of all Moldovan SMEs (about 25.4%). Among the components of the innovative process, worth emphasizing are the methods of production or procession of new or substantially improved products and services, applied by app. 30.8% of local SMEs. 25.1% of enterprises are adopting new logistics methods and 20.3% support new or improved processes (see Figure 6).
The support of innovative activity and technology transfer in the country has 3 areas:

- Investment in the field scientific research;
- Creating innovative infrastructure;
- Support for technology transfer.

The investments in research is carried out by the Academy of Sciences of Moldova, as it shares its functions between researching and filing data about the existent products and supporting innovation, technology transfer and marketing of research results.

REGULATORY FRAMEWORK AND SUPPORT INFRASTRUCTURE IN THE DEVELOPMENT OF INNOVATIONS AND TECHNOLOGY TRANSFER. INSTITUTIONAL ACTORS, THEIR STRATEGIES, POLICIES AND INITIATIVES.

In Moldova, there is a legal framework for the support of scientific research and innovative activity, which includes three major components:

1. The Code of the Republic of Moldova on Science and Innovation, which played a key role in stopping the degradation of science, and in identifying new formula for the development of science and the application of research.

2. The Law on Scientific-Technological Parks and Innovation Incubators, which defines the legal framework for the organization and functioning of the scientific-technological parks and innovation incubators.

3. The Partnership Agreement between the Government and the Academy of Sciences of Moldova.

Also, in order to promote innovation and technology transfer, the following legal instruments have been developed:

- The draft of the National Strategy on innovation for 2012-2020;

Last year, The Agreement on the Association with the European Instrument to Support SMEs – The European Information & Consulting Center was signed; it will provide assistance to SMEs in search for foreign partners in the EU and in entering foreign markets.

In 2011, the annual statistical indicators of the research-development-innovation, with a focus on SMEs have been designed for the first time in Moldova.

In the context of the existing legal framework, there are several elements creating the infrastructure in the field of innovation in the Republic of Moldova. These are:

- Agency for Innovation and Technology Transfer;
- State Agency for Intellectual Property;
- Scientific and technological parks;
- Innovative incubators; and
- Other elements of the innovation infrastructure, such as universities, factories, plants and the industrial sector.

The Agency for Innovation and Technology Transfer (AITT):

- implements the state policy in the field of innovation and technology transfer;
- determines the strategic direction of the area;
- coordinates the creation of infrastructure for innovation and technology transfer;
- provides specialized assistance in this area.

State Agency on Intellectual Property of the Republic of Moldova:

- implements the state policy in the field of protection of intellectual property;
- organizes and manages the national system of intellectual property protection;
provides specialized assistance in this area.

PRESENT GOOD PRACTICES OF INNOVATIVE SME IN THE REPUBLIC OF MOLDOVA.

Worth mentioning is “Academica” - Scientific and Technological Park: more than a half of its residents are companies specialized in the introduction of products in the field of energy, energy efficiency and renewable energy.

The following companies can be qualified as successful in “Academica” Scientific and Technological Park (see Table 2):

- “Vaptos” Ltd. - it is specialized in the production of electronic equipment of high and low voltage;
- “Nobel-Grup” Ltd. - it is specialized in the manufacture and the commercialization of purified potable water using reverse osmosis;
- “Anstec-Mec” - it is specialized on reconditioning and anticorrosive / abrasive metal protection in construction.

Table 2 – The activity indicators of the Science Technology Park “Academica” and the Innovative Incubator “Innovator”

<table>
<thead>
<tr>
<th></th>
<th>Volume of commercialized production (lei/euros)</th>
<th>Nr. of new employed persons in innovation activity (un.)</th>
<th>Attracted Investments (lei/euros)</th>
<th>New residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology Park</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“Academica”</td>
<td>24,297,358 / 1,554,732</td>
<td>33</td>
<td>11,409,714 / 730,081</td>
<td>6</td>
</tr>
<tr>
<td>Innovative Incubator</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>“Innovator”</td>
<td>20,119,882 / 1,287,425</td>
<td>5</td>
<td>2,875,807 / 184,016</td>
<td>3</td>
</tr>
<tr>
<td>General</td>
<td>44,417,240 / 2,842,157</td>
<td>38</td>
<td>14,285,521 / 914,097</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: (Agency for Innovation and Technology Transfer internal reports 2011)

“Innovator” - Innovation Incubator provides innovative development of business from the incipient stage. It provides an opportunity to incubate projects from various priority areas (see Table 2).

The following companies can be qualified as successful in the “Innovator” Innovation Incubator:

- “AvantBIOS” Ltd. - it is specialized in the production of household water purification systems;
- “Avantchim” Ltd. - it is specialized in the manufacture of chemicals, the main product is a fungicide based on copper, produced on the basis of a formula developed by researchers from Moldova.

DEFINING THE PROBLEMS FACED BY SMES IN INNOVATION AND TECHNOLOGICAL DEVELOPMENT AND THE MEASURES TO SUPPORT INNOVATIVE, TECHNOLOGY-ORIENTED, HIGH-TECH AND ENVIRONMENTAL-FRIENDLY SME.

Currently “Academica” scientific - technological cluster is in its development stage, being formed by merging the Innovative Incubator “Innovator” with “Academica” Scientific - Technological Park.

However, according to the European Innovation Barometer, Moldovan innovative efficiency is much lower than that from EU. The innovative potential of Moldovan companies is low and therefore, the impact of innovation in the national economy is small.
The Global Competitiveness Index for 2011-2012 in the field of innovation and difficulty factors is ranking Moldova on the 127th place, moving it four places higher in comparison with indicia for 2010-2011 (see Figure 7).

The Global Competitiveness Index for 2011-2012 in the field of innovation is ranking Moldova on the 128th place, moving it one place higher in comparison with indicia for 2010-2011 (see Figure 8).

Within this context, there is a series of issues, still leaving place for solutions. These are as follows:

- SMEs mistrust the results of researches.
- Shortage of personnel in the management of innovation.
- Poorly developed domestic market in terms of promoting innovation.
- The necessity to cover 50% of the costs associated with the development of innovation.
- Structures supporting innovations are insufficient, and the existing structures do not meet the industrial requirements.

In order to increase the innovative potential of small and medium-sized enterprises active in the field of innovative research and advanced technology, the Agency for Innovation and Technology Transfer, holds an annual competition of innovative projects, which include the introduction of innovations or new technologies. The period of implementation of these projects does not exceed 2 years.

In 2011, 25 projects were approved, with an allocated budget of 7.35 million lei or 480 thousand euros. The projects were 50% funded by the state budget, and the funding can also be accomplished and co-financed by providing equipment needed for the project, which can also be acquired in the process of project implementation.

The residents of scientific and technological parks and innovation incubators benefit of a series of facilitations:

- They are exempt from Value Added Tax and customs duties on goods and services.
- Besides, residents benefit of reduced prices for facility rent.
- In addition, they get lower rates for the use of the production capacity.

The State Agency for Intellectual Property of the Republic of Moldova provides a tremendous support of inventions, covering up to 95% of their costs and the patent fees.

Also, there is a number of funds, as well as of International and European programs, including the development of cross-border programs implemented under the European Neighborhood Policy, which aim to support and develop innovative small and medium enterprises.

In 2011, the Republic of Moldova became an associate member of the Seventh Framework Program for Research and Technological Development.

Moldova is the first country of the Eastern Partnership and the second in the European Neighborhood Policy, having been granted the status of an associate member of the program.

Research centers, universities, small and medium-sized enterprises and multinational corporations, public administration bodies and individuals can also participate in the Seventh Framework Program, which is the main tool for funding research in Europe. The duration of the project is 1-2 years with a budget of 500 thousand to 1.5 million euros.

At this point, two projects have been approved:

- “Farus” Ltd., accomplishing its activity in the field of HASTAC “High Stability Altimetry Systems for Transponders and Air data Computers.”
  - Project duration: 38 months, Start date: 2005.
  - Thematic priority: 4 - Aeronautics and Space.
- Research area: 3 - Improving aircraft safety and security.
Priority fields of activity for the project are space and aeronautics, while the improvement of aircraft safety is a priority research field.

Bullet point: “Business Research Company” Ltd. – an European Network for Better Regulation. The project includes EU and Israel, forecasting later accession of Moldova, Serbia and Ukraine to the consortium of 21 organizations.

- Consortium of 21 organizations (18 initial + 3 later).
- Project Budget: 1,027,701 euros.

Despite multiple challenges, the Government of the Republic of Moldova and the Academy of Sciences have made great efforts to support innovation and a lot of organizations have already benefited from this opportunity.

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State Agency for Intellectual Property internal reports 2011.

Figure 1 – Number of patents of the years 2005-2011

Source: State Agency for Intellectual Property internal reports 2011.
Figure 2 – Dynamics of technology transfer projects of the years 2005-2011

Source: Agency for Innovation and Technology Transfer internal reports 2011

Figure 3 – In-house Innovative SMEs (% from SMEs)

Figure 4 – Introduction of products or innovation processes by SMEs (% from SMEs) for 2010


Figure 5 – In SMEs that introduced a new products or services on the market, regarding the development area

Source: Agency for Innovation and Technology Transfer internal reports 2011
Figure 6 – SMEs that introduced innovation process, by category of innovation process for 2010

Source: Agency for Innovation and Technology Transfer internal reports 2011

Figure 7 – Global Competitiveness Index SubIndex: Innovation and Sophistication factors 2011-2012

Figure 8 – Global Competitiveness Index SubIndex: Innovation and Sophistication Factor Innovation Pillar


Family Photo of the Participants of the BSEC-KAS Workshop on Innovative Entrepreneurship and Sustainable Development for SMEs held on 12-14 September 2012 in Tbilisi (Georgia)

Photo © by Bekir Öncel
EU EASTERN PARTNERSHIP PROGRAMME AND INNOVATIVE SMALL AND MEDIUM ENTERPRISES

ABSTRACT

The convergence of policies of the European Union and Eastern Partnership (EaP) countries towards small and medium enterprises (SMEs) is the flagship initiative of the EU EaP Programme. Such prioritization of the issue means that SMEs being the cornerstone of the economic policy of the European Union should take an appropriate place in EaP country economies as well. For purposes of convergence of the government economic policy to the EU economic policy, some indicators in the sphere of SMEs in Georgia, EaP countries, EU and other successful countries have been studied. The differences in approaches to SMEs have been identified. The changes to be made and the ways of using the EaP for the purpose are demonstrated.

Keywords: innovative SMEs, European Union and Eastern Partnership

JEL Code: F15, L21, L26, O1

1. INTRODUCTION

Policies towards small and medium-sized enterprises (SMEs) are one of the cornerstones of the European economic strategy, both at the all-European and Member Country level. They have been established in the European Charter for Small Enterprises, Small Business Act for Europe and are reflected in national legislations of all Member Countries. In terms of attention and perfection of the SME legal base, the European Union is one of the world leaders, although without being an exception. Similar strategies are characteristic of all developed and successful countries.

Box 1. United States of America

The first Small Business Act was adopted in 1953, amended in 1958 and finally elaborated into a Small Business Jobs Act in 2010, which, notwithstanding constant debates around it, is indicative of a keen interest and long-term significance for economy.

At the Ministerial Meeting in Bologna in 2000 arranged by the Organization for Economic Cooperation and Development (OECD) 47 countries of the World signed the Bologna Charter on SME policies, which outlined the increasing importance of small and medium-sized enterprises (SMEs) in economic growth, job creation,

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4 European Charter for Small Enterprise (ec.europa.eu/enterprise/policies/sme/files/charter/docs/charter_en.pdf)
5 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - “Think Small First” - A “Small Business Act” for Europe. COM/2008/0394 final
7 http://en.wikipedia.org/wiki/Small_Business_Administration
regional and local development, and social cohesion, also through the role played by women and young entrepreneurs. The Charter states that countries will jointly work on perfection of financial and non-financial aid for SMEs and will introduce an international system of SME policies registration and comparison. In Europe, such a system is fully operable under the name the SME Performance Review⁹.

The purpose of introducing the concept of SMEs is to carry out towards them a special policy different from that established for large enterprises. Special privileges have been established in respect of SMEs, the subject-matter of which was initially aimed at protecting small enterprises. Legislations of the most liberal countries also contained this concept. Eventually, it has become evident that SMEs need special regime because of their special role in economy, which is associated with development. In particular, it has been found that many revolutionary innovations were associated exactly with the activities of SMEs. Their dynamism, ability to adapt, let alone the number of jobs and share in GDP being created by them, is a systemic element ensuring existence of a healthy economy.

2. DEFINITION OF SME

In order to qualify enterprises (businesses) as micro, small and/or medium-sized, every country establishes different criteria. In addition, some countries establish such criteria depending on the economy sector. At present, a common definition of SMEs is in effect in EU countries¹⁰. Table 2.1 below explains this definition.

