THE EUROPEAN UNION'S ECONOMIC DIPLOMACY IN THE EASTERN NEIGHBOURHOOD: WHAT IS ITS FUNDING EFFECT UPON SMALL- AND MEDIUM-SIZED ENTERPRISES' BUSINESS PERFORMANCE?

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AA	Association Agreements
BSC	Balanced Scorecard
BSO	Business support organization
CSR	Corporate social responsibility
EaP	Eastern Partnership
DG NEAR	Directorate-Generale for European Neighbourhood Policy and Enlargement Negotiations
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EFQM	European Foundation for Quality Management
EP	European Parliament
EEU	Eurasian Economic Union
ENP	Eastern Neighbourhood Policy
EU	European Union
FDI	Foreign Direct Investment
HRM	Human resource management
IFI	International Financial Institutions
IMF	International Monetary Fund
MNE	Multinational Enterprise
NEP	New Economic Policy
NGO	Non-governmental organization
PCA	Partnership and Cooperation Agreement
PPD	Public-private dialogue
PPRD	Prevention, preparedness and response to natural and man-made disasters
SME	Small- and medium-sized enterprises
TAM/BAS	Turn around management and business advisory services
TNC	Transnational corporations
TQM	Total Quality Management
WCM	World class manufacturing

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ABSTRACT

The face of diplomacy is changing: it has moved away from the conventional statecraft towards becoming more inclusive, welcoming new actors and introducing new instruments, structures and functions. It has also put the *economic dimension* at the heart of diplomacy today. The objective of this thesis is to assess the impact of the EU's economic diplomacy upon the new actors' performance, by exploring the impact of the Eastern Partnership's SME Flagship Initiative upon SMEs' business performance in the Republic of Moldova. This study aims to compare and contrast the theoretical model of diplomacy and its practice, identifying its advantages and challenges. An empirical study was used to test the hypotheses of this thesis, with interviews being conducted with European Commission and Moldovan officials, as well as NGO experts involved in the management and delivery of the East Invest programme. Results have shown that the EU economic diplomacy model has become more (1) complex and more inclusive, but it still lacks (2) agility (including transparency and accountability) and (3) connectivity, in terms engaging with third parties. This study enriches the research on EU economic diplomacy and the Eastern Partnership instruments for SMEs.

Key terms: *EU economic diplomacy, the Eastern Partnership, SMEs.*

CHAPTER 1. INTRODUCTION

1.1 BACKGROUND

The world has become far more complex, connected and contested (European External Action Service, 2015) as a result of changes in the international environment, which Friedman (2007) attributes to the many effects of globalization that led to technological and communications advances. Within this new global environment, we can observe the rise of various important regional players, including the European Union (EU). The EU has been deepening its relations and increasingly engaging not only with its member states, but also with its neighbours, in different policy areas including economic integration, energy and transport cooperation, and economic and social development. In this thesis, my focus will be on the eastern region and the Eastern Partnership Initiative (EaP). The eastern region is a collection of countries that have entered the scene following the break-up of communism, providing an interesting and useful study example of the new diplomatic model. Given the strong economic policy focus of EaP, EU economic diplomacy has become a central focus in the relationships between the EU and its eastern neighbours.

While there has been developing research focusing on the areas such as diplomacy and the EaP (Council of the European Union, 2011; European Commission, 2014a; Hill, 2003; Bayne and Woolcoock, 2007; Odell, 2000), there has been limited focus on EU economic diplomacy in the eastern region and in particular on new local actors on the interface of economic diplomacy such as small- and medium-sized enterprises (SMEs) and business support organisations (BSOs). Hence, this thesis aims to assess the impact of the EaP and in particular, the influence of its SME Flagship initiative upon SMEs business performance within the Eastern region, with particular focus on the Republic of Moldova.

The face of diplomacy has been gradually changing over time, moving away from political statecraft and mytho-diplomacy (managing the estrangement between man and God), towards a diplomatic model, more inclusive and agile, welcoming new diplomatic instruments and actors (Der Derian, 1987). Hence, EU economic diplomacy is now at the heart of bilateral and multilateral communications between the EU and its neighbours, receiving increasing attention in the form of new instruments (e.g.: the EaP's SME Flagship Initiative programmes) and actors (e.g.: SMEs, BSOs). This study defines EU economic diplomacy as ***the management of alienation and relationships within and between the EU, its (Eastern and Southern) neighbours and other regional actors, in influencing and promoting economic development and collaboration for mutual benefit.***

The EU has enlarged its ties with its member states and its neighbourhood, as economic prosperity and integration has become an increasingly important dimension in the EU's ability to create a safe and prosperous community for its members and neighbours (European Commission, 2015a). Launched in 2009, the EaP aims to manage relations between the EU and its six eastern neighbours (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine), fostering economic integration and further political associations (Council of the European Union, 2009).

Over the past few decades, the attention paid to SMEs as drivers of reform in the EU has notably increased, with SMEs being considered prominent contributors to economic growth (European Parliament, 2016), accounting for 99% of European businesses and 67% of European employment[1]. The importance of SMEs as engines for reform and growth has further been recognized by the various institutions involved in the EaP Initiative such as the EU and different NGOs (e.g. Eurochambres). As engines for reform, the EU has increased the involvement of SMEs within EU policy, as we can see in the case of the EaP (chapter 3). Although they have little power and influence alone as distinct business units, the role of SMEs as a sector can make a difference in the economic and political settings, hence the increased focus placed on these small firms. As new diplomatic actors, SMEs have been welcomed in managing relations between state and non-state actors. The case of SMEs within the Republic of Moldova is particularly interesting as out of the six EaP countries, the Republic of Moldova has been the front-runner of EU policy, developing increasingly close relationships with the EU that go beyond collaboration, aiming for further gradual economic and political integration and

[1] Percentages presented in terms of individual business units.

cooperation (European External Action Service, n.d.a). Hence, this thesis focuses on SMEs as new diplomatic actors within Moldova.

1.2 RESEARCH QUESTIONS AND METHODOLOGY

This study is novel in a sense that it aims to compare the conceptual changing nature of diplomacy to its realities in practice, assessing whether economic diplomacy has indeed become more complex, inclusive, agile and better connected, providing a comprehensive and novel empirical analysis. Therefore, we aim to address the literature gap by addressing the following research question:

‘*What is the impact of EU support on SMEs in Moldova?*’

As we can observe, the research question above encompasses two different dimensions: (1) the macroeconomic environment focused on the economic diplomatic relationships between two regional diplomatic actors, the EU and its Eastern Neighbourhood; and (2) the microeconomic environment at the level of individual SMEs. Given the two different dimensions the research question aims to consider, this study will take into consideration a mixed methods approach in the form of explanatory sequential mixed methods (Creswell, 2014), where the qualitative research would provide clarity and explain the quantitative research.

Therefore, we identify the following three sub questions, which would require a mixed methods approach given the quantitative nature of business performance conceptualization (the economic) and the qualitative nature of the development and changes of the EU-Eastern Neighbourhood relationship (the political):

RQ1: How has SMEs’ business performance in Moldova changed as a result of their participation in the EaP?

RQ2: To what extent has the EaP been instrumental to improving SMEs’ performance?

RQ3: Which elements of the EI-EaP have been more effective/useful than others?

In order to be able to address the main research question, the empirical section of this study focuses on conducting qualitative research in the form of structured and semi-structured interviews, and quantitative research in the form of structured questionnaires (Yin, 2014) in order to then engage in advanced statistical analysis using appropriate software (Quinlan, 2011), such as the Statistical Package for the Social Sciences (SPSS). In order to address RQ2 and RQ3, an in-depth, qualitative approach to primary research is more appropriate given the nuanced and detailed nature of the interviews with EU participants and in order to gain a better understanding of the EaP and its role in improving SMEs' business performance. However, in the case of addressing RQ1, given the geographical-scattered nature of SMEs in Moldova, a quantitative approach to primary research is more appropriate, as it would provide easier access to a higher number of participants from different geographical locations and allow us to identify correlations between various business performance measures. The questions addressed during the qualitative and the quantitative research of this thesis can be found in Appendices 1 and 2.

The quantitative data collection process considers the following measures of business performance: profit, sales, number of employees, employee turnover, employee relationships, product/service innovation, new product development, market share, use of technology within the company, and strategy and planning. Having identified dependent and independent variables, the study then use Pearson's chi-square tests of independence in order to detect correlations and associations between different variables, followed by a consideration of a multiple regression model, given that the variables are not of dichotomous nature (Kam and Franzese Jr., 2007).

As the quantitative and the qualitative enquiries are complementary, the study will then consider qualitative research in the form of semi-structured interviews with EU officials in the DG Neighbourhood and DG Enterprise and Industry within the European Commission, the EU delegations in the Eastern Neighbourhood countries, as well as Chambers of Commerce in Moldova, in order to explain *why* Eastern Neighbourhood SMEs' business performance has changed as a result of the economic diplomatic relationship between the EU and its Eastern Neighbours.

Therefore, given the nature of the questions, the interviews will be analyzed by identifying common themes and challenges highlighted by the respondents, while the results of the online surveys will be examined using SPSS as the quantitative software.

1.2.1 Limitations and Barriers to Primary Research

To begin with, one limitation of the empirical analysis of this study could be the language barrier (Squires, 2009; Liamputtong, 2008). Yet, this did not prove to affect the results of the study, given the EU officials' knowledge of the English language, and our understanding of Moldova's national language, which facilitated our discussions with Moldovan officials.

Another possible limitation of the study represents a selection bias (Ghauri and Gronhaug, 2002), as institutional participants and SMEs who have had a positive experience as part of their East Invest involvement, might be more likely to share their experiences. Yet again, this challenge did not have a negative impact upon this study's empirical results, we have targeted different officials from various levels, who have been open to discussing the problems and challenges occurred, as we will see in the subsequent chapters.

Furthermore, another research challenge is the achievement of a high number of responses from SME recipients within the quantitative analysis side of this study. While we have originally targeted a sample of 100 respondents (N=100), achieving this target has proven difficult, not having received any responses from the firms'surveys, given that less than a third of that represented SME participant in East Invest, as discussed in chapter 5 below. In addition, SMEs have been reluctant to discuss their success story, which has given us no choice but to shift our empirical focus upon qualitative data analysis. Yet, the difficulties and lack of financial data from SMEs has not had a major negative impact upon the results of this study, as we have obtained extensive information from various individuals and organisations at different level, that has allowed us to fully and comprehensively address the thesis's research questions.

An additional validity problem represented the selection process itself, as this study aimed solely at measuring the success of East Invest participant SMEs, without considering the national population of SMEs of the Republic of Moldova and their views. Yet again, this did not have a significant impact upon the present study, as the responses obtained during the quantitative data gathering process highlight a wide variety of attitudes and opinions among respondents, providing a detailed picture of their involvement within the SME

Flagship Initiative.

1.3 CHAPTER OUTLINE

The study is structured into seven chapters. The conceptual framework, which is the second chapter of the research, will present an understanding of diplomacy, its changing nature, actors and functions. This chapter will also analyse the role, advantages and challenges of economic diplomacy, in order to then be able to examine the extent of the impact of diplomatic practices on the business performance of SMEs. With the EU as a regional actor[2] growing in importance in (economic) diplomacy, more policies such as the Eastern Partnership Initiative are aimed at managing the relationship between the EU and its neighbours (e.g. Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine) and influencing the neighbourhood, promoting economic collaborations, in particular with SMEs.

The third chapter looks at EU economic diplomacy in the context of the Eastern Partnership and SMEs. This chapter aims to situate SMEs within the EaP and to understand the different types of instruments that are available under the policy for SMEs' advancement, in order to later analyse the effectiveness of the EU economic diplomacy model through SMEs. Hence, this chapter considers the Eastern Partnership, including a discussion of the importance of SMEs, providing a detailed picture of the various SME Flagship Initiative programmes. Yet, while in theory, the different programmes are offering key support to SMEs, it is important to review the characteristics of SMEs and business performance measures, and then assess the extent of the effects of East Invest participation on SMEs' business performance.

The following chapter of the study provides an outline of the entrepreneurial environment in Moldova. It focuses on exploring the principal measures of success within SMEs by reviewing the different dimensions of performance measurement, in order to later analyse the degree of effectiveness of the EU economic diplomacy model at two levels: the EU level (political) and the SME level (economic).

[2] The EU can be regarded as both a global and a regional actor. On the global scale, the EU is a global actor, while within the EU's eastern region, the EU is a regional actor; this study will focus on the EU as a regional actor.

The objective of chapter five is to assess the impact of the East Invest programme upon SMEs' business performance in the Republic of Moldova, based on the primary research conducted for the scope of this study, by considering the institutional set-up, the East Invest 1 instrument and their impact upon SMEs. This chapter will argue, with reference to the regional framework in chapter 2, that the EU has not been agile in terms of engaging its own structures to reach out to all its different actors (the EU and SMEs), failing to be reflective enough of its different instruments, and lacking to fully consider their different actors.

Chapter six of the study assesses and discusses the differences between EU economic diplomacy in theory and practice, with reference to the literature reviewed in chapter 2 of this study. Using the conceptual framework in chapter 2, that there is a major disconnect between EU objectives and the reality of EU economic diplomacy, leaving room for considerable improvements until we can discuss a collaborative, inclusive and forthcoming type of EU economic diplomacy. Finally, chapter seven of the study concludes, looking at lessons learnt and policy advice in moving forward.

CHAPTER 2. CONCEPTUAL FRAMEWORK

Given the changes in the international environment as a result of globalisation (Friedman, 2007), the world has become far more complex, connected and contested (European External Action Service, 2015). f In order to become more effective and legitimate, the EU has developed new structures to reach out, new instruments and it now looks to interact with different actors as well, moving from bilateral engagement to multilateral cooperation, working with SMEs and other actors in the field (European Commission, 2014a). These have seen changes in diplomacy and how it engages with different actors. Therefore, in the thesis, we will explore the changes in diplomacy and the new modalities of diplomacy, and whether the EU is now effective in its dealings with these different actors, by becoming more complex, agile, inclusive and connected. Yet, before we can begin this evaluation, we have to establish what we understand by diplomacy.

This chapter aims to present an understanding of diplomacy, its changing nature, actors and functions, as well as the role, advantages and challenges of economic diplomacy, in order to then be able to examine the three types of diplomatic change: (1) increased complexity (e.g. new instruments, structures), (2) increased inclusivity and (3) increased agility and connectivity.

This chapter is divided into two main sections. The study begins by explaining the significance of power and influence and reviewing and assessing different definitions of diplomacy. Secondly, in order to achieve a thorough understanding of diplomacy, we consider the changing nature of diplomacy, from mytho-diplomacy up to the modern diplomacy (Der Derian, 1987). The thesis then distinguishes between different diplomatic actors, recognizing the growing importance of non-state actors, and businesses and small- and medium-sized enterprises (SMEs) in particular, showing that the new type of diplomacy has become more inclusive. Furthermore, the chapter considers different functions of diplomacy, identifying economic diplomacy as an important instrument in achieving economic development and cooperation, speaking to the complexity and agility of the new EU economic diplomatic model.

Having established the growing importance of economic diplomacy, the chapter then presents a deeper understanding of economic diplomacy. The thesis notes and analyses different scholars' views on economic diplomacy and its actors, proposing own working definition of economic diplomacy. After doing so, we highlight how economic diplomacy has moved away from economic statecraft to the new economic diplomacy, in part, a result of the world changing as a result of technological developments and increasing connectivity (European Commission, 2014a), highlighting its advantages and challenges. Finally, this chapter aims to consider the role of the EU as regional economic diplomacy actor, the eastern region and Moldova, as this thesis's case study.

Given the existing literature on diplomacy and economic diplomacy in particular, the thesis highlights an important research gap in existing academic studies. While the principal focus of existing literature represents diplomacy at the macro-level (within the international system and within the EU Member States), there are only few, recent academic studies that acknowledge the importance of diplomacy at the micro-level, impacting upon SMEs.

2.1 DIPLOMACY

We might think of diplomacy in the global sense as the interaction at a global or regional level between states, NGO and business organisations; hence, diplomacy is one way to manage regional and global relations between states and non-state actors. Given that the EU, as a regional actor, is looking at deepening its interaction with the outside world in a more interconnected way, we need to define diplomacy, understand how it has changed and how its different modalities have emerged. However, firstly, it is important to understand the difference between power and influence, as discussed by Hill (2003), and how they relate to EU diplomacy. Hill (2003) provides one of the most comprehensive understandings of the instruments of power, identifying two principal approaches: hard and soft power.

Hard power, or 'sticks'[3], includes physical coercion, blackmail and coercive diplomacy (threat of force) (Cooper, 2004; Hill, 2003). This realist, palpable form of power has been enforced by various individuals, including Lyndon B. Johnson and Machiavelli (Cooper, 2004). Bismarck, the first chancellor of Germany, enforced his approval of hard power during a speech in the Prussian House of Deputies on 28th January, 1886: '*policy cannot succeed through speeches…and songs; it can be carried out only through iron and blood'* (cited in Ratcliffe, 2011: 237).

Yet, on the other hand, soft power, or the so-called 'carrots', consists of persuasion and deference in the form of *latent influence*, including instruments such as diplomacy, cultural diplomacy and propaganda. It is important to stress the difference between soft power and influence. While Nye (2008) argues that soft power is a source of influence, we argue that different types of soft power are in fact the sources of power that can lead to influence. With Hill's (2003) and Nye's (2008) views and concepts of soft power and influence in mind, we can argue that today, diplomatic influence represents the ***ability to enable others through different soft types of power***, and therefore, in order to have that influence and soft power, state and non-state actors need to engage with diplomacy.

2.1.2 Defining Diplomacy

The origins of the word 'diplomacy' date back to the Greek word 'diploma', that means folding a piece of paper into two, which was used by Greeks to describe official travel documents (Barnhart, 1988). However, the word 'diplomacy' became modern in the context of international relations in the late 18th century (Der Derian, 1987).

Bull (1977) explained diplomacy as '*the conduct of relations between states and other entities standing in the world of politics by official agents and peaceful means*' (p.162), identifying the importance of other actors within diplomacy. A few years later, Wight

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[3] The 'Carrot and Stick' approach is an expression indicating the offer of a combination of rewards or punishments in order to induce certain behavior, being used in the field of International Relations in order to describe the realist concept of 'hard power' and 'soft power' (all means necessary) (Andreoni *et al*, 2003). This approach is known as the 'donkey psychology' in economic diplomacy (Van Bergeijk, 2009). This principle could, however, be counter productive, as countries could run away in the opposite direction, feeling threatened.

(1979) provided a more simplistic definition of diplomacy, as the art of communication between powers, while Watson (1982) highlighted the importance of diplomacy in state collaborations, considering it to be a dialogue between states, which grew from the need of states to communicate with each other. What these definitions suggest is the importance of communication in state collaborations, identifying the rise of '*other entities'* within diplomacy (Bull, 1977: 162). However, given the evolving nature of diplomacy, these considerations of diplomacy, at present, are insufficient, without recognising the multilevel diplomatic actors' engagement or the complexity of the new diplomatic model. Yet, a few years later, Der Derian (1987) succeeded at providing a more comprehensive definition of diplomacy, for he recognised a less invasive and multilevel actors of diplomacy. Der Derian (1987:6) defines diplomacy as '*a mediation between estranged individuals, groups or entities, where mediation is a connecting link, or intervention*'. Elaborating on Bull's (1977) consideration of diplomacy as a '*conduct of relations'*, Der Derian (1987) highlights the important role of diplomacy: managing alienation and building bridges in order to foster collaboration between different actors, which could take place in different settings (e.g. political, social, economic). A few decades later, Barston (2006:1) provides a simpler conceptualisation of diplomacy, considering diplomacy as being '*concerned with the management of relations between states and other actors*'. Yet again, while Barston's (2006) conceptualisation of diplomacy considers the relationships between state and non-state diplomatic actors, the scholar had certain missing links, without tackling the exact nature of 'relations', which Der Derian (1987) speaks to.

While the other scholars showed some aspects of diplomacy, they also had some missing links, which Der Derian (1987) addressed when offering us a more comprehensive conceptualisation of diplomacy, which also speaks to the changes in the global environment and the emergence of different actors, showing that diplomacy has become more inclusive. Therefore, for the purpose of the thesis, we will employ this particular approach in order to understand how the EU engages with its actors. Hence, we define diplomacy as ***the process of managing alienation[4] (Der Derian, 1987) and building bridges between different actors through peaceful means including political and***

[4] The Oxford Dictionary (2015) defined alienation as '*the state or experience of being isolated from a group or an activity to which one should belong or in which one should be involved'*. Synonyms of 'alienation' include isolation, estrangement, separation, and distance.

economic cooperation. Yet, in order to achieve a deeper understanding of diplomacy, given its changing nature, we must consider a few features that will help us in addressing the research questions of this study, as highlighted in the introductory chapter: (1) how diplomacy has evolved over time, moving away from the concept of statecraft, becoming more complex; (2) different actors in the field of diplomacy, becoming more inclusive by welcoming new actors, and in particular, SMEs; and (3) changing functions of diplomacy, speaking to the agile nature of diplomacy.

Yet, in order to achieve a deeper understanding of diplomacy, it is important to consider the changing nature of diplomacy over time, and the effect globalisation had on diplomacy, as its different development phases lead to the existence of different types of diplomacy, an increased range of actors and different functions and instruments of diplomacy.

Scholars in the field of International Relations have acknowledged and considered the current role and the effects of globalization on diplomacy (Bayne and Woolcock, 2007; Al-Motairi and Zaki, 2013). Saner and Yiu (2001) define globalization as a complex set of interdependencies and an increasing number of actors whose aim is to impact the outcome of these relationships. Friedman (2007) announced the death of distances, which, in a truly flat space, would lead to disappearance of the differences between internal and external trade, increased communication and removal of borders (Van Bergeijk, 2009), speaking to a better connected diplomatic model. Friedman's (2007) study and understanding of globalisation speaks to the very nature of this research, as new types of diplomacy and in particular economic diplomacy, together with new diplomatic instruments, such as the EaP's SME Flagship Initiative as we will see in the subsequent chapters, place a strong emphasis on facilitating and increasing trade between the EU and the EaP countries. Moreover, in addition to trade, Friedman's (2007) importance of increased communications, given a more connected world, agrees with Hill's (2003) recognition of the vital importance of communication in today's diplomatic environment, showing that the EU has to be more agile and hence, more transparent in engaging with its structures given the increased global communication.

