

DEVELOPING AN RIA SME TEST METHODOLOGY  
FOR GEORGIA, WHILE STRENGTHENING THE CAPACITY  
OF THE GOVERNMENT OF GEORGIA TO UTILIZE SME RIA  
TOOLS IN PRACTICE

# SME TEST METHODOLOGY

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**DISCLAIMER:** Prepared by ISET Policy Institute with the assistance from the United Nations Development Programme (UNDP) and Sweden. The views expressed are those of the authors and do not necessarily reflect those of UNDP and Sweden.

# BACKGROUND

## About this note

This is a working note outlining the initial processes behind the SME Test Methodology. It is a notable deliverable part of *the Developing an RIA SME Test Methodology for Georgia, while strengthening the capacity of the Government of Georgia to utilize SME RIA tools in practice* Project, as funded by the UNDP and led by ISET Policy Institute.

The note itself serves as a “scene-setting” document for the Project Team to brainstorm on the scope of the Methodology and on possible directions for its elaboration.

The first version of the note was developed by Lorenzo Allio, an international consultant on the Project, and updated by the Team following a team meeting on the 23/05 and after several rounds of internal consultations.

## Preliminary remarks

- ✓ The future Methodology will act as the main guide for the Government of Georgia (GoG) to conduct a typical SME Test.
- ✓ The SME Test complements and builds upon Regulatory Impact Assessment (RIA) procedures. Accordingly, the future Methodology will be read and used in conjunction with the notions, concepts, and methodologies approved on 17 January 2020 under Ordinance No. 35, *On the Approval of Regulatory Impact Assessment (RIA) Methodology* (MATSNE, 2020).
- ✓ The objective of the Project is to deliver a manual that is as practical and user-friendly as possible, one which is also readily applicable and accompanied by an “Excel Tool” with certain simple examples and formulas already plugged in for easy reference. Where possible, the numerical examples will be taken from or inspired by previous Georgian RIA exercises.
- ✓ The Methodology will therefore include visuals and direct Q&A-style guidance information.
- ✓ To this end, several international examples of SME Test Guidelines and Manuals have been, and will continue to be, reviewed. This note already reflects a close consideration of such examples.

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1. A significant sample of relevant documents has already been collected within the shared folder.

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# GLOSSARY OF TERMS USED WITHIN THE SME TEST METHODOLOGY<sup>2</sup>

**Administration and enforcement costs**, or Public Service Implementation Costs, are incurred by the Government when administering and enforcing regulatory requirements.

**Administrative burdens** are those costs incurred by firms, consumers, or others in obtaining, reading, and understanding regulations, developing compliance strategies, or meeting mandated reporting requirements, although excluding the substantive compliance costs.

**Appraisal** is the process of defining objectives, examining options, and weighing up the relevant costs, benefits, risks, and uncertainties before a decision is made.

**Business as Usual (BAU)** is the continuation of current arrangements as if an intervention under consideration were not to happen. It is necessary to discern what the consequences of inaction would be (even if unlikely to be acceptable), as it provides a relevant counterfactual to act as a baseline. This serves as a benchmark to compare any alternative interventions.

**Cost-Effectiveness Analysis (CEA)** compares the costs of alternative ways of producing the same or similar outputs.

**Cost-Benefit Analysis (CBA)** is a formal analysis of the impacts of a measure or program, based on welfare economics, designed to assess whether the advantages (benefits) of the measure or program are greater than its disadvantages. A CBA involves monetary estimates of both costs and the effects or benefits of a measure.

**Cost of capital** is the cost of raising funds and is sometimes expressed as an annual percentage rate.

**Counterfactual** – see Business as Usual – refers to an alternative scenario, distinct from what happened or is expected to occur given planned actions or policies, should one or more elements, actions, or policies be different.

**Direct impact** is an effect that can be identified as resulting directly from the implementation, removal, or simplification of a regulation.

**Discounting** is a technique used to compare costs and benefits occurring over different periods of time.

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2. Adapted from the HM Treasury *Green Book*, *Irish RIA Guidelines*, the *OECD Regulatory Policy Outlook 2018*, the UK *Better Regulation Framework Manual March 2015* and the *NICE Glossary* – see References for full details.

**Discount rate** is the annual percentage rate by which the present value of future monetary values should be adjusted over time.

**Economic efficiency** is achieved when nobody can be made better off without another individual being made worse off. Such efficiency enhances social welfare by ensuring resources are allocated and used in the most productive manner possible.

**Evaluation** is the systematic assessment of an intervention's design, implementation, and its outcomes.

**Indirect impacts** are incidental to the main purpose of a regulation, for example those affecting third parties, those resulting from behavioral change, or dynamic effects caused by market changes over time; also known as "second round" impacts. See multiplier effects.

**Information asymmetry** is a difference in the information available to parties involved in a transaction that provides an advantage to one side. This is because it is relevant to determining an efficient contract, a fair price, or for rewarding performance.

**Intervention** refers to a policy, program, or project that is being appraised.

**Market value or price** is the price at which a commodity can be bought or sold, determined through the interaction of buyers and sellers in a market.

**Multi Criteria Analysis (MCA)** is a technique that is sometimes employed to consider trade-offs that cannot be monetized. An MCA evaluates options against a set of criteria and measures the extent to which the objectives have been achieved through these criteria. The extent the options impact the criteria is typically measured through a scoring factor.

**Multiplier effects** measure the extent to which an intervention produces an increase in national income greater than the initial impact, through demand or supply side linkages. They are a specific form of indirect impact.

**Net Present Value (NPV or PV)** is a generic term for the sum of a stream of future values (those already in real prices) that have been discounted to bring them to the current value.

**Net Present Social Value (NPSV)** is the difference between the present value of a stream of social benefits and the present value of a stream of social costs or, equivalently, the present value of a stream of benefits net of costs as they occur over time.

**Nominal terms** refer to the value in the current cash prices of an expenditure at the time it takes place.

**Opportunity cost** is the value of the next best alternative use of an asset or resource.

**Proportionality** is the principle that the greater the importance or significance of a proposal, the more analyses that will be required. The significance of proposals may derive from either their overall economic, social, or environmental importance or their impact on one particular sector.

**Real price** is the nominal price (i.e., the current cash price at the time) deflated by a measure of inflation.

**Real discount rate** is the nominal discount rate (i.e., the interest rate used to discount costs and benefits) deflated by a measure of inflation.

**Real terms** is a reference to the value of expenditure at a specified general price level (calculated by dividing a nominal cash value by a general price index, such as a GDP deflator).

**Regulatory Impact Assessment (RIA or IA)** may refer to both the process of policymakers' thinking through and understanding the consequences of governmental intervention; and the specific tool or document that enables a government to weigh and present the relevant evidence on both positive and negative effects of such interventions.

**Risks** are specific uncertainties that arise in the design, planning, and implementation of an intervention.

**Specific impact tests** are additional analyses required when there are significant specific impacts on, for example, the environment, competitiveness, poverty, equality, or social exclusion.

**Standard Cost Model (SCM)** provides a framework for measuring the administrative burdens of regulation.

**Substantive compliance costs** are the incremental costs of complying with a regulation, other than administrative burdens. They only include the direct cost borne by those on whom the regulation imposes compliance obligations. Examples include implementation costs, direct labor costs, overheads, equipment costs, material costs, and the costs of external services.

**Substitution** is where firms or consumers substitute one activity for another as a result of an intervention. As economic activity changes, it may lead to corresponding productivity changes that are costs or benefits.

**Transition costs and benefits** are transient, or one-off, costs or benefits, which normally relate to the implementation of a measure.

# I. INTRODUCTION

## I.1. Purpose and structure of this Methodology

This Methodology seeks to assist government officials during the implementation of an assessment appraising whether and how Small- and Medium-sized Enterprises (SMEs) are affected by a government initiative (the SME Test). As such, the Methodology contributes to enhancing evidence-based, participatory decision-making in Georgia.

The SME Test consists of three main steps (Distributional analysis; Impacts assessment; and Mitigation appraisal), which must also be accompanied and informed by consultation with the relevant SME stakeholders and by data collection.

This document provides various types of guidance:

- ✓ Section II. illustrates the methodological sequence of an SME Test.
- ✓ Section III. consolidates the main questions underpinning the analysis in each step of the Test.
- ✓ Section IV. expands on the notions and tools required to carry out the analyses.
- ✓ A series of Annexes provide additional information and insights.

## I.2. Why SMEs require particular consideration

SMEs play a vital role in the European economy in terms of employment, turnover, and dynamism. In OECD countries, over 99% of companies are SMEs and they generate about two-thirds of GDP. In developing countries and countries in transition, SMEs also represent more than 90% of all companies, however their GDP contribution is notably lower – sometimes less than 20% (MoESD, 2021). Nevertheless, in each case, SME health is key to an economy's long-term sustainability and viability; consequently, SMEs are considered a principal contributor to many of the UN's Sustainable Development Goals (SDG)<sup>3</sup>.