### TABLE 2.1: Definition of SMEs in EU

<table>
<thead>
<tr>
<th>Category</th>
<th>Employees</th>
<th>Annual turnover, EUR</th>
<th>Annual balance sheet total, EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium</td>
<td>&lt; 250</td>
<td>&lt; 50 million</td>
<td>&lt; 43 million</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>&lt; 10 million</td>
<td>&lt; 10 million</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt; 10</td>
<td>&lt; 2 million</td>
<td>&lt; 2 million</td>
</tr>
</tbody>
</table>

The main criteria for determining in which category an SME falls are the number of employees, annual turnover and balance sheet total (although other criteria are also applied for specific purposes). The application of the three criteria ensures the definition flexibility. This enables both the enterprise and the aiding agency to make the best choice in a specific case (for example, depending on the economy sector).

### TABLE 2.2: Definition of SME according to number of employees

<table>
<thead>
<tr>
<th>Category</th>
<th>EU</th>
<th>USA, Canada¹¹</th>
<th>Japan</th>
<th>Georgia¹²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium</td>
<td>&lt; 250</td>
<td>&lt; 500</td>
<td>&lt; 300</td>
<td>&lt; 100, annual turnover GEL 1.5 million</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>&lt; 100</td>
<td>-</td>
<td>Before January 2011&lt;br&gt;After January 2011 – annual turnover GEL 100,000</td>
</tr>
</tbody>
</table>


¹¹ The data given here concern the industry sphere. In other economy spheres, different definitions are applied.

¹² According to the Laws of Georgia On Entrepreneurs (1994) and On the National Investment Agency (2006), such definition applied before January 2011. At present, under the Tax Code of Georgia, the staff headcount indicator is no longer applicable in respect of a small enterprise, while its annual turnover shall not exceed GEL 100,000. The definition of a micro enterprise has also been determined.

Table 2.2 gives the definition of SME according to number of employees (annual turnover is also given for Georgia). With the adoption of new Tax Code (September 2010, in effect since January 2011), a small enterprise has changed it definition and is now known as a micro enterprise. The staff headcount is no longer applicable to a small enterprise, while the upper limit of the annual turnover has equalled GEL 100 thousand. The definition of a medium-sized enterprise has not changed. Table 2.3 below shows how the SME definitions differ according to balance sheet total. In Georgia, this criterion is not applied.

**TABLE 2.3: Definition of SME according to balance sheet total**

<table>
<thead>
<tr>
<th>SME’s balance sheet total, USD million</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>India</td>
</tr>
<tr>
<td>&lt; 60</td>
</tr>
<tr>
<td>&lt; 3</td>
</tr>
<tr>
<td>&lt; 2.2</td>
</tr>
</tbody>
</table>

The European Parliament and the Council have agreed to recommend Member States to to create a simple financial reporting environment for enterprises with €500,000-worth turnover or €250,000-worth balance sheet total. However, they have failed to agree on applying the same preferential tax treatment to micro enterprises with annual turnover worth €1,000,000 and balance sheet total worth €500,000, because of the opposition on the part of some Member States.

The given examples clearly demonstrate that EC and Member States give a great attention to the SME sector and try to support it as much as possible. On the other hand, the same examples indicate that the criteria for determining the category of SMEs differ much and are not, on the face of it, subject to any regularity. It has been found that in determining the criteria, first the statistical regularities are being considered and only then the political/administrative expediency is discussed; thus, the final decision represents a complex combination of opinions. In spite of this, definite regularities are still observable (see tables 2.4, 2.5). In particular, it turns out that in every successful country SME is so defined that its output constitutes a substantial share of GDP, varying between 40 to 75%.

**TABLE 2.4**

<table>
<thead>
<tr>
<th>Japan</th>
<th>Thailand</th>
<th>EU</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of SMEs [million]</td>
<td>4.3</td>
<td>2.2</td>
<td>19.3</td>
</tr>
<tr>
<td>Share of SMEs in total number of companies [%]</td>
<td>99.7</td>
<td>99.8</td>
<td>99.8</td>
</tr>
<tr>
<td>SME workforce [million]</td>
<td>28</td>
<td>11.8</td>
<td>97.4</td>
</tr>
<tr>
<td>Share of SMEs in total number of workforce [%]</td>
<td>70.0</td>
<td>75.4</td>
<td>69.7</td>
</tr>
</tbody>
</table>

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14 See reference 3
The statistics of the most FSU countries are in clear-cut contrast with these data (Table 2.6). 7.2% of GDP created by Georgian SMEs as per Table 2.5 also includes a share of micro enterprises, since no concept of a micro enterprise existed in Georgia until 1 January 2011. These differences are conditioned by methodologically incorrect definitions of micro, small and medium-sized enterprises. In particular, a much greater number of enterprises must fall in the category of SMEs. Assumptions concerning the causes of such situation exist, although a special study is to be conducted to specify them.

<table>
<thead>
<tr>
<th>Country</th>
<th>SMEs’ share in GDP, %</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>9.5</td>
<td>2000</td>
</tr>
<tr>
<td>Ukraine</td>
<td>11</td>
<td>2006</td>
</tr>
<tr>
<td>Georgia</td>
<td>16</td>
<td>2009</td>
</tr>
<tr>
<td>Russia</td>
<td>15-20</td>
<td>2009</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>24</td>
<td>2010</td>
</tr>
<tr>
<td>Armenia</td>
<td>35</td>
<td>2009</td>
</tr>
<tr>
<td>Moldova</td>
<td>45</td>
<td>2009</td>
</tr>
</tbody>
</table>


16 Georgia’s statistics are taken from Ministry of Economy’s web-page.

17 Formal statistics do not exist (or are unaccessible). Data are taken from the ruling party’s web-site.
3. SUPPORT MEASURES FOR SMES IN EUROPEAN UNION

3.1 Overall review

As mentioned above, the essence of legal definition consists in the circumstance that legislation implies definite aid/support for enterprises of this category. The essence and directions of such support in the European Union were established by the European Charter for Small Businesses in 2000\(^\text{18}\). They have also been reflected in the European innovation development Lisbon Strategy adopted in 2000 and strengthened in the Small Business Act\(^\text{19}\) for Europe adopted in 2008.

It is natural that in the Europe 2020 Strategy, in particular in its documents An Integrated Industrial Policy for the Globalization Era\(^\text{20}\) and Innovation Union\(^\text{21}\), support for SMEs occupies a fitting place. In the first 33-page document, SMEs are mentioned 30 times.

Directions of support/aid for SMEs provided for in these documents are as follows:

- Promote SMEs’ managers re-training
- Simplify bankruptcy and competition rules for SMEs
- Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance
- Direct by governments and EU of financing to starting-up and innovative firms, micro enterprises and other venture undertakings
- Simplify for SMEs access to loans\(^\text{22}\) and assist them in business internalization (collaboration, access to foreign markets)
- Simplify for SMEs statutory-specified refund of taxes, receipt of consulting and information
- Facilitate SMEs’ participation in public procurement
- Facilitate SMEs’ general tax burden and simplify reporting
- Strengthen representation of SMEs’ interest on political level
- Make public administrations responsive to SMEs’ needs
- Enable SMEs better use the State Aid Law\(^\text{23}\)
- Enable SMEs to turn environmental challenges into opportunities
- Improve SMEs’ access to research.

The last aid/support direction reflects that public funds represent a significant source of research and innovation, particularly in respect of young entrepreneurs, start-ups, spin-offs and high-tech SMEs.

EU, in terms of support for SMEs, makes a wide use of the experience of other countries, e.g. of the USA. It is of interest that the USA recognized as the follower of the “liberal economy” and “free market”

\(^{18}\) The European Charter for Small Enterprises (http://ec.europa.eu/enterprise/policies/sme/best-practices/charter)


\(^{20}\) Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. An Integrated Industrial Policy for the Globalization Era. Putting Competitiveness and Sustainability at Centre Stage. [Sec(2010) 1272] {Com(2010) 614}


ideology is a pioneer in such matters as granting privileges to small business in public procurement and some other benefits, on which we shall dwell below.

3.2 Innovative SMEs in the European Union

One of the motives of providing aid for SMEs by the State is their innovation efficiency. The history of such companies as Apple, Google, and Skype is well known. In reality, in addition to these companies, there are tens of thousands (possibly hundreds of thousands) successful companies in the world which were, in their time, considered as pioneering innovators. In fact, high-growth companies are always innovative – the basis of their development is either a novel technology or a new business scheme. In Europe, such companies fall in a special category known as innovative SMEs. They shall comply with the following conditions:

- the R&D expenses of the beneficiary represent at least 15% of its total operating expenses in at least one of the three years preceding the granting of the aid;
- the respective EU Member State (its competent authority) can demonstrate that the enterprise’s products, services or processes are competitive on the EU market;
- the beneficiary is an enterprise that has been in existence for less than 6 years at the time when the aid is granted.

Assistance to such enterprises is regulated by State Aid law (2006), which defines what aid is eligible to private enterprises without infringing fair competition rules (control over compliance with the rules is exercised by the Directorate General for Competition). The eligible aid directions are as follows:

- **Aid for R&D projects**: Personnel costs (researchers, technicians and other supporting staff to the extent employed on the research project); costs of instruments and equipment to the extent and for the period used for the research project; costs for building and land, to the extent and for the duration used for the research project; cost of contractual research, technical knowledge and patents bought or licensed from outside sources at market prices as well as costs of consultancy and equivalent services used exclusively for the research activity; additional overheads incurred directly as a result of the research project; other operating expenses, including costs of materials, supplies and similar products incurred directly as a result of the research activity.

- **Aid for technical feasibility studies**: Costs for studies preparatory to industrial research activities and for studies preparatory to experimental development activities.

- **Aid for industrial property rights costs for SMEs**: Costs relating to the preparation, filing and prosecution of the application as well as costs incurred in renewing the application before the right has been granted; translation and other costs incurred in order to obtain the granting or validation of the right in other legal jurisdictions; costs incurred in defending the validity of the right during the official prosecution of the application and possible opposition proceedings, even if such costs occur after the right is granted.

- **Aid for young innovative enterprises**: Complete or partial coverage of innovative projects costs.

- **Aid for process and organizational innovation in services**: Eligible costs are the same as for aid to R&D projects. In case of organizational innovation, however, costs of instruments and equipment cover costs of ICT instruments and equipment only.

- **Aid for innovation advisory services and for innovation support services**: costs associated with management consulting; technological assistance; technology transfer services; training; consultancy for acquisition, protection and trade in Intellectual Property Rights and for licensing agreements; consultancy on the use of standards; as regards innovation support services - the costs of office space; data banks; technical libraries; market research; use of laboratory; quality labelling, testing and certification.

- **Aid for the loan of highly qualified personnel**: Eligible costs are all personnel costs for borrowing and employing highly qualified personnel, including the costs of using a recruitment agency, as well as a mobility allowance for the seconded personnel.

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• **Aid for innovation clusters:** The eligible costs shall be the costs relating to investment in land, buildings, machinery and equipment as well as the personnel and administrative costs.

Most of the above-cited aids are eligible for SMEs only, although some large enterprises can also receive them. The examples of application of the State aid law in individual Member States are given in Georgian in the work by Tamaz Vashakidze26.

Within the SME universe, EU distinguishes a group that has received the greatest attention over the past years, namely the high-growth **SMEs** or “gazelles”, one reason for the fast growth of which is the source of their differentiation, namely innovation. The definition most widely used in the literature characterizes high growth firms as having a sales growth rate of at least 20% per year for 3 or more consecutive years. A gazelle has to grow at least 20% a year for four years, from a base of at least USD100,000 in revenues at least doubling in size over that four year period27. Obviously, innovation does not necessarily mean radical innovation (which accounts for less than 5% of all innovation). In most cases, innovation is usually of organizational nature, especially in the services sector. It may involve business models, management practices, and administration schemes. The problem here is the registration, demonstration and support of high-growth **SMEs**. It should be noted that although the special importance of this category enterprises in creation of jobs and growth has been recognized28, a particular policy towards them is still under the process of development. The issue is still a subject of intensive scientific research29.

### 3.3 Access to research

As has been mentioned above, access to research is one of the most important directions of SME support. Its source on the European level is the participation in the **European Framework programmes**; on the national level – participation in national research and development programmes, and on the regional level – participation in programmes financed by the **European structural funds**. In addition to grants that an enterprise may get from the mentioned programmes, EU practices preferential taxation of costs for research works. In many European countries, the costs of research conducted by own strength or under a contract job (e.g., in a university) are preferentially taxed or are completely tax-exempt, while in some countries amounts are taxed only in proportion to research costs (the untaxed amount may constitute 150% and more of the research costs). Preferences are applicable to pays30, as well as to the costs incurred on equipment, buildings and materials necessary for research31.