The European Commission (2014a) acknowledges the impact of globalization as a strong force in changing the global environment for the past century. Through empowerment of individuals and promotion of soft instruments of power in the form of *influence*, globalisation has shifted the focus away from government and national states, towards non-state, inter-state and transnational actors, such as markets, businesses, societies and individuals (European Commission, 2014a). Globalisation has facilitated a shift in diplomacy, becoming more complex, and its very definition, aiming to build bridges and manage alienation between different state and non-state actors, aspiring to be more inclusive. Der Derian (1987) himself recognised the importance of globalisation in increased world connectivity, with globalisation changing the nature of diplomacy and becoming more complex by facilitating communication, increasing trade and promoting the engagement of different state and non-state actors, speaking to the scope of this study. Hence, the new EU diplomatic model has become more complex.

Yet, in order to gain a full understanding of the changing nature of diplomacy over time, we shall not only limit our considerations to the effects of globalization on diplomacy, but also consider Der Derian's (1987) conceptualisation of diplomacy, presenting various forms diplomacy emerging over time, from mytho-diplomacy to the current techno-diplomacy, in order to see how diplomacy has evolved over time, becoming more complex. Mytho-diplomacy embraces the assumption that diplomacy has its roots in faith, traced back to God's relationship with Adam and Eve (Der Derian, 1987). Nicolson (1988), an English diplomat, identified that the 16th century theorists considered angels to be the first diplomats when serving as messengers between heaven and earth, which is consistent with Wight's (1979) and Watson's (1982) definitions of diplomacy discussed earlier in this chapter. The ideal ambassador in mytho-diplomacy is identified as a man ruled by flexibility, practicality and reason, having a wide knowledge of a variety of subjects (Callières, 1963). Following mytho-diplomacy, proto-diplomacy, dating back to the Middle Ages, was facilitated by advances in technology innovations, and was inseparable from war in the form of hard power (Watson, 1982; Hill, 2003). Another form of diplomacy identified in Der Derian's (1987) conceptualization of diplomacy is Anti-diplomacy, focused on the diverging world views of Hobbes and Kant, both of whom saw diplomacy as increasingly irrelevant. On one hand, the Hobbesian state of nature that was in a permanent conflict '*of all against all*', while the latter saw the progress towards '*perpetual peace*' as diminishing the need for diplomacy.

Neo-diplomacy, or ‘Nouvelle Diplomatique’ is the successor of Anti-diplomacy, being promulgated by Ducher, official of the French foreign office, emerging at the end of 18th century and recognized during the French and Russian revolutions (Der Derian, 1987). Again, we can observe that the foundation of Neo-diplomacy is the focus on ‘*all means necessary’* to advance world revolutions (Hill, 2003). Ducher outlined the principles that would bring a new order under neo-diplomacy, including neutrality in wars among monarchs, relations based on free commerce and a natural bond between free people as the guarantor of peace. However, neo-diplomacy was put to rest in 1922, as a result of failure and abandonment of the world revolution[5] (Der Derian, 1987).

The final and contemporary form of diplomacy identified by Der Derian (1987) is techno-diplomacy. In this context, the expansion of the European states system did not only leave room for cooperation, but also for confrontations through increased levels of travels and advances in technologies (for example, the advance of nuclear weapons as well as technocratic forms of government) (Der Derian, 1987). Der Derian identifies the shift in diplomacy from the events themselves to the velocity of events, due to instantaneous communications, weapon delivery and response times (Der Derian, 1987). While an increasing tendency has been identified among statesmen to ‘*treat each other as objects of information, rather than subjects in communication’*, Der Derian (1987: 207) considered crisis management to replace reflective decision-making in present diplomacy. Hence, Der Derian (1987) showed a need for improved and increased communication between states and states representatives (which is consistent with the effects of globalisation as discussed above), in order to become more effective in making the correct decisions and implementing diplomatic instruments effectively, instead of having to employ crisis management as a result of poor decision-making and lack of effective communication.

Looking at Der Derian’s (1987) conceptualization of diplomacy, we can observe how diplomacy has changed and evolved over time, becoming more inclusive by facilitating the involvement of new actors; Der Derian’s (1987) conceptualisation of diplomacy highlights the importance of effective communication in the present techno-diplomacy, which speaks to the effects of globalisation previously discussed. This shows that

[5] The Soviet Union abandoned world revolution and reverted to ‘Socialism in one country’.

diplomacy has become more complex, yet it is important to consider whether the new type of diplomacy has become better connected as well, which the empirical section of this study aims to address. Hence, given the increased significance of effective communication, we can observe that globalisation has had an important effect on diplomacy, allowing the EU to become more efficient, inclusive and agile in its diplomatic instruments. Der Derian's (1987) conceptualisation of diplomacy is vital for this study in highlighting the move from political statecraft at state level towards a more inclusive type of diplomacy, welcoming new diplomatic actors and instruments. Hence, we argue that globalisation has affected the nature of diplomacy today, placing a strong emphasis on communication and collaboration at different levels, shifting our understanding of diplomacy away from simply political statecraft, towards more inclusive, complex and agile types of diplomacy.

As globalization creates a more complex, connected and contested world (Friedman, 2007; Van Bergeijk, 2009; European External Action Service, 2015), diplomacy has changed and developed, becoming more flexible and inclusive, moving away from the traditional focus of diplomacy (Barston, 2014; Bayne and Woolcock, 2007) towards more specific interest-based areas of diplomacy. Various types of diplomacy have been developed as a result of the changing face of diplomacy, showing that diplomacy has become more complex. Diplomacy has evolved from purely political diplomacy (Moomaw, 2012), addressing topics including war and peace, borders, trade disputes, with the primary goal of defending state territoriality and sovereignty, into new forms of diplomacy (Barston, 2014). Additionally, given the effects of globalisation on the changing nature of diplomacy and the introduction of new diplomatic instruments and actors, the EU has become more complex in terms of its organisation and its structures, developing from merely political statecraft. There are now various forms of diplomacy, focused on areas of interest, including public diplomacy (Sharp in Melissen, 2005), health diplomacy (Kickbusch *et al*, 2007), visa diplomacy, knowledge diplomacy and economic diplomacy.

In order to become more effective, the EU has become more complex, developing new structures and instruments, moving away from state level and targeting new actors (European Commission, 2014a). However, in order to be able to provide an overall picture of diplomatic actors, we must revisit the definitions of diplomacy as noted by Bull (1977), Wight (1979), Watson (1982) and Der Derian (1987). Despite all being part of the English school tradition, we can observe that while Bull (1977), Wight (1979) and Watson (1987) identify states and political powers as the only actors of diplomacy. Der Derian (1987) does not limit his approach of diplomacy to states, and proposes new actors in diplomacy, recognizing the importance of individuals, groups and entities, and the inclusive nature of diplomacy. Political economists Keohane and Nye (1974) have stated similar views as Bull (1977), Wight (1979) and Watson (1982). Still, while they acknowledge the existence of international organizations and multinational corporations (MNCs), the scholars do not consider them actors in diplomacy, but rather platforms for diplomacy state actors (Keohane and Nye, 1974): international organisations and MNCs are not just objects, but they are rather becoming subjects, being new actors and agents that the EU uses in becoming more effective. Hence, the new diplomatic model has become more inclusive.

Consequently, we believe Der Derian's (1987) consideration of other actors has been strongly influenced by the advancing force of globalization, which is highly important for the purpose of this study, bringing SMEs to the heart of diplomacy today and highlighting that diplomacy has become more inclusive. Der Derian's (1987) conceptualization of diplomacy is complex, recognizing the existence of non-state actors in diplomacy. The effects of globalisation on increased communication, diminishing trade barriers and improved collaboration has led the EU to being more inclusive, welcoming new non-state diplomatic actors such as small businesses, as the world becomes more complex and connected. Additionally, these effects have also led the EU to become more agile in engaging with its structures, given the increased communication and improved collaboration and the higher number of diplomatic actors the EU engages with, which should lead to increased transparency. Taking the example of the Eastern Neighbourhood Policy (ENP), in order for the EU to become more effective and legitimate, diplomacy within the Eastern Neighbourhood has moved away from being limited to the bilateral engagement between states, placing a strong emphasis on multilateral cooperation, introducing new actors such as SMEs and business support organisations, aiming to promote inclusiveness.

The European Commission (2014) report is consistent with Bayne and Woolcock's (2007) findings in this area. Woolcock (Bayne and Woolcock, 2007) has identified a range of non-state actors at national, regional and global level, including interest groups, MNCs, consumer organisations, non-governmental organisations (NGOs) and other individual firms, illustrating the effect globalization has been having on diplomacy: the introduction of new, non-state diplomatic actors in order to drive the effectiveness and legitimacy of the EU, showing that EU diplomacy has become more inclusive. However, while Bayne and Woolcock (2007) recognise the importance of MNCs as diplomatic actors, they do not place a strong emphasis on SMEs as actors of diplomacy, overlooking their potential for influencing state and non-state relationships in order to build bridges and manage alienation. Yet, while we have noted increased EU inclusiveness in terms of greater engagement of new diplomatic actors, it is highly important to consider whether or not this inclusivity has also been registered in practice, which this study will consider in chapters 5 and 6.

Having highlighted the proliferation of diplomatic actors over the past decade with a growing focus on non-state actors, underlining that diplomacy has become more inclusive, it is important to consider the new functions of the more complex and agile type of diplomacy, as identified by Hill (2003), which we will then apply to the empirical analysis in chapters 5 and 6. Hill (2003) recognized four functions diplomacy exercises as an international actor: communication, negotiations, participation in multilateral institutions and the promotion of economic goods (economic diplomacy).

Firstly, communication is a political and economic activity of the highest importance, since states and governments need to be careful in terms of the signals they aim to send in important matters and the actual signals delivered, as they might leave room for misinterpretation (Hill, 2003). Although, as mentioned by Hill (2003), any actor needs to keep some information confidential, Nicolson stresses the importance of policy being in the open even if negotiations take place in confidentiality, as miscommunication can lead to disastrous consequences. We have previously seen that communication has been at the core of diplomacy, from Bull's definition of diplomacy to European External Action Service's (2015) report on the importance of communication as a result of globalization. With the increased focus on communication, we also expect diplomacy to become better connected and agile, facilitating dialogue between its different structures and agents. As diplomacy becomes more agile and better connected as a result of the increasing importance of communication, engaging with more structures and actors, the new diplomatic model should also ensure transparency within its increasingly complex structures. Yet, we will review this in the empirical sections of this study, chapters 5 and 6.

The second function of diplomacy Hill (2003) notes is the capacity to conduct (often) technical and complex negotiations, highlighting that negotiations in the international environment require highly skilled and experienced diplomats. Bayne and Woolcock (2007) agree with Hill (2003), considering in detail theories of negotiations. Yet, we must acknowledge that as a result of globalization and the shift from state actors to businesses, markets and individuals, negotiation is remaining relevant mostly at the state-level, which has also been argued by Hill (2003).

The third function of diplomacy identified by Hill (2003) is the participation in multilateral institutions, as both state and non-state actors need to be aware of their behaviour in environments that require a balance of interests between states (Hill, 2003). In this sense, diplomacy has become more agile, being accountable for its dealings with different diplomatic structures and actors.

Finally, the promotion of economic goods, in the form of economic diplomacy, focusing on boosting export efforts and attracting foreign investment in order to boost employment, represents the fourth function of diplomacy, which this study will focus on in greater detail (Hill, 2003). Many scholars have considered a growing importance of economic diplomacy, not only in terms of trade and investment but also negotiations (Bayne and Woolcock, 2007; Okano-Heijmans, 2011; Moons and Van Bergeijk, 2013), observing its transition to overshadowing traditional political diplomacy (Petrovsky, 1998), highlighting the inclusive role diplomacy, and in particular economic diplomacy has today, becoming significantly more complex and welcoming new and highly important diplomatic actors such as SMEs.

Having discussed the changing role of diplomacy over time, moving away from state level actors towards non-state actors, EU diplomacy has become more complex, inclusive and it also should be better connected, as a result of technological and communication advances. As a result, the economic focus of diplomacy (economic diplomacy) has become highly important in the world environment (European External Action Service, 2015).

2.2 ECONOMIC DIPLOMACY

2.2.1 Defining Economic Diplomacy

After having established an understanding of what diplomacy is, its changing nature, main actors and functions, we will now consider economic diplomacy in more detail, an area of diplomacy that has been growing in importance over the past decades (Hill, 2003; Bayne and Woolcock, 2007).

Odell (2000) argues that economic diplomacy is defined by the issues that provide its content, which are policies relating to goods, services, money, investment and more, stressing its sensitivity to market developments. Hence, in his definition, Odell (2000) highlights the importance of economic diplomacy: the consideration of economic affairs and in particular, economic policies, in order to manage and build partnerships. In addition, Odell (2000) argues that economic diplomacy is concerned with what governments do rather than what foreign ministries do, acknowledging the participation of non-state actors in economic diplomacy. However, Odell (2000) does not provide a clear definition of economic diplomacy, and while he acknowledges the existence of non-state actors, Odell suggests that economic diplomacy takes place at a governmental level, without consideration of business and individual levels, suggesting a lack of inclusivity in the EU economic diplomatic model. However, Odell's (2000) understanding of economic diplomacy highlights yet again the changing nature of diplomacy, as previously discussed, and sensitivity of economic diplomacy to market developments, speaking to the complex nature of diplomacy, suggesting that EU economic diplomacy has become more complex and inclusive. With economic diplomacy being sensitive to market changes, it is thus even more important to ensure appropriate communication and collaborations between different economic diplomatic actors. While Odell's (2000) understanding of economic diplomacy is somehow complex, there are some missing links in terms of new economic diplomatic actors acknowledgement, which has been spoken to by Der Derian (1987).

Building on Odell's (2000) consideration of economic diplomacy, Van Bergeijk and Moons (2007) understand economic diplomacy as a set of activities related to cross border economic activities, such as investment, export, import, aid and migration, which are pursued by actors globally. Van Bergeijk and Moons (2007) identify economic diplomacy as comprising three main activities: (1) the use of political *influence* and relationships in order to promote/influence/improve investments, trade, the way markets function and/or address market failures; (2) the use of economic assets and relations in order to increase economic security; and (3) means to consolidate the appropriate political environment and collaborations in order to institutionalise these objectives. However, looking back at the changing face of diplomacy over time as earlier noted, Van Bergeijk and Moons's (2007) understanding of diplomacy is limited in actors and scope, as they do not discuss the shift away from state actors and the global perspective of diplomacy towards non-state actors not only at the international or transnational level, but also at a regional, national and individual level, suggesting that on the contrary, the EU economic diplomatic model has not become more complex.

Bayne and Woolcock (2007) do not provide a definition of economic diplomacy, instead contending that there is a lack of a single theory of economic diplomacy due to its focus on the interaction between international and domestic factors and between political and economic concerns. Yet, they suggest a number of characteristics of economic diplomacy: being concerned with international economic issues, as well as domestic decision-making, as a result of advances in globalization; and using a range of instruments that differ from voluntary cooperation and informal negotiations to the enforcement of binding rules, showing that economic diplomacy has become more complex (Bayne and Woolcock, 2007). Hence, the effects of globalisations are not only observed broadly at a general diplomatic level, but also within the different types of diplomacy, such as economic diplomacy, speaking to its complex nature.

While various scholars provide different considerations of economic diplomacy, as illustrated above, Der Derian's (1987) conceptualisation of diplomacy, together with the changing nature of diplomacy, provide the foundation of this study's own working definition of economic diplomacy. Hence, we define economic diplomacy as ***managing relationships and building bridges between different state and non-state actors including private enterprises (e.g. SMEs), using influence in order to further economic collaboration and achieve economic objectives.***

2.2.2 The changing nature of economic diplomacy: becoming more complex

Economic diplomacy is constantly evolving, becoming more complex as a result of globalization and moving away from economic statecraft as a primary practice of economic diplomacy (Bayne and Woolcock, 2007; Hill, 2003). Smith *et al* (2012) define economic statecraft as the use of economic tools as well as relationships in order to achieve foreign policy objectives, being only one area of economic diplomacy. Economic statecraft can be negative, as ‘sticks’, including trade restrictions, financial sanctions, investment restrictions and monetary sanctions, or can be positive, as ‘carrots’, in the form of tactical or structural linkages (Smith *et al*, 2012).

While the use of negative economic statecraft has prevailed since the end of the Cold War, scholars argue that the use of economic sanctions has failed to achieve its aims in terms of political objectives, being considered ineffective instruments of statecraft (Pape, 1997). On the other side, positive economic statecraft, in the form of tactical linkages, also known as ‘specific positive linkage’, operates at a more immediate level, promising well-specified economic concessions in an effort to alter target government’s foreign policy (Smith *et al*, 2012). Additionally, structural linkages, also known as ‘general positive linkages’ are unconditional and operate in the long-term, using a steady package of economic benefits for target countries (Smith *et al*, 2012). Yet, it is argued that while ‘sticks’ have received the attention of governments and academic studies more than the ‘carrots’, the end of the Cold War created a different international environment for sanction attempts, reviving the scholars’ interests in positive economic statecraft (Jentleson, 2000).

Having explained economic statecraft and taken consideration of the changing nature of diplomacy, we argue that ***economic diplomacy has been developing, moving away from economic statecraft, becoming more complex, inclusive and better connected***. At present, economic statecraft is only a small section of economic diplomacy, becoming disregarded as changes in global environment lead to more complex and flexible diplomacy and specifically economic diplomacy, with new actors and instruments.

2.2.3 The shift towards non-state economic diplomatic actors: becoming more inclusive

Unlike Van Bergeijk and Moons (2007), Bayne and Woolcock (2007) acknowledge the existence of non-state actors in economic diplomacy (e.g. individuals, independent businesses in the form of MNEs, business groups, NGOs), showing that EU economic diplomacy has become more inclusive. Hence, Bayne and Woolcock (2007) provide three different levels of analysis of economic relations between states: (1) systematic theories, concentrating on the relations between states as single entities; (2) domestic theories, concentrating on international behaviour within the state; and (3) ideas and individuals, having a significant impact on policies. Yet, while Bayne and Woolcock (2007) take into consideration the domestic contribution of diplomacy, their study places a strong focus on negotiation and decision-making, which are mainly practiced within formal political or economic groupings at state or ministerial level. Additionally, we must point out that Bayne and Woolcock (2007) only consider MNEs and transnational corporations (TNCs) as non-state independent business actors, without taking into consideration the existing role of SMEs in economic diplomacy, which is increasing in importance. The increasing importance of SMEs in economic diplomacy has been recognised by the EU, introducing new economic diplomatic instruments aimed specifically at small firms, such as the SME Flagship Initiative, which we will discuss in the following chapter. Yet, despite economic diplomacy becoming more inclusive, it is important to assess whether it has become better connected as well, which chapters 5 and 6 of this study aim to address.

2.2.4 Advantages and Challenges of Economic Diplomacy

Van Bergeijk and Moons (2007) discuss several advantages of economic diplomacy, including increased foreign direct investment (FDI), trade and economic security, and addressing market failures. The recognition of the benefits of FDI goes back to the 1920s, when Lenin (1920) acknowledged that FDI could increase the price of war and therefore, reducing the conflict occurrences. Today, most FDI is carried out by multinational corporations (MNCs) aiming to enter foreign markets, and depending on the level of involvement and penetration of FDI within another state, a series of economic, political and social effects would occur (Moosa, 2002); these include national gains through taxes on foreign profits; increase in real wages at the expense of profits (MacDougall, 1960); reduced tariffs and liberal economic policies (Büthe and Milner, 2008). Yet, it is important to mention that FDI is only one of the benefits of economic diplomacy, with another highly important advantage being increased trade, as trade leads to higher economic growth, which the empirical analysis of this study focuses on.

While all of these advantages could be seen at macro rather than micro level, Moosa (2002) has identified the benefit of a more competitive environment that would lead to developments in local industries. We believe that this is a highly important matter for businesses and enterprises at the microeconomic level, as increased competition encouraging innovations and product developments, which, in turn, lead to job creation and economic growth not only at a national level, but also at a regional and global level (Baily *et al*, 2005). This is an advantage that is highly relevant to the concept of diplomacy: a more competitive national economic environment requires individuals to increase their business acumen, increasing trade and building economic partnerships between different countries and regions, such as the EU and the EaP.

Despite the several advantages mentioned above, economic diplomacy today also faces important challenges, which include the emergence of new economies with very different institutions and cultural backgrounds; weak global security leading to decreased trade (Blomberg *et al*, 2006; Fratianni *et al*, 2006; Rose, 2007; Maurel and Afman, 2007; Nitsch, 2007); and new players that will influence global values and norms, having a significant impact on international trade and investment (Van Bergeijk, 2009). Yet, while these challenges are experienced at a global level, they could also impact on new participants engaged or subject to economic diplomacy such as businesses and individuals, which is why it is highly important for all diplomacy, and economic diplomacy, actors to be able to manage alienation and promote economic, political and social growth.

Having explained the concepts of economic diplomacy, its actors, changing nature and advantages and challenges, we will now assess the role of the EU as a regional actor in economic diplomacy, one of the most important regional actors in diplomacy, acknowledged by scholars including Bull (1982), Bàtora (2003), Hocking and Spence (2005), Melissen (2005), Bayne and Woolcock (2007).

2.3 SITUATING ECONOMIC DIPLOMACY IN THE REGIONAL CONTEXT

Particularly because the face of economic diplomacy is changing and impacting upon policy, we recognise the emergence of various players in the field of economic diplomacy, such as the Economic Bank for Regional Development (EBRD), the International Monetary Fund (IMF) and the World Bank as international economic diplomacy actors, the European Union and the Eurasian Economic Union (EEU) as regional economic diplomacy actors. However, in the context of the Eastern Partnership, we recognize the importance of two large powers: the EU on one side, and the EEU on the other. Yet, it is important to stress the fact that with the EU being a multilevel actor, economic diplomacy does not only take place at the EU level, but also bilaterally between Member States. For the purpose of this study, given the focus on policy, we will consider the EU in its entirety, rather than Member States as different actors.

2.3.1 The European Union

The Treaty of Rome sets out the principles of the EU. Article 1 of the Treaty of Rome (European Union, 1957) notes the establishment of a European Economic Community between Belgium, Germany, Netherlands, Luxembourg, France and Italy, laying the foundations of '*an even closer union among the people of Europe*' (European Union, 1957; p.3). The activities towards achieving this goal are highlighted in Article 3 of the Treaty, and include, among others: the elimination of customs duties and restrictions on import and export goods; free movement of people, capital and services; adoption of common policies in different domains; and the '***association of the overseas countries and territories in order to increase trade and promote jointly economic and social development'*** (Art. 3(k) of the Treaty of Rome; p. 4). We can observe in Art. 3 of the Treaty of Rome (European Union, 1957) that the EU's main aims comprise of the management of relations within the EU, its neighbours and other regional actors, with a particular aim of promoting economic and social integration. We argue therefore that economic diplomacy lies at the heart of the EU, which given its reach and longevity, is in itself an important regional actor to consider.