This interdependency has been highlighted in a recent publication by the UN's Department of Economic and Social Affairs (UN-DESA, 2020). Interestingly, large companies themselves seem to benefit from a strong SME sector. In essence, small- and medium-sized enterprises provide crucial industrial linkages that can instigate a chain reaction of broad-based industrial developments. Without SMEs, as subcontractors and suppliers of intermediate inputs to multinational enterprises (MNEs) and domestic large-scale enterprises (LSEs), industrial growth in developing countries may not be able to sustain increased domestic value, employment, productivity, or industrial linkages. SMEs are moreover considered to be an essential source of local employment opportunities, with the ability to control the present economic turmoil. As such, SMEs have a critical function in the development of a country's economy (Foghani et al., 2017).

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3. Available from: <https://sdgs.un.org/goals>



As shown in Table 1, most businesses are small companies, as is the case in Georgia.

**Table 1. Distribution of active Georgian enterprises, by size (1 October 2023)**

	<b>Total</b>	<b>Large</b>	<b>Medium</b>	<b>Small</b>	<b>Unknown size</b>
<b>Enterprises</b>	248,170	720	3,162	205,256	39,032
<b>Share</b>		0.3%	1.3%	82.7%	15.7%

Source: Geostat

In Georgia, SMEs are a significant part of the economy, accounting for 59% of employment and 54% of output in the business sector in 2022.<sup>4</sup> The Georgian Government has therefore recognized the importance of SMEs to the economy; in particular because the country lacks the large and truly propulsive firms that drive further output, for example, General Motors, Walmart, Apple, etc. within the US economy. Accordingly, the Government’s *SME Development Strategy of Georgia 2021-2025* (MoESD, 2021) recognized the respective contribution as well as the problems within the local SME community.

**Box 1.** provides the operational definitions of SMEs in Georgia:

**Box 1. Small- and Medium-sized Enterprises: A definition**

Since 2017, the size of enterprises has been determined by the following methodology:

**Large enterprises** have an average annual number of employees that exceeds 249 persons or an average annual turnover volume of 60+ million GEL.

**Medium size enterprises** are all organizational-legal form enterprises, where the average annual number of employees ranges from 50 to 250 persons or there is an average annual turnover between 12 and 60 million GEL.

**Small size enterprises** are all organizational-legal form enterprises, where the average annual number of employees does not exceed 50 persons or there is an average annual turnover of under 12 million GEL.

Source: Geostat ([https://www.geostat.ge/media/32250/BS\\_Methodology\\_ENG.pdf](https://www.geostat.ge/media/32250/BS_Methodology_ENG.pdf), retrieved 25 May 2023)

Small and medium enterprises are not only the most numerous economic entities, but they are also a vital factor contributing to the health and diversity of the economy. Accordingly, the SME Test should place emphasis on two critical dimensions. On the one hand, new entrants and young businesses enhance competition by challenging incumbent companies, while also being an important source of innovation and bringing new ways of doing business. The vitality

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4. National Statistics Office of Georgia, Business Statistics.

of the small business sector is therefore critical to the Government's objective of raising the productivity growth rate in Georgia, as identified in the *SME Development Strategy of Georgia* (MoESD, 2021).

From an economic efficiency and entrepreneurship perspective, the SME Test should therefore focus particularly on the impact of a regulatory proposal on those SMEs most likely to make a difference in terms of competitiveness or in other key policy goals, like Georgia's green transition.

On the other hand, it is important to note that, given the number of people they employ, SMEs play an important role in terms of social stability, and those proposals affecting wide segments of the labor force (hence reaching Georgian households) may impact equality and welfare conditions. Thus, this dimension should also be kept under consideration during an SME Test.

Besides its strategic importance, the main economic rationale behind the need to carry out an SME Test is the assumption that these enterprises tend to be *disproportionately affected* by regulations. Certain costs resulting from compliance with regulations are fixed, i.e., they do not depend on the size or the output of a business. Since larger businesses operate on a greater scale, such fixed costs are likely to be a smaller proportion of their overall costs. An identical increase in fixed costs in absolute terms would resultingly translate into larger relative costs for SMEs. In addition, SMEs are usually "price-takers" on the market,<sup>5</sup> and it becomes challenging for them to pass on such costs to downstream users or consumers. In such instances, SMEs are therefore more likely to experience a decline in their profit margins.

Resultingly, it is important to consider the interests of SMEs and the conditions under which they operate as early as possible in the policy formulation process.

The SME Test thus seeks to help design proposals in a manner that meets your specific objectives, without unduly limiting or damaging opportunities for small businesses.

At the EU level, the "Think Small First" principle, introduced by the European Commission in 2008, underpins measures launched in the framework of the EU Small Business Act, a key instrument to implement the previously entitled Lisbon Strategy for Growth and Jobs.<sup>6</sup> According to this principle, policy makers give full consideration to SMEs at the early policy development stage. Ideally, rules impacting business should be created from an SMEs perspective or, in other words, SMEs should be considered by public authorities as their "prime customers" as far as business regulation is concerned. The principle relies on the fact that "one size does not fit all", while a lighter approach can also be beneficial to larger businesses. Conversely, the rules and procedures designed for large companies create disproportionate, if not unbearable, burdens for SMEs as they lack the economies of scale.

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5. A price-taker company must accept the prevailing prices of its products on the market, as it lacks the market power to influence prices on its own. Effectively, the company's own transactions are unable to affect the market price.

6. On the Think Small First Principle, see: <https://ec.europa.eu/docsroom/documents/10038/attachments/1/translations/en/renditions/native>

## I.3. The SME context in Georgia

### I.3.1. Brief economic overview

SMEs comprise the majority of the business sector in Georgia – as of 1 October 2023, the number of registered, active SMEs amounted to 248,170, which represents 99.7% of the total business sector. Most SMEs are concentrated in wholesale and retail trade activities (42.7%), followed by transportation and storage (9.0%), manufacturing (8.8%), construction (7.8%), and accommodation and food services (4.7%).<sup>7</sup>

Between 2015 and 2021, SMEs demonstrated a consistent upward trajectory in their generated output and added value, with the exception of 2020, when the COVID-19 pandemic caused a decline of 0.5% in output and a 2.0% decrease in value added. Over this period, the average annual growth rate for output reached 9.8%, while the average annual growth rate for value added stood at 9.4%. In contrast, the same indicator for the total business sector from 2015-2021 comprised 11.5% for output and 11.2% for value added. In 2021, SMEs generated an output and a value added of 30,625 million and 14,691 million GEL, respectively. By 2022, there was a further increase in output, reaching 37,116 million GEL (calculated as the sum of the four quarters).<sup>8</sup>

The number of individuals in hired employment within SMEs presented a continuous increase between 2015 and 2021; with the exception of 2020, which experienced a significant decline of -9.7% in employment due to the impact of the pandemic. Significantly, the 2020 decline was higher for men (-10.0%) than for women (-9.2%). It is also noteworthy that, despite a post-pandemic recovery, the number of employees in the SME sector remained below the pre-pandemic levels in 2021. The average annual employment growth rate from 2015 to 2021 stood at 0.8% (this indicator reached 1.0% for women and 0.6% for men). By 2021, SME employment encompassed 403,909 individuals. Out of this total, small-sized enterprises employed 257,068 people (63.6%). By gender, SMEs employed 58% men and 42% women in 2021, with gender distribution being similar in both medium- and small-sized enterprises. In 2022, the employment levels decreased and settled at 370,820 (averaged across four quarters), with small businesses still accounting for the majority of total employment at 59.5%.<sup>9</sup>

As SMEs constitute the predominant portion of companies in the business sector, their impact on the overall sectoral output, value added, and employment is significant. In both 2021 and 2022,<sup>10</sup> SMEs employed 59% of the total workforce within the business sector; although it is noteworthy that this proportion has gradually been decreasing since 2015. Regarding the SME contribution to output, it exhibited a relatively stable trend, fluctuating within the range of 58% to 60% from 2015 to 2020. However, in 2021, this contribution declined to 53%, and it showed only a moderate improvement to 54% in 2022.<sup>11</sup> In terms of value added, SMEs accounted for a

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7. National Statistics Office of Georgia, Business Register.

8. National Statistics Office of Georgia, Business Statistics.

9. National Statistics Office of Georgia, Business Statistics.

10. The share of SME employment in total business sector employment is calculated using the four quarter average employment values.