Another direction/instrument of support for start-ups is the foundation of SMEs by universities and non-profit (public-funded) research organizations. In this case, a SME gets the research outcome obtained by public resources (in the form of patented intellectual property or know-how). University staff can combine jobs in such enterprises. The university participation forms are diverse. In such schemes, Europe is the follower of the USA, where the well-known **Bayh-Dole Act**32 was passed in 1980. Similar practices have taken root in Israel.

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30 For instance, payments to scientists and specialists engaged in technoparks in some countries may be exempt from income tax.

31 It would be appropriate mention here the Tax Code of Georgia that provides for certain preferences for research but not for costs incurred on instruments, facilities, construction, etc., which is a great barrier to up-to-date research.

In this respect, the USA is of a particular interest, for apologists of the so-called ‘liberal economy’ do frequently cite USA as an example of non-interference or equal approach to businesses. In addition to the Bayh-Dole Act, the USA adopted in 1982 the Small Business Innovation Development Act, under which an SME is eligible to receive a state grant worth USD 100-150,000, for 6 months, for preliminary research purposes. In case this stage is successfully completed, the enterprise may apply for another 2-year grant worth up to USD 1 million for developing an advanced technology. In 1992, in order to ensure the conduct of a joint research having a commercializing potential by small firms and public research organizations, the Small Business Technology Transfer Act was adopted. Under this Act, an organization may apply for USD 100,000 at the trial stage, as well as for USD 750 thousand at the further stage, in case it is successful.

Thus, aid for SMEs can be divided into several categories. As has been seen, aid can be both financial and non-financial. The latter encompasses, in turn, direct financial aid and tax preferences (preferential tax rates, postponement of payment, etc.). The Georgian reader may learn more of the preferences in force in Europe in the articles by Tamaz Vashakidze and Nana Aslamazishvili.

4. POLICIES TOWARDS SMES AND INNOVATIVE SMES IN GEORGIA

Enterprises which are qualified under Georgian legislation as small and medium-sized generate only 15% of GDP. This can also serve as explanation of a little attention being paid to them here than in successful countries. In other words, SMEs are the entities with a low share of production in GDP and do not, therefore, requiring much attention.

As has been indicated above, before 1 January 2011, Georgian legislation qualified SMEs as follows: medium-sized – number of employees < 100, annual turnover < GEL 1.5 million; small – employees < 20, annual turnover < GEL 500,000; micro enterprises have not been defined and fell in the category of small ones. These definitions were declaratory, since the tax preferences for SMEs specified under the Tax Code were not based on them. In particular, it was established that enterprises with the annual turnover less than GEL 100 thou were exempted from VAT (which in itself is not a great privilege); however, the ‘GEL 100,000’ scale in the SME definition was absent.

The SME definition was used only to calculate their share in GDP. Analysis of the SME definition in Georgia is given in the doctoral theses of Madonna Khuskivadze (2010). From 1 January 2011, the definition of medium-sized enterprise has remained the same; the new tax Code has introduced a definition of a small enterprise, as well as that of a micro enterprise.

<table>
<thead>
<tr>
<th>Enterprise category</th>
<th>Before 1 January 2011</th>
<th>After 1 January 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employees</td>
<td>Annual income/turnover</td>
</tr>
<tr>
<td>Medium</td>
<td>&lt; 100</td>
<td>&lt; GEL 1.5 million</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 20</td>
<td>&lt; GEL 500,000</td>
</tr>
<tr>
<td>Micro</td>
<td>Was not defined</td>
<td></td>
</tr>
</tbody>
</table>

As can be seen, the number of employees in the small business definition is no longer applied; however, based on the income indicator, the number of full-time employees of such an enterprise shall make about 3-5. According to the definitions being in effect in most countries, it is to be a micro enterprise. Under the new definition, the total share of the SME’s production in GDP will remain at the level of previous years, whereas the share of small and micro enterprises will be reduced.

The new Tax Code contains a “Chapter XII. Special Income Tax Regime” being fully dedicated to small and micro businesses. No preferences (special tax regimes) for a medium-sized business are envisaged. Small and micro businesses no longer pay VAT, as provided in the previous Tax Code. An individual with the status of a micro business (Article 86) is exempt from personal income tax. A small business is liable for income tax at a 5% rate of gross income, and, in case definite conditions are met, the applicable income tax is further reduced to 3% (Article 90). The efficiency of these preferences will be evidenced with time. One thing is clear—the special regime concerns the enterprises generating a very small part of GDP. According to Table 2.5, when an enterprise with the annual income less than GEL 500,000 was considered as a small one, small and micro enterprises used to jointly generate 7.2% of GDP. Now, when the income limit went down to GEL 100,000, their share in GDP has been further reduced. For how much - the 2011 outcomes will show. It is a fact that in successful countries the incentives influence the process of generation of a much greater portion of GDP.

A concept of an innovative small enterprise has not been established in Georgian legislation, although the legislation contains some elements that can be considered as the above-described tax preferences in respect to innovative enterprises. In particular, the Tax Code mentions a virtual zone legal person (entity). Such persons are exempt from tax on the profit received from the supply outside of Georgia (export) of information technologies produced thereby (Article 99). Under the same article, exempted from corporate income tax will be the portion of income of medical establishments received from medical activities which has been reinvested into the establishment’s technical base. Also, under Article 110, “Deductible are expenses on R&D, project-design services related to the receipt of gross income, with the exception of expenses on the acquisition and installation of fixed assets, and other capitalized expenses”. Here, too, a difference from legislations of the EU Member States relating to tax preferences for research is obvious. Preferences in EU are applicable to total costs, i.e. without exclusion of capitalized costs.

Out of other innovation-related tax preferences mention should be made of exemption from VAT of some activities: import of information (books, journals, etc.), research work connected with the restoration of monuments, education services. In addition, land plots used for agricultural experiments are exempted from property tax.

Overall, the enumerated tax preferences are few and non-systemic. However, the most important is that these preferences relate to the activities that are hardly implementable by small enterprises with the annual turnover of GEL 100,000 and number of employees from 3 to 5.

Georgian legislation does not provide for non-financial aid for SMEs. That is, the provision of grants, tax loans, and other benefits for SMEs is not envisaged.

In addition, SMEs (like any profit-oriented legal entity) lack an access to sources of public finances for R&D. In particular, they cannot participate in the Rustaveli Foundation grant competitions for conduct of research work. There are no other research and innovation-targeted foundations in Georgia (in distinction of EU Member States, where such funds are many and available).

**Box 2. Example: Research organization as LLC**

In 2003, many research organizations in Georgia were granted the status of a limited liability company, i.e. they became profit-seeking organizations – small or medium-sized enterprises. Thus, their rights to take part in public financing and grant competitions have been restricted. The erroneous character of such a decision was clear from the very beginning. The large-scale research directions necessary for the country (e.g., medicinal research) have been fully or significantly curtailed. Subsequently, the State challenged them as profit-oriented organizations with a 100% state share as unprofitable and subjected their assets/property to sale

Research organizations in some countries have the status of a legal entity of private law. This does not imply that they are not eligible to public finance or are required to make profit. For instance, a LLC in the USA should not be necessarily oriented to profit. This legal status is enjoyed by large national laboratories whose budgets are practically 100% formed by the State funds. Thanks to such status, the laboratory employees are not regarded as public servants. Their remuneration is determined by the labour market.
Let us consider representation of SMEs’ interests on political level, which, mostly, in all successful countries is exercised by SME administrations (agencies) formed there. The SME administration within the structure of the Government of Georgia was annulled in 2003. Interests of SMEs are represented by several NGOs, who are trying to form a public opinion and provide the government authorities with proposals on their development. Several proposals concerning the State administration of SMEs have been published. For example, the Georgian Small and Medium Enterprises Association (GSMEA) has drafted a SMEs’ Development Project, which implies:

• Development of a State action plan for SMEs development
• Allocation of 2% from the State budget to cover the plan fulfilment costs
• Setting up a small business administration/agency within the Government
• Financing business development centres in regions
• Introducing a mechanism of financial guarantees for the private sector
• Arranging training, retraining and skill development courses for SME staff
• Creating a possibility for an effective dialogue with the State.

There were also other initiatives. The Centre of Innovation and Development of Enterprises asked for introducing fixed taxes for definite categories of SMEs for the purpose of simplifying their activities and increasing independence of SMEs.

Box 3. Development of innovative SMEs and qualification of public servants

SME development programmes are based on clear-cut priorities. Their implementation, moreover the development and management of innovation programmes, requires continuous training of public servants. The relevant work in Georgia generally implies the training courses financed by foreign organizations, which, of course is not sufficient. A public training and retraining system operating on the permanent basis needs to be created, which, of course, does not concern the issues of SMEs only. However, it should be said here that tax legislation, for example, contains a sufficient number of exceptions and preferences, i.e. the tax authorities manage to take them into consideration in their work. However, since the exceptions and preferences are not based on the priorities established by the state policy, they seem to be non-systemic. They fail to consider the interests of small business to the extent which the best world practices dictate. A thorough knowledge by the civil servants of the national legislation and the state structure is a must.

Numerous non-financial aid instruments for SMEs developed in EU are rather weak in Georgia. The matter concerns business incubators, technological parks, technology transfer centres, patent and consultancy centres, also the legislative frameworks of cooperation of the SMEs with public R&D organizations, etc. Thanks to assistance of international donor projects, much work has been done in this direction. However, the nuclei of services having remained without the post-project aid from the State fail to come out from the embryonic stage. Every new donor project on a new place actually starts from nothing, affecting thus the assistance efficiency. Several research institutes in Georgia themselves developed business incubators. Regrettably, these organizations no longer exist – some have been seized of premises, some have been annulled, others have been incorporated into universities with the revocation of the status of a legal entity.

5. EAP CIVIL SOCIETY FORUM AND SMALL BUSINESS DEVELOPMENT IN GEORGIA

The small business matters represent one of the main directions (flagship initiative) in the EaP agenda. Accordingly, they occupy a prominent place in the EaP’s immediate plans. The convergence of Georgia’s and EU’s policies is the principal of the EaP’s economic platform. It encompasses the convergence of policies in the sector of SMEs, which, as mentioned above, is one of the cornerstones of the economic policy of the EU (and of any successful country). In connection with this, the Working Group 2 of the EaP’s Civil Society Forum (EaP CSF), the activities of which correspond to those of the government economic

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37 The Georgian SMEs Association has drafted a SMEs’ Development Project
platform, has set up a SME subgroup, underlying thus importance of the issue for development of all the six EaP countries and European integration.

A great part of the General Recommendations of the Working Group 2 of the EaP CSF to the EC and Eastern Partner countries (Berlin, 2010) was dedicated to innovation and SMEs’ problems, i.e. the non-government sector considers SMEs and innovation as the most important issues for their countries, which lack proper attention both in the countries and in EaP’s government agenda and which interferes with the European integration. First of all, as has been mentioned, it finds its reflection in the incorrect definition of SMEs. The number of enterprises in need of a special preferential regime has been unjustifiable reduced, while the aid instruments, especially in relation to innovative enterprises, are rather few.

Below given are the interesting to us paragraphs of the recommendations39.

“Working Group 2:

- Asks EU to encourage innovation driven transformation of Eastern Partner countries and recommends Eastern Partner governments to take inspiration from the Flagship Initiative “Union of Innovations” of the Europe 2020. The measures should include support programs for innovative SMEs, promotion of business incubators, technological parks, skills development and technology transfer, participation in research and development framework programmes and clustering mechanism.

- Recommends in the SME sector:
  - to promote the Eastern Partnership Charter of SMEs based on experience of the Mediterranean Small Business Charter and Small Business Act of the EU;
  - to organize regularly big matchmaking event for the SMEs from EaP countries and EU in the form of Europartenariats40.
  - to promote and support the establishment of clusters as a tool for upstreaming the activities of the SMEs in partnership with the academic and R&D sphere and extend the clusters to involve the partners from the bordering regions between the EU and EaP countries.

- Recommends transforming B2B (Business to Business) meetings into Business Forums or Development Forums.

- Recommends in the sector of Technical Regulations and Standards to provide mechanism for developing Impact Assessment studies in Eastern Partner countries for the gradual introduction of the Global directives into the national legislation.

- Recommends in the sector of intellectual property rights to develop a special guide on actions to enforce the IPR legislation in Eastern Partner countries.

- Emphasizes the necessity to develop and support the Green Business in Eastern Partner countries by exchanging best practices from EU Member States, transfer of appropriate technology and know-how”.

The above Recommendations serve to underlie the fact that in the EaP countries, including Georgia, the attitude towards SMEs, in general, and innovative SMEs, in particular, does not comply with that existing in EU, while policies in this sector are still to be developed. This circumstance is well comprehended by the civil society. It is necessary that the authorities would take decisive steps in this direction.