After establishing the roots of EU diplomacy and its importance, we will now consider different views on the impact of the EU on diplomacy and the existence of a European diplomatic system. Bàtora (2003) identifies three levels at which the EU challenges diplomacy: (1) bilateral diplomacy, which is considered to remain intact to the present, despite growing European integration; (2) multilateral diplomacy at the central EU level, where the involvement of the Comité des Representants Permanents (COREPER) transformed the role of diplomats into an ambiguous and blurred one; and (3) external diplomatic relations of the EU, with the main aim of the EC to develop a culture of a unified diplomatic service in the form of the European External Action Service (EEAS), external to the Commission's, and create EU diplomats-generalists in order to gradually move towards a unified foreign policy of the EU. Bàtora's (2003) study underlines the impact of the EU on the field of diplomacy, as it moves towards deeper integration, in terms of unified foreign policy at the EU level, in line with the main principles set out in the Treaty of Rome (1957). Hence, the EU institutional structure of diplomacy includes the EC, the EEAS and the various EU and non-EU member states, which engage in economic diplomacy, coordinating with each other on different levels, as we will discuss in the empirical analysis of chapter 5.

Hocking and Spence (2005) go on to identify a shift from the traditional diplomatic system towards a European diplomatic system, whose major administrative component is the EC's external relations directorates and delegations outside the EU. According to Hocking and Spence (2005), the intention to create a unified European diplomatic system dates back to the fall of communist systems in Central and Eastern Europe in 1989. Yet, it is not until 1996 when David Williamson, former Secretary-General of the EC, produced a key report recognizing the need for the development of a group of people willing to serve abroad as part of a life-long diplomatic career (Hocking and Spence, 2005). By that time, the EC already had a large body of delegations outside the EU, comprised not of diplomats, but rather more technical advisors. In 2000, the European Parliament (EP) proposed the establishment of a common European diplomacy (Hocking and Spence, 2005). Following the EP proposal, ten years later, a common European External Action Service (EEAS) was formed and together with the proposal for the creation of an EU Foreign Minister, which was subsequently replaced by a post of High Representative, aiming towards higher consistency and professionalism in EU foreign policy and a more unified relationship with its partners (Hocking and Spence, 2005). Hocking and Spence

(2005) consider the emergence of the EEAS to represent a significant step in the creation of a European Diplomatic System. Although the EU diplomatic structures have encountered some difficulties, given the development of structures within the EU, the EC role as a diplomatic actor and main trade negotiator has increased since the early 1990s, leading to the creation of EEAS and the involvement of EC representations and relationships with foreign national governments. Taking the example of the Eastern Partnership, the role of the EU as a diplomatic actor and trade negotiator has been reflected in the complex institutional frameworks of its policies, collaborating with various business support organisations, NGOs and the Chamber of Commerce and Industry of the Republic of Moldova. Yet, we will explore this matter in further detail in chapters 5 and 6 of this study.

In contrast, Melissen (2005) perceives the EU as a weak actor in international politics, arguing that EU member states' inability to communicate a shared set of opinions and values in the international politics setting compromises EU's ability to become an independent political power in the future. Additionally, Melissen (2005) highlights that the EU has not been able to speak with one voice in terms of foreign policy, an important requirement for any actor aiming to promote its values in the international context. Yet, Melissen (2005) does not consider the economic and social faces of diplomacy, which, as we have previously established, increase in diplomatic importance.

Given the arguments noted above, we agree with Bàtora's (2003) and Hocking and Spence's (2005) views of EU diplomacy, considering the EU a strong regional diplomatic actor, for it moves towards deeper integration, managing alienation and in particular influence its neighbours and other regional actors, moving towards a European diplomatic system. However, it is important to analyse the effectiveness of the EU as a diplomatic actor in practice, which the empirical analysis of this study will later address.

Moving on to considering economic diplomacy within the EU, Bomberg and Stubb (2003) divide the regional economic groupings into four main categories, the most advanced type being the EU, which was placed at the heart of strategic decisions since 1957, encompassing a range of common economic policies at both the internal and external levels and a single currency. Various scholars have recognized the importance of the EU in the international economic diplomacy setting (Duke, 2002; Woolcock, 2012). The

European dimension of diplomacy and economic diplomacy have seen an important evolution (Bayne and Woolcock, 2007), from the Treaty of Rome (1957) to the Single European Market promoting European international competitiveness, followed by the creation of the Economic and Monetary Union under Jacques Delors (Senior Nello, 2012), President of the Commission between 1985 and 1995. This evolution highlights the increased complexity of the EU, stressing the importance of the EU becoming more effective and legitimate.

Yet, we must highlight that the European economic diplomacy setting has been shaped by a wide range of ideas (Bayne and Woolcock, 2007; Woolcock, 2012; Duke, 2002). Bayne and Woolcock (2007) consider European economic diplomacy by assessing at two main policy areas, European Trade Policy and the European Monetary Union, within European economic diplomacy from the prism of negotiation theories.

In matters of European Trade Policy, Bayne and Woolcock (2007) suggest that the European Commission makes proposals on the mandate, which is to be maintained as broad as possible in order to provide negotiation flexibility, after consulting Member States, EU-level interests and the EP (Bayne and Woolcock, 2007). In addition, the EC negotiates in collaboration with Member States in EU trade policy (Meunier and Nicholaidis, 1999), where the latter are also welcomed to sit in formal meetings. As in agenda setting, the Member States in the Council ratify the agreements negotiated by the EU. However, the European Parliament does not have any real power in the negotiations and has never majorly challenged a multilateral trade agreement (Bayne and Woolcock, 2007). In EU monetary policy, the lead agency is the European Central Bank, which has significantly more autonomy than the EC in trade policy, due to its political and financial independence (Bayne and Woolcock, 2007). However, in matters of international negotiations, EU's monetary competence is disputed and ill defined (McNamara and Meunier, 2002). The power of ECB is limited and there is no agreement on who would represent monetary policy for the EU at an international level, as ECB has merely a role of observer at the IMF, with the President of the ECB only attending a limited number of meetings (Padoa-Schioppa, 2004). Therefore, the EU has its hands tied when it comes to influencing international monetary policy, in comparison to international trade policy.

As we can observe, Bayne and Woolcock (2007) concentrate on the assessment of the macro economic environment when considering European economic diplomacy, without taking consideration of smaller new economic diplomatic actors, such as SMEs, showing existing missing links in their study. Just as globalization led to a shift from diplomatic state actors to diplomatic non-state actors, we must recognize the necessity of different diplomacy functions and instruments, moving away from negotiations and the general management of relations between governments towards a more concrete measures. Therefore, this study finds Bayne and Woolcock's (2007) considerations of European economic diplomacy insufficient, without speaking to the current economic diplomatic environment and, looking back at this study's working definition of diplomacy, we define EU economic diplomacy as ***the management of alienation and relationships within and between the EU, its (Eastern and Southern) neighbours and other regional actors, in influencing and promoting economic developments and collaborations for mutual benefits.***

2.3.2 The Eastern Region

The EU has evolved, introducing new diplomatic structures, instruments and actors, aiming to reduce alienation not only within the EU, but more importantly, within its vicinities and especially within the EU's Eastern region and the Eastern Partnership countries. Since the 2004 EU enlargement, six countries (i.e. Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova and Ukraine) from EU's eastern region have become EU's direct neighbours (Barcer and Balfour, n.d.), leading to increased interactions and relations between the EU and its newly eastern neighbourhood. Yet, the Eastern region space is distinct from the rest of the EU.

As a former soviet space coming from a command economy, the newly democratic Eastern region is still **governed by complex bureaucratic procedures and corruption** (Transparency International, 2015), which has an impact upon the region's political, economic and social prosperity. The lack of progress in fighting **corruption** in the eastern region undermines the prospect of a greater economic and political progress in the area and cooperation with the EU (Transparency International, 2015). Political and business elites, also known as the former '***nomenklatura***' who were engaged in political manoeuvring while retaining their complete power and having superiority over all the others in the Soviet system (Foreign Affairs, 1984), still exert their influence upon key institutions in the region, allowing for their power to go unquestioned and to defy the law (Transparency International, 2015).

Complex bureaucratic procedures still remain a source of frustration in the eastern region, especially for new businesses (Financial Times, 2014). Coming from an economy with limited state capacity where **SMEs represent a new phenomenon**, there are complex bureaucratic procedures in place that hinder the full potential of entrepreneurship in the Eastern region (Ibid). Yet, despite its post-soviet heritage, Mieczyslaw Wilczek, Polish entrepreneur who fostered innovation among start-ups in Poland, stressed the importance of entrepreneurship in the eastern region: "*Entrepreneurialism has sprung up in central and eastern Europe as a means of economic survival*" (Ibid), reducing the complexity of tax procedures and bank loans for start-ups. Hence, Wilczek acknowledges the vital role of entrepreneurship and SMEs within the previous post-Soviet space (Ibid), which was originally aimed at economic survival and now receives increasing attention in order to foster further economic growth in the region. However, there are still difficulties in understanding the role of SMEs and therefore, delivering targeted support to these firms, which we will discuss in chapters 5 and 6.

Despite its difficulties in terms of complex bureaucratic procedures, previous economy and corruption, the eastern region is very much still developing, with the relationships between the EU and the Eastern space aiming to be deepened through the creation of the Eastern Partnership in 2009, aiming to further political and economic integration (Council of the European Union, 2009). In addition to the EU, the Eastern space has another important regional actor, which we need to account for, the **Eurasian Economic Union (EEU),** coming into force as of January 2015 (Ministry of Foreign Affairs of the Republic of Belarus, 2015a; Popescu, 2014). According to the Ministry of Foreign Affairs of the Republic of Belarus (2015a; 2015b), the EEU ensures free movements of goods services, capital and labour force in its borders and common policies in the economic sectors, being similar in some respects to the EU and having the potential to become an important diplomatic regional actor. Yet, given the focus of this study, we will not explore it any further.

However, despite its eventful past, the eastern region's political and economic instability can also be linked to economic and social weaknesses (Barcer and Balfour, n.d.). The global economic crisis has strongly affected the eastern region countries, putting their progress and growth on hold and its financial systems under duress. Additionally, another (security) challenge the region has faced was the frozen conflicts and Russia's assertiveness, as in the case of the Ukraine war and Crimea annexation to Russia in 2014 (Barcer and Balfour, n.d.).

Taking into consideration the challenges and the opportunities the eastern region has been facing, making it a very interesting case to study in comparison to EU's less developed southern region, the EU has shifted its attention towards its eastern neighbours, leading to the formation of the Eastern Partnership Initiative (Council of the European Union, 2009).

Out of the six Eastern countries, the Republic of Moldova has been the front-runner of EU policy, developing increasingly close relationships with the EU that go beyond collaboration, aiming to further gradual economic and political integration and cooperation (European External Action Service, n.d.a). Therefore, the thesis will focus on the Republic of Moldova as a case study.

2.3.3 The Republic of Moldova

Situated between Romania and Ukraine, the Republic of Moldova emerged as an independent republic in 1991, following the collapse of the Soviet Union. With a population of 3.5 million people (BBC, 2016) and an area of 33846 km^2, the local currency in the Republic of Moldova is the Moldovan Leu, and the country's total GDP as of 2013 is $13,299 billion (BBC, 2016; Moldova Investment and Export Promotion Organisation, n.d.). The chief industry in Moldova is the agri-food sector, given the country's high quality soils and favourable climate (Moroz *et al*, 2015). Moldova's agricultural specialisation includes the production of high value crops, such as fruits and vegetables, as well as the production of wine, with one of the country's most renowned vineyards, Cricova, being situated just outside the country's capital, Chisinau (Moroz *et al*, 2015). Other industries include retail, real estate and manufacturing, as illustrated in Figure 4.1 of chapter 4 (p.64).

Politically, since the Soviet Union collapse, the communist party was in power in Moldova until the communist President Vladimir Voronin resigned in September 2009 (BBC, 2016; European Forum for Democracy and Solidarity, 2015), opening the way for a pro-European coalition. Moldova has experienced several political crises that fostered instability and citizens' mistrust during the past 25 years, one of the most recent being the disappearance of $1 billion from three Moldovan banks, representing 15% of Moldova's GDP, leading to high risks and implications for the Moldovan economy (European Forum for Democracy and Solidarity, 2015; Holmund, 2015).

Yet, despite its Soviet legacy and the complex bureaucracy and corruption that has resulted because of it, the relationships between Moldova and the EU have intensified since the Partnership and Cooperation Agreement of 1994 and the most recent EU-Moldova Association Agreement (AA), which was fully enforced as of 1st July 2016 (European External Action Service, 2016). The EU-Moldova AA aims to create stronger ties between the EU and Moldova, setting up reform plans for Moldova in areas such as good governance, economic development and the strengthening of cooperation in several sectors (European External Action Service, 2016).

In addition to the EU-Moldova AA, there have been several EU programmes aimed at boosting political, economic and social prosperity in Moldova, as part of the EaP. Trade represents an area of utmost important in Moldova and the EU-Moldovan relationships, with an economy relying heavily on agriculture (BBC, 2016). Hence, we can see an increase in the number of Moldovan exports to the EU in terms of sunflower seeds, nuts, grapes and wheat, to name a few, putting Moldova as the front runner of the EaP countries in terms of furthering economic growth with the EU (European External Action Service, 2016).

As SMEs and start-ups have become the main means of economic survival in Moldova, following the break up of the Soviet Union, later becoming more than a means of survival, but rather a means of economic growth, this study will focus on studying the case of the Republic of Moldova in the context of EU economic diplomacy, being a useful test ground in understanding how the EU interacts in terms of economic diplomacy with third parties.

In summary, this chapter has reviewed new EU diplomatic structures, new instruments and the interaction with different actors (European Commission, 2014). Diplomacy has developed and changed and ***EU economic diplomacy has become more complex and inclusive.*** Yet, we are still to determine if the EU economic diplomatic model has also become more agile and transparent. We have noticed a change of focus from the international political environment towards economic and social settings, which has also reflected in new diplomatic actors such as markets, businesses and individuals, with growing importance. Together with this shift, we have identified that diplomacy itself has developed from the traditional political methods focused mainly on interactions between officials and negotiations, now placing a strong emphasis of economic diplomacy.

After gaining an understanding of diplomacy and reviewing the existing literature on the definition of economic diplomacy, we have provided our own working definition of economic diplomacy as ***managing relationships and building bridges between different state and non-state actors such as individual businesses (e.g. SMEs), in order to further economic collaboration and achieve economic objectives.*** Just as diplomacy, economic diplomacy itself has been changing and developing, moving away from economic statecraft and acquiring new important actors such as businesses, individuals, and in particular SMEs. With the EU as a regional actor growing in importance in (economic) diplomacy, more instruments such as the Eastern Partnership Initiatives are aimed at managing the relationship between the EU and its neighbours (e.g. Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine) and influencing the neighbourhood, promoting economic collaborations, in particular with SMEs.

CHAPTER 3. EU ECONOMIC DIPLOMACY: THE EASTERN PARTNERSHIP AND SMEs

Given the growing importance of the EU as a regional actor of economic diplomacy over the past decades, it has moved away from economic statecraft and state diplomatic actors, and become more inclusive and welcoming of new and critical non-state actors such as private businesses in the form of SMEs. As a result, the EU economic diplomacy model has been placing an important focus on SMEs as economic diplomatic actors and engines for reforms, who are now receiving an increasing amount of attention not only from the EU, but also within the Eastern Neighbourhood and the Eastern Partnership Initiative (EaP). As a foreign policy instrument, the EaP was launched in 2009 (Council of the European Union, 2009), with the aim to manage relations between the EU and its six eastern neighbours (e.g. Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine). The EaP's objectives include assisting the region with reforms, aiming to foster economic integration and further political associations (Council of the European Union, 2009).

This chapter aims to situate SMEs within the EaP and to understand the different types of instruments that are available under the policy for SMEs' advancement, in order to later analyse the effectiveness of the EU economic diplomacy model through SMEs.

This chapter is divided into three main sections. This chapter begins by reviewing the European Neighbourhood Policy (ENP) and its objectives, explaining what the ENP is and looking at how the ENP has led to the creation of the EaP. Furthermore, the study will consider the EaP into detail, reviewing its main objectives, as well as its bilateral and multilateral track, and the various programmes and frameworks targeting SMEs. The second section of the thesis will then explain the importance of SMEs as engines for reforms and principal vehicles of entrepreneurship, examining the main challenges SMEs face nowadays. The last part of the chapter will focus on SME-specific programmes offered by the EaP and assessing the SME Flagship Initiative and its different programmes.

3.1 THE EUROPEAN NEIGHBOURHOOD POLICY

The ENP has its roots in the early 2000s, when the EC conducted exploratory talks with its Southern and Eastern neighbours who were under Partnership and Cooperation Agreements (PCAs) and Association Agreements (AAs) in order to assess their positions on a common Neighbourhood Policy (European Commission, 2004). In 2004, as a result of the interest in a common Neighbourhood policy of Israel, Jordan, Moldova, Morocco, the Palestinian Authority, Tunisia and Ukraine, the EU launched the ENP in response to the 2004 successful enlargement in the East, including Cyprus and Malta. Therefore, the ENP represented a foreign relations instrument, aiming to create an area of '*prosperity and good neighborliness, founded on the values of the Union and characterized by close and peaceful relations based on cooperation*' (Official Journal of the European Union, 2010; Art. 8(1)). In other words, the ENP was a framework to organise cooperation between the EU and its neighbours. However, it is important to stress the nature of this collaboration pursued by the EU: all Southern and Eastern EU neighbours were expected to align themselves with the EU (Langbein and Börzel, 2013), rather than, together with the EU, mutually realigning each other (European Commission, 2004; 2009).

The main objectives of the ENP were to share the benefits of EU's 2004 enlargement (Commission of the European Communities, 2004) and promote closer cooperation between the ENP partner states and the EU, as well as between the ENP member states themselves (European Commission, 2004). The ENP aimed to address two strategic issues: (1) promotion of prosperity and stability inside and outside the union's borders; and (2) avoidance of further division lines in Europe (Commission of the European Communities, 2003). Therefore, the EU and partner countries would identify a set of priorities that would be, jointly with the EU, incorporated into agreed Action Plans (APs), differentiated by country and reviewed and amended when needed, in different key areas, including research and innovation, trade, social policy, energy and people-to-people contacts (European Commission, 2004).

The bilateral nature of relations within the ENP policy gave businesses and SMEs a special play, stressing their importance and the beneficial role these private companies would bring to the ENP, as it aimed to promote prosperity and collaboration between the different ENP countries in the key areas outlined above. Additionally, we can argue that the ENP itself represents a new diplomatic initiative, highlighting the changing nature of diplomacy explained in the previous chapter, covering economic, social and political developments. However, the 'one size fits all' approach received a mixed response from the Eastern neighbours, who were hesitant of the outcomes of the ENP (European Commission, 2009; Korosteleva, 2011). Dangerfield (2009:1735) argues that the ENP '*looked inadequate before it even got off the ground*', facing criticism from the EU and being rejected by Russia. Despite European Commission's 2006 ENP review, the ENP was still rejected and considered inadequate (Dangerfield, 2009). Given the inefficiency of the ENP and its main focus on the bilateral nature of collaboration, Polish and Swedish prime ministers Sikorski and Bildt proposed an Eastern Partnership between Armenia, Azerbaijan, Georgia, Moldova and Ukraine, with Sikorski underlining the difference between the Southern and Eastern neighbours within the 2004 policy: '*to the South, we have neighbours of Europe, to the East, we have European neighbours*', urging for EU's Eastern neighbours to follow the example of the Visegrad Group[6] (EU Observer, 2008). Sikorski clearly distinguished the EU membership prospects between the proposed Eastern Partnership and Sarkozy's French-sponsored proposal for the creation of a Mediterranean Union (EU Observer, 2008). With a clear process of regionalization taking place, the EC tabled the proposal of an ambitious Eastern Partnership (European Commission, 2008). As a result, the EaP has been set into place on 7th May 2009 at the Prague summit (Korosteleva, 2011), when the policy was regionalized for the East and the South.

3.2 THE EASTERN PARTNERSHIP INITIATIVE

Formally separating the southern and eastern dimensions and focusing on the specific Eastern dimension of the ENP (Gower and Timmins, 2011; Dangerfield, 2009), the EaP was shaped as a regional framework and aimed to create necessary conditions in order to '*accelerate political association and further economic integration*' (Council of the European Union, 2009). Having a more clear geographical focus than its predecessor, the EaP targets six Eastern countries: Armenia, Azerbaijan, Belarus (only informally part of it, it never officially joined), Georgia, Moldova and Ukraine; being committed to the principles of law and fundamental values (European External Action Service, n.d.a). Yet,

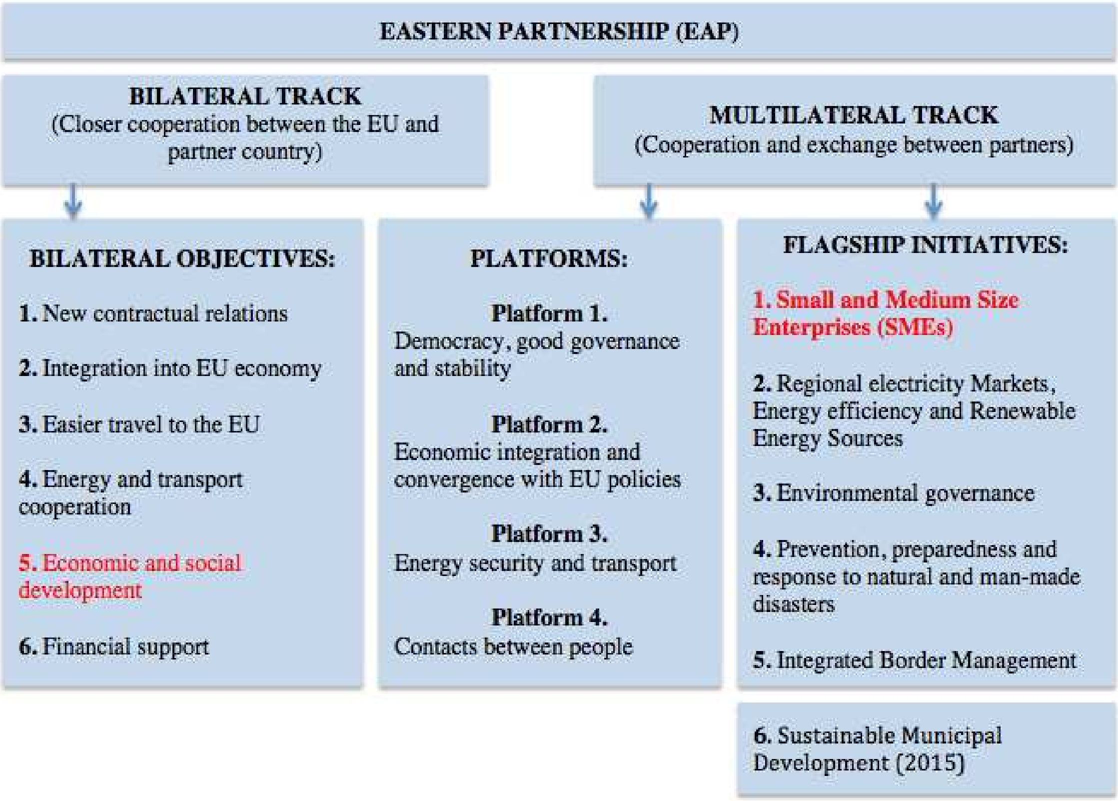
[6] The Visegrad Group was founded in on 15 February 1991 as a framework for internal and external cooperation between Hungary, Poland, Slovakia and the Czech Republic (Dangerfield, 2009).

it is important to mention that the EaP does not substitute any existing relations between the EU and the Eastern neighbourhood countries, but was necessary to complement and operate beside the existing relations between the EU and the EaP states (Solonenko, 2008; Gowen and Timmins, 2011).