11. The share of SME output in the business sector's output is calculated using the sum of the four quarter's output values.

share ranging from 53% to 61% of the total business sector's value added throughout 2015-2021, with the lowest contribution (53%) recorded in 2021.<sup>12</sup>

In summation, the Georgian business sector is primarily represented by small- and medium-sized enterprises at present, those which contribute to a substantial portion of output, value added, and employment. Considering their role in the economy, the competitiveness and vitality of SMEs are crucial aspects of Georgian economic growth as a whole.

The development of small and medium enterprises in Georgia is currently supported by several SME associations. Two of the largest of which are the Small and Medium Enterprises Development Association (SMEDA), a Georgia-based non-profit organization with a mission to support SMEs through advocacy, innovative solutions, consulting, and training, and the country's first digital association; and the Georgian Small & Medium Enterprises Association (GSMEA), which is a non-political, non-profit organization, with a mission to improve the business environment, enhance competitiveness, and promote productivity in the private sector. These associations are involved in the protection of SMEs' interests, in fostering healthy competition, and in facilitating communications with public agencies, financial institutions, and international organizations. Furthermore, the following business associations are also involved in SME development: the European Union – Georgia Business Council (EUGBC), the Business Association of Georgia (BAG), the Georgian Tourism Association (GTA), and the European Business Association (EBA), amongst others. In terms of SME development, two key public agencies should also be mentioned: Enterprise Georgia (EG) and Georgia's Innovation & Technology Agency (GITA). Specifically, EG plays a pivotal role in supporting SMEs through multiple support programs, whereas GITA focuses on innovation and technological development while supporting startups.

### 1.3.2. General requirements and organization

The *SME Development Strategy of Georgia 2021-2025*, developed by the Ministry of Economy and Sustainable Development of Georgia (MoESD), is a testament to the nation's dedication to fostering SME growth (MoESD, 2021). The strategy is organized around seven strategic directions, each addressing a crucial aspect of SME development. These include refining legislation; institutional consolidation; improving the operational environment for SMEs; promoting entrepreneurial skills; enhancing access to finance; facilitating export growth and internationalization; fostering innovation and research; promoting women's entrepreneurship; and supporting the development of a green economy. The strategy document furthermore calls for the explicit introduction of the SME Test in RIAs and for an expansion of the scope of RIA applications (Priority 1 – Objective 1.1). The Economic Policy Department of the MoESD regularly monitors the implementation of the action plan, thereby ensuring accountability and transparency.

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12. National Statistics Office of Georgia, Business Statistics.

The Georgian Government recognizes the importance of aligning its legal framework with international standards to foster SME growth. In 2021, the adoption of the new Law on Entrepreneurs,<sup>13</sup> which came into force in 2022, marked a significant milestone. The Law aims to harmonize corporate regulations with EU legislation, thus strengthening the country's attractiveness to foreign investors. Additionally, the Law on Mediation<sup>14</sup> and the Law on Rehabilitation and the Collective Satisfaction of Creditors' Claims<sup>15</sup> each reflect Georgia's commitment to alternative dispute resolution and enterprise rehabilitation during insolvency.

Furthermore, approval of Ordinance No. 35 in January 2020 introduced the requirement for the systematic application of Regulatory Impact Assessments. RIAs are now mandatory for legal amendments initiated by the Government concerning 20 key laws, and this Methodology further envisages the assessment of impacts on SMEs.

According to the Ordinance (Article 9), in those instances, an RIA report must be prepared in its standard form and consist of the following five parts:

- ✓ Part 1 of the RIA report shall provide general information on the initiative and responsible ministries or other responsible agencies.
- ✓ Part 2 of the report shall outline the analytical stages of RIA set out in Article 13 of the Ordinance, including:
  - Identification of problems or issues.
  - Identification of the baseline scenario.
  - Setting intervention goals.
  - Elaboration of options (including the option of no intervention).
  - Analysis of the impacts (prediction of the possible development of circumstances).
  - Comparison and assessment of the options.
  - Preparation of the monitoring and implementation plans.
- ✓ Part 3 of the report shall contain information on the results of completed procedural stages and on public consultations (discussed in Article 25 of the Ordinance).
- ✓ Part 4 of the report shall contain the signature of a competent person at the agency initiating the respective draft law.
- ✓ Part 5 of the report should include annexes.

Finally, an RIA report ought to contain clear references to the evidence gathered and the sources employed during the drafting process.

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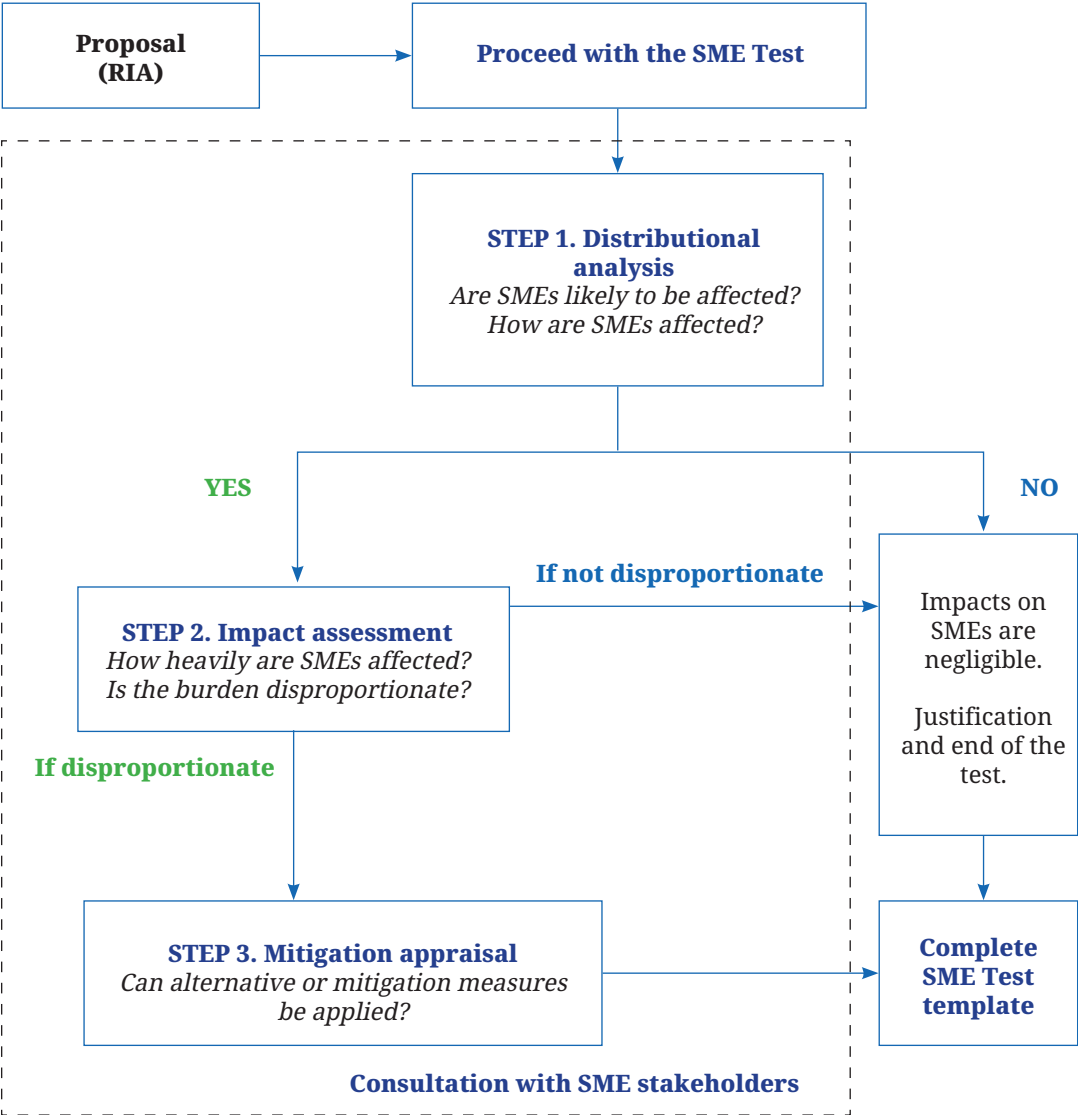
13. Law of Georgia on Entrepreneurs: <https://matsne.gov.ge/en/document/download/5230186/2/en/pdf>

14. Law of Georgia on Mediation: <https://matsne.gov.ge/en/document/download/4646868/0/en/pdf>

15. Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims: <https://www.matsne.gov.ge/en/document/download/4993950/0/en/pdf>

# II. SME TEST – WORKFLOW

The “logic” of an SME Test could, for instance, appear as follows:



# III. SME TEST – CHECKLIST

The following are the key questions required for the execution of an SME Test:

## STEP 1. Distributional analysis

- ✓ *Is the proposed legislative change targeting SMEs?*
- ✓ *Is the proposed legislative change affecting one or more economic sectors including at least 2% of Georgian small enterprises or 5% of medium enterprises?*
- ✓ *Are there expected negative impacts of any form on SMEs?*
- ✓ *What economic sectors or sub-sectors fall into the scope of the proposal?*
- ✓ *Are SMEs up or down the supply chain affected?*
- ✓ *How many are there, and what is the proportion of medium-, small-, and micro-enterprises, respectively?*
- ✓ *What is the proportion of each SME subcategory in terms of employment, annual turnover, market share, value added (or other relevant metrics)?*
- ✓ *Are female entrepreneurs more or less likely to be negatively affected?*

## STEP 2. Assessment of impacts on SMEs

- ✓ *What are the likely impacts on administrative costs and direct compliance costs (not only in absolute terms, but relative to the size of the business and other suitable indicators: e.g., historical operative income, historical administrative costs, etc.)?*
- ✓ *What are the likely indirect impacts on aspects like employment, output, productivity, R&D, and investment?*
- ✓ *What are the likely impacts on exports and imports; the inflow of foreign investment; the market share; and barriers to entry?*
- ✓ *Are the impacts expected to differ depending on the gender of the entrepreneur?*

## STEP 3. Mitigation appraisal (if possible and relevant disaggregated by gender, based on the findings of STEP 1 and STEP 2)

- ✓ *Can alternative or mitigating measures for SMEs be introduced? Considerations should be given to:*
  - Partial or complete exemption
  - Common commencement dates
  - Longer transition periods
  - Access to targeted assistance
  - Tailored requirements
  - Risk-based enforcement
  - Tiered penalties for non-compliance
  - Voluntary solutions
  - Financial aid

- ✓ *Are such measures desirable and proportionate? Considerations should be given to:*
  - The “policy cost” of mitigation and exemption
  - The benefits from mitigation and exemption

## Consultations with SME stakeholders and with the public

- ✓ *What is the goal of conducting consultations? Consideration should be given to:*
  - Objectives to be achieved through consultation (e.g., data requests or hypothesis validation)
- ✓ *Who is impacted by the proposal? Consideration should be given to:*
  - Primary and to indirect stakeholders
  - Groups that run the risk of being excluded from consultations (“leave no-one behind”)
- ✓ *What is the appropriate format for a consultation within this proposal? Consideration should be given to:*
  - Complexity and impact of the proposal
  - Stakeholders identified for participation in the consultations
  - Resources and time for the disposal of the consultations
- ✓ *How to efficiently implement the chosen consultation format? Considerations should be given to:*
  - The target audience
  - The best methods to reach out to the target audience
  - The most suitable communication tools
- ✓ *How to best process and present the results of a consultation? Considerations should be given to:*
  - The consultation period
  - The list of stakeholders involved and those who did not mobilize
  - The influence and representativeness of the stakeholders
  - Comments and suggestions received
  - Feedback on the comments and suggestions given to stakeholders



## IV. SME TEST – STEPS

A typical SME Test consists of the following three steps:

- ✓ Distributional analysis.
- ✓ Measurement of the impacts on SMEs.
- ✓ Assessment of alternative mechanisms and mitigating measures (mitigation appraisal).

Each of the steps within an SME Test must be informed by meaningful consultations with SME stakeholders and with data collection.

### IV.1. Distributional analysis

The objective of this step is to conduct a distributional analysis – i.e., identify whether firms of different sizes (large, medium, small, and micro businesses) are likely to be affected by the proposal. To consider *whether and which SMEs are affected* by the proposal, one can retrieve information from various statistical sources,<sup>16</sup> disaggregated per economic sector if possible. In practice, you will likely have to approximate and extrapolate. Consequently, you should present your assumptions and any data limitations transparently. You can refine your analysis during a later stage of the Test (e.g., further consultation rounds).

It is important to take a dynamic perspective, for instance, to understand how the economic sector (the industry) is structured, and which businesses are present along the value chain. By relying on the intervention logic model, it will help target your analysis.

Guiding questions:

- ✓ *What economic sectors and sub-sectors fall into the scope of the proposal?*
- ✓ *Are SMEs up or down the supply chain affected?*
- ✓ *How many are there, and what is the proportion of medium-, small-, and micro-enterprises, respectively?*
- ✓ *What is the proportion of each SME category in terms of employment, annual turnover, market share, or under other relevant metrics?*

The following factors may further diversify the impacts on SMEs:

- ✓ Whether there is a geographical differentiation for the industry (e.g., rural areas, coastal regions, etc.).
- ✓ Whether companies are primarily active in the import or export sectors.
- ✓ Whether companies operate on special business models (e.g., sub-contracting, part-time, home-based, self-employed, unionized contracts, etc.).

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16. A number of institutions can be consulted in order to retrieve the necessary statistical information, including the National Statistics Office of Georgia (Geostat): <https://www.geostat.ge/en>; and the National Bank of Georgia: <https://nbg.gov.ge/en> and <https://nbg.gov.ge/en/statistics/national-data>.

## IV.2. Assessment of impacts on SMEs

### IV.2.1. Nature of the impacts

If SMEs are affected, it is important to ascertain *how the proposal is impacting* their activities. Your proposal may generate various types of impacts (costs as well as benefits) – see Box 2. below.

The SME Test should first and foremost ensure that small businesses are not disproportionately affected by administrative or direct compliance costs. It should, moreover, investigate indirect impacts on SMEs. Notably, producing firms are the consumers of intermediate goods and the services produced by other firms (such as raw materials, components, or business services). The linkages between firms (so-called value chains) grow in importance as firms increasingly outsource elements of their production to subcontractors, often abroad.

#### Box 2. Classification of costs and benefits<sup>17</sup>

**Costs are linked to the diversion of resources due to regulatory requirements.** *Direct compliance costs* are an important category of costs, as they are directly incurred by businesses and other parties when undertaking the actions necessary to implement and to comply with new regulatory requirements.

Compliance costs are often calculated as the aggregate of all direct costs generated by legislation. It is often useful to analyze (and estimate) compliance costs on the basis of their individual components, namely:

- ✓ *Charges* (fees, levies, or taxes imposed by the proposal on certain stakeholders).
- ✓ *Administrative costs* (the costs of complying with obligations stemming from the proposal).
- ✓ *Substantive compliance costs* (incremental costs, other than charges and administrative costs, such as: implementation costs, direct labor costs, overheads, equipment costs, material costs, cost of external services, etc.).

*Indirect costs* are second-order negative impacts that are borne either by those addressed by the regulation as a result of their compliance, or by other entities on the market and in society that are affected but are not however the primary addressees of the regulatory requirement. Indirect costs are usually transmitted through changes in the prices of the goods or services produced in the regulated sector. Changes in these prices then ripple through the rest of the economy, causing prices in other sectors to rise or fall, and ultimately affecting the income of consumers.

**Benefits** do not have as clear a classification as costs. They can, however, be direct or indirect in nature, meaning that they can affect the same stakeholders targeted by the initiative or go beyond the target group and even become diffuse societal benefits. Specifically:

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17. This guidance largely draws from the European Commission's Better Regulation Toolbox, Tool #59 on Methods to assess costs and benefits. Available from: [https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox\\_en](https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox_en). A further relevant source is the OECD Regulatory Compliance Cost Assessment Guidance. Available from: [https://read.oecd-ilibrary.org/governance/oecd-regulatory-compliance-cost-assessment-guidance\\_9789264209657-en](https://read.oecd-ilibrary.org/governance/oecd-regulatory-compliance-cost-assessment-guidance_9789264209657-en).

- ✓ *Direct benefits* can be expressed in terms of improved market efficiency, or the additional utility, welfare, or satisfaction of citizens.
- ✓ *Indirect benefits* include spill-over effects related to third-party compliance with legal rules (with so called “indirect compliance benefits”); wider macroeconomic benefits, including GDP improvements; productivity enhancements; greater employment rates; and other non-monetizable benefits, such as the protection of fundamental rights, international and national stability, etc.

For further details, Annex A.2. expands on the characterization of impacts for SMEs.

#### IV.2.2. Measurement of impacts on SMEs

The objective of this step is to measure the impact of a proposal on SMEs. The impacts should be analyzed in quantitative (and monetized) terms to the greatest extent possible, using studies, analyses, reports, and other available statistical data, that which is validated and supported by consultations with the relevant stakeholders.

##### IV.2.2.1. Assessing direct compliance costs

**Compliance costs can be estimated along their individual components: charges, administrative costs, and substantive compliance costs.**<sup>18</sup> Some core examples of the methods employed to measure such costs are:

- ✓ *Measuring charges* – Charges may be measured by estimating the population of stakeholders (SMEs) that will have to pay the proposed charges, the frequency of payment, and the unit cost (cost of the charge, fee); and then multiplying the three parameters.