Policies in the innovative SME sector of Georgia need to be worked out, for which purpose EU proposes a whole series of models. It would be reasonable to use EaP for the purpose of adaptation of such experience under conditions of Georgia.

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40 Europartenariats – meetings of small and medium business representatives, periodically held in European regions (mostly less developed ones). A part of companies arrange an exhibition, while others arrive at the preliminarily planned meetings. The event is attended by thousands of companies.


17. HANDBOOK ON COMMUNITY STATE AID RULES FOR SMES, INCLUDING TEMPORARY STATE AID MEASURES TO SUPPORT ACCESS TO FINANCE IN THE CURRENT FINANCIAL AND ECONOMIC CRISIS (ec.europa.eu/competition/state_aid/studies_reports/sme_handbook.pdf)


27. The European Charter for Small Enterprises (http://ec.europa.eu/enterprise/policies/sme/best-practices/charter/)


29. The US Bayh-Dole Act (Public Law 96-517)

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HUNGARIAN AND INTERNATIONAL MICROFINANCE LEGISLATION

ABSTRACT

The financial crisis of the previous years and its consequences, the increasing unemployment, the impoverishment, the social tensions raised the awareness for the contradictions of the bank lending. As the result of the debt crisis it is even more difficult to obtain financial resources for the start-up small enterprises and those deficient in funds. In the seventies was invented the practice of microcrediting as a special resolution for tackling the actual world economic crisis. The up-to-dateness of the topic is shown by the European Union’s decision making institutions accepting three programmes within the framework of the Progress that support the economic growth and employment. The main topics of my research are the objectives and regulations of the microcredit programmes of the European Union as well as the presentation of the function of the Hungarian institutions focusing on microfinance.

Keywords: microcredit, microenterprise, small and medium-sized enterprises (SME), Hungarian Foundation for Enterprise Promotion (HFEP), Local Enterprise Agencies (LEA), National Microcredit Programme (NMP)

JEL Code: G21, G32, L26, O16

1. INTRODUCTION

The microcredit word was not in use before the 1970s, but nowadays it refers to the most mentioned developing policy of the last decades. The microcrediting practice which is different from that of the commercial banks was introduced in nearly hundred countries. In Hungary, the mass privatization in the period after the political transformation at the beginning of the 1990s and the SME sector came into existence as a result of it, created the demand of that special facility. What do we understand by the concept of microcrediting?

“The primary objective of microcrediting is the creation of a crediting system that allows the capital provision, professional and financial assistance which cannot be financed by conventional/commercial banks for the non-bankable poor people.”[41]

Since the first microcredit was provided (in 1976 by the GRAMEEN Bank founded by the Nobel Peace Award laureate professor Muhammed Yunus), several UN programmes, the World Bank and the European Union are interested in the underprivileged part of the population. The first EU resolution of this kind in 1997 emphasized the importance of the microenterprises and formulated the raison d’être of the institutions performing microfinancial activities: “Sections of the population which do not have access to formal financial sector services, in particular the poor and women, should be assisted by providing support for microfinance institutions.”[42]

In the first chapter of my study the European microcredit strategy may also be presented by describing the three significant microfinancial programmes of the European Union.

2. MICROCREDIT PROGRAMMES OF THE EUROPEAN UNION

2.1. JEREMIE

In 2006 Danuta Hübner – European Commissioner for Regional Policy – valued the European microcrediting strategy in the European Parliament and she urged the member states to do as much as they

can to allow that the advantages of the JEREMIE programme are taken. This programme is one of the three political initiatives which were launched that year to promote the investments, growth and job creation of the member states and the regions. The acronym JEREMIE means ‘Joint European Resources for Micro to Medium Enterprises’. This programme takes a significant part of the Regional and Cohesion Policy for the 2007-2013 period. For the sake of an efficient crediting practice

- the regulations of microcrediting were set (e.g. the upper limit is EUR 25,000 for the microloans),
- the tax and insurance system for the borrowers was simplified,
- help and instructions are provided for the participants
- the microfinancial institutions are supported and self-supporting is provided,
- the microcrediting institutions cooperate and exchange experience,
- microcredit guarantee systems were set.

The group of microcredit institutions was created which can be classified in the following way:

- credit unions,
- non-governmental institutions (foundations, non-profit organisations),
- commercial banks,
- microcredit banks.

2.2. JASMINE

In 2007 the European Commission accepted its new programme to promote growth and employment. The acronym JASMINE means ‘Joint Action to Support Microfinance Institutions in Europe’. The JASMINE further clarifies the objectives and recommendations for the member states as well as the advantages in microcrediting for the dynamism of the economy. It supplements the JEREMIE programme launched by the European Commission and the European Investment Bank, allowing the member states to convert the subvention coming from the Structural Funds into microcredit. 20 member states have joined the JEREMIE programme. According to the estimates relying on the data of the Eurostat, the demand for microcredits in the EU is more than 700 thousand new loans – in all EUR 6.3 billion – on the short term. For the microenterprises excluded from the services provided by conventional commercial banks, a useful facility could be the refinancing of the most promising microcredit institutions according to the JASMINE program, as they suffer from lack of capital. The project was launched in 2009 with a budget of EUR 50 billion. In Hungary 15 chosen organisation could apply from which 2 Local Enterprise Agencies (LEAs). Those can apply for the resources who have been given the best microfinancial practice.

As the Hungarian practice was given the best qualification among 12 Central and Eastern European countries at the Best Practices in Microfinance Expert Meeting organised in 1998 according to the survey of the British Bannock Consulting 43, we have chances to initiate new resources.

2.3. PROGRESS

The European Union programme for Social Change and Innovation has a triple structure:

- the PROGRESS Programme launched by the resolution 1672/2006/EK
- the EURES
- The PROGRESS microfinance facility for employment and social mobility launched by the resolution 283/2010/EU

It aims to solve the main effort of the European Union’s employment and social policy, the concerted action is supported by the programme’s financial framework which is approved for the 2014-2020 period in a value of EUR 958.19 million.

Which are the objectives implemented in certain areas of the programme?

- The first element of the programme aims social innovation, execution of the social reforms, share of the good practices and developing the union regulations. 60% of the financial resources shall be devoted to the realisation of the Lisbon Treaty (Europe 2020).

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43 Dr Szabó Antal: Mikrohitelek a világban Tanulmány 2006. 10.oldal
• The EURES fosters the freedom of movement of persons as one of the four liberties; hereby it contributes to the economic development and the reduction of the unemployment. However, the geographical mobility has several legal and administrative obstacles in the Union. The objective of the EURES is to improve the transparency in the labour market by releasing employment possibilities and providing assistance to the concerned. 15% of the financial resources available shall be devoted to these duties.

• The PROGRESS microfinance facility contributes to the achievement of the objectives of Europe 2020 by creating and reinforcing new enterprises. Nearly 85% of the employment are provided by microenterprises, however, the obstacle that the enterprises face is the accessibility of credits. In the sake of growth the microcredit institutions of the Union need to develop and maintain appropriate financial models. For this purpose it is clearly necessary to enforce the institutional capacity building (especially in the case of the microcredit institutions outside the banking sector). The domain of microfinance and social enterprises provides in all 20% of the financial plan.

The remaining 5% is annually distributed as it is suitable for the political priorities.

In the next chapter I am going to give a detailed presentation of the PROGRESS microfinance facility which is important in the point of view of my topic. I believe that special attention is need to be devoted to this facility by institutions participating in microfinance, especially the non-profit LEAs operating as foundations, because it aims to refinance this type of institution.

2.3.1. Presentation of the PROGRESS microfinance facility

The Resolution of the European Parliament and Council specifies certain concepts, according to which the microenterprise in the social economy "should mean a microenterprise which produces goods and services with a clear social mission or which provides services to members of the community with a non-profit purpose".

The microcredit is a loan which does not exceed EUR 25,000.

The definition of the microenterprise is an enterprise employing less than ten people, including self-employment, and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million, according to the previous Commission Recommendation of 2003.

The target market of microfinance is defined by the 22. article of the Resolution: persons who have lost or are at risk of losing their job, or who have difficulties entering or re-entering the labour market, as well as persons who are facing the threat of social exclusion or vulnerable persons who are in a disadvantaged position with regard to access to the conventional credit market and who want to start or further develop their own microenterprise, including self-employment; as well as microenterprises which employ persons referred to in the previous enumeration.

The beneficiaries of microfinance are: public and private bodies established on national, regional and local levels.

It is not enough to provide the crediting facility, further support measures are necessary, such as: mentoring, information and communication activities, training programmes, interest rate support, and capacity building of the micro creditors.

The financial resources shall be decided during the European Union’s annual budgetary procedure according to the agreements with the European Commission (contribution of the European Investment Fund and the European Social Fund).

2.3.2. Instructions concerning the monitoring and the evaluation of the programme

One of the important criteria of the regulation is the evaluation of the realisation of the objectives. For this purpose the Resolution gives performance measures which I summarized in the following tabulation.

Table 1.

The evaluation of the PROGRESS microfinance facility (own compilation)

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44 European Parliament and Council Resolution 283/2010/EU Article 2
### Objectives

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Performance measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing the availability and accessibility of</td>
<td>providing 50 thousand micro credits</td>
</tr>
<tr>
<td>microfinance</td>
<td>credit amount of EURO 500 million</td>
</tr>
<tr>
<td></td>
<td>50% of the beneficiaries is unemployed or underprivileged</td>
</tr>
<tr>
<td>Building the institutional capacity of microcredit</td>
<td>supporting 50 institutions providing microcredit</td>
</tr>
<tr>
<td>providers</td>
<td>the institutional resources and the finance exceed the 2009 level</td>
</tr>
<tr>
<td>Developing the social enterprises</td>
<td>1000 assisted social enterprises</td>
</tr>
<tr>
<td></td>
<td>the volume of the investments is EURO 270 million</td>
</tr>
</tbody>
</table>

The performance measures published in the tabulation face long term impacts, the investments will only come to an end 10 years after the facility was launched (it means that the final evaluation of the microcredit obtained in 2014 is due in 2025).

3. **THE MICROFINANCE LEGISLATION IN HUNGARY**

As I stated in the previous chapter, the European regulation of microfinance was established by 2010 within the framework of the PROGRESS. It was necessary because the mutual action of the member states that help each other is also needed for the successful and innovative employment and social policy. In the Hungarian context we can state as an introduction that there is no general legal framework regarding the microcrediting sector, however, special regulations are in force which regulate the operation of institutions dealing with microcrediting. In this chapter I am going to describe the main periods of the development of the regulation and present the main actors and interests of the microcredit programme.

3.1. The establishment of the microfinancial organisations

In Hungary the small entrepreneurial sector came to existence after the political transformation at the beginning of the 1990s. The lack of capital and entrepreneurial experience caused great problems which were meant to be tackled within the framework of the PHARE programme. The programme financed by the European Community allowed the creation of the Hungarian Foundation for Enterprise Promotion (HFEP) aiming the stimulation and assistance of the enterprises. An aid-programme of 21 million ECU was reserved for the development of small and medium-sized enterprises, handled by the HFEP. It was also required to set up a Local Enterprise Agencies’ (LEA) network where those who wanted to start their enterprise were supported in the form of professional counselling and business services. There were altogether 20 (regional and metropolitan) LEAs established in form of a foundation between 1991 and 1998.

In 1992, 1.15 million ECU were separated for the National Microcredit Programme, with this the microcrediting system was set up in Hungary. Legislation of the operation of the NMP:

- HFEP – responsibilities of the national programme co-ordinator and mediator of the sources: liaising with the donors, source allocation, providing technical assistance for the Local Enterprise Agencies, mediating the sources to the LEAs.
- LEA – receiving loan applications, assessing and approving of loan applications, collecting instalments, checking loans, risk management.
- Commercial Banks – keeping the separate programme account of the LEA, concluding the loan agreements with the clients on the basis of the decision of the LEA, disbursing the loan, collecting instalments, keeping loan accounts (credit records), supplying the LEAs with data.

This system operated in a decentralized manner, each regional enterprise promotion foundation managed its own fund. The social objectives were achieved; the Hungarian practice was qualified as the best microcredit programme of the region (on the basis of the criteria presented in 2.2.). However, there were problems along with the success:
it was necessary to adjust the loan products to the changing financial needs of the clients, and the proposals could only come into force after it had been approved of in Brussels; this made the system very inflexible,

- with regard to the financing of the operating costs the system was not sustainable,
- the involvement of the commercial banks in the operation of the programme was unjustified.

Solving the problems was followed by the modification of the regulation with the result of the centralization of the microcrediting system.