The EaP has two tracks, as highlighted in Figure 3.1: (1) the bilateral dimension, aiming to deepen bilateral engagement through new AAs (European External Action Service, n.d.b.), Comprehensive Institution-Building Programmes and support for citizens' mobility and visa liberalization; and (2) the multilateral dimension, created in 2011, encouraging multiple cooperation (Council of the European Union, 2009) and focusing on implementing several Flagship Initiatives in support of cooperation projects between the EU and the EaP countries (Council of the European Union, 2011; European Commission, 2015b).

Figure 3.1 shows the various platforms for economic and social change, providing evidence of diplomacy and economic diplomacy discussed in the previous chapter.

Figure 3.1. The Eastern Partnership: the Bilateral and Multilateral Tracks.



Source: European Commission. (2015b). *Eastern Partnership*.

According to the Council of the European Union (2009) and the European Commission (2015b), the bilateral track of the EaP aimed to (1) further economic integration within the EU and foster political collaborations; (2) boost sector collaboration; and (3) support citizens' mobility and visa-free travel in the long term, in partner countries. As illustrated in Figure 3.1, the bilateral dimension aims to address six objectives: (1) new contractual relations; (2) integration into the EU economy; (3) foster conditions for easier travel to the EU; (4) promote energy and transport collaborations; (5) encourage economic and social development; and (6) offer financial support (European External Action Service, n.d.c). Within the bilateral track, just as its predecessor, the EaP places emphasis on businesses and prioritises SMEs as engines of change (Council of the European Union, 2011), recognized the importance of an innovative SME sector through different programmes as part of its bilateral track, such as the launch of an Eastern Partnership Business Forum and Micro-Financial Assistance for EaP countries, as highlighted during the Warsaw Summit (2011).

In addition to the bilateral dimension, the multilateral dimension, launched in 2011, aims to foster links between partner countries, encompassing four platforms, each of which conducted relevant work through different panels and programmes, as highlighted in Figure 3.1 above: (1) Democracy, good governance and stability; (2) Economic integration and convergence with EU policies; (3) Energy security; and (4) People-to-people contacts (European External Action Service, n.d.a). The importance of EaP's multilateral track was also acknowledged at the Vilnius Summit in 2013, recognizing the importance of strengthening the linkage between bilateral engagement and multilateral cooperation (Council of the European Union, 2013). While the bilateral track of the EaP already places a strong emphasis on SMEs as part of the economic integration and sector collaboration processes, the multilateral dimension is even more dedicated to placing SMEs at the heart of the EaP, having SME-specific panels within its second platform on economic integration and convergence with EU policies. However, given the limited scope of this study, we will not explore this any further.

In addition to the four individual platforms mentioned above, the multilateral framework of the EaP also includes several flagship initiatives, translating the aims of the EaP into concrete actions (Council of the European Union, 2011; European External Action Service, n.d.a): (1) Small and Medium Enterprises (SME) Facility; (2) Regional electricity Markets, Energy efficiency and Renewable Energy Sources; (3) Environmental Governance; (4) Prevention, Preparedness and Response to natural and man-made Disasters (PPRD); and (5) Integrated Border Management. In addition, a new flagship initiative has been launched in 2015: (6) Sustainable municipal development. Given the highly important emphasis on SMEs not only within the bilateral track of the EaP policy, but also within its multilateral track, through the various SME-specific panels within Platform 2 and through the SME Flagship Initiative, as highlighted in Figure 3.1 above, the study will now assess the reasons behind this focus, by looking at the importance of SMEs, and will explore into more detail the SME Flagship Initiative, the principal EaP instrument dedicated to SMEs.

3.3 SMEs: ENGINES FOR REFORM

The importance of SMEs as engines for growth has been increasing over the past decade, as the EU has increased the involvement of SMEs within EU policy, as we can see in the case of the EaP. While having little power and influence alone as individual business units, the role of the SME sector affects the economic and political environment. Therefore, their influence and importance have increased, as SMEs have been welcomed as new economic diplomatic actors in managing alienation and multilateral cooperation, being adaptable and innovative in order to ensure not only economic survival, but also economic growth in the eastern region, as highlighted in chapter 2.

SMEs are defined based on their number of employees and balance sheet total or total turnover, as follows: (1) A micro firm has between one and nine employees and less than €2 million in balance sheet total/turnover; (2) a small firm has an employee headcount between 10 and 49 with less than €10 million balance sheet total/turnover; (3) a medium sized firm with 50 to 249 firm has less than €43 million in balance sheet total or €50 million in turnover (Centre for Strategy and Evaluation Services, 2012).

In the past few decades, the importance of SMEs in the EU has significantly increased, with SMEs being considered prominent contributors to political economic growth (European Parliament, 2016), accounting for 99% of European businesses and 67% of European employment[7]. With SMEs being an essential source of employment and the most important vehicle of entrepreneurship, creating value in a number of sectors, the EU has important economic, social and political benefits to gain from supporting these enterprises (Dalberg, 2011).

The importance of SMEs is not limited to the EU borders, but pushes it outside, especially towards the eastern region and the EaP states, where SMEs could have an even stronger and positive impact in emerging countries. As a result, we can observe a stronger focus in policy on SMEs within these specific countries. Similarly to EU SMEs, EaP SMEs account for over 95% of businesses, employing 50% of the population and contributing to 30% of GDP, leaving significant room for improvement. However, the EU acknowledges SMEs' potential to significantly contribute not only to job creation, but also to the consolidation of open societies and the move towards a greener economy. While SMEs are seen as organisations that do not have high production or manufacturing processes, having a relatively small environmental impact, the cumulative impact of

[7] Percentages presented in terms of business units.

SMEs across the Europe on the environment is important and therefore, these organisations have been gaining more attention in the move towards a greener economy (Flash Eurobarometer 426, 2015).

The cultural context is crucial to understanding SMEs, given the various perceptions surrounding small companies within the EU and outside it. For example, Italy is characterized as an SME economy, having a strong entrepreneurial culture and a high number of SMEs and entrepreneurs who excel in their market niches, given the favourable environment for SMEs and business start-ups (OECD, 2014). Another example of an SME-oriented country is Romania, country that had 605,000 SMEs in 2011, where these firms represent the engine of the Romanian economy, which are mainly family-owned SMEs (KPMG, 2012). Within the Eastern Neighbourhood countries, given the nature of post-communist countries' economies, the transition from socialism and command economies to democracy and a free-market economy has led to an increase in the number of SMEs, which are regarded as a new phenomenon in a fully functioning market economy today within the Eastern space, as there were no such business models in the past in that area (Danis and Shipilov, 2002). While in the 1920s, Lenin's New Economic Policy (NEP) allowed private businesses to function, in the form of small or medium farms, the nature of the economy then was mainly agricultural, which differentiates SMEs today, whose culture is different, being developed and operating within a wide range of industries.

Despite the benefits SMEs could bring to their national economies, the EaP and ultimately, the EU, there are several challenges SMEs are facing within this process, having a negative effect on the firms themselves and on the extent of the benefits they can create and deliver. Several studies have been published on this matter, grouping the challenges as follows: (1) poor access to finance; (2) inadequate legal and regulatory framework; (3) limited knowledge base or business skills; and (4) limited access to markets, all of which have been identified as major challenges in the EU and EaP countries (Mohnen and Rosa, 1999; Berger and Udell, 2006; Veugelers, 2008). Within the EaP states, most of which lack in development compared to EU member states, SMEs could even face additional, fiercer challenges, provoking their ability of conducting business in a growing, yet unstable and challenging environment. One of these specific challenges SMEs are facing, which has been identified as important within the EU, but critical within the EaP, is bureaucracy, political instability and corruption (Acs and Audretsch, 1990; HWWA, 2004; Rammer *et al.*, 2006; BMBF, 2006). For example, in the case of Moldova, the country has been identified as having the highest levels of corruption among the six EaP member states, being ranked 102nd out of 177 countries in the Corruption Perception Index (Transparency International, 2013). Corruption is a particular feature of the post-communist landscape, conditioned by the past legacies, the previous regulated economy and to some extent past legacies, which creates a rather difficult environment for SMEs to prosper. This, subsequently, has a strong, negative impact on SMEs, slowing or even decreasing their growth, productivity and local, national and EU impact. Additionally, within this regional context, given the new entrepreneurial environment of the Republic of Moldova, SMEs might lack the business acumen or skills in conducting business, showing a large gap between Eastern SMEs and Western EU SMEs.

However, in spite of these challenges SMEs are facing, the EaP's significant focus on SMEs as engines of change and growth aims to help the businesses overcome these difficulties and prosper as actors of economic diplomacy, through various programmes, the principal being the SME Flagship Initiative.

3.4 SMALL AND MEDIUM ENTERPRISE (SME) FLAGSHIP INITIATIVE

The SME Flagship initiative was created to support the needs of SMEs in the EaP countries, providing provisions for growth and employment (EuropeAid Development and Cooperation DG, 2011), in response to the various constrains different EaP and EU countries face in relations to SMEs, such as business regulatory framework inadequacies, lack of funding, business skills and lack of available and/or cost effective advisory centres (European Commission External Relations, 2009). The SME Flagship initiative was launched in 2009 within the six EaP countries, and complements the EU bilateral engagement on economic development and Platform 2 of the multilateral collaboration in EaP countries, as highlighted previously in this chapter (European Commission, 2015b).

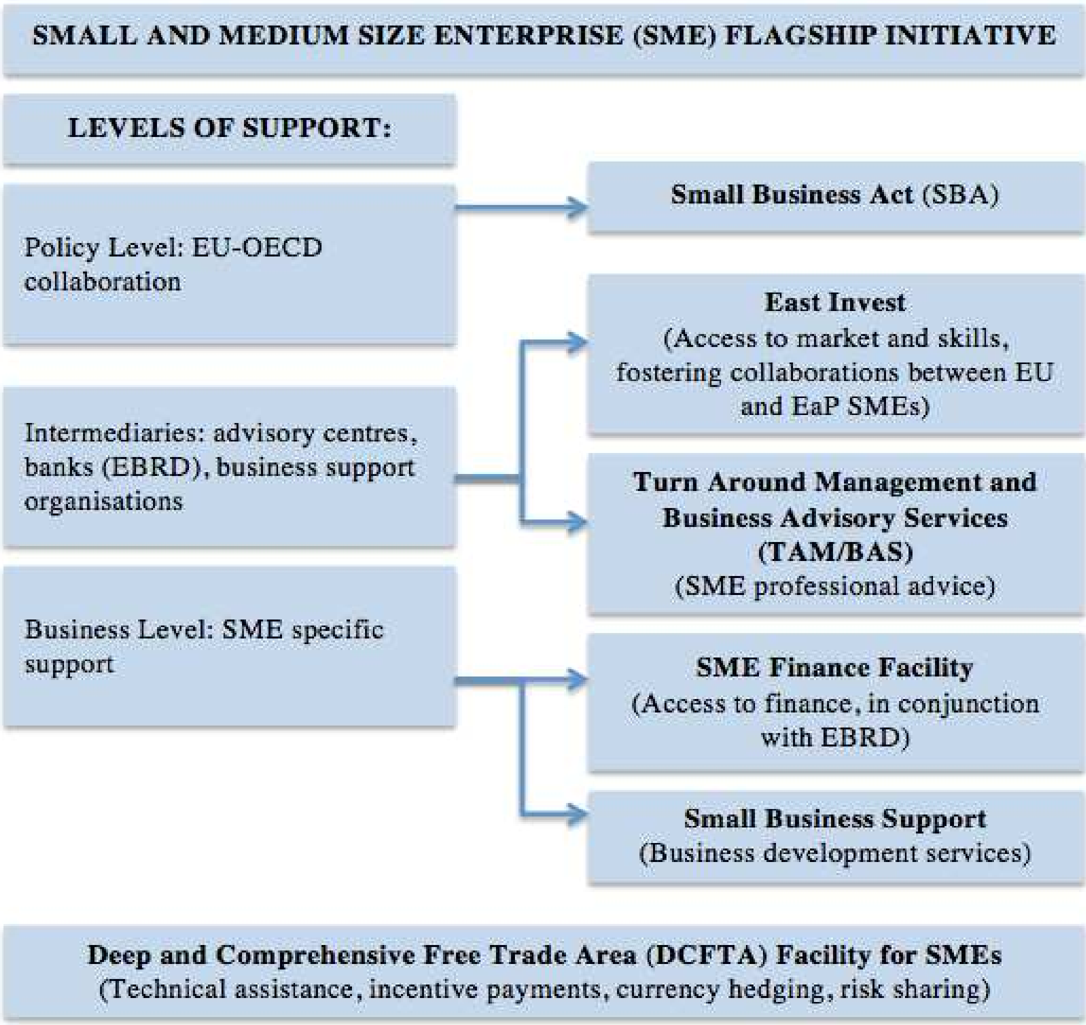
The SME Flagship initiative offers support on three different levels, as highlighted in Figure 3.2 below: (1) at policy-level, where the EU is collaborating with the Organisation for Economic Co-operation and Development (OECD) in order to assist the EaP countries in effective SME policies, using the Small Business Act (SBA) as a vehicle of change; (2)

through advisory services within a pan-European networking programme, aiming to promote investment and trade through capacity building of business associations and networking within the EaP countries; and (3) at business level, where the EU facilitates SMEs’ access to finance through different programmes such as the SME Finance Facility or the Small Business Support programme (European Commission, 2015b).

Depending on the structure of EU intervention (Figure 3.2), with policy intervention creating an enabling business environment, intermediaries intervention responding to the needs of the SME sector and SMEs intervention providing access to finance and market, the SME Flagship initiative aims to address a variety of inclusive development issues, such as boosting women entrepreneurship, rural and development, youth employment and promoting a greener economy (European Commission, 2015b).

Each level of support of the SME Flagship initiative includes several different programmes that offer different types of support. As illustrated in Figure 3.2, we notice that at a policy level, the initiative targets the collaboration between the EU and the OECD with relations to the SBA. However, looking at the EU support offered through intermediaries, we notice more focused programmes, East Invest and TAM/BAS, aiming to improve the access to market and skills, foster collaborations between EU and EaP SMEs, and offer professional advice, through advisory centres, banks and/or business support organisations. Even more, on the business level, SMEs receive direct and specific support through the SME Finance Facility and the SME Business Support programme, helping businesses access finance and business development services.

Figure 3.2. SME Flagship Initiative: Levels of Support.



Source: European Union. (2015b). *Eastern Partnership: Small and Medium Sized Enterprises Flagship Initiative*.

Having explained the various programmes included in the SME Flagship initiative, we shall now consider the East Invest, TAM/BAS and SME Finance Facility in more detail. Given the focus of the study, we will not explore all of the SME Flagship initiative programmes.

3.4.1 East Invest

The East Invest programme is a EC initiative managed and implemented by Eurochambers, which ran between November 2010 and April 2014 within the EaP countries, offering support for the development of business partnerships and associations, as well as networking (EuropeAid Development and Cooperation DG, 2011). East Invest had three main objectives: (1) facilitate and promote investment between the EU and the

EaP countries; (2) develop concrete actions that would generate immediate results for SMEs within their region; and (3) develop the East Alliance, mobilizing business alliances from the EU and the EaP, promoting partnership and dialogue within the private sector and towards the public sector (East Invest, 2011). As a result, East Invest aims to ***address the access to market challenge*** that SMEs are currently facing, through a variety of activities for small companies. East Invest programme promoted activities for the SMEs as well as for Business Support Organisations, having a total budget of €7 million.

Activities for SMEs

In terms of the support offered to SMEs, East Invest offered training opportunities and technical assistance for enterprises within the EaP countries, offering them networking and building opportunities, through a variety of means (East Invest, 2011). Firstly, SMEs could participate in ***SME Roadshows***, where an EaP partner from the East Alliance gathers a group of minimum 10 SMEs who are able, wish to and are capable of exporting to an EU country (East Invest, n.d.a). The EaP partner then contacts the EU partner to check their willingness to engage, agreeing on a programme for the SME roadshow and submitting their proposal online to EUROCHAMBERS (East Invest, n.d.a). Following the approval of EUROCHAMBERS, the partners can then engage in the desired activity. The SME Roadshow project has been implemented in a variety of countries, with Armenian SMEs going to Germany, Georgian SMEs going to Germany, Belgium, Slovakia and the Netherlands, Moldovan SMEs going to Poland, Italy, the Baltic States, Belgium and the Netherlands, and Ukrainian SMEs going to Poland (East Invest, n.d.a).

In addition to SMEs Roadshows, the ***Investors Fora*** project offers SMEs the opportunity to participate in six investment conferences (one in each EaP country), where the companies would have the opportunity to discuss potential partnerships with other EaP or EU SMEs, as well as analyze the investment opportunities in the region (East Invest, n.d.a).

Another SME activity as part of East Invest is SMEs' could participation in ***SME training seminars***, actively enhancing their knowledge of the EU and the internationalization process. This project targeted two groups of SMEs: (1) the 'Starter' category, which included SMEs with limited knowledge in the areas outlined above; and (2) the 'Advanced' category, which included SMEs who had a higher degree of knowledge (East

Invest, n.d.a). With regards to the contents of the seminars, the EU training package focuses on free movement of services and goods, technical standards and regulations, customs, competition policy and intellectual property rights, while the internationalization package addresses the issues of quality standards, marketing strategy, access to finance and management skills (East Invest, n.d.a). The content of these seminars would enable SMEs to gain and/or improve their business knowledge and know-how, coming as an important help to the challenges outlines in the previous section.

Moreover, participating EaP SMEs would have the opportunity to join ***business-to-business (B2B) trade fairs***, where they could get in contact with potential business partners (East Invest, n.d.a), including a briefing of the group, the official welcoming event, seminars with relevant speakers from the sector, a 1-day pre-organised B2B meetings at the fair, and debriefing (East Invest, n.d.a). However, only the SMEs that have participated in the SME workshops, as described above, can participate in the B2B trade fair module of East Invest (East Invest, n.d.a). In spite of this limitation, SME participation in B2B trade fairs would help them in the process of accessing different markets.

Furthermore, SMEs could also benefit from 12 ***study visits,*** 2 for each of the EaP countries, gaining an initial experience abroad by visiting European trading fairs, in order to better understand the foreign markets, products available, their requirements and observe the participants' business practices such as marketing techniques or product design (East Invest, n.d.a). The study visit is somehow similar to the B2B trade fairs and would include a briefing of the group, welcome event at the fair, relevant seminars with speakers from the market, a guided tour through the fair and a debriefing, discussing the lessons learnt and the opportunities to follow up the network established during the visit (East Invest, n.d.a). However, it is compulsory that before attending the study visits, the SMEs must have attended the SME training seminars (East Invest, n.d.a).

Finally, EaP SMEs could also benefit from ***coaching*** with opportunities for further capacity building and the generation of a sustainable internationalization process, having already participated in the earlier stages of the East Invest programme, such as study visits, B2B or roadshows (East Invest, n.d.a).

While these various activities for SMEs offer the enterprises the necessary business knowledge and networks to access foreign markets, grow their business and productivity, the main visible limitation of these activities is conditionality: as mentioned above, only those businesses who attended certain activities have the opportunity to apply for others. Hence, the support offered becomes more bespoke the more committed the SME is to the scheme, but in order to access the most intensive support, it is a precondition that SMEs participate in the earlier stages of the programme, with the objective of fostering links and networks.

Activities for Business Support Organisations (BSOs)

In addition to SME support, East Invest also offered different activities for BSOs. Through their participation, BSOs could benefit from a series of activities under the East Invest Programme, enhancing their opportunities to support and represent SMEs. To begin with, BSOs could gain value from two ***audits***, addressing separate performance indicators for nine topics including leadership, quality management, strategy and planning, personnel, communication and knowledge, clients and membership, interest representation, services and finance and accounting (East Invest, n.d.b). Secondly, BSOs could take part in ***East Invest twinning*** initiatives, which encourage concrete and sustainable collaboration between EU and EaP BSOs through joint projects, creating sustainable links and establishing long term technical cooperation (East Invest, n.d.b). Thirdly, BSOs could participate in exchange programmes through the ***BSO Exchange Facility***, offering EaP BSOs the opportunity to learn from their EU colleagues through a short-term traineeship (East Invest, n.d.b). Complimentary to the BSO Exchange Facility was the EU Consultancy service, allowing BOSs experts from the EU East Alliance partner organizations to go on consultancy visits and assist their EaP partners within their organisations for a period of 1 to 4 weeks (East Invest, n.d.b). Furthermore, BSOs would benefit from their participation in ***Train the Trainers*** events, taking place in a three-step process where they could develop the capacity to train SMEs within EaP BSOs, deliver SME training to a selected number of SMEs, and offer support to the SMEs in visiting trade fairs. Finally, BSOs could participate in the ***East Invest Academy***, where they would benefit from enhanced networking among EaP BSO executives, receive specialized management training and strengthen aspects of BSO management (East Invest, n.d.b).