*For example, if you expect 1,000 enterprises will have to pay a license fee of 80 GEL twice a year, your total will be  $(1,000 \times 80 \times 2) = 160,000$  GEL annually.*

- ✓ *Measuring administrative costs* – Administrative costs may be estimated using a Standard Cost Model (SCM). Recurring administrative costs and, where significant, one-off administrative costs each have to be taken into account. The SCM equation assesses the administrative cost using the following parameters:
  - Time required per action
  - Labor cost per hour
  - Frequency of required actions
  - The number of entities concerned

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18. To review the requirements set by the Government of Georgia, as well as the approved methodology, see Ordinance number 35 of the Government of Georgia, On the Approval of Regulatory Impact Assessment Methodology (MATSNE, 2020). Available from: <https://matsne.gov.ge/en/document/download/4776100/0/en/pdf>.

The multiplication of these parameters offers the assessment of administrative costs for the obligations in a proposed legislation.<sup>19</sup>

- ✓ *Measuring substantive compliance costs* – Different methodological approaches can be utilized to estimate various types of compliance costs (e.g., costs for wage labor, non-wage labor, overheads, equipment, materials, or cost for external services). Each of these approaches have a common underlying assumption: that compliance can be represented as a set of activities to be carried out. In reality, this is not always the case, especially when policy proposals are complex, and compliance can be achieved in different ways.<sup>20</sup>

#### IV.2.2.2. Assessing indirect costs

Indirect costs may factor in both SMEs directly affected by the proposal as well as other stakeholders. They can be monetized, but their assessment is more complex and time-consuming. You should proceed to such an assessment only if appropriate and seek expert advice from economists, while also relying on stakeholders' insights.

Indirect costs may take several forms and may impact productivity levels; research and development (R&D) and innovation; and trade. Each of these categories may have significant impacts on the competitiveness of an SME. As previously mentioned, these considerations are particularly relevant when those SMEs that are the most dynamic, likely to grow, and deliver on economic growth are primarily affected. Regulatory proposals might change the distribution of R&D or operating costs throughout the development and production cycles of these firms, and therefore make investments no longer attractive or profitable. As a result, opportunities for innovation and market access would be reduced.

Identifying and assessing these types of dynamics requires a fairly comprehensive understanding of the investment economics and the business models of these innovative firms. It is therefore recommended to engage in rounds of structured consultations (e.g., through focus groups or direct interviews). International guidance offers further elements to consider when investigating indirect costs for competitiveness, innovation, and trade.<sup>21</sup>

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19. For a short discussion and examples based on Georgian experience see the RIA Manual for Practitioners (USAID, 2021) pp. 93-94 and 98-105. Available from: <https://iset-pi.ge/storage/media/other/2021-07-13/64dd0710-e3de-11eb-9a86-cf56b5fdf018.pdf>. For greater detail: <https://www.oecd.org/regreform/regulatorypolicy/34227698.pdf> or <https://ec.europa.eu/eurostat/documents/64157/4374310/11-STANDARD-COST-MODEL-DK-SE-NO-BE-UK-NL-2004-EN-1.pdf/e703a6d8-42b8-48c8-bdd9-572ab4484dd3>.

20. For a short discussion and examples based on Georgian experience see the RIA Manual for Practitioners (USAID, 2021) pp. 93-94 and 98-105. Available from: <https://iset-pi.ge/storage/media/other/2021-07-13/64dd0710-e3de-11eb-9a86-cf56b5fdf018.pdf>. For a detailed discussion of the methods to quantify (direct) compliance costs see, for instance: OECD Regulatory Compliance Cost Assessment Guidance (2014). Available from: [https://www.oecd-ilibrary.org/oecd-regulatory-compliance-cost-assessment-guidance\\_5jz78m5mpm0t.pdf?itemId=%2Fcontent%2Fpublication%2F9789264209657-en&mimeType=pdf](https://www.oecd-ilibrary.org/oecd-regulatory-compliance-cost-assessment-guidance_5jz78m5mpm0t.pdf?itemId=%2Fcontent%2Fpublication%2F9789264209657-en&mimeType=pdf).

21. Tool #21 on Sectoral Competitiveness, Tool #22 on Research & Innovation, and Tool #27 on External Trade and Investment from the European Commission Better Regulation Toolbox provides insights and links to further guidance on how to quantify these impacts. Available from: [https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox\\_en](https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox_en)

### IV.2.3. Determining disproportionate costs

Many compliance costs are largely fixed in nature, as they either do not increase with the level of business output or any increase is proportionately less than the increase in output. This implies that compliance costs tend to be, relatively, higher for small businesses (*measured as a proportion of input costs or per unit of output*).

A comparison should consequently be made between the various types of business – primarily, SMEs vs. larger businesses, but also micro-businesses vs. medium-sized enterprises. One feasible and simple method to ascertain disproportionality is to divide the overall costs that you calculated by the number of staff employed to obtain the average cost per employee (see Box 3. below for an example).

Extrapolations and generalizations across industry structures may however be highly misleading. You are thus strongly advised to enquire directly with the representatives of those businesses identified as particularly affected by your proposal.

#### Box 3. How to determine disproportionate costs

Understanding and familiarization with the requirements of a new legislative measure can be, as mentioned, proportionally more burdensome for SMEs than for larger businesses, which might, for example, employ a dedicated regulation manager. It may be necessary for SMEs to spend more time and resources to implement the requirements of a regulation, as it may include training staff, changing IT systems, or developing new processes.

- ✓ **Dividing the overall calculated costs of a regulation by the number of staff employed** is one method of determining disproportionality, using the cost per employee value. For example, if a regulation costs 150,000 GEL for each business to implement, the cost per employee for a firm with 100 employees equates to 1,500 GEL; while for a firm with just five employees this reaches 30,000 GEL.
- ✓ Identified costs of a regulation can also be **compared to the total overhead or turnover** of a business to see if they disproportionately affect SMEs. Reverting to the example above: for a small company with a turnover of 1 mln. GEL, a cost of 150,000 GEL would represent 15% of the company's turnover, while for a large company with a turnover of 60 mln. GEL, it would represent barely 0.25% of their turnover.
- ✓ The **nature of the requirements** imposed by a regulation also has to be taken into account. For example, in larger enterprises investments into digitalization (IT software and equipment), as a result of imposed requirements and the rationalization of regulatory obligations, will often be advantageous because of the large number of administrative cases these enterprises manage. For SMEs, on the other hand, such an investment may not be worthwhile as they deal with smaller numbers and less frequent cases.

### IV.3. Assessment of alternative mechanisms and mitigating measures

The objective of this step is to assess the existence and suitability of alternative, flexible ways in which small businesses can more readily meet regulatory objectives, given their particular characteristics.

#### IV.3.1. Considering possible measures

The following are possible measures worth consideration:

- ✓ *Partial or complete regulatory exemption* – Although decisions must be taken on a case-by-case basis, in principle this should be the default option when addressing impacts on micro-enterprises and businesses with fewer than 10 employees. Exemptions should not be granted if there is a high “policy cost” or there are chances of significant unintended consequences (see 3.2. below).
- ✓ *Common commencement dates* – By limiting the number of dates on which new regulatory provisions may enter into force (typically twice a year), this helps raise SMEs’ awareness of forthcoming legal requirements and, accordingly, allows them to anticipate and plan ahead for compliance.
- ✓ *Longer transition periods* – Additionally taking the form of “temporary exemptions”, these allow small businesses to become familiar with regulatory requirements, obtain external advice on compliance issues, and adjust administrative, production, transport or marketing procedures, etc.
- ✓ *Access to targeted assistance* – This may include providing dedicated advice to small businesses to help them comply with regulatory requirements, or facilitating access to information (e.g., in the form of helplines, e-One-Stop Shops, under the “only once principle”,<sup>22</sup> with training, etc.).
- ✓ *Tailored requirements* – This may include requiring small businesses only to have to register rather than be fully licensed; allowing them to use simplified templates, forms, or fast-tracked procedures; thus, implementing less onerous, or less frequent, reporting or inspection regimes, for small businesses, etc.
- ✓ *Risk-based enforcement* – A risk-based approach to delivering regulation ensures lower risk businesses can operate without unnecessary intrusion from enforcers (inspectors). Under a risk-based approach, compliance costs for business and administration costs for regulators are proportionate to the risks posed to regulatory outcomes and, in turn, to the community.<sup>23</sup>
- ✓ *Tiered penalties for non-compliance* – This could imply, for example, varying the amount of a fine according to the size of a company or their output, as well as launching initial “warning statements” before fining smaller businesses.

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22. The only once principle imposes the burden of retrieving information already provided by a stakeholder to a public administration on the authorities themselves. Under the principle, citizens and stakeholders thereby have the right not to provide the same information already requested by a public administration again.