3.2. The centralized operating structure of the National Microcredit Programme

In 1998 the regulation was modified: the crediting activity performed by the Hungarian Foundation for Enterprise Promotion and the LEAs do not fall under the effect of the Act on Credit Institutions and Financial Enterprises anymore. Along with this took place the centralization process which has taken the microfinance out of the regional and metropolitan foundations’ responsibilities, the National Microcredit Fund is now handled by the HFEP and the LEAs only participate in the crediting process with the rights of a mediator in return for a fee. The role of commercial banks is only limited to keeping the bank accounts and to perform the related transactions.

During this period the appearance of the local microcredit programmes more suitable for the entrepreneurs’ financial needs shall be evaluated as a process with positive impacts. It made necessary to create an internal regulation system which provides a professional framework to implement the local microcredit programmes independent from the HFEP. Due to this fact most of the LEAs were able to rapidly join the JEREMIE Programme (these types of regulation were required for the participation).

3.3. The JEREMIE Microcredit Programme in Hungary

20 member states (like Hungary) out of 27 have joined the JEREMIE Programme in 2006. As the refinancing interest rate was low, the number of participants in the microfinance has rapidly grown. The profit orientated financial enterprises were primarily interested as they received the sources under the same conditions as the non-profit foundations. The New Hungary Microcredit Programme was managed by the Hungarian Enterprise Promotion Private Limited Company (HEP). The HEP performs its duties as a financial enterprise, its main activity is the portfolio guarantee. The financial resources – as it comes from public funds – were not set independently but in cooperation with the National Development Agency and the Ministry of Economy. It provided a significant additional funding for the banks with a result of a false microfinancial practice in Hungary. In the case of the profit orientated sector the maximum amount that may be granted was increased to HUF 50 million (EUR 169,500), while the loan combined with a non-refundable subsidy reached HUF 20 million (EUR 67,800). According to the internationally accepted principles, due to the amounts that can be granted, the security requirement and the range of clients financed, this type of financing in not considered as microfinancing – states in his study Tibor Szekfü, managing director of the Fejér Enterprise Agency (Székesfehérvár, Hungary). The study referred to above shows in the first diagram the result of the programme implementation. With the help of the interest matrix, the author’s aim is to illustrate the contradiction that the use of public funds if mediated by a profit orientated creditor is related to the profit increase; as a result of which not the social goals are fulfilled but the profit of the donor (or the mediator representing it) increases.

Figure 1.

Interest matrix and the fulfilment of the social goals in the Hungarian JEREMIE Programme

4. PROBLEM SOLUTION AND SUMMARY OF EXPERIENCE

I summarized the fundamental characteristics of Hungary’s microfinancial practice from the previous years in the following statements:

- The National Microcredit Fund was centralized,
- The local enterprise agencies are interested in the fulfilment of the public goals, this is well-adapted to the local microcredit programmes,
- The microcrediting activity of the LEAs is regulated and complies with international practice,
- The internal microcrediting regulations of the LEAs provide the use of the JEREMIE resources,
- The appearance of the JEREMIE resources in the case of profit orientated financial enterprises is unjustified, it is not considered as microcrediting,
- According to the social goals and expectations a regulatory framework would also be needed, that would contribute to strengthen the sector opposite the banks,
- I also consider it important to rank the social goals. There is a contradiction among the expectations which may be resolved by defining the priorities and securing the microcreditors’ interest. For example actions against poverty by creating social enterprises, while economic recovery and job creation may be stimulated by permanently financing the microentrepreneurs’ investments,
- The requirements concerning sustainability are high enough, so the profit orientated financial institutions do not focus on the fulfilment of the social goals while providing resources,
- The internal regulation of microcrediting in itself does not resolve the problems mentioned above, because it is not even related to the regulatory system. For the spread of microcrediting, it would be necessary to handle in a complex way the financial, taxation and advocacy processes existing in the social and economic environment.
5. CONCLUSION

The social solidarity and the microfinancial practice aiming to achieve the economic growth were being developed in the last decades. In order for microcredit to be efficient, it is not enough to provide financial facilities; microenterprises need mentoring and the capacity building of microcreditors is also necessary. For that reason, the Hungarian and international regulatory practice presented above is important but not adequate, that only being efficient in case if it does not provide the sources in a fragmented way, with the mediation of a complicated financial network.

It needs to be achieved that microcredits for the underprivileged and vulnerable be provided by non commercial microcrediting institutions. In Hungary this activity is fulfilled efficiently by the LEAs for practically twenty years by also meeting the European Union's microfinancial criteria.

I am of the opinion that the PROGRESS microfinance facility to be used in the 2014-2020 period provides even more possibilities to support the microenterprises, and I hope that every Hungarian LEA will use its benefits in the future.

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HUNGARIAN MICROFINANCE LEGISLATION

PART I.

ABSTRACT

The purpose of this document is to provide a short summary of the legislation currently applicable to the microcrediting sector in Hungary. It also gives a brief outline of how the legislation is put into practice and how it has evolved throughout the times. The document itself does not aim at completeness, i.e. it does not intend to describe the structure and practice of all the organizations defining themselves as ‘microfinance’ institutions without having a significant social impact. It rather concentrates on the determinant institutions and the practice thereof. However, the legislation presented is considered as standard with regard to all the organizations not mentioned herein.

Keywords: entrepreneurship, microcrediting, microcredit institutions, microcredit legislation, Hungary

JEL Code: G21, G32, L26, O16

1. INTRODUCTION

There is no general legal framework regarding the microcrediting sector in Hungary. However, there are special rules in force which regulate the operation of institutions that deal with microcrediting. In order to interpret and understand these rules and regulations it is inevitable to learn about the history of microcrediting in Hungary. For this reason, I shall also write about the evolution of the microcrediting sector in Hungary briefly.

2. HISTORICAL OVERVIEW – THE ESTABLISHMENT OF NON-PROFIT MICROFINANCE ORGANIZATIONS

2.1. Political and democratic transformation in Hungary

After the political changes, the number of micro and small enterprises started to increase rapidly at the beginning of the nineties in Hungary, mainly due to the fact that a lot of people who had been made redundant as a result of the closing down of factories were forced to set up their own enterprises. Since after the change-over from the centrally planned economic model to market economy these enterprises had to form the backbone of the national economy, the Hungarian governments that came into power after the political changes aimed at strengthening this sector. Due to their high number and ability to provide employment, it is indeed an important national economic interest.

The development and efficient operation of the enterprises (and especially their survival) belonging to the sector were significantly hindered by the fact that there were no real entrepreneurial traditions in the country and the people did not have entrepreneurial experience or knowledge. At the same time the lack of capital in the sector posed a serious problem. The countries of the European Community (and later the European Union) provided great help to Hungary in order to tackle the problems. The first entrepreneurship promotion projects were started at this time within the framework of the PHARE programme.
2.2. **PHARE enterprise promotion programme**

In 1989, the group of 24 developed industrial countries decided to support the process of economic and political transformation in the former socialist countries of Central and Eastern Europe for the first time. The PHARE programme was started in 1990 in Poland and Hungary (that is what PHARE stand for: Poland-Hungary Assistance for the Reconstruction of the Economy, in other words Aid-programme for the Economic Transformation of Poland and Hungary) within the scope of this support.

Following the historical changes taking place in the region, the number of the countries receiving the benefits increased gradually. The purpose of the aid-programme was to facilitate the change-over to market economy in the countries of the region, which among others included privatization and the full liberalization of the economy, too. This step provided funds from which the individual governments could finance the transformation managed by themselves.

Recognizing that small and medium-sized enterprises play a determinant role in furthering the economy, the government of the Hungarian Republic worked out an entrepreneurship promotion programme. As an important element of this, the government initiated the establishment of an agency aiming at supporting and motivating the enterprises. Various financial institutions and bodies representing interest joined this initiative, and the 16 founders set up the **Hungarian Foundation for Enterprise Promotion (HFEP)** on 27 March 1990 with a starting capital of HUF 4.24 billion (approximately EURO14 million).

2.3. **Setting up the enterprise promotion network**

Since the objectives of the PHARE programme launched in Hungary and the objectives of HFEP were the same, the HFEP was entrusted with the handling of the aid-programme of 21 million ECU reserved for the development of small and medium-sized enterprises in the 1990 budget of the PHARE programme. PHARE required the setting up of a **Local Enterprise Agencies (LEA)** network, where the previously mentioned target group was supported in the form of professional counselling and business services. Thus, since 1991 one of the main activities of HFEP has been to establish the national network of LEAs (enterprise development foundations on county and on Budapest level). 46

At the beginning, HFEP selected the independent foundations established by various founders by means of tenders, and later it also created such foundations. There are twenty Local Enterprise Agencies altogether (*there is one in each and every county and one in the capital*).

2.4. **Launching the microcrediting schemes in Hungary**

The concept of launching the National Microcredit Scheme was formulated at the beginning of 1992. Within the framework of the PHARE programme the Committee of the European Community wanted to handle the problem developed economies also had to face, i.e. that most of the micro and small enterprises are not credit-worthy in the eye of the profit orientated credit institutions. This is such a market failure where the market mechanism does not operate suitably (*the supply does not satisfy the demand being present permanently*), the solving of which is in the interest of the national economy, and makes the intervention by the government justified and necessary.

**Market failures:** *a situation when government intervention is required in order to maintain undisturbed operation.*

**Incomplete markets** *are a type of market failure, because the quantity of a product demanded by consumers does not equate to the quantity supplied by suppliers.* **Certain capital markets can also behave in this manner.**

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46 At the outset six pilot LEA’s were set up – **in the form of a foundation** – (Enterprise Agency of Jász-Nagykun-Szolnok County /Szolnok/, Enterprise Centre of Tolna County /Szekszárd/, Enterprise Agency of Borsod-Abaúj-Zemplén County /Miskolc/, Enterprise Centre of Somogy County /Kaposvár/, Fejér Enterprise Agency /Székesfehérvár/, PRIMOM Enterprise Agency of Szabolcs-Szatmár-Bereg County /Nyíregyháza/), then the network was expanded to the whole territory of the country.
In reply to these demands, the Committee of the European Community separated EURO 1.15 million from the EURO 21 million subsidy directed to the sector of Small and Medium-sized Enterprises in the 1990-budget of the PHARE programme in order to finance the programme to be launched.

After this, the enterprise agencies operating in the counties and the capital® started to operate the first microfinance programme in Hungary – under the name of Microcredit Scheme (today National Microcredit Programme) – in 1992 under the financial interposition and professional co-ordination of HFEP. At the outset the sources for the programme were provided by PHARE (then the Hungarian government as a co-finance) in the form of earmarked subsidy.


The legislative background of the microcrediting practices to be presented will be grouped according to the following aspects:
- the legal status of the organizations concerned,
- the general legislation regarding the operation of the organizations concerned (resulting from their legal status),
- special legislation having an impact on the crediting practice of the organizations concerned,
- general legislation having an impact on the crediting practice of the organizations concerned,
- internal regulation regarding microcrediting,
- supervision, reporting obligations

3.1. Organizational and operating structure

The following diagram shows the organizations participating in the operation of the Microcredit Scheme, their most important responsibilities as well as their connections:
3.2. Organizations involved in the operation of the programme

The following diagram shows the organizations participating in the operation of the Microcredit Scheme, their most important responsibilities as well as their connections:

**National programme co-ordinator and mediator of the sources – Hungarian Foundation for Enterprise Promotion**

*Legal status:* non-profit foundation

*Responsibilities:*
- liaising with the donors,
- source allocation,
- providing technical assistance for the Local Enterprise Agencies (LEAs),
- professional evaluation of the programme,
- checking programme implementation,
- mediating the sources to the LEAs in the form of earmarked subsidies.

**Local Enterprise Agencies (LEAs)**

*Legal status:* non-profit foundation

*Responsibilities:*
- receiving loan applications,
- assessing and approving of loan applications,
- collecting instalments,
- checking loans, risk management.

**Commercial Banks**

*Legal status:* profit orientated commercial banks operating under the effect of the Act on Financial Institutions and the Activities of Financial Institutions.

When the Microcredit Programme was launched in 1992 the operation of profit orientated financial organizations was regulated by Act No. LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions. The basic function of the Act was to protect depositors and to regulate the operation of profit orientated players of the money market. (*This Act was repealed and replaced by Act No. CXII of 1996 on Credit Institutions and Financial Enterprises.*)

Although the LEAs acting as creditors in the Microcredit Programme
- did not deal with deposit taking,
- received the sources – public money – in the form of earmarked subsidy in order to finance programmes fulfilling specific social goals, and
- performed their activities as non-profit organizations (they did not make any profit),
several experts believed (in my opinion quite wrongly) that commercial banks should be included in the operation of the programme because according to the provisions of the above-mentioned Act ‘only banks may grant loans’ in Hungary. Though this conclusion could not be drawn from the context (and function) of the Act, due to the various opinions and to ensure that the programme did not violate the Act, commercial banks were also included in the programme.