3.4.2 Turn Around Management and Business Advisory Services (TAM/BAS)

The second programme of the intermediaries level of the SME Flagship initiative (Figure 3.2) is TAM/BAS. This programme, having a budget of €5 million, received support from the EU in conjunction with the EBRD, offering professional advice on best practices for micro and small and medium enterprises (MSMEs) in the case of TAM, as well as a range of consulting services for MSMEs in the case of BAS (European Bank for Reconstruction and Development, 2011). As a result of the programme's activities, TAM/BAS aims to ***contribute to SME's limited knowledge base and business skills***, a challenge SMEs are facing, as previously identified. In a TAM project, the advisers would work directly with the MSMEs management, sharing their know-how and helping introduce better management skills (European Bank for Reconstruction and Development, 2011). Yet, TAM advisors would not only provide support related to the management side, but also provide knowledge and advice in production, human resources, marketing, sales and financial management, exploring different opportunities for obtaining international qualifications, exporting and energy efficiency (European Bank for Reconstruction and Development, 2011).

Within the BAS projects, individual MSMEs would be provided with opportunities for receiving grants in order to engage with local consultant within their country, on issues such as management information systems, market analysis and feasibility studies (European Bank for Reconstruction and Development, 2011). For both TAM and BAS schemes, MSMEs would be provided with the necessary advice that might facilitate potential EBRD-financed projects in the future.

In spite of the professional business assistance offered to MSMEs, the TAM/BAS programme lacks the practical support (e.g. networking opportunities, trainings) offered by the East Invest programme to SMEs, through the various seminars, trade fairs and visits. Therefore, this study could consider East Invest to be the most effective programme at the intermediate level of support of the SME Flagship initiative.

Another important level of support of the SME Flagship initiative is the business level, encompassing two main programmes: the SME Finance Facility, and the Small Business Support programme.

3.4.3 SME Finance Facility

With a EU contribution of €15 million, the SME Finance Facility programme takes place between 2010 and 2019 within the EaP countries at a meso-level, being implemented by the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the German Development Bank (KfW), under the umbrella of the Neighbourhood Investment Facility (European Commission, 2015b). The SME Finance Facility combines EBRD, EIB and KfW loans to the participating financial intermediaries (PFIs), loans that would then be available to SMEs and micro-enterprises to apply for. As a result, the SME Finance Facility aims to ***improve SMEs' access to finance***, which has been identified as a challenge for SMEs, as we have earlier highlighted. According to the EU Neighbourhood Info Centre (n.d.a), the programme contains two windows: (1) the EIB window (which contains a €5 million fund), providing interest-free loan co-financing of up to 10% of the traditional EIB loan to PFIs, which are then passed interest-free to SMEs; and (2) the EBRD/KfW window (which contains a €10 million fund), providing credit enhancement support for SMEs lending in the EaP countries and favorable credit lines for SMEs. As illustrated, this particular programme addresses SME's access to finance problem. However, in spite of having poor access to finance as the first challenge for SMEs, enterprises face a wider and more complex set of problems, more of one that need addressing. This will be further explored in chapter 4.

3.4.4 Small Business Support

In addition to the SME Finance Facility, the Small Business Support programmes organized by Business Advisory Centres (BAS) and Enterprise Growth Programmes (EGP) between 2010 and 2014, with a budget of €10 million, encourage good management practices within MSMEs (EU Neighbourhood Info Centre, n.d.b). Similarly to the TAM/BAS programme, Small Business Support aims to ***contribute to SME's limited knowledge base and business skills***. As part of Small Business Support, BAS and EGP offer technical assistance and consultancy services to individual SMEs, improving the management culture, supporting business change, and assisting and consulting the enterprises through the duration of particular projects (EU Neighbourhood Info Centre, n.d.b). While having similar characteristics to the SME Finance Facility (at the business level) and TAM/BAS (at an intermediate level), it can be argued that Small Business Support programmes only cover a few areas that prove problematic to SMEs, without consideration to access to new markets, network building or trade fair participation.

Bringing together the EaP bilateral and multilateral engagement and cooperation regarding SMEs, the EaP's long-term goal of regional integration across the neighbourhood countries and the creation of a self-standing common market could be achieved through the creation of the European Neighbourhood Community, which would place SMEs at the heart of the neighbourhood economy. While the current support offered to SMEs represents a tailored sector, it is highly important to not disregard the means through which SMEs interact with each other, and more importantly, the results and benefits of their interaction not only for the organisations themselves, but for the EU as a whole and other regional actors.

While the SME Finance Facility, the Small Business Support programmes and TAM/BAS are conducted in collaboration with EBRD, focusing mainly on providing specific loans and certain training, this study recognizes the vital need of addressing SMEs' problems in accessing markets, building partnerships and acquiring practical business training. As discussed above, the EU has a complex portfolio of multiple instruments and agents to effectively operate within the EaP, which we can see in the different activities of the three SME Flagship initiatives discussed above (Figure 3.2; p.52). Yet, it is important to consider the results of these initiatives and assess their efficiency, within the complex and challenging environment of the EaP and in particular, the Republic of Moldova. This study aims to assess the impact of such EaP initiatives upon SMEs' business performance, and to address the extent to which the EaP has been instrumental in improving SMEs' performance, speaking to the research questions outlined in the introductory chapter of the thesis. Hence, the empirical section of this study will consider the effects of East Invest programme participation on SMEs' business performance.

As EU economic diplomacy has been moving away from economic statecraft and state diplomatic actors, becoming more complex and inclusive, non-state actors, particularly

SMEs, have become important engines for reform and growth within the EU economic diplomacy model. The EU has established the EaP as a regional framework for managing the relations with its Eastern Neighbours, placing a strong emphasis on SMEs within its bilateral and multilateral tracks, with EU economic diplomacy aiming to become more agile in engaging with its structures. As a result, the EaP offers specialized support in different forms (e.g. access to finance, market, skills, networking) at three different levels under the SME Finance Facility, recognizing the importance of SMEs in today's EU world economy, aiming to boost the EU economy and addressing the various challenges the enterprises are facing today. Hence, we can observe that ***EU economic diplomacy and its instruments have become more complex and inclusive***, involving different actors in a variety of projects. While in theory, the different programmes are offering key support to SMEs as EU economic diplomacy has become more complex and inclusive, an understanding of the characteristics of SMEs and appropriate business performance measures is required in order to assess the extent of the effects of East Invest participation upon SMEs, and also to see whether the EU economic diplomacy has become better connected and more agile/responsive.

CHAPTER 4. MEASURING SUCCESS IN SMEs

Participation in the EaP SME Flagship Initiative schemes will only occur if there are clear benefits for SMEs. While these benefits and opportunities could take the form of improved access to overseas market, knowledge and finance, as well as the creation of new networks, the ultimate benefit for SMEs comes in the form of improved business performance. Given the move toward economic diplomacy, moving away from economic statecraft, the EU policy objective is for SMEs to benefit from the EaP and in particular, the SME Flagship Initiative, through improved performance and the EU achieving its objectives of deepening political integration and fostering economic growth in the eastern region. Hence, it is important to consider the vital role of SMEs as new actors of economic diplomacy and consider the impact of their new role on their internal business processes and in particular, business performance, testing whether EU policy has achieved its objectives.

This chapter aims to explore the principal measures of success within SMEs by reviewing the different dimensions of performance measurement, to later consider the effectiveness of the EU economic diplomacy model at two levels: the EU level (political) and the SME level (economic).

This chapter is divided into two main sections. The first part of the chapter begins by considering the importance of SMEs in the EU and in the Eastern Neighbourhood, as important engines for reforms, considering Gibrat's law of proportionate effect in differentiating young enterprises from small enterprises. Furthermore, the chapter will consider the main challenges faced by SMEs in today's economy, including their limited access to finance, skills, market knowledge and their difficulties in dealing with high levels of bureaucracy. The second part of this chapter will then explain the different measures of success for SMEs, examining the main modern and traditional business performance measures used in analyzing performance of businesses and in particular, of SMEs.

4.1 SMEs: ENGINES FOR REFORM

4.1.1 Importance of SMEs

There is no doubt that the importance of SMEs in the world and, in particular the European economy, has attracted significant attention from the EU in the past decades, with SMEs being referred to as the '***backbone of the European economy***' (The Parliament Magazine, 2015) and '***engines of the European Union'*** (European Commission, 2005; p. 3). The important role of SMEs is not limited within Europe, but can be visible around the globe and especially in developing countries, where these firms are instrumental in reducing poverty (The Economist, 2016). Yet, given the focus of this thesis, we will consider SMEs in the European and EaP context.

As highlighted in the previous chapter, an SME, as defined by the European Commission, represents a small- or medium-sized company with no more than 249 employees and less than €43 million in balance sheet total or €50 million in turnover (Centre for Strategy and Evaluation Services, 2012). Today, SMEs in the EU account for no less than 99.8% of all EU businesses, with 99 out of 100 companies in the industry being an SME (European Commission, 2014b).

SMEs do not only dominate in terms of existing business units, but also in terms of employment and economic growth, being key drivers of growth and entrepreneurship in the EU. At the macroeconomic level, being an essential source of employment, SMEs today provide 66.7% of European employment (European Commission, 2013), creating around 85% of new jobs in the EU in the past five years across all business sectors (European Commission, 2015d). In addition to being an excellent source of employment and an important vehicle of entrepreneurship, SMEs play a highly important role in research, development and innovation at the microeconomic level, as they are often required to innovate and adapt in order to survive and overcome their competition, being considered key engines for economic developments (Schlögl, 2004; Schumpeter, 1951).

4.1.2 The SME Environment within the Republic of Moldova

The importance of SMEs has not gone unnoticed outside EU borders, and especially within the Eastern Neighbourhood countries. As highlighted by the European Union (n.d.), SMEs account for 95% of EaP businesses, providing employment for 50% of EaP citizens, in comparison to 66.7% in the EU (European Commission, 2013). Given this thesis's focus on the Republic of Moldova, it is vital to review its SMEs environment. The Moldovan environment is highly important for SMEs, offering a suitable setting for business growth and development and therefore, offering grounds for policy intervention. The vulnerable macroeconomic environment of the country to both internal and external shocks has been a result of various factors including structural challenges in the financial sector (e.g. low levels of corporate governance and transparency, limited competition) and most importantly, regional geopolitical instability (OECD *et al*, 2015). While the Moldovan economy has experienced overall growth since 2000, with an estimated GDP growth of 4.6% in 2014, its economy has also registered downturns: (1) the 2009 global financial crisis upon trade; (2) 2012 Eurozone crisis, lead to an economic decrease of 0.6% that had a direct negative impact on agricultural output; and (3) in 2015 significant depreciation of the nation's currency of over 20% (the Moldovan Leu), lead to contracted remittances and exports (OECD *et al*, 2015). The Republic of Moldova continues to be the poorest country in Europe, with an economy that is largely dependent on remittances and a small internal market that leave it vulnerable to regional dynamics (OECD *et al*, 2015). Despite relatively significant economic growth between 2000 and 2013, Moldova's employment rate decreased from 58% to approximately 41%, a result of youth migration and labour outflow towards the EU and Russia (OECD *et al*, 2015). Therefore, we can argue that Moldova is a nation that is trying to play catch-up, hence the relatively high rates of economic growth, but also one that is seeing youth migrate to other regions, leaving policy makers to worry about the country's long term economic future and how to create an environment that encourages long term economic growth.

In terms of the SME environment in Moldova, the Moldovan definition of SMEs is in accordance with global SMEs law and definitions of such firms, being included in the 2006 law on supporting the SME sector (OECD *et al*, 2015). However, the turnover and balance sheet thresholds in Moldova differ from the EU thresholds, as illustrated in Table 4.1 below.

Table 4.1. Definition of SMEs in the Republic of Moldova.

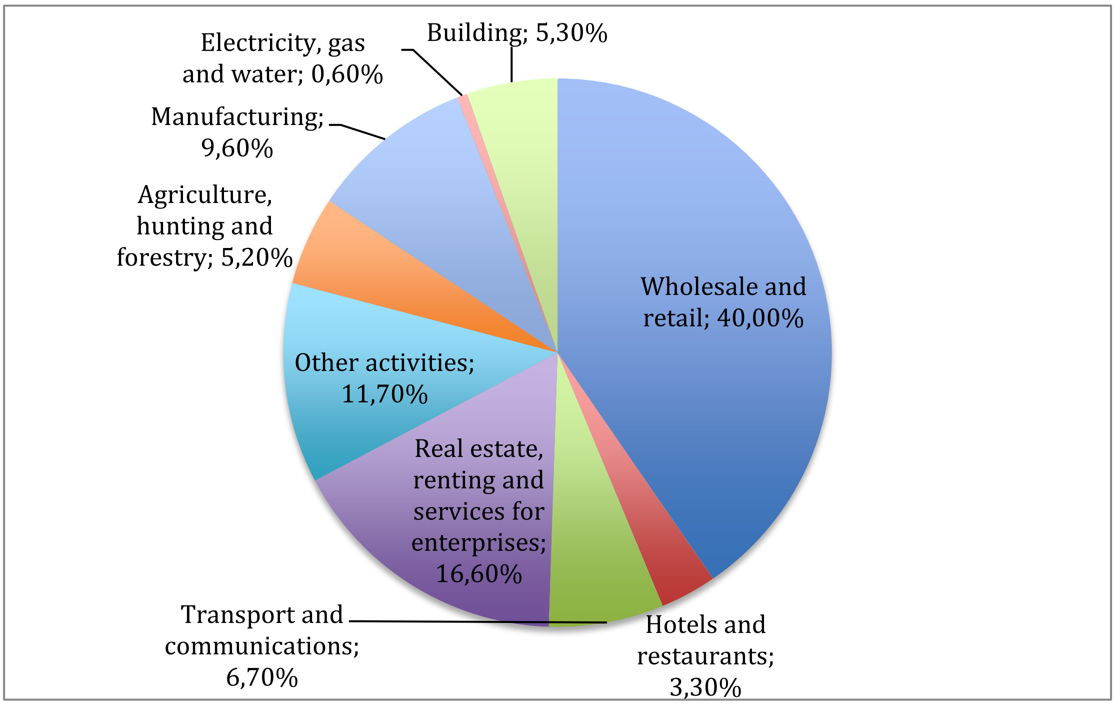
	Micro	**Small**	**Medium**
Average number of employees	< 10 employees	<50 employees	<100 employees
Average annual revenues in MDL (EUR)	<MDL 3 million (EUR 182,000)	<MDL 25 million (EUR 1.5 million)	<MDL 50 million (EUR 3 million)
Average annual total assets	<MDL 3 million (EUR 182,000)	<MDL 25 million (EUR 1.5 million)	<MDL 50 million (EUR 3 million

Source: Law Nr. 206-VXI (July, 2006) on supporting the SME sector, Republic of Moldova.

The SME sector has registered a slower increase over the past few years in comparison to the overall private sector, in terms of number of employees, number of enterprises and turnover, with 509,000 SMEs in 2013, representing 95% of all Moldovan businesses, 85% of which were micro enterprises with no more than five employees (OECD *et al*, 2015). In terms of their distribution, SMEs are unequally distributed across Moldova, with 66% of SMEs operating in Chisinau (OECD *et al*, 2015), the country's capital, suggesting a major discrepancy between urban and rural SMEs.

The plurality of Moldovan SMEs are operating in the wholesale and retail industries, as highlighted in Figure 4.1 below, followed by 17.6% of SMEs being involved in real estate, renting and services for enterprises (National Bureau of Statistics of the Republic of Moldova, 2013). Only 5.2% of Moldovan SMEs operate in the agriculture, forestry and hunting sectors, which is a highly interesting figure, given that agriculture represents the main industry in Moldova. Hence, we understand that while agriculture is the most important sector in Moldova, it is mainly dominated by large companies, rather than SMEs. Only 0.6% of Moldovan SMEs operate in the electricity, gas and water sector (OECD *et al*, 2015).

Figure 4.1. The Moldovan SME environment by sector and industry[8].



Source: National Bureau of Statistics of the Republic of Moldova (2013).

Despite operating in a more difficult economic and political environment than EU businesses, as noted by the European Union (n.d.), Moldovan SMEs are considered to be key players in the development of the Republic of Moldova and the EaP countries, being important agents of economic development, the consolidation of open societies and moving towards a greener economy.

4.1.3 Young vs. Small Businesses: Gibrat's Law of Proportionate Effect

Much of the policy discussion identifies SMEs as a single economic entity and yet, it is clear that SMEs are exceptionally diverse across Europe, having different levels of innovative activity, differences in employment strategies, managerial activities, products and services and so on. Veugelers (2008) provides the most extensive study in this area of study, dividing SMEs into four main categories, as following: (1) basic SMEs, conducting little or no research; (2) adopting SMEs, having a low innovative profile but acquiring new technologies; (3) leading SMEs, developing new products, services or technologies that are new to the firm as well as the market; and (4) young and innovative small

[8] Percentages considered in terms of business units.

companies, which are young companies with a maximum of 20 employees, conducting fundamental innovation.

While Veugelers (2008) provides a useful typology for SMEs, given the purpose of this study, we will focus on the element of the young versus small businesses. While there is a high correlation between young and small companies, Gibrat's (1931) law of proportionate effect explains that the growth rate of a firm is independent of the firm's size at the beginning of the period examined (Nassar *et al*, 2014). The economic implications of this have been discussed extensively in Singh and Whittington (1975), who highlights 3 basic conclusions: (1) there is no optimum size of firm; (2) what happens in one period is independent of what happens in another period; and finally (3) industries will become more concentrated over time. However, Gibrat's law has come into question several times since 1931, with various scholars conducting studies in order to question its validity, and today, it is very much regarded as an empirical question. While Choi (2009) assessed the relationship between firm age, size and growth rate in the United States insurance market among 823 firms, Leitao *et al* (2010) questioned Gibrat's Law in their study conducted on 39 Portuguese firms over a period of six years, between 1998 and 2004. As a result of their investigations, both Choi (2009) and Leitao *et al* (2010) found that there are no correlations between firm size and growth, accepting Gibrat's Law, confirming the findings of previous studies in the area including Fariñas and Moreno (2000), Audretsech *et al* (2002) and Fujiwara *et al* (2008), taking place between 1990 and 2004.

Despite the acceptance of Gibrat's Law among the scholars mentioned above, there have been several studies that rejected the law of proportionate effect, on the basis of mixed empirical results. Nunes and Serrasqueiro (2009) conducted a study on Portuguese SMEs, accepting Gibrat's Law for lower levels of growth distributions, but rejecting it for the upper levels. Furthermore, Tang's (2013) study on the Swedish Energy sector revealed that Gibrat's Law held for over 70 percent of the cases examined. Therefore, given the variety of studies accepting Gibrat's Law, we argue that in spite of a high correlation between young and small firms, a small firm is not necessarily young, and *vice versa*. While young firms are dynamic, not all small firms are young, and therefore, from a policy perspective, it is important to look closer at young firms, given they have more opportunities for growth and are more likely than small firms to embrace change.

4.1.4 Challenges for SMEs

Despite all the benefits that SMEs bring to the local, EU and world economy, these businesses also face their own challenges, having to overcome difficulties such as access to finance, skills and markets, and high levels of bureaucracy, to name a few. One of the main challenges SMEs face is their access to finance, as argued by Mohnen and Rosa (1999). Traditionally, access to finance represents a challenge for small firms, as they have less collateral and in the case of young firms, do not have the track record that would justify potential loans, being perceived to be a higher risk than larger, more established firms. Moreover, it is unlikely that such small firms will be able to raise finance through equity/share issue. As a consequence of this, a variety of schemes have been developed and supported by various government levels. Various financing opportunities currently exist for SMEs, which include loan guarantees, loans to start a company, venture capital funds, co-investment funds or EU initiatives as highlighted by the National Audit Office (2013) and the European Commission (2015e).

A report published by the University of Surrey and Kingston Smith LLP (2012) shows that a high number of SMEs use as their principal sources of funding personal or family savings, followed by bank loans and income arising from secondary activities. Despite of these additional sources of finance available to SMEs, one of the main identified barriers to these companies has been the lack of knowledge of schemes. However, it has been identified that SMEs have limited knowledge of EU funding or research grants and projects available to them, which could be a result of limited capacity to access to information, events that could occur in micro and small businesses that do not encompass the manpower to conduct thorough research on all available sources of funding (Massa and Testa, 2008). Additionally, the businesses showing awareness of these types of external funding often complain about the untimely receipt of the relevant funding, which could be considered a weakness in respect of EU funding (Massa and Testa, 2008).

Poor access to finance has also been identified by the European Union (n.d.) as one of the main difficulties faced by SMEs in the EaP countries, with businesses lacking the skills to write comprehensive and professional financial reports that could help them in obtaining funding from financial institutions. According to an East Invest (2013) survey, the primary financing sources for SMEs in the EaP countries are their own capital in the form of savings and collateral from their own properties, followed by financial aid received from commercial banks that offer enhanced financial opportunities specifically for SMEs, and friends and family funding. Therefore, East Invest offers SMEs the opportunity to increase their networks and therefore, business performance, through participation in the various activities highlighted in chapter 3, overcoming the difficulty of poor access to finance.

Another major difficulty SMEs face is the lack of access to skills, including the lack of business skills and knowledge (Veugelers, 2008; European Union, n.d.). Various studies have shown that SMEs encounter a shortage and/or delayed access to qualified employees, given their limited resources in financing, knowledge and manpower (FES, 2004; Rammer *et al*, 2006). Additionally, certain businesses also encounter difficulties in recruiting the most appropriate personnel and retaining talent (PriceWaterhouseCoopers LLP, 2014), given a lack of appropriate funding for human resource (HR) processes or limited knowledge in recruiting personnel with the best fit of skills for the respective company. Other companies, in particular SMEs and start-ups in the high-tech industry, which are considered fast-growing firms in most of the cases, often face the challenge of needing to develop the skills of their employees themselves, given the novelty of the product/service, which might be a difficult challenge to meet at times. In their study, Mason *et al* (2012) have identified that fast-growing companies tend to engage in substantial training or employee recruitment in order to meet the needs of the firms, in particular preceding rapid growth. Yet, the skills challenges that these fast-growing firms face are mostly overcome given the assets and capabilities of the firms, which are well equipped in overcoming these challenges (Mason *et al*, 2012).