23. In theory, under a risk-based approach, lower risk businesses may be subject to fewer inspections and less frequent reporting obligations, which can reduce the costs for both businesses and the regulator. Conversely, higher risk businesses may face additional compliance costs, particularly if scrutinized closely by regulators.

- ✓ *Voluntary solutions* – Small businesses could be invited to join private voluntary schemes led by industry, trade, and professional associations.
- ✓ *Financial aid* – This may happen directly (e.g., through lower fees and levies for small businesses) and indirectly (e.g., SMEs could obtain subsidies, easy credit terms, or reimbursements for compliance costs).

#### IV.3.2. Determining the appropriateness of a measure

You should assess the costs and benefits associated with any of the alternative options identified to assess their appropriateness.

Unlike an RIA, which should consider the net societal benefits of a given government intervention,<sup>24</sup> the SME Test should determine whether such mitigation measures and exemptions are possible, desirable, and proportionate. Such an appraisal should consider two aspects (see Box 4. for examples):

- ✓ *The “policy cost” of mitigation and exemption* – You should provide an assessment of how much the policy objective set out in your proposal would be compromised by applying an exemption or mitigation to SMEs. This includes identifying whether there are significant potential unintended effects associated with alternative approaches for smaller firms.
- ✓ *Benefits of mitigation and exemption* – You should provide an indication of how much overall costs to SMEs could be saved by applying the envisaged mitigation measures.

#### Box 4. Proportionate alternative and mitigating measures for SMEs: Examples

- ✓ An example of the **policy objective being compromised** may refer to a case where small businesses supply a large proportion of consumers, and flat exemptions might endanger consumers’ health or safety.
- ✓ An example of **unintended consequences** triggered by mitigating measures denotes an instance where a full exemption for firms below a certain threshold (above which firms need to fully comply with the measure) can create barriers to expansion for those firms operating just below the threshold. Such firms may decide not to expand their operations if the increase in compliance costs, as a result of crossing the compliance threshold, results in a significant increase in costs.<sup>25</sup> A phased approach (where the degree of compliance increases incrementally with the size of the firm) could instead result in reduced barriers to expansion compared to a full exemption.
- ✓ One example of **benefits from exemption** may be a case in which small businesses (below a certain income threshold) are completely exempt from the payment of certain prescribed fees. This results in both financial and administrative savings for the SMEs concerned.

24. Typical methodologies deployed in RIAs are Cost-Benefit, Cost-Effectiveness, and Multi-Criteria Analyses.

25. As an illustration, consider a regulation that imposes costs on firms in proportion to the number of workers employed. Assume compliance costs are approximately 1,000 GEL per employee, where firms with fewer than ten employees enjoy a full exemption. If a firm with nine employees wishes to expand operations and employ an additional worker, the increase in compliance costs faced by that firm as a result of employing one additional worker would amount to 10,000 GEL.

- ✓ An example of **benefits from mitigation** may refer to cases where the requirements of a proposed legislation are calibrated to the size of businesses required to comply (small businesses have simpler, “lighter” requirements than large businesses). This reduces the costs small businesses incur in order to comply with the legislation.
- ✓ Another example of **benefits from mitigation** are cases where SMEs are granted access to targeted assistance through the establishment of dedicated agencies and organizations. By providing access to the relevant information, they reduce the time and effort SMEs have to invest familiarizing themselves with regulatory and other requirements.

These appraisals involve collecting information during consultations on the likely benefits to representative firms relating to the alternative regulatory approaches (such as reduced administrative costs; reduced costs of changing production processes; reduced costs of external advice; delaying expenditure on new equipment or other technology; reduced penalties for non-compliance etc., each relative to the original proposal).

It also involves estimating any additional costs or benefits to the Government from alternative approaches (such as the cost of providing targeted assistance, reduced revenue from penalties, reduced costs associated with noncompliance, delayed achievement of regulatory objectives due to extended implementation times, etc.)

#### IV.4. Consultation with SME stakeholders and data collection

Consulting small businesses is not an easy task, and as a general rule, the smaller the business, the more difficult it is to hold a consultation. Nonetheless, targeted consultation is central to the execution of an SME Test.

Recall that consultations organized for an SME Test are tailored to obtaining the most relevant information on the SMEs affected by the proposal. Guidance provided in this manual helps you target your consultation effort to that end. You should however also perform wide stakeholder mapping and consider all relevant economic actors and groups throughout society as a part of the RIA analysis.<sup>26</sup>

Inputs from consultation with SME stakeholders should **inform every Step of your SME Test**. Consideration should especially be given to the following:

- ✓ *Consultation during the distributional analysis* – During Step 1. *The distributional analysis*, you should be able to retrieve the majority of statistical data from public administration databases. However, should this prove difficult, it is vital to clearly define the context of your analysis and invite SMEs stakeholders to offer direct input on any relevant information. It will also be important to validate and complete your mapping of both the economic sector(s) and the SMEs that are affected.

26. For a more detailed discussions and examples derived from the Georgian experience, check pp.16-30 of the RIA Manual for Practitioners. Available from: <https://iset-pi.ge/storage/media/other/2021-07-13/64dd0710-e3de-11eb-9a86-cf56b5dfd018.pdf>.



- ✓ *Consultation during the impact assessment* – During Step 2. *Impact assessment*, it is critical to consult with stakeholders to retrieve necessary information on the measurement of impacts. For example, when completing a SCM calculation, affected businesses can best answer questions regarding the time spent performing administrative obligations. Statistical data (such as number of enterprises in a specific sector), which is potentially not readily available, can also be obtained through consultation with sectoral organizations, such as trade associations and industry chambers. Consultation during this step is also particularly helpful in detecting any indirect costs and unintended consequences of the proposed legislation that may have been overlooked.
- ✓ *Consultation during the mitigation appraisal* – During Step 3. *Mitigation appraisal*, consulting with stakeholders can better inform your choice of possible mitigation measures. Businesses can offer first-hand experience of the measures that simplified adjustments to regulatory objectives, as well as previously implemented measures that, in practice, did not alleviate the regulatory burden. It is thereafter imperative to carefully consider the comments and suggestions provided by the relevant stakeholders and to assess their merits in direct comparison to your proposed mitigation measures.
- ✓ *Consultation on the finalized Draft SME Test* – Public consultations of the finalized Draft SME Test are carried out.

Annex A.3. expands on appropriate planning for consultation rounds, and on possible beneficial consultation and data collection methods within the context of an SME Test.

Box 5. provides certain key tips for conducting consultations during each of the aforementioned steps of your SME Test:

#### **Box 5. Consultation tips**

- ✓ Inform the public clearly and in a timely manner about the consultation period, the deadlines, and about the channels through which they can ask questions and submit contributions. This will allow the stakeholders to better organize data collection, prepare evidence, and provide their responses. It will also increase the chance of their participating in the consultations.
- ✓ Provide adequate information within the SME Test proposal to illustrate why a certain legislative solution is recommended. This will allow stakeholders to offer comprehensive feedback on the SME Test, not only on the legal provisions stated in the proposed legislation.
- ✓ At the same time, clearly indicate what specifically you are seeking from the consultation – ask questions as clearly and precisely as possible. Moreover, combine closed and open questions as this will increase the usefulness of the exercise.
- ✓ Provide feedback on the comments and suggestions received from stakeholders during a consultation. Elaborate clearly and support, with evidence, which inputs were retained and which were discarded – and explain why this was the case.
- ✓ Ensure transparency of the consultations conducted by keeping records and publicizing meetings with stakeholders during the consultation period.

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# ANNEXES

## A.1. The SME Test Template

PROPONENT MINISTRY: .....

TITLE OF THE INITIATIVE: .....

REGISTER NUMBER: .....

CONTACT DETAILS: .....

PLACE, DATE: .....

SIGNATURE: .....

### 1. DISTRIBUTIONAL ANALYSIS

State the results of the distributional analysis – i.e., whether firms of different sizes (large, medium, small, and micro businesses) are likely to be affected by the proposal, and the expected nature of such impacts on firms. Sources for numerical indicators should also be cited.

The key questions to be answered within this step are:

- ✓ Are SMEs likely to be affected?
- ✓ What are the characteristics of the SMEs affected? (e.g., number of businesses, size, ownership type – sole proprietor, partnership, limited company, etc. – and geographic distribution?)
- ✓ How are SMEs affected?

*See Section IV.1. of the SME Test Guide.*

### 2. IMPACT ASSESSMENT

State the impact of the proposal on SMEs. Impacts should be analyzed in quantitative (and monetized) terms to the best extent possible, using studies, analyses, reports, and other available statistical data. Consideration should be given to both direct and indirect compliance costs. The sources for numerical indicators should be cited, including the Standard Cost Model template used for determining administrative costs.