*Responsibilities:*
- keeping the separate programme account of the Local Enterprise Agency,
- concluding the loan agreements with the clients on the basis of the decision of the LEA,
- disbursing the loan from the bank account of the LEA,
- collecting instalments,
- keeping loan accounts (credit records) separately from their own loan portfolio,
- supplying LEAs with data with regard to the loan portfolio.

The LEAs were selected by the Hungarian Foundation for Enterprise Promotion via tenders, and the commercial banks were selected by the LEAs also by means of tenders.
LEAs paid the commercial banks a fee, which could be accounted for to the debit of the fund. The bank did not assume any kind of risk related to the lending.

3.3. General legislation concerning the operation of the foundations


The main general characteristics of the foundations on the basis of the referred rules of law:

- they are non-profit organizations having independent legal personality;
- the objectives of the organization are defined by the founders in the Deed of Foundation and the set objectives may only be modified later on with limitations;
- the assets of the foundation are handled by the Board of Trustees specified by the founders in the Deed of Foundation;
- the rights of the founders are limited:
  - they may only participate in handling the assets of the foundation and the management thereof with limitations (the founders may not represent a majority in the Board of Trustees);
  - any member of the Board of Trustees may only be removed if it can be proved that he/she hinders the operation of the foundation in view of the set objectives;
- the Deed of Foundation may only be modified with the uniform agreement of all the founders;
- the founders or donors may not claim back the donations provided for the achievement of the objectives in any manner,
- the foundations are represented by the President of the Board of Trustees;
- in order to perform operative tasks the foundation may set up a work organization, which is managed by the Managing Director,
- the foundations are registered by the Courts, and the statutory supervision is exercised by the Public Prosecutor's Office.

In 1992 the operation of commercial banks was regulated by Act No. LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions. This Act was repealed and replaced by Act No. CXII of 1996 on Credit Institutions and Financial Enterprises.

3.4. Special legislation relating to the microcrediting activity

When the programme was launched in 1992, there was no general legal framework regarding the microcrediting activity, nor was there any special legislation in force concerning the microcrediting activity of the individual microfinance organizations.

3.5. General regulation

The general rules regarding the accounting and reporting obligations of the organizations participating in the operation of the microcredit programme were provided by Act No. XVIII of 1991 on Accounting. This Act was repealed and replaced by Act No. C of 2000 on Accounting.

3.6. Internal regulation

The internal rules of procedures of the programme are laid down in the Manual of the PHARE Microcredit Programme. The Manual and the terms and conditions of the programme were developed by a British specialist company with the co-operation of Hungarian experts, in view of the national characteristics and legal background.

According to the regulation the funds were operated in a decentralized manner. Each enterprise promotion foundation managed its own fund, which was handled separately from its other funds.
In order to run the programme each foundation set up its own microcredit division, which was managed by a microcredit manager having a degree in economics or law. These microcredit managers learnt how to manage the funds on courses organized by Western European specialists.

The foundations created a sub-office network, which spawned more than 150 contact points all over the country. In these regional and central offices the potential clients were not only able to submit their loan applications but they also received technical assistance. The entire assessment and portfolio management was performed by the microcredit division of the foundations. The loans were assessed by the Microcredit Committees set up at each foundation. Economic specialists, lawyers, entrepreneurs and the managers of the individual foundations participated in the work of these committees as a social undertaking. The loan assessment was always preceded by the examination of the loan application and the business plan and a personal visit paid to the client. Then, on the basis of the recommendation of the microcredit division the Microcredit Committee decided on the disbursement of the loan. The operation of the programme was checked by an international audit company on behalf of the HFEP quarterly.

The bank disbursed the loans (concluded the contracts) from the microcredit fund (deposit) placed at the bank in return for a fee, collected the instalments and the interests, as well as kept the records. However, the microcredit division of the foundations was responsible for monitoring the loan portfolio, conducting follow-up checks and managing legal procedures aiming at the collection of overdue debts.

The payments made by the clients – including the interests as well – had to be ploughed back into the funds. The operation was financed by calling the budget from the funds, the amount of which depended on the number of loans disbursed and the interest received from the clients.

The procedures were conducted quickly and flexibly, and the foundations showed maximum tolerance towards businesses that had payment difficulties.

In the first period the foundations were not allowed to request anything else but the asset purchased from the loan as the security of the loan so that the social goals could be achieved. The auditors of the PHARE programme checked the adherence to this requirement regularly.

At the national co-ordinator, which was the HFEP, all the tasks related to the central co-ordination were performed by a manager and an administrator.

Ágnes Kiss, Director of the ÉLETPÁLYA Foundation, Secretary of the ERENÉT makes Presentation on her foundation at the Workshop on Youth Entrepreneurship held in Frankfurt am Main

Photo © by Antal Szabó
FEW NOTES ABOUT DEBT PROBLEMS
VERSUS FINANCIAL AND ECONOMIC CRISES

ABSTRACT

The paper discusses the potential causes of financial and economic crisis. The basic problem is to identify the most important causes, because different economic schools and economic theories have different opinions on problem. Comparison, analysis and synthesis of different opinions and knowledge allow identifying causes and proposing ways of solution. Analysis of credit boom, debt problem and problems of financial sector will identify ways of prevention and solution financial and economic crisis.

Keywords: Credit boom, debt problem, financial crisis, economic crisis, financial sector

JEL Code: G 15, F-34

1. INTRODUCTION

It is generally known that the current financial and subsequent economic crisis originated in the U.S. and gradually varying intensity spread to other economies. Media during the crisis is notorious, in September 2008, Lehman Brothers went bankrupt, which in turn led to a domino effect of bankruptcies of other U.S. banks. The emergence of the mortgage bubble started companies Freddie Mac and Fannie Mae that caused the crisis in the real estate market in the U.S. Mortgage crisis followed crisis of liquidity across the financial sector, mortgage borrowers from small to large multinational companies, through limiting the availability of credit to the crisis of public finances (Greece, Ireland, Portugal, Italy, and USA). The result of this process is the economic recession spreading global economy is addressed through government rescue packages of varying quality.

More important than the place of origin and course of the crisis, its causes are undoubtedly behind bankruptcies and economic problems of a large number of businesses, volatility of financial markets and the threat of global recession. Opinions on the causes are quite different from the remuneration of managers through an irresponsible policy of banks leading to a preference for short-term profits at the expense of long-term performance, providing high-risk loans to low-net-worth individuals, to inadequate regulation of financial markets and virtualization. A significant group of economists shows the dramatic problem of income inequality and pulling apart the various derivative financial transactions and virtual from the real economy.

Economists and politicians and right-minded liberal argument about lack of responsibility of bankers and financial sector regulation and refuse to show an irresponsible monetary and fiscal policy. In their view, the crisis caused by irresponsible monetary and fiscal policy accompanied by low interest rates, limiting economic freedom through excessive taxation and redistribution, over-budget expenditure and general waste by irresponsible governments. Extreme views even blame the very existence of central banks as an administrative monopoly determining the amount and cost of money, the only possible way they see the reintroduction of the gold standard and strictly restrictive monetary policy.

2. ABOUT THE CAUSES OF CRISES

As a fundamental problem arises for economists identify the root causes of the financial and economic crisis. The basic problem of causality, i.e. causes and consequences, of course, is not new in economic theory and practice has its important place. The earliest economic models understand the financial crisis as a crisis primarily monetary and currency, which arises as a result of faulty economic policies in poor
and badly managed economies. These models considered the cause of crises particularly bad economic policy, threatening monetary stability (excessive money supply) and monetary stability (exchange rate risk). The shift in understanding the causes of the crisis brought to recent economic theories and models that came with the idea that the crisis can cause a variety of financial speculation, and may also spread through various channels of infection and affect a relatively healthy economy. In this wider conceived began to analyze the crisis of the late 20th century, which took place in three regional waves.

Besides the main causes of these crises began to look for and identify the ways in which the crisis spread from one economy to another, i.e. channels of contagion. As the main channels of dissemination of financial crises have shown the financial systems of individual countries, in particular linking the bank - credit markets, foreign exchange and derivative markets. Interesting is the fact that in most cases were identified before the crisis phenomenon of excessive credit expansion, and economists should therefore focus their attention on the banking and credit operations, in particular the ongoing domestic and international financial market. It is the credit channel in the globalized world economy appears to be one of the major causes of debt, banking and financial and then economic crises.

Of course, the loans are vital for the economy as finance real investment activity, but also speculation and public deficits. Poor credit expansion, however, threatens the stability of the banking system and causes problems of the entire financial system. A high proportion of loans in foreign currencies may cause the corporate, banking and public sector through serious problems and currency fluctuations. In traditional economic models of schools and the importance of unhealthy credit expansion and debt problems are often underestimated or completely marginalized. An interesting analysis carried out by G. Kaminski / 1997/, who compared the dozens of predictive study confirms the hypothesis of a significant proportion of the debt problem of the financial crisis. Conversely traditional Austrian School is based on Wicksell's hypothesis that an expansive monetary policy causes a decrease in interest rates and increases the convenience of credit, causing growth to investment and consumption.

In the short term, although it leads to growth of the product, but in the long term to increase the price level. The decline in interest rates during boom means growth of long-term loans used to fund low effective investment projects. In the subsequent period, the price level and interest rates, investment becomes inefficient and a significant proportion of them must be terminated or liquidated, which could lead to recession. L. Mises and F.A. Hayek developed Wicksell views in formulating the monetary theory of business cycles, as a major cause of excessive money supply sees expansionary monetary policy of central banks. L. Mises had to admit the fact that excessive amounts of money may not only cause an expansionary monetary policy of central banks, but also excessive credit expansion of commercial banks.

From the foregoing it can be assumed that excessive credit expansion is not possible to include the most important potential causes of financial crises. In connection with the statement, new ideas, discussion and analysis that excessive credit expansion could be one of the causes of the Asian financial crisis, or even the Great Depression of the 30's 20th century.

3. EXPANSION OF CREDIT POLICY

Excessive credit expansion is one of the possible causes of crises; they are a very dangerous phenomenon for the financial and overall economic stability. For the identification of excessive credit expansion is very important its exact definition. Problem definition of excessive credit expansion lies in the fact that the Anglo-Saxon countries, using two very similar terms "rapid credit growth" and "credit boom" respectively. "Excessive credit growth". "Rapid credit growth" represents the development of the economy where lending is growing faster than GDP growth. This development is characteristic of the boom phase of the economic cycle or transition economies. "Credit boom" respectively. "Excessive credit growth" represents the development of the economy when the growth rate of loans deviated from the trend of more than 1.75 times the standard deviation.

With excessive credit expansion in the economy is usually associated investment and consumer boom. This trend cannot last indefinitely, due to the pressures on the price level and increasing interest rates. Investment projects are becoming less effective or even ineffective, and a significant proportion of them must be stopped or cancelled entirely. Systematic destruction of inefficient investment projects caused by credit expansion becomes a cause of slowing economic growth or even recession. On the other hand there is also an increase in loan defaults and subsequent difficulties in the banking sector, i.e. debt problem arises because the previous investment boom was financed by loans that borrowers are not able to repay. Excessive credit
expansion boom is not just the financial sector and the growth of lending, but inevitably led to increased indebtedness of economic agents. In this context, the question arises to what extent the high rate of economic growth before the crisis period based on the use of excessive credit expansion. There was a reduction in real savings and capital accumulated in the majority of the population, wealth was concentrated in the hands of a small group of people.

4. THE DEBT PROBLEM AND ITS CAUSES

Debt problems in the economy arise where an increasing share of non-performing (classified) loans and leads to their transfer to the creditors so intense that it threatens the stability and liquidity of the bank and then the whole financial sector. The root of the debt problem lies in excessive credit expansion, which allows the loan to acquire businesses with low-grade. The essence of the problem of debt is unsound borrowing entities, i.e. a debt that does not provide sufficient funds to repay loans, including interest.

In the past it was assumed that unhealthy borrowing in the economy can only arise in cases of negligent excessive household consumption, risky financial speculation or to pay back old debts outstanding new loans. Financial and economic crisis, however, show that the abnormal indebtedness may occur even in seemingly effective financing investment projects. The reason is that investors have not compared the profitability of their investment projects, the equilibrium market interest rate, but with artificially reduced interest soot period of credit expansion. Loans are covered by the inefficient investment, which is inadequate for their repayment, which is why the emergence and deepening of the debt problem in the economy.

Debt problems can have two basic expressions, the internal debt problem arises in the context where the loans are domestic financial institutions in local currency, external debt problem arises in a context where the loans provided by foreign financial institutions in foreign currency. If the loans used to finance investments with low returns, worsening the financial situation of the investor and, consequently his creditor. Unsound loans to repay and the resulting interest, investors must often use the proceeds of other effective investment in the worst case reserves or selling assets. In borderline situations, borrowers can even take advantage of new loans to repay Old loans. Restructuring of loans can sometimes be successful, but sometimes only serves to reduce the notional amount of non-performing loans of banks and camouflaged debt problem. Solving the debt problem in this way to move forward, but the financial situation of borrowers and their ability to repay loans and interest on loans is dumb, or it may be arising with time even worse.