This barrier to SMEs' success has not only been identified inside EU Member States, but also within EaP countries. As highlighted by the European Union (n.d.), the educational systems' inertia has a direct and negative impact on citizens' transition from studies to the business environment, identifying a lack in professionally skilled workforce fit for the existing business environment, with little or no vocational training.

Furthermore, SMEs themselves identify difficulties in accessing local or foreign markets and meeting market needs (FES, 2004; HWWA, 2004). However, arguably, this could be a direct result of their limited access to business skills and knowledge or limited access to funding. In EaP countries, businesses might lack the knowledge required to enter foreign markets, such as certain product specification or trade information, limiting their target customers' poll and their market presence (European Union, n.d.). Furthermore, depending on the country of origin or the market they wish to enter, some SMEs may encounter high barriers to trade. We aim to consider whether East Invest participant SMEs have been involved in trade for the duration of the programme, which will be covered in the process of quantitative primary data gathering.

Two other major challenges facing certain SMEs in trying to survive, grow or expand their business are bureaucracy and high levels of corruption (Acs and Audretsch, 1990; HWWA, 2004; Rammer *et al.*, 2006; European Union, n.d.). Veugelers (2008) highlights the fact that excessive bureaucracy imposes a disproportionate burden on the correct functioning of SMEs in comparison to larger companies, with overly rigid or long administrative procedures, briberies or unnecessary licenses and compliance costs (Bannock and Peacock, 1989; Martini, 2013). Veugelers (2008) has identified the same results in the case of corruption.

The difficulties imposed by high levels of bureaucracy, as well as corruption, are not limited to SMEs within the EU Member States, but also extend to EU's Eastern Neighbourhood countries (European Union, n.d.). However, given the fact that these difficulties are not SME-specific, this study will not analyse these difficulties in further detail, but will attempt to gather East Invest participant SMEs' opinions more generally on whether their business performance has been affected in any way by bureaucratic procedures.

Having established that firms face challenges, and in particular SMEs face them disproportionately more, in order to establish the impact of the programmes aimed at helping SMEs overcome their challenges and fostering economic growth, we need to consider how business performance can be measured.

4.2 SMEs: MEASURING SUCCESS OF THE FIRM

In spite of the barriers and challenges SMEs are facing today, it is important to assess the business performance of firms not least in order to establish the impact various programmes, such as East Invest, have on SMEs' business performance, by considering different performance measures and the means of measuring success within SMEs.

4.2.1 Measuring Success of SMEs

By its very nature, business performance measurement is a complex subject, requiring expertise and knowledge from a variety of different disciplines, including accounting, marketing, human resource management (HRM), operations management and economics (Neely, 2002). Meyer (2003) further stresses the importance of performance measurement as a complex topic, by arguing that performance has the potential of becoming a new management discipline (Neely, 2002). Neely (1999) further argues that business performance measurement is multifaceted concept, given the following seven influences: (1) increased competition, (2) the changing nature of work, (3) national and international quality awards/standards, (4) the changing organizational roles, (5) improvement initiatives, such as total quality management (TQM), world class manufacturing (WCM) and lean production, (6) the changing of external demands, and (7) the influence of information technology. Yet, in order to achieve increased business performance, it is imperative for these measures to be aligned and integrated with one another for all business performance, as misalignment could lead to low business performance, which could have a devastating impact upon the business (Neely, 1999). Business performance measurement has become more complex, given the following two factors: (1) what are the best measures a firm should take into consideration and adopt, and (2) that these measures are expected to change over time, given the dynamic nature of the world business environment (Neely, 1999). Given the rapid changes occurring on the global scale, businesses have become more holistic in their approaches, considering their wider impact on their external environment and placing stronger emphasis on sustainable growth and corporate social responsibility (CSR) (Salwan, 2007).

Measuring business performance has been constantly changing and developing over the past decades, becoming more inclusive, moving away from the traditional performance measures, and welcoming new measurement frameworks, such as the Balanced Scorecard (BSC) or the European Foundation for Quality Management (EFQM) business excellence model (Neely, 1999; Kennerley and Neely, 2003; Neely, 2002; Ritchie and Dale, 2000). Before moving forward to considering traditional Key Performance Indicators (KPIs) for

SMEs, the thesis will consider the main characteristics of the new measurement frameworks, and their suitability for SMEs.

The BSC combines different types of financial and non-financial measures of performance, taking into consideration the following core areas: innovation, financial situation, customers and internal business processes (Kennerley and Neely, 2003). Despite the various advantages the use of BSC could bring to a company, including improved strategy communication and execution, improved management information and organizational alignment (Marr, 2015), various scholars have highlighted that it is inappropriate for SMEs, due to resource limitations (Hudson et al, 2001; Beldiman, 2015), complexity and costs (Lipe and Salterio, 2000) and differences in innovation (Garengo *et al*, 2005). Therefore, we will not consider the BSC in further detail.

Another framework for measuring business performance is the European Foundation for Quality Management (EFQM) business excellence model, a framework that "*encourages … cooperation, collaboration and innovation*", as highlighted by Herman van Rompuy, former President of the European Council (EFQM, 2012; p.2). By recognizing the need for any organization to continually improve and innovate in order to face the challenges of a world that is continuously changing, the EFQM model aims to allow people and organisations to understand the cause and effect relationships between what the organization does and its results (EFQM, 2012). The model is comprised of three main components: (1) the Fundamental Concepts for Excellence; (2) the Criteria and; (3) the RADAR.

Ritchie and Dale (2000) have discussed a series of advantages of the EFQM model, including the encouragement of employee involvement and ownership, balances of long and short-term investments and the encouragement of performance improvements and focus on processes as well as the end product. However, Ritchie and Dale (2000) have highlighted several important disadvantages of the EFQM business model, which are particular relevant for SMEs, such as lack of resources (finance, time, manpower), the time consuming nature of the process and the difficulty of human resources in realizing the need for documented evidence.

In addition, various scholars clearly differentiate SMEs from larger companies by a number of characteristics, including severe resource limitation in terms of manpower, finance and management, flat and flexible structures, reliance on a small number of customers, highly innovative potential and informal, dynamic strategies (Marri *et al*, 1998; O'Regan *et al*, 1998; Haywood, 1999). Therefore, given the nature of the EFQM business performance framework and the nature of this study, we consider the EFQM model to be more suitable for larger companies, and we will not consider the model into further detail, focusing rather on more traditional measures of success within SMEs.

The most traditional and critical measures of business performance, as identified by various scholars in the past decades, are financial indicators (Venkatraman and Ramanujam, 1986; Camp, 1989; Kaplan and Norton, 1992; Hudson *et al,* 2001). While Venkatraman and Ramanujam (1986) place a strong emphasis on profitability (in the form of return on investment and equity) and earnings per share, these are large company business performance measures, and Hudson *et al,* (2001) identify eight elements within the financial dimension of business performance, more suitable for SMEs: (1) cash flow, (2) market share, (3) overhead cost reduction, (3) inventory performance, (4) cost control, (5) sales (Agarwal *et al*, 2009), (6) profitability, (7) efficiency and (8) product cost reduction. Despite of the financial dimension of performance being considered the narrowest conception of business performance (Venkatraman and Ramanujam, 1986), being heavily criticized as encouraging 'short-termism' (Banks and Wheelwright, 1979; Hayes and Abernathy, 1980) and lack of strategic focus (Skinner, 1974), Hudson *et al* (2001) consider it to be a highly relevant measure of success for SMEs. Hudson *et al* (2001) argue that given the lack of monetary safety in overcoming the short-term instabilities resulting from dealing with change, financial performance measures of success are vital for SMEs. As a result, this study will also consider profitability and sales as measures of business performance when surveying East Invest participant SMEs.

In additional the financial dimensions of performance, growth represent a highly important traditional business performance measure. Murphy *et al* (1996) have identified growth as another important measure of business performance, in terms of sales and employee turnover, finding that has also been put forward by Mason *et al* (2012). Therefore, it is important to consider growth in terms of sales and employee turnover when assessing a company's business performance.

The processes of internationalisation and exporting represent another measure of business performance measurement, closely related to the sales of a company. With one third of total EU exports coming from SMEs (Cernat *et al*, 2014), small firms who decide to enter the process of internationalization could do so through franchising or licencing, through foreign direct investment (FDI), or through exporting. While FDI represents a high level in the process of internationalisation, requiring substantial capital, the majority of SMEs choose to export, understanding the next market they target. Exporting, however, is not as clear of a business performance measures as the other discussed throughout this chapter, with some scholars arguing that export intensity is not related to an SME's economic performance (Ural and Acaravci, 2006). Additionally, from a research-based perspective, SMEs lack the necessary internal resources, business acumen, financial resources and foreign markets' knowledge (Da Chiarra and Minguzzi, 2002; Acs *et al*, 1997; Alvarez, 2004; Wolff and Pett, 2000) that would allow them to engage in exporting activities. While exporting has traditionally been considered to be a difficult measure of business performance for SMEs, given their financial, knowledge and manpower constraints, without being able to enjoy all the entire internationalisation process (Baird *et al*, 1994; Stampacchia and Da Chiara, 1996), recent studies have shown that even after controlling for SMEs' internal resources, activities such as the use of trade shows, business support organisations and programmes identifying distributors and agents, have a positive impact upon SME business performance (Wilkinson and Brouthers, 2006).

Another traditional performance measure is customer satisfaction, a highly important metric for SMEs, as their reliance on a small number of customers given the size of their business suggests that SMEs must remain competitive and therefore, register high customer satisfaction (Hudson *et al*, 2001). Hudson *et al* (2001) have identified the following seven dimensions of customer service as a measure of business performance, most of which could be measured through customer-orientated surveys and direct customer feedback, as well as an analysis of the SMEs' operations: (1) market share; (2) service; (3) image; (4) integration with customers; (5) competitiveness; (6) innovation and (7) delivery reliability.

In addition to customer satisfaction, human resources represent another traditional business performance measure, as identified by Hudson *et al* (2001), Kaplan and Norton

(1992) and Fitzgerald and Moon (1996). As a result, Hudson *et al* (2001) have identified nine particular measures of human resources business performance measures, as follows: (1) employee relationships; (2) workforce; (3) employee involvement; (4) employee skills; (5) labour efficiency; (6) learning; (7) quality of work life; (8) productivity; and (9) resource utilization. Yet, while some of these measures, such as employee relationships or productivity, might be difficult to manage given the limited time and resources of the companies', the flatter structure of SMEs and lower number of employees required a highly motivated and skilled workforce, placing the human resource dimension of business performance towards the top performance measures.

Quality, time and flexibility have also been considered to be critical dimensions of performance, which could be mainly measured in terms of innovation of quality, delivery reliability, product performance, product innovation and new product production (Kaplan, 1983; Collier, 1995; Slack *et al*, 1998; Medori and Steeple, 2000; Hudson *et al*, 2001).

Yet, after having reviewed the modern and traditional measures of success, it is imperative to acknowledge the possibility of measuring success differently within different types of SMEs, depending on the firm strategy, operations, characteristics and business cycle. For example, a micro firm of 5 employees would be more likely to focus on growth, innovation and customer satisfaction in order to grow, while a medium-sized firm of 200 employees might focus on maintaining constant business performance levels, or even firm survival, depending on the industry and competition.

4.2.2 Measuring Success of the EaP's SME Flagship Initiative

Having reviewed the different measures of success most suitable for SMEs, it is important to consider how success of EU projects, and in particular EaP's SME Flagship Initiative, can be measured. Therefore, we must go back at reviewing the main aims and objectives of the SME Flagship Initiative and in particular, the East Invest project, which are a measure of success themselves, if achieved.

The provisions for growth and employment in the Eastern Neighbourhood countries represent the principal measure of success of the SME Flagship Initiative (EuropeAid Development and Cooperation DG, 2011). More particularly, at a policy-level, the collaboration between the EU and OECD aims to assist the EaP countries in effective SME policies through the use of the SBA. Secondly, the SME Flagship Initiative, through the East Invest programme, aims to promote investment and trade through capacity building of business associations and networking within the EaP countries. Finally, the SME Flagship Initiative aims to facilitates SMEs' access to finance through different programmes. We will consider the main aims and objectives of the East Invest project insofar as they change the fortunes of SMEs in Moldova and also the role they have with regard to furthering economic diplomacy.

In addition to promotion of investment and trade, with a total budget of €7 million, East Invest has two additional objectives: (1) develop concrete actions that would general immediate results for SMEs within their region; and (2) develop the East Alliance, mobilizing business alliances from the EU and EaP, promoting partnership and dialogue within the private sector and towards the public sector (East Invest, 2011). Yet, in order to be able to measure the success of East Invest, in particular the project's main aims, we must first consider how the operationalization of this objectives can be measured, which we will consider in the following main section of this chapter, which focuses on research methodology.

4.2.3 Empirical Studies: SME performance and industrial support

Although few in number, in addition to the academic literature on the various business performance measures, there have been a mixture of empirical studies carried out on SMEs and their business performance in relation to industrial support (Criscuolo *et al*, 2014; Harris and Robinson, 2004; Higon and Driffield, 2011). Criscuolo *et al* (2014) have identified in a study carried out in 18 countries a disproportionately high number of start-ups in comparison to the large share of more mature businesses lacking growth. In addition, Criscuolo *et al* (2014) argue that not all small firms are net job creators, with start-ups registering a decline in net job creation in the past few years, bringing a new dimension to the European Institutions' statements viewing SMEs as important job creators, as these firms have the potential to divert resources away from productive uses. While Criscuolo *et al* (2014) argue that SMEs are not as important job creators as the EU stresses, Harris and Robinson (2004) look at the role of industrial support on UK firms in the 1990s and find that some grants do not impact upon firms' productivity, leading us to question whether EU funding has a significant and positive impact on SMEs' performance.

In addition to Criscuolo *et al* (2014) and Harris and Robinson' (2004) empirical studies, Higon and Driffield (2011) have investigated the link between innovation and exporting among UK SMEs, basing their analysis on the 2004 Small Business Survey. Higon and Driffiels's (2011) main findings highlight that a multitude of characteristics are highly important for the export performance of SMEs, including firm-specific characteristics, owner characteristics and other firm-specific factors controlling for risk. Hence, not only the specific support offered by EU programmes, including East Invest, has an effect upon the SMEs' export performance, but even more so, the firms' themselves.

The field of business performance measures has been changing and developing over the past decades, becoming more inclusive and moving away from the traditional performance measures, welcoming of new measurement frameworks. Despite the various benefits of using the BSC and EFQM model, given the different characteristics of SMEs and their importance, traditional business measures such as trade, profit, sales and product/service innovation, represent more suitable indicators of SMEs' business performance. In order to gain a wider understanding of the impact of the SME Flagship Initiative on SME's business performance in Moldova, it is important to consider measuring success from the project's perspective, analyzing the results of the data collection process, as ***EU economic diplomacy has become more complex and inclusive***. Yet, this is part of a wider analysis, allowing us to consider the EU available instruments, EU structures to support work with SMEs and SMEs within the EaP and their business performance, considering the particularities of the new EU economic diplomacy and its efficiency, by addressing RQ1, RQ2 and RQ3.

CHAPTER 5. EAST INVEST IMPACT UPON SME BUSINESS PERFORMANCE IN MOLDOVA

The Eastern Partnership's SME Flagship Initiative European, regional and national focus aims to foster a suitable environment for SMEs to develop and improve their business performance. Hence, it is important to consider the benefits and areas of improvement of these particular programmes. While the number of Moldovan SMEs has increased over the past years, it is highly important to ensure an appropriate environment and support for SMEs to grow and therefore, increase their business performance. As a result, it is imperative to consider the effects of SME participation in EU instruments upon their firm's business performance, in order to identify areas for further development and support, which if addressed, would positively contribute not only to firms as individual business units, but to the economic, political and social environments of the Republic of Moldova, the EaP and ultimately, the EU.

This chapter aims to assess the impact of the East Invest programme upon SMEs' business performance in the Republic of Moldova, based on the primary research conducted for the scope of this study, by considering the institutional set-up, the East Invest 1 instrument and their impact upon SMEs. This chapter will present, with reference to the regional framework in chapter 2, the EU has not been agile in terms of engaging its own structures to reach out to all its different actors, failing to be reflective enough of its different instruments, and lacking to fully consider their different actors.

This chapter is divided into three main sections. Firstly, the thesis will consider the institutional set-up of East Invest, looking at the role of the EU, the Chamber of Commerce and Industry of the Republic of Moldova and the various NGOs encountered as part of East Invest, their challenges and difficulties. The second part of this chapter will conduct an instrument analysis, looking at the East Invest set-up, assessing its different stages and difficulties that might have aroused during the delivery. The final part of this chapter will address the SME dimension, considering the Moldovan entrepreneurial environment within the instrument, the main challenges facing SMEs during their involvement, and analyzing the firms' business performance as a result of East Invest 1 participation.

Yet, before discussing the success of East Invest and participant SMEs, it is imperative to address the programmes' aims and objectives, which as highlighted in chapter 3, are the following: (1) facilitate and promote investment between the EU and the EaP countries; (2) develop concrete actions that would general immediate results for SMEs within their region; and (3) develop the East Alliance, mobilizing business alliances from the EU and the EaP, promoting partnership and dialogue within the private sector and towards the public sector (East Invest, 2011), aiming to ***address the access to market challenge*** that SMEs are currently facing.

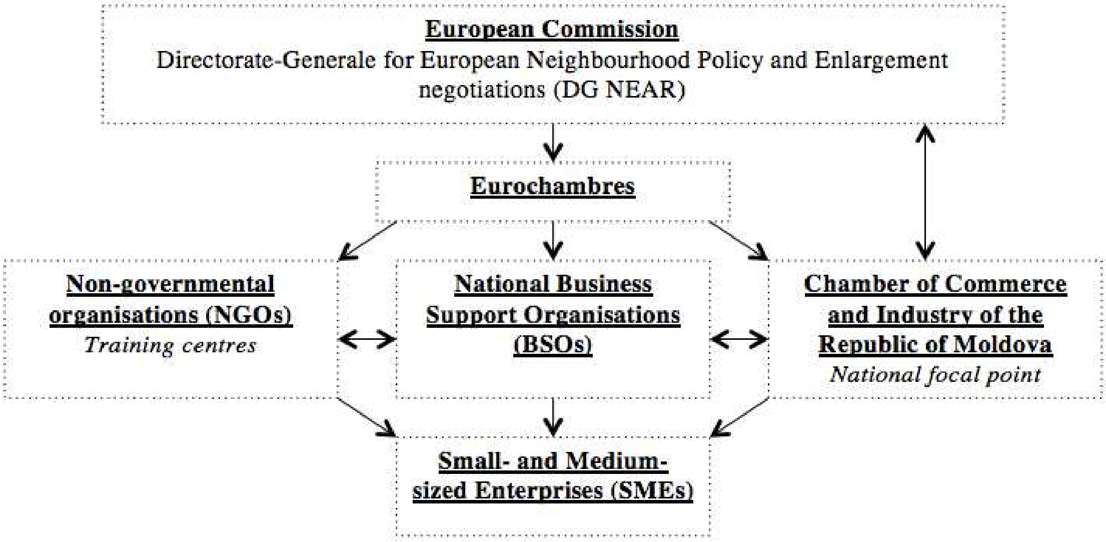
5.1 INSTITUTIONAL FRAMEWORK: FROM THE EUROPEAN COMMISSION TO THE CHAMBER OF COMMERCE AND INDUSTRY OF THE REPUBLIC OF MOLDOVA

The institutional dimension of the East Invest programme in Moldova embraces the involvement of numerous specialists from different levels of the EU organisations, as well as NGOs and national institutions of the Republic of Moldova engaged in the strategic planning, delivery and overseeing of the programme. The European Commission, more specifically the Directorate-Generale for European Neighbourhood Policy and Enlargement Negotiations (DG NEAR), represents the highest EU institution involved in the East Invest, overseeing the strategic management of the programme, as highlighted in Figure 5.1 below. Several DG NEAR experts coordinate East Invest, with the main aims of strategically overseeing the programme on the ground, in Moldova. Their activities include ensuring suitable EU communications and the organization of several events within the programme's different stages, by liaising and coordinating directly with Eurochambres, in the delivery of East Invest workshops in Moldova. In terms of their engagement with other bodies, specialists within DG NEAR occasionally participate in direct communications with the Chambers of Commerce and Industry of the Republic of Moldova regarding the various activities under East Invest. However, the European Commission does not manage direct relationships with different NGOs, BSOs or Moldovan SMEs directly.

The next level of the institutional framework focuses on Eurochambres, the principal actor in the delivery of the programme (European Commission official 1, 2016). Hence, Eurochambres has various specialists who directly manage the East Invest programme by liaising with the different European NGOs involved in delivering EU training for SMEs, the creation and management of different national BSOs and their activities, as well as the officials within the Moldovan Chamber of Commerce and Industry (European Commission official 1, 2016). The main task and accomplishment of Eurochambres within the programme represents the creation and management of the East Alliance, which represents one of the three main objectives of East Invest, which has been successfully achieved. Additionally, Eurochambres occasionally coordinates with DG NEAR in terms of strategic management of the project, and more specifically, in finding the best means to address the programmes' aims and objectives, keeping records of all the East Invest events.

Following Eurochambres, the third level of the institutional framework includes the various NGOs, BSOs and the Chamber of Commerce and Industry of the Republic of Moldova. The principal function of NGOs involved in East Invest is their role as training centers for SMEs and BSOs, providing EU *acquis* and internationalisation trainings to SMEs and ensuring trainings for BSOs, within the Republic of Moldova and EU member states. Hence, NGOs have been in close contact with BSOs and SMEs, during the delivery of training, as well as with the Moldovan Chamber of Commerce and Industry, in organizing the respective trainings. Secondly, the principal role of BSOs in East Invest represents offering direct tailored support to SMEs, encouraging them to build networks and partnerships, providing support to Moldovan firms (European Commission official 2, 2016). Consequently, BSOs are in direct contact with European NGOs, in receiving appropriate training, as well as with the Chamber of Commerce and Industry, in joining the East Invest activities, which requires appropriate communications between the above-mentioned organisations. The Chamber of Commerce and Industry of the Republic of Moldova represents the national focal point of East Invest, being one of the most important institutional players in East Invest, given the existing knowledge of the national economic and political environment and the country's relations with the EU as well as national SMEs. Therefore, the Chamber of Commerce and Industry is assumed to be the first point of call for DG NEAR within East Invest, promoting constant dialogue in order to ensure success of the programme for the Republic of Moldova, the EaP and the EU. Additionally, the national focal point represents the key contact for Eurochambres in Moldova, and liaises with NGOs and BSOs in organizing national events for the benefit of East Invest participant SMEs, liaising with Moldovan firms in regards to their participation in the programme.