The key questions to be answered in this step are:

- ✓ How heavily are SMEs affected?
- ✓ Is the burden disproportionate?

a. State the results of your analysis in the table below:

Requirement in the proposal	Costs (negative impacts) on SMEs
<i>Requirement 1</i>	
<i>Requirement ...</i>	
<p>Note: should quantification (monetization) not be possible, use the following qualitative criteria (in such a case, also indicate also why quantification was not possible):</p> <ul style="list-style-type: none"> <li>-- significant negative impact</li> <li>- limited negative impact</li> <li>0 no impact</li> <li>+ limited positive impact</li> <li>+ + significant positive impact</li> </ul> <p>b. Indicate here the sources and methods behind your estimates.</p> <p>c. Please determine whether and why the estimated costs on SMEs are disproportionate.</p> <p><i>See Section IV.2. of the SME Test Guide.</i></p>	

### 3. ASSESSMENT OF THE ALTERNATIVE MECHANISMS AND MITIGATING MEASURES

Assess the existence and suitability of alternative, more flexible ways in which small businesses can readily meet regulatory objectives, given their particular characteristics. Certain possible alternative and mitigating measures for SMEs are partial or complete regulatory exemption; common commencement dates; longer transition periods; access to targeted assistance; tailored requirements; etc. Thereafter, assess the costs and benefits associated with any identified alternative options to determine their suitability.

The key questions to be answered in this step are:

- ✓ *Can alternative or mitigation measures be applied?*
- ✓ *Is it opportune to apply them?*

*State the results of your analysis in the table below:*

<b>Alternative / mitigating measures</b>	<b>Benefits (positive impacts / savings) for SMEs</b>	<b>Costs (negative impacts) for the economy / public authorities</b>
<b>Measure 1</b>		
<b>Measure ...</b>		

Note: you should be in a position to quantify (monetize) the benefits for SMEs from mitigating measures. You should also attempt to quantify costs for the economy and public authorities to the best extent possible.

Should quantification (monetization) not be possible, use the following qualitative criteria (in such a case, also indicate why quantification was not possible):

- significant negative impact
- limited negative impact
- 0 no impact
- + limited positive impact
- ++ significant positive impact

*See Section IV.3. of the SME Test Guide.*

#### CONSULTATION SUMMARY

This part of the template should be completed after targeted consultations with SME stakeholders have been carried out during the drafting phase of the SME Test.

State here the summary of consultations conducted with SME stakeholders and the mandatory public consultation carried out in a clear manner, including exact start and end dates, dates of individual events, etc. The total number of received opinions, remarks, and suggestions must be stated, as well as the number of accepted comments on the draft SME Test and the proposed legislation.

*See Section IV.4. of the SME Test Guide.*

## A.2. Characterizing the impacts on SMEs

### When are SMEs likely to incur administrative and direct compliance costs?

- ✓ *A company's implementation of the (regulatory) provisions established in your proposal requires significant one-off or ongoing investments or (external) costs.* If compliance with your proposal imposes high fixed material expenditure or initial costs, or if it increases the overheads costs – in a way that is disproportional to the size of the company or its output – then SMEs tend to be disproportionately affected in comparison to larger businesses. Such expenditures may take the form of specific training; purchasing and applying new technologies; adapting equipment and infrastructure; modifying the manufacturing process; or the management of other economic operations.
- ✓ *A company's implementation of the (regulatory) provisions established in your proposal requires labor-intensive investments.* Unlike larger companies, SMEs may be disadvantaged because IT systems and software are not as readily available, because they are expensive to purchase, update, and maintain, or because they lack the necessary know-how. Labor costs to discharge administrative tasks also vary between small and large companies. Staff time is a critical cost driver as in very small firms, regulatory compliance responsibilities are usually dealt with personally by the owners of businesses, who are more expensive than administrative staff.
- ✓ *A company's implementation of the (regulatory) provisions established in your proposal does not generate a routine process.* Experience shows that there is a learning curve in ensuring compliance with legal requirements and that compliance costs depend on the frequency with which the requirements are processed. An example is the regulatory standards to draft work certificates for outgoing employees: the larger the company, the more frequently work certificates are issued. SMEs are often less experienced than larger businesses with the handling of these documents because of a smaller turnover of employees.
- ✓ *A company lacks specialist or dedicated staff tasked with the implementation of the (regulatory) provisions established in your proposal.* SMEs often incur higher compliance costs relative to larger businesses, notably if they do not have dedicated departments to discharge financial and accounting tasks, for human resources affairs, or for legal issues. Often, such tasks must be outsourced to external commercial partners, or carried out on a part-time basis by untrained staff, which extends the time required to comply and hence the cost.

In addition, SMEs may disproportionately suffer from legal uncertainty or delays in regulatory amendments, because their reserves are smaller than in larger businesses, as the diversification of markets and risks is more limited, and as competition tends to be higher.

### The following questions help consider potentially relevant indirect impacts:

- ✓ *Does the proposal create indirect compliance costs?* – Indirect compliance costs are a second-order consequence of the measures that an affected business has to undertake

to comply with the proposal. They can be restrictions of output, higher downstream prices, or any other additional costs for economic operators and entities other than those targeted by the regulation.

✓ *Does the proposal lead to substitution effects?* – In particular:

- Would citizens or businesses other than the regulated entities shift to alternative sources of supply?
- Would citizens or businesses other than the regulated entities shift to alternative modes of consumption?

If this is the case, you should attempt to monetize those impacts by estimating the opportunity cost of the induced behavior, i.e., the value or the surplus foregone by those individuals or businesses that have been induced to engage in the substitute behavior.

✓ *Does the proposal lead to increased transaction costs?* – Transaction costs are normally very difficult to estimate and are most readily assessed through direct consultation. To the best extent possible, you should consider the following questions:

- Would the proposal increase:
  - The cost of negotiations between parties, e.g., to adopt collective decisions?
  - The cost of information gathering for private parties?
  - The cost of looking for a contractual counter-party?
  - The likelihood of strategic behavior between private parties?
  - The cost of monitoring a counter-party's behavior?
- Would these costs harm the likely efficiency of the proposal at hand or even lead to a cancellation of the transaction?

✓ *Does the proposal lead to a reduction in competition?* – More specifically:<sup>27</sup>

- Does the proposal limit the number or range of economic actor in the market?
- Does the option limit the ability of economic actors to compete?
- Does the option reduce competition among economic actors, including by increasing incentives for collusion?
- Does the option limit the choice and information available to consumers?

*Note: in the case of collusion, the economic literature observes that the average overpricing from a price-fixing cartel amounts to approximately 15-20%.*

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27. For detailed guidance on Competition Impact Assessment, see the European Commission's Better Regulation Toolbox – Tool #24 on Competition. Available from: [https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox\\_en](https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation/better-regulation-guidelines-and-toolbox/better-regulation-toolbox_en); and the related OECD Toolkit: <https://www.oecd.org/daf/competition/assessment-toolkit.htm>.

In each of these cases, you should attempt to attach a monetary value to the likely loss of consumer surplus due to reduced competition. This is inevitably a case-by-case exercise.

- ✓ *Does the proposal lead to reduced market access?* – One way to assess this indirect cost would be to estimate the lost consumer surplus (for individual consumers), or the lost profit (for businesses) that would occur due to losing access to a given market because of regulatory restrictions or to costs imposed by regulation on upstream market players.
- ✓ *Does the proposal lead to reduced investment or innovation?* – Common indicators are the number of patents produced, the volume of R&D investment, the amount of technology transfer, etc.

### **When might further relevant indirect costs emerge?**

- ✓ *The proposal has negative consequences on the market share or turnover of economic operators or creates barriers to entering (or remaining in) the domestic or international market.* If the proposal makes it more difficult for companies to remain on the market or to enter a new market, then SMEs are especially disadvantaged because “it is no longer worth it”: the price to pay to remain on the market is excessive and their competitiveness is drastically reduced. This also holds for international markets (for instance because of non-tariff barriers to trade).
- ✓ *The proposal affects the availability and price of production factors along the supply chain.* Small firms have less freedom to adapt to new market conditions and depend more on a small number of suppliers and customers. Limitations to accessing substances, products, technologies, equipment, financial resources (e.g., foreign capital or credits), or (skilled) labor affect SMEs more heavily than larger companies because they are usually price-taker and have fewer possibilities to diversify their supply chain.
- ✓ *The proposal makes Research and Development more costly.* The most dynamic SMEs often work on innovative markets and operate on high added value business models. R&D investments are therefore vital. Provisions negatively affecting the incentives to allocate resources for R&D disproportionately affect SMEs because they tend to operate on fixed budgetary reserves; they do not have access to international capital markets; and they cannot benefit from economies of scale. An example of negative impacts on innovation might thus be more stringent safety assessment standards or patent applications, as well as the weaker protection of intellectual property rights.