Credit channels becomes a holder of financial problems and crisis developments in the financial system pushes the axis afford bad debtors (enterprises, households and governments), illiquid banking sector, fall in the price of securities and financial instruments and the volatility of financial markets. If you have trouble repaying the loans, only a few borrowers, financial institutions can use to cover losses reserves and revenue from other financial transactions, which only causes deterioration in their liquidity. The problem is much more serious situation in the economy, when the formation of unhealthy loans is a systemic disorder (e.g. excessive credit expansion) and a problem with repayment of loans has a lot of businesses, households, or even states. Excessive credit expansion, which, according to L. Mises leads to a decrease in market interest rates and thus to inefficient investment appears to be typical system failure before the crisis from the perspective of the causes of and during financial crises.

Debt problems may also have external causes and interactions in the case where loans from foreign sources and foreign currency. The problem is the influx of foreign capital and the possibilities of its effective utilization, and efficiency of its use is largely determined by internal factors and the volume of foreign capital inflows depends mainly on external factors. The decisive motive for the inflow is not surprising advantage of the investment climate in the country, but decided by the country in terms of exogenous factors. In particular, reducing the real return, but also investments in developed countries in Europe and North America, encourages capital flight abroad. The massive outflow of capital from these countries is reflected in the target countries as an external shock, which is cyclical. The cyclical nature of the temporary nature due to the influx of foreign capital in the target countries and regions, and generates a massive influx of their problems and brain. Cause of excessive credit expansion and debt crisis may be just the wrong monetary policy, bank loans and junk, but it can cause exogenous cause. Especially vulnerable are small open economies, which may decrease Seth interest rates and massive inflow of foreign speculative capital in particular, that cause major economic problems.
5. **Problems in the financial sector itself**

Tidal cycle and the consequent outflow of foreign capital are also bad for the stability of the financial sector. The intensity of impact is not only determined by the volume of capital and its structure (or direct, Portfolio capital), but also the degree of saturation of the financial market. If there is an inflow of foreign capital in the period of lack of liquidity in the financial sector to negative consequences usually there at least until the effective exhaustion of investment opportunities. However, if the financial market saturation occurs in the further increase in supply of cheap credit to excessive credit expansion, i.e. to finance investment projects less effective, while the market in real assets, there may be formation of bubbles (e.g. real estate bubble). The problem lies in the fact that the financial sector to secure and increase the volume of domestic or foreign sources of credit, but the problem is the speed of credit expansion, which rapidly exhausts effective investment opportunities. Consequently decreases the rate of return on investments and income from current assets and financial.

Sector will provide loans to junk dubious investment projects and implement their own high-risk speculative financial transactions. Another problem of the financial sector in developed economies is their sprawl into enormous proportions, with large multinational financial corporation's becoming dominant economic players in national, international and global markets. The scope of the financial sector, the volume of financial transactions carried out by him has an upward trend. Slovak economist at the University of Chicago acting L. Pastor's comments: "The financial sector has dramatically inflated, especially in the U.S. Although the financial sector was initially act as an intermediary in the economy, its share reached almost 25% of total U.S. corporate sector, the profits of financial companies reached a level of even 40% of total corporate profits. In this position owes its financial sector in particular highly debt."

The problem of the financial sector will become the innovation of financial instruments that are divorced from the real economy. Financial innovation is usually caused by lack of transparency and raising awareness of systemic risk in the financial sector. In the area there is a continuing movement of capital away from investment in manufacturing and service companies to invest in various types of financial derivatives and virtual transactions. Virtual global financial economy has great potential for development but also to destroy the real economy. The rapid development of global capital, foreign exchange and derivatives markets, through which they operate virtual financial transactions based on speculation as a phenomenon, what the history of the world economy has experienced. Among the range of financial operations and the extent of real international trade emerged more and more space. The result is a "virtualization" of the world economy and its "detachment from the real economic fundamentals."

In relation to the interaction between crises and financial sector is gaining importance and controversy of his control. Liberal economists who oppose an increase in the financial sector regulation argue that in the period before the crisis were in such force. International rules governing the capital adequacy of banks (Basel II) and ensure economic stability (Stability and Growth Pact). Another argument against tightening regulation is that strong regulation encourages financial institutions to implement the methods and ways to circumvent it, the risk that the financial

6. **CONCLUSION**

Based on the above knowledge and its synthesis can be hypothesized that financial crises are common causes of excessive credit expansion and debt problems. The scope of the debt problem that causes the crisis, it is possible to quantify the volumes of non-performing (classified) loans. Combined impact of excessive credit expansion, debt problems and problems in the financial sector alone can explain the emergence of a systemic financial crisis. The financial crisis may grow into the economic crisis and the overall national economic downturn or even recession, global economy, as shown Another potential means of resolving the crisis are monetary measures in the areas of implementation have been decided many central banks, led by the U.S. Central Bank FED. For neoclassical economists and liberal monetary instruments, i.e. regulate the amount of money in circulation, the best solution. Many economists admit that the dramatic effects of the financial sector liquidity crisis has been averted by the quick response of central banks - that does not mean that the "printing of fiat money" especially in the U.S. and EMU solve the causes of the crisis, on the contrary will only transfer to their future, which may cause even greater problems.

Some neo-liberal economists, based mainly on the Austrian school to come up with proposals to abolish the central bank to return the gold standard. This proposal for resolving the crisis drained the
statement that if the money were all issued covered in gold, avoid the excessive credit expansion, finance inefficient investment, debt problems, if artificial economic growth. Proponents of the Austrian School free and prefer at least a regulated market, without government interference. Utopia of this solution lies in the fact that central banks, governments and EU institutions to give up their economic decision-making and control. In the world there is probably no government, which would completely abandon the possibility of regulation and the impact on an economy of his country and would release his power absolute free market.

If again there is excessive credit expansion will result in a new debt crisis and subsequent financial and economic crisis, regardless of attempts to delay its arrival with new loans, monetary and fiscal stimulus measures. Onset of the crisis is ultimately always a signal to start the healing process. The recession is not just an economic slump, but the period when I happen to uncovering the causes of mistakes and wrong decisions in the economic recession comes a time when credit expansion slows or stops completely, and consequently there is a liquidation of inefficient investment, the restructuring of individual sectors of the economy and declining the risky virtual financial transactions. Financial and then economic crises cannot be avoided, if there is still cause to their cause. The best option is to prevent crises, by limiting credit expansion only slightly, which corresponds to real savings, elimination of the debt problem by the financial sector to lend responsibly and regulation to cap the high-risk virtual financial transactions and financial derivatives.

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WHISPERING by Borinne Boureau
Nature is like tattoo on the skin of people, its indelible and cannot be removed, erased or washed out, its a part of us, a part of our equilibrium, as well as a source of energy and intense emotion. I believe there is a cosmic solidarity between human beings all around the word, with very strong collective memories.

These I Want to explore.
The Workshop on “Innovative Entrepreneurship and Sustainable Development for SMEs” was held in Tbilisi, Georgia, on 12-14 September 2012. It was jointly organized by the Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation (BSEC PERMIS) and the Konrad-Adenauer-Stiftung (Foundation) (KAS) in Turkey.

Welcoming statements were delivered by Ambassador Traian CHEBELEU, Deputy Secretary General of BSEC PERMIS; Dr. Colin DÜRkop, Head of Office of the Konrad-Adenauer-Stiftung (KAS) in Turkey; Dr. Canan ATILGAN, Head of the Regional Program “Political Dialogue South Caucasus” of the Konrad-Adenauer-Stiftung in Tbilisi; H.E. Irakli MATKAVA, First Deputy Minister of Economy and Sustainable Development of Georgia; and Mr. Giorgi PERTAIA, Deputy Director, National Investment Agency of Georgia.

The Workshop was co-chaired by Ms. Eteri MAMUKELASHVILI, Chief Specialist, Economic Analysis and Policy Department, Ministry of Economy and Sustainable Development of Georgia; Mr. Fikret N. ÜÇCAN, President of TOSYÖV (Turkish Foundation for Small and Medium Business); Ambassador T. CHEBELEU; Mr. Samir AHMADOV, Executive Manager of BSEC PERMIS; and Dr. A. SZABO, UNECE ret. Regional Adviser on Entrepreneurship and SMEs, Scientific Director of ERENET.

The Workshop was attended by the representatives of the following BSEC Member States: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Hellenic Republic, Moldova, Romania, Serbia, Turkey and Ukraine.

On the second day of the Workshop, Ms. Lali GOGOBERIDZE, Head of Economic Analysis and Policy Department, Ministry of Economy and Sustainable Development of Georgia, SME Coordinator, Eastern Partnership Platform 2 – Economic Integration and Convergence with EU Policies; Prof. Dr. Hans-Jürgen WEISSBACH, University of Applied Sciences Department of Economy and Law, Institute for Entrepreneurship, Frankfurt am Main; Mr. Dieter IBIELSKI, Presidential Counselor of the Union of Small and Medium Sized Enterprises (UMU); and Dr. A. SZABO addressed the Workshop as lead speakers.

On the third day of the Workshop, presentations were made by Mr. Raphael JOZAN, Advisor to the Minister of Economy and Sustainable Development of Georgia; Mr. George NANOBASHVILI, Team Leader of Economic Development in UNDP Georgia; Mr. Kakha SHAHADZE, Director of Ajara Economic Development Project; Ms. Nino ELIZBARASHVILI, Founder and President of the Georgian Association Women in Business; and Dr. Kakha NADIRADZE, President of Association for Farmers Right Defense.

The following points were made in conclusion:

1. Creativity and innovation are the heart and spirit of the enterprise and thus companies must constantly innovate, even if only gradually. Innovation is considered as an essential characteristic of entrepreneurship which relates to new products, new production methods, new market and/or new form of organization.
2. Innovative enterprises are those which respond to the challenges, accept change, increase the profitability, undertake new actions, develop new products and offer more efficient and user-friendly services.

3. Innovation is not a component of one designated Ministry’s policies, but has to permeate all policies and be endowed with appropriate effective instruments with clear objectives, continuous assessment and benchmarking with competitors.

4. Innovation is market driven and pushed not only by the companies. Innovation management is a prerequisite for innovation. The majority of SMEs encounters difficulties in planning, implementing and marketing innovative products. Innovation should work only by taking people (employees, customers, stakeholders, etc.) into account.

5. SMEs often ignore the true meaning of innovation. Enterprises which do not innovate would quickly stagnate and lose their competitive position without renewing.

6. SMEs must feel the stimulating forces for the innovative environment and sustainable development and have to understand that when something is changing, they have to change too.

7. Reasons that slow down the process of innovation are:
   - fragmented and undeveloped markets;
   - political uncertainty and lack of confidence to build common research subregions in the BSEC countries;
   - costing price of innovations is too high;
   - SMEs have found it expensive to defend their intellectual property rights;
   - poor information levels about products and services;
   - low level of social acceptance for the innovation results and outcomes.

8. A different type of entrepreneurial creativity is required for factor-driven, efficiency-driven and innovation-driven economies.

9. BSEC countries are extremely heterogeneous from factor-driven economies (e.g. Azerbaijan) through efficiency-driven economies (e.g. Romania) and mixed economies (e.g. Russia) up to moderate innovator (e.g. Greece). Different types of entrepreneurs and entrepreneurial creativity are needed in different situations and countries.

10. In some BSEC countries the lack of transparent policy actions create unpredictable changes in legislation (e.g. in Ukraine) and the lack of analysis of the impact of legislation (e.g. in Romania) hamper the development of SMEs.

11. Not enough concern is given to the aspect of entrepreneurial training, particularly “financial literacy”, and to advisory services.

12. While focusing on tax and regulation system, the importance of improving the quality and “smartness” of business ideas has been widely neglected.

13. Agricultural producers are in a weak situation with regard to international chains as their main customers. The generated illiquidity hampers the development of SMEs and supports them to build adequate value chain (e.g. in Serbia).

14. Improvement of tax code (Albania, Georgia) containing incentives for micro and small businesses and simplification of starting business procedures would create a good basis for small and medium business further development.

15. The access to credit and capital is essential for SMEs. In that context, the Turkish SME support and credit model seems to be particularly efficient. It is close to the EU best practice.

16. The Europe 2020 Strategy, especially two cross-cutting flagship initiatives: The Innovation Union and Industrial Policy for the Globalization Era will help to improve and plug the innovation gap for the EU countries, the countries with the EU association agreements as well as with the ones...
within the EU Eastern Partnership Program.