Figure 5.1. The Institutional Framework of the East Invest Programme.



Source: Republic of Moldova official 2 (2016).

The fourth level of the East Invest institutional framework represents Moldovan SMEs, the main beneficiaries of the East Invest activities and trainings, as highlighted in Figure 5.1. East Invest participant firms in Moldova are in direct contact with NGOs, given their training seminars, BSOs, given the aim to build networks and partnerships, and with the Moldovan Chamber of Commerce and Industry, given their vital role of national focal point within East Invest. However, given the structure of the programme, Moldovan SMEs are not in direct contact with Eurochambres and the European Commission, given the further strategic role of the later.

5.1.2 Challenges of East Invest Institutional Framework

As highlighted in Figure 5.1, the organization and delivery of East Invest in the Republic of Moldova takes place on four different levels: (1) the European Commission; (2) Eurochambres; (3) the Moldovan Chamber of Commerce and Industry, together with NGOs and BSOs; and finally, (4) the SME level. Such an extensive institutional framework is highly important in allowing the EU to become more agile, engaging with the different actors within the framework and therefore allowing for greater inclusiveness in the EU, welcoming more diplomatic actors and instruments, as highlighted in chapters 2 and 3 of this study. Thus, close intra-institutional communication, inclusiveness and dialogue are vital in ensuring programme success, and the various institutions should ensure constant communication between themselves, in order to be able to then communicate with SMEs and ensure programme success. Hence, these institutions are supposed to work together, to support each other, yet, there are significant problems.

Given the crucial role of the Chamber of Commerce and Industry in the success of East Invest, the focal point has not always been kept informed by BSOs and Eurochambres of the East Invest various activities and workshops (Republic of Moldova official 1, 2016), which resulted in the Chamber of Commerce not being able to offer their full support given their lack of knowledge of activities. This shows a clear ***lack of communication and collaboration*** between DG NEAR and Republic of Moldova officials, highlighting that the EU has not been agile and transparent in engaging with its own structures (Republic of Moldova official 2, 2016).

Without appropriate communication between the various institutions on the different levels of Figure 5.1, it is yet even ***harder to ensure appropriate communication from the organisations towards participant Moldovan SMEs as EU economic actors***. Poor communication of EU projects in the Republic of Moldova can have crucial effects on the success of the programme and most importantly, SMEs. Given the new and growing SME environment in the post-communist space, as highlighted in chapter 3, the SME Flagship Initiative and East Invest programme are new to the Moldovan business environment. Hence, communication is not only vital at an inter-institutional level, but most importantly towards SMEs, being vital in providing extensive information to the Moldovan businesses and citizens on the advantages of these programmes. Without appropriate communication and promotion of the programme from the EU institutions, and given the modest, but growing infrastructure of the Republic of Moldova, SMEs from rural areas will be at a disadvantage, as without appropriate information on the SME support schemes (NGO expert 2, 2016), they could not access and join the programmes. To a certain degree, this would have a negative impact on the success of East Invest, without reaching its full potential in terms of SME participation and showing that the EU is not agile and transparent in engaging with its own structures. The lack of communication within and between the different institutions highlights that while EU economic diplomacy has welcomed new instruments, it shows a clear lack of communication, which is one of the vital functions of diplomacy highlighted by Hill (2003) and previously discussed in chapter 2, showing a mismatch between EU economic diplomacy in theory and its practice. Therefore, it is imperative to further address communication and information towards SMEs as areas for significant improvement, in order to encourage rural SMEs' participation, foster the national economy and ensure EaP initiative's programmes success.

In addition to the challenges mentioned above, as it can be observed Figure 5.1, the ***EC does not have official representation in the Republic of Moldova*** for East Invest (NGO expert 2, 2016). This would not be considered a problem if there is appropriate communication and dialogue between the various institutions. Yet, this is a major weakness in the delivery of the programme, showing a clear lack of agility and transparency within the EU: given the lack of communication between the EC and the national focal point, EC individual country representation would ensure a better understanding of the political, economic and social environment of Moldova, as well as the local culture and the areas of improvement for SMEs (NGO expert 2, 2016). By either ensuring constant dialogue between the different institutions or assigning a EC individual country representative that would closely liaise with the national focal point, this challenge could be addressed, subsequently leading to more successful results at SME, national, programme, EaP initiative and EU levels.

In addition to a lack of communication, another challenge of the institutional framework is bureaucracy. With strict rules and regulations within the EaP countries, given their past challenges in the post-soviet space, complicated EU administrative procedures foster a ***bureaucratic programme environment*** (NGO expert 2, 2016), where long administrative procedures within East Invest have a direct impact on the success of the programme and SMEs' business performance. Yet again, without appropriate communication between the different institutions, bureaucracy of the programme cannot be tackled. Hence, the bureaucratic character of the programme could be minimized by ensuring appropriate communication between the different institutions involved in East Invest as well as SMEs, restructuring East Invest's administrative channels within the institutions involved in the programme.

While the aims of East Invest are quite broad, starting the programme with adaptable objectives can become a major difficulty, as without defining success, it is difficult to identify and monitor it (NGO expert 2, 2016). Keeping a ***programme's aims and objectives general and vague*** could be considered by some to be a successful strategy, as it allows for flexibility and reaction on the East Invest results' mismatches (NGO expert 2, 2016). However, real and sustainable success involves monitoring of the programme and its activities from the inception phase of the programme, to the development, delivery and after the programme is finished. While the third objective of the programme (the creation of the East Alliance) has been more focused and therefore has been a success, the other aims and objectives of East Invest set by the EC do not allow for identifying and achieving clear goals and therefore, measuring the success of the programme and SMEs' business performance changes (NGO expert 2, 2016).

Having revised the institutional framework of East Invest, there is a high potential for **inclusiveness** within the framework. If the organisations cannot communicate intra-institutionally, they will not be able to communicate inter-institutionally, with their recipients, and therefore, the institutions lack organisation and dialogue between themselves, which directly translates into a lack of communication with SMEs as economic diplomatic actors, representing the first major pitfall of EU economic diplomacy within East Invest:

> **P1: The EU is not agile and transparent in terms of engaging its own structures to reach out to all its different actors.**

5.2 INSTRUMENTS OF EU POLICY: EAST INVEST 1 AND EAST INVEST 2

Having discussed the institutional framework for East Invest, we shall now move on to considering the different instruments of the SME Flagship Initiative, their structure, organization and challenges that have occurred.

As reviewed in chapter 3, the literature available shows that the East Invest programme has started in 2010, with a duration of 4 years, aiming to provide access to market for

SMEs. Yet, the information published by the European Institutions neglects to discuss that East Invest has been divided into two main projects: East Invest 1 and East Invest 2. East Invest 1 started in 2010, with an initial duration of 4 years, but received a 3-year extension, until 2017 (European Commission official 1, 2016; NGO official 1, 2016). Being set as a grant agreement, East Invest 1 had a budget of €7 million in order to organise various activities for SMEs and BSOs, in order to improve SMEs' exporting skills and access to market, having the same aims and objectives as highlighted in the East Invest literature in chapter 3, and reviewed at the beginning of this chapter.

On the other hand, East Invest 2 started in 2014 for a duration of 4 years, and it is more complex, offering more technical assistance. The nature of East Invest 2 differs from that of East Invest 1, being a service contract, and therefore, it focuses on public private dialogue (PPD), providing more expertise rather than specific organized series of activities, of a tangible nature, with direct recipient engagement, as in the case of East Invest 1 (European Commission official 2, 2016; NGO expert 2, 2016). Therefore, it is highly important in being aware of the differences between a grant and service contract, as they offer different types of support, one being more tangible and the other having an intangible nature, and hence, different effect upon SMEs, requiring distinctive types of success measurement. Yet, given the scope of this study, we will focus primarily on East Invest 1, as it is more established, having more information as well as indicators for evaluating the instrument, while East Invest 2 has only recently started and there is not enough information available in order to make qualified judgement.

5.2.1 East Invest 1: from Selection Process to Final Reporting

As discussed in Chapter 3, there are various activities SMEs could take part in given their participation in East Invest, yet before we illustrate the order the events take place in, we must first consider the SME selection process in East Invest 1. While it has been difficult to identify and mobilize SMEs with the appropriate knowledge and skills (European Commission official 1, 2016), the SME selection for East Invest 1 has been conducted appropriately in Moldova in comparison to other EaP countries, such as Azerbaijan and Belarus, where the selection and the programme itself have been a disappointment (NGO expert 2, 2016). This highlights a good organization and institutional collaboration in terms of SMEs' selection in Moldova, in comparison to the other EaP countries, once again high pointing the pitfalls identified within the institutional framework (P1), showing that the EU is not agile in involving its different institutions. Yet, within the SME selection process in Moldova, it has been difficult to identify firms with the appropriate knowledge and capabilities, which are considered ready to join the programme (NGO expert 1, 2016). This could be the result of two issues: (1) poor communication from the institutional perspective towards recipients (SMEs), who were not all aware of the opportunity of participating in East Invest 1, as we have highlighted in the previous section; and (2) the EU selection criteria for SMEs has been too ambitious, following a Western perspective and having too high expectations, without considering the new entrepreneurial environment of Moldova.

Having considered the SME selection criteria, we shall now move on to looking at the different stages of East Invest 1. As illustrated in Figure 5.2 below, participant SMEs in the programme attended events and trainings at 5 different stages.

The first stage, represented by training seminars, aimed to prepare SMEs' export skills (NGO expert 1, 2016), by targeting 2 different categories of SMEs, "Starters" (firms who do not have previous export experience) and "Advanced" (firms with previous export experience) SMEs (NGO expert 1, 2016; NGO expert 2, 2016), which is consistent with the EC literature reviewed in chapter 3. The training seminars have been fairly extensive, taking place in 2011 and 2012, with 34 SMEs receiving 25 days of training on EU acquis and internationalization (NGO expert 2, 2016). Direct training was offered by the Chamber of Commerce and Industry of the Republic of Moldova and targeted participant SMEs, and indirect training, through the "Train the Trainers" sessions, was offered to BSOs in ordered to offer better support for SMEs (NGO expert 2, 2016). The different training aimed to help Moldovan SMEs acquire "*valuable knowledge and instruments for exporting and doing business in EU*" (NGO expert 1, 2016), and "*enhancing and deepening their contacts with European Companies*" (NGO expert 1, 2016). We can observe in Figure 5.2 that almost double the number of participant SMEs have attended basic training, showing that they did not have previous exporting experience, while 11 Moldovan SMEs have received training aimed at increasing their product presence within EU markets.

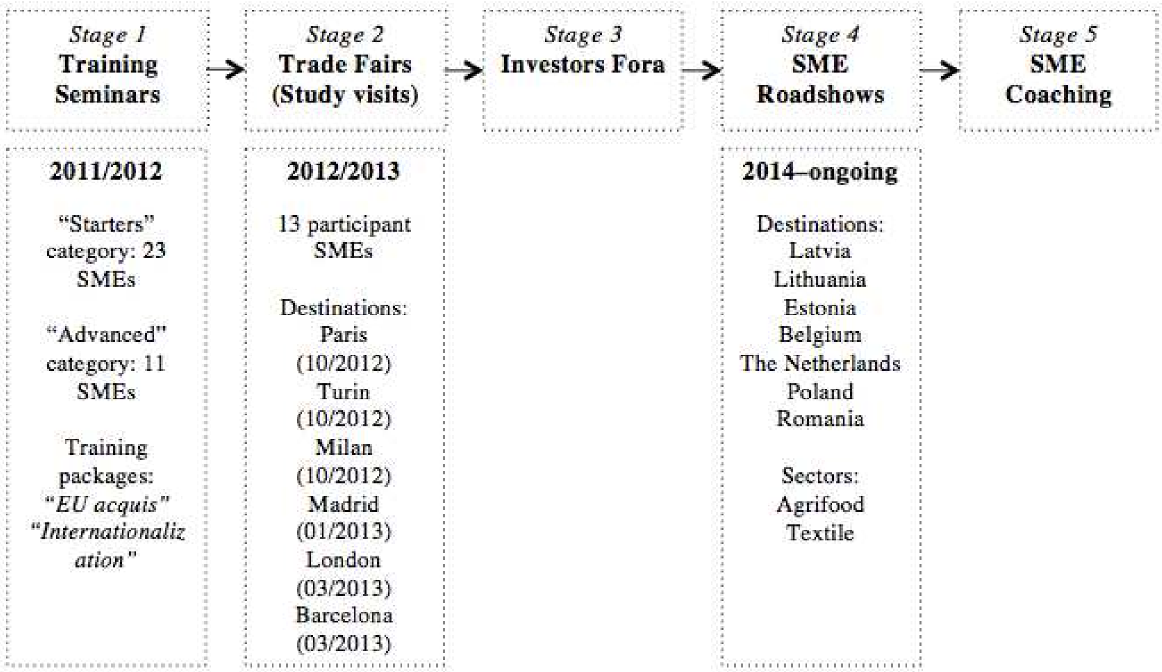
While the different types of training, depending on SME categories, target main business and EU areas that SMEs need to acquire knowledge of before exporting, are considered to have been a beneficial part of East Invest 1, it has been difficult to assess the full success of the first stage of the programme, given the lack of follow-up meetings and SME progress checks preceding the trainings (NGO expert 2, 2016). Hence, we identify a second pitfall of the programme:

> **P2: The EU has not been reflective enough in evaluating the effects of the SME Flagship Initiative.**

We consider this to be an area for significant improvement, as follow-up and feedback are vital in understanding whether the expectations and needs of SMEs have been met, and identify areas for future progresses, therefore increasing the success of the programme, which would translate into achieving its aims and objectives.

The second stage of East Invest 1 represents trade fairs in the form of study visits, where 13 SMEs who have considered successful in stage 1 continue their participation in the programme, attending fairs in 6 different EU cities (European Commission official 3; NGO expert 1). This stage has been perceived as highly beneficial for SMEs, who had the opportunity to pursue partnerships with other EU SMEs within their specific industry, and no difficulties have been registered from the project's perspective (NGO expert 1, 2016).

Figure 5.2. East Invest 1: SMEs - Different Stages and Activities.



Sources: NGO expert 1 (2016), NGO expert 2 (2016), Republic of Moldova official 2 (2016).

Within stage 3, the SMEs who have been considered successful in stage 2 have then attended Investors Foras in the Republic of Moldova, which required EU SMEs to travel to Moldova, where they would meet with the East Invest 1 SME participants at an open event, facilitating the building of further networks and partnerships (Republic of Moldova official 1, 2016; NGO expert 1, 2016). While this stage has been considered generally successful by Moldovan SMEs, the main difficulty encountered represented European SMEs' participation, as EU firms were reluctant to travel and attend the events organized in the EaP countries (European Commission official 2, 2016). While there is no available information as to the reasons behind this, EU SMEs' reluctance can be result of the challenging political, economic and social environments in these post-socviet countries, in comparison to the Western environment. This is an issue of the utmost importance that needs to be taken into consideration by EU institutions when promoting the programme, as it can have a direct impact upon EU-EaP SMEs collaborations. Yet, this difficulty could be overcome by improving intra- and inter-institutional communications, as highlighted in the previous section (P1).

The fourth stage of the programme represents the SME Roadshows, where Moldovan SMEs would yet again travel to EU countries to strengthen and build further partnerships with EU SMEs (Figure 5.2 above), aiming to promote Moldova as an investment destination to the EU (NGO expert 1, 2016). Therefore, Moldovan firms would attend the Roadshow that is closest to their industry; for example, SMEs within the textile industry have attended the Roadshow in Poland (NGO expert 1, 2016). This stage of the programme has not been designed at the beginning of the programme, in 2010, and has only been added in 2014, as an extension of East Invest 1, given still an existing availability of funds, being offered exclusively to SMEs (NGO expert 1, 2016). Reviewing the SME Roadshows' organization, the EU partners are firstly decided upon, followed by the project planning and delivery, with 23 SMEs exporting to the EU as a result of SME Roadshows participation (NGO expert 1; Republic of Moldova official 2, 2016). Hence, stage 4 has been considered successful by both SMEs and the EU (European Commission official 2, 2016). However, looking at the programme perspective, it has been reported that certain Moldovan firms did not have the financial or human resources (HR) power to fund and/or attend these particular events. Yet again, this point will be further explored later in this chapter.

The final stage of East Invest 1, SME coaching, has not been compulsory to SMEs, allowing Moldovan firms to receive tailored coaching as to their business and export activities (Republic of Moldova official 1, 2016; NGO expert 1, 2016). However, SMEs have been reluctant to joining the East Invest 1 coaching scheme (NGO expert 1, 2016). This can be a direct result of the political and cultural environment of the Republic of Moldova; as a post-soviet state, the entrepreneurial environment represents a new feature of the Moldovan economy. Yet again, we will consider this challenge in the following section of the chapter.

5.2.2 East Invest 1 and East Invest 2: Difficulties and Challenges

After reviewing the different stages of East Invest 1, it is important to closely consider the difficulties and challenges of this instrument. To begin with, given the programme's 3-year extension, ***no interim or final report has been published*** on the results of the programme (NGO expert 2, 2016). While the EU has not been fully satisfied with the delivery and effects of East Invest 1 (NGO expert 2, 2016), being a long and difficult process (European Commission official 3, 2016), there is an imperative need for the European institutions conduct a critical evaluation of East Invest 1, with both its positive and negative aspects. Therefore, it is important to not further disregard the difficulties that have occurred (NGO expert 2, 2016), in order to improve upon in future similar programmes in the area, and ensure political, economic and social progress of both the EaP countries and the EU.

The second challenge of the instrument represents the ***prolongation of East Invest 1***, which encountered a certain negative perception. For certain events organised under the instrument, the Chamber of Commerce and Industry of the Republic of Moldova, together with BSOs, receive funding as follows: 40% of funds at the end of the activity, 10% at the end of the respective year, followed by 10% at the end of the programme itself (Republic of Moldova official 2, 2016). The 3-year extension of the programme led to a delay of three years in returning the remaining 10%, given the organization of East Invest 1, which led to certain financial difficulties and therefore, dissatisfactions between the various institutions involved in East Invest 1 (Republic of Moldova official 2, 2016). Furthermore, given the extension of the programme, the EC did not seek consultation with the other organisations involved in the programme with regards to the dispersion of funds, leading to the EU institutions receiving negative popularity from the other organisations involved in East Invest 1 (NGO official 2, 2016). The dissatisfactions thus not only affect the institutions within the instrument, but also the SME recipients, who might not receive the support of the same quality when the organisations delivering it are not content with the programme management. This brings us back to P1 highlighted above, that the EU is not agile in engaging with its own structures in reaching out to all the different actors.

The existing lack of EU agility in engaging with its own structures (P1) has also been reflected in the problems arising within East Invest 2. The second instrument did not have a focal point in Belarus or Azerbaijan (NGO official 2, 2016), and its activities have registered significant difficulties in terms of major delays in reports and payments: with East Invest 2 starting in 2014, the EU Institutions did not appoint a communication officer until spring 2016 (NGO expert 2, 2016). Although it has opened up a little more in terms of strategic vision (European Commission official 3, 2016), having learnt from some of the East Invest 1 errors, the ***extension and difficulties of East Invest 1 have clearly already affected the second instrument***.

Furthermore, the ***overly ambitious selection criteria*** for SMEs within the instrument did not take into consideration the political, social and economic environment of Moldova, following a Western perspective and having too high expectations. Yet, the institutions involved in managing the instrument should differentiate between Western SMEs and entrepreneurial environment and the new entrepreneurial environment of a post-soviet state, and tailor their support accordingly, without choosing a *one size fits all* approach. Therefore, in the instance of the Republic of Moldova, it is important to consider that 66% of SMEs are located in Moldova's capital, and focus not only on the urban firms, but also on the rural firms, the majority of which operate within the agriculture sector.

The difficulties and challenges of the first instrument have, to a small extent and behind closed doors, been recognized by the European institutions, who considered East Invest to be somehow a missed pilot, with a weak implementation and significantly missing strategic vision (European Commission official 3, 2016). Yet, the EU officials consider SMEs' mentality to be the main root of the problems (European Commission official 1, 2016), disregarding the lack of any critical evaluation of the East Invest 1 major problems and therefore, impeding the overall analysis of the instruments and the problems that have occurred from the past. While there have been new EU structures and instruments, involving various organisations (Figure 5.1, p.80), there is a clear lack of effectiveness in the functions of communication and negotiations, whose importance has been recognised by Hill (2003) and discussed in chapter 2, suggesting a lack of appropriate consideration of the EU towards its diplomatic instruments. This leads us to consider another major pitfall in EU policy:

> **P3: The EU has been prolific in introducing different instruments by way of setting up East Invest 1 and 2, but not reflective enough, as East Invest 1 was left poorly evaluated and rather critical in terms of its major structural problems, which had implications on East Invest 2.**

5.3 MEASURING SME SUCCESS

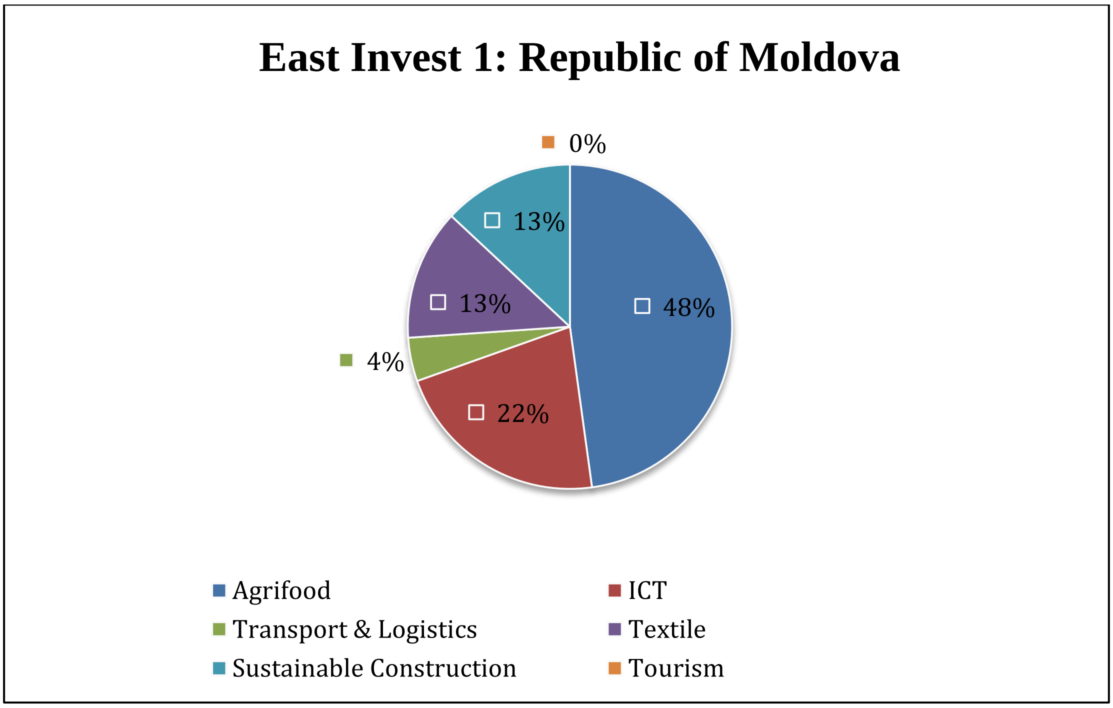
5.3.1 The SME Environment as part of East Invest 1

Having considered the institutional and instrument structures of the SME Flagship Initiative and in particular, East Invest 1, we will now turn our attention to the Republic of Moldova, and in particular, its entrepreneurial environment and SME recipients.