## **A.3. Consultation and data collection for the SME Test**

### **A.3.1. Consultation strategy**

To maximize your efforts in preparing and running consultation rounds, you should formulate a consultation strategy or plan. The following questions can be of assistance:

- ✓ *What is the goal of conducting consultations?* – Consultations can assist in gathering new ideas; collecting views and opinions; gathering factual information, data, and knowledge; and testing existing ideas and analysis. Determining the main goal of a consultation informs all the following steps in the consultation process.



- ✓ *Who is impacted by the proposal?* – Establishing a list of stakeholders affected by the proposal (such as private companies from specific sectors, associations, sectoral chambers, etc.) is vital to ensure proper representation of all stakeholder groups and to subsequently select the most appropriate consultation method.
- ✓ *What is the appropriate format for consultations in this proposal?* – There are various formats of consultation: roundtable discussions, focus group meetings, hearings explicitly targeting SME representatives, SME panels, etc. When choosing the one best suited to the discussed proposal, take into account the complexity and impact of the proposal itself.
- ✓ *How to implement the chosen consultation format efficiently?* – Define how information on the consultation will be disseminated to stakeholders and how the request for participation will be formulated. Considerations should be given to:
  - Target audience – who are the identified stakeholders impacted by the proposal and that need to be contacted?
  - Best methods to reach the target audience – What are the best ways to reach stakeholders (e.g., by direct contact, through business associations, via sectoral chambers or NGOs)?
  - Most suitable communication tools – What are the best tools to communicate with stakeholders (e.g., e-mail communication, face-to-face meetings, social media posts)?
- ✓ *How to best prepare and present the results of a consultation?* – When presenting the results, verify that the report of consultations performed contains all the necessary information, such as the name of the proposed policy option, a list of all stakeholders involved, the consultation period, the comments and suggestions received, feedback given to stakeholders, etc.

#### **Box A.3.1.1. The consultation strategy<sup>28</sup>**

The consultation strategy can help better determine the objective of a consultation, making the process more effective and efficient. The strategy should cover the following key elements: consultation scope and objectives, identification of stakeholders, envisaged consultation activities, their timing, and the language regime.

##### **1. Determining consultation scope and objective**

- ✓ From the beginning, be clear about what is ‘in-scope’ and ‘off-scope’ due to legal or political limits.
- ✓ Map the sources and information that are already available. This also includes a review of past, but still valid, stakeholder consultation work.
- ✓ Identify what type of information is missing and is needed to assess the policy options discussed: quantitative data or qualitative data.
- ✓ Identify which sources should be used in order to gather the missing information.

28. This guidance draws from the European Commission’s Better Regulation Toolbox (Tool #52, The Consultation Strategy. Available from: <https://commission.europa.eu/system/files/2023-07/BRT-2023-Chapter%207-Stakeholder%20consultation.pdf>.

- ✓ Define the scope of stakeholder involvement necessary to perform consultations.
- ✓ Pay special attention to sensitive, controversial, or highly uncertain issues that may be discussed.
- ✓ Be aware of potential blind spots that should be detected through consultations (e.g., indirect costs, unintended consequences).

## **2. Identification of stakeholders**

- ✓ Map all stakeholder categories that are relevant for or interested in the policy options discussed.
- ✓ Classify stakeholders into groups, depending on the level of interest in and the level of influence on the policy options to be consulted upon.
- ✓ Identify target groups that run the risk of being excluded (do not solely limit yourself to obvious stakeholders).
- ✓ Use existing stakeholder lists gathered during previous consultations or in the context of networks, expert groups, stakeholders listed in registries, etc.

## **3. Determining consultation activities, their timing, and accessibility**

- ✓ Choose the best suited consultation activities depending on the nature of the policy options, the scope of the consultation, the identified stakeholders, as well as the available time and resources.
- ✓ Plan ahead: consider the timing of the proposed consultation work and operational arrangements that need to be made.
- ✓ Ensure adequate coverage for consultation activities, according to the scope and outreach of the chosen activity.
- ✓ Ensure that persons with disabilities can participate in consultations on an equal basis.
- ✓ Draft a communication plan as part of the consultation strategy. This will ensure that the relevant target groups (identified stakeholders) are reached in the most effective way. This plan should identify the most effective ways to communicate, taking into account the targeted stakeholders and the chosen consultation activities (such as: publications, face-to-face meetings, social media posts, etc.)

### **A.3.2. Data collection and consultation methods**

You can rely on several specific data collection and consultation methods to maximize the effectiveness of your consultations with SMEs. This following section describes a few potential options.

You should opt for one method or another depending on what you intend or need to achieve in your consultation and based on the scope of the impact of the proposal on SMEs. You must also consider the timing and costs of reaching out to stakeholders in a structured, planned manner. The different methods can also be combined, for instance you could have different iterations (rounds) of consultation and use different methods.

If the data gathered through the initial consultation requires further validation, conduct additional interviews with stakeholders (either in person or by phone) to confirm the answers received.

## **1) Interviews with stakeholders**

Direct (face-to-face) interviews with affected stakeholders are the preferred method for gathering information during consultations. These interviews typically have a duration of 1-2 hours, depending on the complexity of the proposal and the available resources. In the case of particularly complex proposals, an additional interviewer can be used to provide support. The interviews are structured as a dialogue between the interviewer (representative of the proponent ministry or regulatory agency) and the subject (stakeholder representative). Interviews can also be conducted by phone or through video-conferencing platforms – in this case it is advisable to limit the duration to 30-60 minutes.

There are a few methods for determining which stakeholders to interview. Representatives of the SMEs affected by the proposal can be selected at random, keeping in mind that a representative sample of businesses should be contacted (e.g., if the proposal impacts in equal measure micro, small and medium enterprises, then one representative - minimum - from each group should be contacted). Stakeholder representatives can also be selected with the help of business and trade associations and sector chambers.

Before conducting an interview, it is important to ascertain that the selected stakeholders are indeed affected by the proposal. Any preparatory materials (guidelines, preparatory questions, etc.) should, if possible, be sent to the stakeholders in advance. During interviews, be sure to use clear and concise language, and reserve time for stakeholders' comments and suggestions, which may prove helpful in identifying any possible unintended consequences of the proposal.

If there is a need to verify information obtained from the stakeholders contacted, additional follow-up interviews can be conducted.

## **2) Focus group meetings**

Focus group meetings are usually reserved for more complex proposals. They can be organized in cooperation with business associations, sector chambers, or other relevant organizations, which can provide a list of affected stakeholders and additional experts from specific sectors (e.g., accounting). Where possible, it is recommended to hold three focus groups with at least six participants per group – they can be divided by the size of the businesses participating (e.g., a separate focus group for micro businesses, small businesses, and for medium businesses), or specific business activities or sectors. When organizing focus groups, keep in mind the number of participants should not exceed 12 to ensure a productive and effective discussion.

As with interviews, if possible, send all pertinent information and preparatory materials to the participants in advance. Focus groups should last between 2-3 hours, depending on the complexity of the proposal. Thereafter, a summary report of the meeting with the key points discussed and suggestions made should be sent to all participants, along with an invitation to submit any additional proposals or comments.

## **3) Surveys**

In those cases when one-on-one interviews or meetings are not a plausible option, surveys are a method of collecting data from a large number of stakeholders. All respondents are asked

exactly the same questions in exactly the same manner, and provided with the same choices to answer those questions. Surveys may be administered in a number of ways including face to face, telephone, video-conferencing platforms, e-mail, and postal, each of which has positive and negative implications with regard to issues such as response rates and cost. Surveys may also be used in conjunction with other data collection methods (e.g., focus groups may be used for collecting more qualitative data, surveys for quantitative inputs).

When preparing questionnaires consideration should be given to the following:

- ✓ *Questions* – The questions should be clear, concise, and designed in a neutral manner. The language used should be easily understandable and adapted to the stakeholders. Respondents should be granted the possibility to add comments, suggestions, or elaborate their answers. Combine open-ended and closed questions.
- ✓ *Format* – The format of the questionnaire should also be adapted to the target audience. Aim for a simple format that is easy to complete, and that is not too long – consider the possibility of using online tools. Be sure to include a brief instruction and offer contact details in case additional information is needed to complete the questionnaire.
- ✓ *Time* – Indicate the estimated time required to fill out the questionnaire. Moreover, when determining the deadline by which questionnaires have to be completed and returned, ensure enough time is offered to stakeholders to provide their answers.
- ✓ *Stakeholders* – Questionnaires can be sent directly to the relevant stakeholders, or they can be sent to a business association or sector chamber, to then be forwarded to their members, depending on the availability of relevant stakeholders for a certain proposal.