The following recommendations were made:

1. In the time of economic crises measures and researches are needed to help transform ideas into new marketable products and services, creating jobs and growth both in Europe and in the BSEC region.

2. Governments have to introduce a wide range of schemes to support SMEs, including tax reduction for R&D, contribution to research investment and establishment of innovation centers, link SMEs with academic research institutions, universities and industry. A special range of subsidiary programs is needed for start-ups and small innovation companies.

3. There is a need for elimination of bureaucracy and legislation burdens, as well as for formulating new orientation policies towards an innovation friendly environment.

4. BSEC countries have to develop business skills through education, especially for young people. For some countries the project of Training of Trainees in youth SMEs should be developed.

5. Support actions have to be taken through (i) new legislative measures that simplify procedures and boost competitiveness; and (ii) creation of new financial schemes and facilities such as by more effective use of the EU structural funds.

6. An international workshop on leadership and partnership of youth SMEs in South Caucasus should be organized.

7. Cross-border cooperation, linkage, networking of business services institutions and innovation consultation companies should be required.

8. It is suggested to create networks of business incubators and technological parks in the BSEC countries and collect and disseminate best practices in this field.

9. BSEC countries should develop women entrepreneurship development policy within the framework of their national SME policies.

10. Support and control of the quality of the business concepts are needed if entrepreneurs are subsidized.

11. Innovation performance should be improved through:
   (i) smart and new government policies;
   (ii) creation of business and innovation friendly environment; and
   (iii) creation and improvement of access to finance as well as innovation policies.

12. BSEC should continue to promote SMEs in the Black Sea region. In this process the traditional cooperation would be maintained with KAS. The BSEC countries would benefit from the intellectual potential of the ERENET Network which provides also a good platform for cooperation and exchange of experience among academicians, university lecturers, representatives of research institutions and NGOs in the field of entrepreneurship from the BSEC countries.

13. The BSEC countries are encouraged to prepare themselves for the application of the Competitiveness of Enterprises and SMEs (COSME) Program for 2014-2020 of the European Commission.

14. The Turkish Small and Medium Enterprise Development Organization (KOSGEB) expressed its readiness and willingness for sharing of experience on “SMEs Exchange”, “Venture Capital Trust” and “SMEs Credit Models” through organizing workshops and seminars (minimum five applications).
INSTITUTIONAL PROFILE

EIB provides EUR 100 million to support smaller projects in Croatia

The European Investment Bank (EIB) is providing a loan of EUR 100 million to the Croatian Bank for Reconstruction and Development (HBOR - Hrvatska banka za obnovu i razvitak) to finance the projects of small and medium-sized enterprises (SMEs), mid-cap companies and municipalities in Croatia.

The loan contract was signed in Dubrovnik following the meeting of the EIB’s Board of Directors, which took place in Croatia for the first time. The Republic of Croatia has obtained observer status in the EIB’s Board and will become an EIB shareholder when it joins the European Union.

EIB President Werner Hoyer said: “The EIB supports projects in Croatia intended to help the country to meet the EU accession criteria and integrate rapidly into the Union. The loan signed today will improve the access of Croatian SMEs and mid-cap companies to long-term financing provided on favourable terms, foster the implementation of their projects and strengthen their competitiveness”.

The EIB loan will finance the projects of SMEs and medium-sized companies in the areas of industry and services, including tourism, and also support small and medium-scale infrastructure schemes promoted by local authorities, projects in the knowledge and technology-intensive sectors and additional priorities such as energy, environmental protection, health and education. A minimum of 70% of the loan amount will be allocated to SME and mid-cap projects.

Anton Kovačev, president of Croatian Bank for Reconstruction and Development said: “More than 1,200 projects, financed from the funds raised, have led to the creation of thousands of new jobs, and even more significant is the fact that many existing jobs have been maintained, owing to our loans. It is essentially important that the European Investment Bank and the Croatian Bank for Reconstruction and Development continue this successful cooperation, so that we can ensure quality resources to Croatian business owners which are a precondition for the initiation of a new investment cycle.”

This loan represents a continuation of the very successful cooperation between the EIB and HBOR. The EIB has previously provided six credit lines to HBOR exceeding EUR 760 million.

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CALLS – EVENTS – NEWS

A DAY IN QUBA 47

By Rolando | Published: 7 November 2012

Heading north from Baku, the grey, monotonous flatness of the Caspian coast eventually gives way to a more verdant terrain, tree-lined roads, and plenty of apple orchards, apples being Quba’s other claim to fame. Beyond Quba are forested valleys and the snow-capped peaks of the Greater Caucasus. The town itself is low and flat and muddy in winter and decidedly underwhelming. The most ubiquitous sight here looks like this: two old Soviet-era Lada 7’s driven at manic speed swerve dangerously to avoid each other at an intersection. They come to a screeching halt in the middle, blocking what little other traffic there is. Windows are unrolled and an altercation seems about to explode when the two drivers recognize each other as acquaintances, and whatever acerbic language was about to form on their lips melts away into inquiries about the family. Small town life in a nutshell.

Quba was for long an important carpet-weaving centre. The names of various villages nearby – like Shahnazarli, Chichi, Perpedil – identify some of the most characteristic and arresting patterns in the Azeri carpet heritage. Nowadays, however, these exotic labels identify design concepts more than provenance – there is only small-scale weaving in these villages and in Quba itself, while carpets with traditional Quba patterns are woven in greater volumes in Baku and elsewhere in the country.

Aygun unrolls some of World of Carpet’s creations

So why make the three-hour journey from Baku? Perhaps the most important reason was to visit World of Carpets (Xalça Dünyst Assosiasiyast) and to meet its remarkable founder, Fatima Aghamirzayeva, perhaps the first female entrepreneur of post-Soviet Azerbaijan and a dedicated carpet revivalist. Over cups of tea and portions of paxlava (looks and sounds like baklava, but tastes more like a laddoo), Fatima told me her story in broad strokes, with her daughter Aygun translating patiently.

Towards the end of the Soviet era Fatima began her efforts by teaching local women the craft of designing and sewing clothes – a subject on which she has authored three books. In the late 1990s she turned her attention to bringing back traditional carpet weaving techniques that had all but disappeared after the collapse of the Soviet Union. The Soviets had collectivised the carpet-weaving industry and managed it, like everything else, as a state industry intended to churn out carpets in quantity. Carpet-making was not an art form, and little attention was paid to authenticity, traditional forms, or quality. The Soviets also centralised all supply chains for yarns and synthetic dies. When the Soviet Union disintegrated, these state-run factories were dissolved and, importantly, supply chains were broken, such that weavers had nowhere to turn to for the required materials. Even today some of the materials used by

47 The Editor Board of the ERENET PROFILE express its appreciation and thanks for the ARASTAN Studio for allowing publication of the article by Rolando Montecalvo as of http://www.arastan.com/journey/day-quba.
World of Carpets are difficult to come by in Azerbaijan. For certain high grades of wool warp, Fatima must make several trips to Iran every year to supervise special orders she places to Iranian spinning mills.

Fatima’s journey to revive the art of weaving in Quba started with a painstaking study lasting several years, during which she and a few collaborators pieced together what knowledge was still available by collecting anecdotal data, samples, and interviewing village women and former factory weavers about methods and designs. She sought out a few remaining master weavers and engaged them to train a new generation of artisans. She collated a great deal of information learned from her father, a lifelong nature enthusiast, about natural coloring agents such as walnut peel, madder, and pomegranate skin, and about natural fixing agents. With the help of international aid agencies she was also able to enlist the help of foreign textile consultants, whose advice she follows to this day.

After this long period of research, which also included analysis of museum pieces and travel to other
regions in Azerbaijan, Fatima and her newly trained weavers made their first attempts at replicating traditional Quba rug patterns and knot types. Two years of experimentation and development eventually yielded good results, and the workshop has been thriving since. Today the workshop employs weavers in several surrounding villages as well as at the centre in Quba, and unites multiple small producers in an association, founded in 2006, that aims to foster the revival of a traditional carpet craft relying exclusively on natural materials and handcrafted work. The workshop produces mostly custom-ordered pieces. Access to a wider market remains difficult and scaling up the production while abiding by Fatima’s strict principles is also problematic. Hopefully Arastan can help bring their creations to a wider audience.

Old synagogue facade in Krasnaya Sloboda

After leaving World of Carpets the day was still young, so there was still time for a drive around town, a visit to another carpet workshop, a stop at the market (where my driver and guide Eynulla bargained hard for white cheese and some fish), a short excursion into the picturesque woodland beyond Quba, and also and a brief tour across the river to the peculiar town of Krasnaya Sloboda. This is one of those little oddities of history – a Jewish settlement dating from the eighteenth century, when Feteli Khan, the ruler of the Quba khanate, gave a group of Jews permission to set up a community free of persecution across the river from Quba. Despite a dwindling population it has several active synagogues, and several gaudy mansions attest to the fact that relatives either working in Israel or trading in Russia are doing well.

Finally, a quick lule kebab (think of a seekh kebab without any spice, and with mint chutney conspicuously absent), and back to Baku.

Remark:

The Secretariat of ERENET congratulates to its Member Fatima Aghamirzayeva and her daughter Aygun for this excellent and interesting publication. Quba is a pearl of carpet manufacturing in Azerbaijan and we are proud of having such kind of masters as Member of our network.
OBITUARY NOTICE

Besim Ćulahović, Ph.D., was born on July 22, 1943. He graduated from Faculty of Natural Science and Technology in Ljubljana in 1969 and got a MSc degree from the same faculty in 1997. He got a Phd degree from Faculty of Economics and Business Administration in Sarajevo in 1999.

He started his professional career on December 1969 in „Vunarski kombinat“ in Bijelo Polje, where he worked on the position Technologist in fully integrated woolen & worsted yarn & fabrics company for two years. After that, on September 1971 he got his job in Carpet factory Sarajevo, Illidža in Sarajevo where he worked on positions: Chief of technical preparation department, Manager of the tufting mill, Manager of development and investment department and Deputy general manager, until October 1983. On October 1983 he became a Secretary of Association of Textile and Leather-processing Industries in Chamber of Economy of Bosnia and Herzegovina in Sarajevo. He worked there until January 1983. Then he became a Member of managing Board and General secretary of Association of Textile and Leather-processing Industries in Chamber of Economy of Yugoslavia in Chamber of Economy of Yugoslavia in Belgrade, where he worked until May 1992. On July 1992, he became a Special Adviser of President of Chamber of Economy of Slovenia and Chief of Representative Office of Chamber of Economy of Bosna and Herzegovina in Chamber of Economy of Slovenia in Ljubljana, where he worked until April 1993. On April 1993, he started working in Embassy of Bosnia and Herzegovina in Ljubljana as Chargee d’affair a.i., Minister-counsellor and deputy of Ambasador, where he was until September 1996. On September Besim Ćulahović became a Minister of Foreign Affairs in Bosnia and Herzegovina. He worked on that position until February 1997. On February 1997, he became a Economy adviser of chairman of Council of Ministers in Council of Minister of Bosna and Herzegovina. He worked on that position until January 1999. On January 1999, he became a Deputy General Manager and after that a General manager in Foreign Investment Promotion Agency (FIPA) in Sarajevo, where he worked until September 2001. From April 2001 until May 2004, he worked as a President of Steering Board in Holiday Inn Hotel in Sarajevo. Besim Ćulahović became a full professor on Faculty of Economics in Sarajevo on October 1999, where he used to work as Lecturer of Economics of Transition, Environmental Economics, Economics of Globalization, Business Environment, World Economic Development, Trade Analysis; Head of Department for International Projects and co-redactor of Scientific Journal “SEE Journal of Economics and Business”.

His key qualifications referred to: globalization issues; environmental and development policy; industrial, technology and development policy; transition (structural adjustment) of institutions, companies and industrial sectors.

Besim Ćulahović was a member of many professional bodies: International Society for Ecological Economics, Society of Economists of Canton Sarajevo in Sarajevo, The Textile Institute in Manchester and Economics Institute in Manchester, and since 2008, ERENET Network.

Professor Besim Ćulahović had great international experience by working on many international projects such as: TEMPUS projects, EU projects and many others.

Professor Besim was (co)author of great number of university books; essays and articles in various academic journals; papers presented at various economic and business conferences in B&H, former Yugoslavia and abroad; research, investment and organization studies and projects (author, coauthor or consultant).

Professor Ćulahović had won a number of honours. On 28 January 1970, he won a University Presern Prize, Prize for the best graduate dissertation in textiles for 1969. On 28 December 1989, he was awarded with the Presidency of Yugoslavia Decoration on Decoration of labour with golden garland, Prize for the results in development of textile in clothing industries in Bosnia and Herzegovina.

Prof. Besim Ćulahović passed away on 24 February 2012. He is very much missed in his family, at the School of Economics and Business as well as among the Members of ERENET.
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