Participant SMEs in East Invest 1 have derived from a variety of industries, as illustrated in Figure 5.3 below. As we can see in Figure 4.1 of chapter 4 (p.64), that only 5.2% of overall Moldovan SMEs operate within the agriculture, forestry and hunting industries. Yet, 48% of East Invest 1 recipients are engaged in the agrifood industry, with SMEs exporting fruit, vegetable oil, meat, grains, seeds, popcorn in assortment and nevertheless, honey (NGO expert 3, 2016). This could be a direct result of the role of the agricultural sector in the Moldovan economy: despite of agriculture being one of the main driving forces of Moldovan economy, lack of investment and capital have led farmers to applying low yield technologies (Moroz *et al,* 2015). Hence, the individual sub-sector of the Moldovan economy, represented by small farms (Moroz *et al*, 2015), seek to improve their production and subsequently, export, by participating in the East Invest 1 instrument. In addition to exporting honey and bee products, firms also offer exchange of experience opportunities in the processing of honey (NGO expert 3, 2016), which represents a major, positive prospect for the future of the Moldovan entrepreneurial environment, setting the ground for future experience exchanges that would further the Moldovan entrepreneurial environment.

Following the agrifood environment, 22% of participant businesses in East Invest 1 derive from the information and communications technology (ICT) industry (NGO expert 3, 2016). Looking back at Figure 4.1 in chapter 4 (p.64), we can observe that again, only a small percentage (6.7%) of SMEs operate within the transport and communications industries, with even a lower number operating solely in ICT. Yet, no SMEs from the ICT environment have been registered to have participated in the study visits in either Italy, the Baltic countries or Poland, which, as shown in Figure 5.2, have solely focused on the agrifood and textiles industry, suggesting that ICT participant SMEs did not meet the requirements to proceed towards the later stages of the programme.

Figure 5.3. Percentage of East Invest 1 SME participants (by sector).



Source: NGO expert 1 (2016).

Following the ICT industry, 13% of SME recipients operate in the textile industries, exporting Moldovan carpets, clothing for women and children, leather articles and uniforms (NGO expert 3, 2016). While the majority (40%) of the SME population in Moldova operate in the wholesale and retail industries, the small number of SME recipients from the textile industry highlights the need for increased participation of such SMEs within the instrument, in order to increase the targeted support for wholesale and retail SMEs.

An additional 13% of SME recipients operate in the sustainable construction environment (NGO expert 1, 2016), although there has been no information available as to the number of companies and the products they export. Only 4% of Moldovan SMEs participating in East Invest 1 operate within the transport and logistics industry. Finally, as we can observe in figure 5.3 above, no SMEs from the tourism industry have participated in East Invest 1 (NGO expert 1, 2016). This is a greatly noteworthy detail, which could be a direct result of the former political environment of Moldova, given its past feature of a post-soviet state that did not place the Republic of Moldova as one of the first tourist destinations. However, the political and economic environment of the Republic of Moldova has been steadily changing in the past decades, and together with the various programmes aimed at increasing trade and investments between the EU and the EaP, such as East Invest, the attractiveness of Moldova as a tourist destination and provider of tourist services and products will grow in the years to come.

Given the nature of the programme, aiming to increase access to the market for Moldovan SMEs and facilitate trade between the Republic of Moldova and the EU, the vast majority of SME participants in East Invest 1 are product providers, given the tangible nature required for exporting and importing goods. In addition, we can discuss that recipient SMEs manufacture labour intensive, low-tech products, given the size of the company and therefore, the East Invest 1 instrument would allow them improve their business acumen, which would lead them to adopting better technologies, improve their productivity, and therefore, increase their exports. Additionally, reporting to Gibrat's law as discussed in chapter 4, according to NGO expert 1 (2016), the majority of SME recipients are young firms, who are proactive in their means of conducting business and willing to learn, rather than small firms. Yet again, this comes as a surprise, as young firms, by nature, would be high-tech and capital-intensive. However, given the nature of the support offered by the East Invest 1 instrument, SMEs that operate in basic industries, such as agriculture, with low skilled labour and access to a medium to high amount of raw materials, represent the easiest East Invest 1 market target for a developing economy, allowing the firms to gain the business acumen and connections that would then permit them to build upon their performance and exports.

Yet before, moving towards an analysis of how SMEs' business performance has been influenced by East Invest 1 participation, it is important to consider the different challenges of the SME dimension within the programme.

5.3.2 East Invest 1: SMEs' Difficulties and Challenges

One of the major difficulties for SMEs within the Republic of Moldova is the country's ***modest entrepreneurial environment***. Given the past soviet nature of the Republic of Moldova, SMEs represent new entities in the country's economic environment, as previously mentioned in this study, and therefore, Moldovan citizens do not have the knowledge, capabilities or understanding of entrepreneurship, in comparison to the Western European states. While the government has taken significant steps in improving this matter, by introducing entrepreneurship as a subject to be studied in schools and higher education, targeting future generations, the Moldovan government lacked an intervention towards the current generation of business professionals, whose business acumen should be improved and who should receive targeted government support in terms of entrepreneurial education. Additionally, corruption and a lack of transparency at a government level, as touched upon in chapter 2, pose major challenges for SME development, and should be carefully addressed and overcome in order to ensure economic prosperity. This mentality has reflected into the East Invest 1 instrument, as entrepreneurs have been reluctant to the ideas of business coaching or consultancy. While this issue will be to some extent solved by the passing of time, as the Moldovan entrepreneurial grows naturally, as well as through different EU SME-oriented programmes aimed towards Moldovan SMEs, government intervention towards the Moldovan society is necessary in assuring an appropriate, growing entrepreneurial environment.

Another difficulty SMEs have encountered during their participation in East Invest 1 represents their ***lack of financial resources*** to fund their travel arrangements on study visits and SME Roadshows. While the participation *per se* in the different activities has been financed by the programme itself, SMEs have had to fund their travelling to the activities, which led to some SMEs dropping out of the programme, given their difficulties in accessing finance (NGO expert 1, 2016). This represents a major problem for SMEs, who might draw important benefits from programme participation but don't have the means to, which could be overcome through the assurance of all costs from the programme's budget. On the other side, full funding for SMEs could lead to the firms showing less commitment and not attending the events they have signed up for, as they have not had to financially contribute to their participation, and therefore, are not fully dedicated (NGO expert 2, 2016).

In addition to lack of financial resources, several firms have withdrawn their participation in East Invest 1 given the ***lack of manpower*** (NGO expert 1, 2016). With the majority of companies being micro firms with less than 10 employees, SMEs have found it difficult to simultaneously manage their business and attend the events (NGO expert 1, 2016), although they could significantly benefit from their participation in East Invest 1. Yet, this could be overcome through more tailored training, in smaller groups, after consulting with the SMEs business schedules, or alternatively, by organizing activities outside working hours. In addition, SMEs could receive more tailored help in finding EU SME partners (Republic of Moldova official 2, 2016), which would not only help firms who do not have the human resource capacity to engage with them, but would also, indirectly, contribute to increased exports, and therefore, positively impact upon the national economy.

Another main challenges SMEs have been facing during their participation in the instrument represents their ***reluctance in sharing their success stories*** as a result of programme participation. Moldovan SMEs have been avoiding having their success stories available on a national and international scale, as it might increase their visibility and hence, their national competition, by providing information about the programme to their competitors (NGO expert 1, 2016; Republic of Moldova official 2, 2016). This perception shows a lack of understanding of how the market works on the SME side, which should have been clarified and addressed by the EU, who organised and managed the programme. A good example of such a firm is a company exporting honey to France, whose story was published by the European institutions, followed by the Moldovan national press. While there might have been other success stories in addition to the honey exporting SME, for instance a grain exporting SME, firms are reluctant to share any information on their experience as part of East Invest 1, which has led us encounter difficulties in the process of quantitative data gathering. Yet, this study has overcome this challenge by obtaining extensive information on SME participation from other sources, and therefore, the scarcity of financial data does not impact upon the results of this thesis.

5.3.3 Effects on SMEs’ Business Performance: success story or room for improvements?

In the process of analyzing SMEs’ business performance as part of their participation in East Invest 1, this thesis will consider the following measures, as reviewed in chapter 4 of this study: (1) access to market; (2) financial measures in the form of exports; (3) human resource measures in the form of number of employees, employee training and knowledge of foreign languages; (4) product and process innovation; and (5) customer service measures, as discussed in chapter 4.

Given the main aim of East Invest 1, providing ***access to markets*** for SMEs, Moldovan firms have been facilitated their access to new markets, through the programmes’ various activities in their home country and within the EU, giving them the opportunity to build networks and partnerships with other EU countries. Therefore, we argue that in terms of access to market, SMEs' business performance has increased as a result of their EU instrument participation. Yet, it is important to consider whether or not SMEs have taken advantage of gaining access to foreign markets, which brings us to the financial measures of business performance, and more exactly exports.

With 13 out of 34 SMEs moving from stage 1 of East Invest 1 towards the further stages of the programme (NGO expert 1, 2016), it is believed that Moldovan firms have increased, although to a limited extent, their ***exports***, given the success stories of the honey and grains exporting firms in Moldova. Their knowledge of the main requirements and indications on how to export to the EU has been improved through the various trainings in stage 1 of East Invest, leading SMEs to gaining knowledge on exporting to the EU, despite the fact that the success of the trainings was not measured through follow-up meetings with participant SMEs. However, it is imperative to mention that exports do not represent a clear indicator of business success, as it can only be considered positive in the case of increased turnover, without certainly guaranteeing increased business performance (NGO expert 2, 2016). The firms who were prepared to export have been more likely to establish new links with EU other SMEs, possibly attracting more investment and starting new export collaborations than the SMEs who attended the trainings in order to gain knowledge and start exporting to the EU (NGO expert 2, 2016). However, the number of SMEs who participated in stage 2 onwards of East Invest 1 is significantly low in comparison to the total population of Moldovan SMEs and while growth has occurred as a result of increased exports at an individual business level, the effect this has on the Moldovan national economy is nearly insignificant. A reason why SMEs might not be significantly involved in their exports is their human resource capacity, given that the majority of participants SMEs are micro firms (NGO expert 2, 2016), which leads us to considering the human resources measures of success.

In terms of ***human resource measures*** of business performance, with the majority of participant firms having 10 or less employees, SMEs often lack the manpower to ensure high levels of production or attend events that might lead them to new collaborations, as previously highlighted (NGO expert 1, 2016). Additionally, given the political and social past of the Republic of Moldova, the employees of the company might not have the required language skills to export to other country than those in their immediate vicinity, whom language they are likely to speak (NGO expert 2, 2016). While East Invest 1 stage 1 seminars have ensured training in EU acquis and internationalization, SMEs have not had access to language courses under the programme. Additionally, with East Invest 1 focusing on increasing access to foreign markets and therefore, exports, SMEs need to increase their production capacity and considering the industries participant SMEs originate from, this can mainly be done through new and innovative machinery that would ensure high production with minimal costs, rather than increasing the number of employees. As a result, without receiving language training in order to help overcome likely language barriers between SMEs in the EaP countries, and without the need for increased employment, as a result of East Invest 1 participation, Moldovan SMEs' business performance has not increased in terms of human resources measures enough to make an impact upon the firms' success.

The increase in the number of exports and partnerships registered by Moldovan SMEs requires the firms to ensure ***product and process innovation*** in order to be able to deliver the required quantity and quality. While firms might have improved their processes and products in order to guarantee increased production and comply with EU rules and regulations, process innovation can, in turn, have a direct impact upon the human resources dimension of business performance in the form of a negative relationship: as processes become more efficient and businesses adopt new technologies and machineries in order to increase production, they do not require the same manpower, sometimes being under pressure to reduce their number of employees. With SMEs having increased innovation in the areas of processes and products, in order to ensure increased exports, having a positive impact upon business performance, the impact this has on the human resources measure might be negative, lowering their business performance, although not significantly. Additionally, at a national level, this could have a major impact upon employment, increasing the rate of unemployment. However, any decrease in national employment would not have been a direct result of East Invest 1, given that less than 0.5% of Moldovan SMEs participated in the programme.

The final measure of business performance, ***customer service***, is closely related to the access to market, exports and processes and product innovation. Therefore, as SMEs' access to market increased, as well as their exports and processes and product innovation, their innovation and image increase as well, suggesting a positive relationship between the variables above. Hence, the customer service measure of success has positively contributed to SMEs' business performance that participated in East Invest 1.

All the challenges and difficulties encountered by SME participants within the instrument, together with the poor Moldovan entrepreneurial environment, reveal another important pitfall in EU policy:

> **P4: The EU has attempted to engage with different actors. However, there is a significant need for better consideration and a tailored approach towards achieving SMEs needs and the individual country economic environment when implementing instruments, as *one size does not fit all*.**

The empirical analysis shows a lack of coherence and coordination of EU institutions for economic diplomacy not only in Brussels, but also in the Republic of Moldova. While the EU introduced new diplomatic instruments and the ***EU economic diplomatic model is complex and more inclusive***, it lacks flexibility and proficiency, ***failing to be agile and transparent***. In relation to the new diplomatic local actors (SMEs), EU communication was not collaborative, as SMEs were not offered the opportunity and did not have appropriate means of communications with the EU. Hence, in spite of their participation, there has been little to no improvements in SMEs' business performance.

CHAPTER 6. EU ECONOMIC DIPLOMACY IN THE EASTERN NEIGHBOURHOOD

In order to become more effective and legitimate, the EU has developed new structures in reaching out to its external environment. EU economic diplomacy has aimed to manage alienation and build bridges, trying to be more inclusive, through the welcoming of new actors, trying to be more flexible, through the introduction of new structures, and trying to be more agile by instating new ways of communication. Yet, the EU has not been fully successful at connecting with the structures and the actors on the ground, showing a clear lack of communication, flexibility and agility.

This chapter aims to assess and discuss the differences between EU economic diplomacy in theory and practice, with reference to the literature reviewed in chapter 2 of this study. This chapter will present, with reference to the conceptual framework in chapter 2, that there is a major disconnect between EU objectives and the reality of EU economic diplomacy, leaving room for considerable improvements until we can discuss about a collaborative, inclusive and forthcoming type of EU economic diplomacy.

The present chapter is divided into four main sections. Firstly, the study will review the main assumptions of the theoretical model of EU economic diplomacy, as presented in chapter 2. The thesis will then move on to question the theoretical assumption within the real setting of EU economic diplomacy, by considering three main characteristics: (1) multi-actor; (2) inclusivity; and (3) multi-instrumental. Thirdly, the chapter will take into consideration the main advantages and challenges of EU economic diplomacy, highlighting that, at present, EU economic diplomacy has registered fewer advantages than challenges, exposing its weak and non-agile nature. Finally, the thesis will consider Van Bergeijk and Moons's (2003) activities of economic diplomacy, in assessing the achievements and failures of the new EU economic diplomacy.

6.1 EU ECONOMIC DIPLOMACY: THEORETICAL MODEL

In order to evaluate EU economic diplomacy in practice within the EaP and more specifically, the SME Flagship Initiative, we look back at the conceptual framework (chapter 2). As highlighted at the beginning of this study, EU diplomacy has evolved over time, moving away from political statecraft towards an inclusive economic diplomacy. Therefore, we have identified three main features of the new EU economic diplomatic model: (1) multi-actor (structure and inclusivity); (2) multi-instrumental, and (3) communication.

With the EU economic diplomacy aiming to manage relationships and build bridges between different state and non-state actors. EU economic diplomacy has become more inclusive, promoting collaboration and communication not only between state actors, but also between state and non-state actors. The recognition of non-state actors within diplomacy goes back to Der Derian (1987), who does not limit his approach of diplomacy to states, and proposes new actors in diplomacy, recognizing the importance of individuals, groups and entities. Der Derian's (1987) consideration of other non-state actors has been strongly influenced by the advancing force of globalization, which, as earlier discussed, is highly important for the purpose of this study, bringing SMEs to the heart of diplomacy today. For instance, within the EU and EaP countries, the Eastern Partnership Initiative not only been limited to the bilateral engagement at state level, but has also placed a strong emphasis on multilateral cooperation, welcoming of new actors such SMEs and business networks and individuals, as discussed in chapter 3. Given its inclusive nature, EU economic diplomacy has also welcomed new instruments, for instance, the EaP and in particular the SME Flagship Initiative. Various EU economic diplomatic instruments, as seen in Figure 3.2 in chapter 3 (p.52), exclusively focus on offering targeted support to SMEs within the EaP countries, and in particular, we have focused on the intermediaries' level of support, the East Invest programme. Hence, the theoretical model of EU economic diplomacy, as discussed in chapter 2 and revised above, has shown increased inclusivity, welcoming new actors, new instruments and encouraging partnerships, collaboration and open communication between state and non-state actors, such as SMEs.

6.2 EU ECONOMIC DIPLOMACY IN PRACTICE

6.2.1 Multi-actor feature of EU economic diplomacy

As highlighted in Figure 5.1 (p.80), the institutional framework of East Invest 1 and the SME focus within the programme highlight that the EU economic diplomacy has been trying to engage multiple economic actors. However, two of the major pitfalls (P1 and P4) identified in the previous chapter highlight important difficulties in EU economic diplomacy multi-actor engagement.

Firstly, EU economic diplomacy has not proven to be responsive in terms of engaging its own structures in reaching out to its different actors. While the EU has recognised the economic diplomatic role of NGOs, BSOs and SMEs, as demonstrated through the SME Flagship Initiative and in particular, East Invest, EU economic diplomacy in practice did not ensure suitable engagement between its own structure, and towards SMEs as economic diplomatic actors. While introducing new economic diplomatic actors, the EU has failed to fully engage them in communicating intra-institutionally, between themselves, and most importantly, inter-institutionally, with SME recipients, showing a clear lack of agility on the side of the EU.

Additionally, the EU has failed in addressing the various economic diplomatic actors individually. As we can see in Figure 5.1 of chapter 5 (p.80), the EC has directly engaged with Eurochambers and the Chamber of Commerce and Industry of the Republic of Moldova. Additionally, Eurochambers has closely interacted with NGOs, BSOs and the Moldovan Chamber of Commerce and Industry, who, in turn, interacted with SMEs, as economic diplomatic actors. Although SMEs are included in the institutional framework of the economic diplomatic instrument, the EC seems to have failed to conduct a thorough analysis of the Moldovan entrepreneurial environment and therefore, to offer Moldovan SMEs tailored support. Given the political, economic and social environment of the Republic of Moldova, as a post-soviet space, its new entrepreneurial environment significantly differs from the Western European one: Moldovan SMEs lack the basic entrepreneurial knowledge, being labour-intensive and low-skilled. Hence, it is imperative to conduct a thorough analysis of the Moldovan entrepreneurial environment before engaging with SMEs as economic diplomatic actors within the East Invest 1 instrument, in order to understand their needs and requirements, which are different from those of EU

SMEs, and offer tailored support towards achieving their needs, increasing trade, as *one size does not fit all*.

Furthermore, the variety of actors within EU economic diplomacy, and especially SMEs, do not seem to fully understand their role and contribution to the national, regional and EU political, economic and social environment. While SMEs have received training on *EU acquis,* and more specifically, on EU rules and regulations on trade and exporting, they did not receive any coaching as to their important role as non-state economic diplomatic actors. This is a matter of high importance as, by firstly being informed of the importance of their businesses and participation in such instruments to their businesses and national economy, SMEs might increase their engagement within the programme and be even more motivated to succeed in order to make a difference.

Given the effects of globalization (Bayne and Woolcock, 2007; Friedman, 2007), diplomacy has become more inclusive, with new and highly important diplomatic actors emerging, stressing the highly important role of SMEs as diplomatic actors within the EU and the EaP countries, as previously highlighted. Inclusivity of EU economic diplomacy is closely related to the engagement of multiple diplomatic actors. By welcoming new economic diplomatic actors such as SMEs, as well as NGOs and BSOs, it is vital to ensure these new actors are being taken into account, and their views and needs are being address. Yet, our empirical analysis shows a clear lack of inclusivity of the EU economic diplomatic model, failing to appropriately manage alienation and build bridges through the welcoming of new local diplomatic actors (SMEs).

The lack of a tailored approach towards SME support and EU's difficulties in engaging its structures highlights that while EU economic diplomacy has evolved, engaging multiple diplomatic actors, as highlighted in chapter 2, the ***EU economic diplomatic model has engaged with more non-state actors, but it needs to closely consider and address its different actors, through more tailored approaches and increased interaction between its structures***. This leads us to considering inclusivity as the second feature of EU economic diplomacy.

6.2.3 The multi-instrumental nature of EU economic diplomacy

While the EU has been prolific in introducing different economic diplomatic instruments, such as East Invest 1 and 2, the regional actor has not been reflective enough, as the instruments have been left poorly evaluated and rather critical, in terms of major structural problems (P2, P3), as highlighted in the previous chapter. Hence, the EU economic diplomatic model, while complex and inclusive, lacks agility and transparency. Given the prolongation of East Invest 1, the EU has failed to produce an interim report on the instruments' progress to date (NGO expert 2, 2016), or to conduct a critical and thorough analysis of the instrument, only publishing the positive outcomes of the programme. From a policy perspective, transparency is necessary when EU citizen's money is used in such grants, and an investigation of the programme should always be conducted in order to identify its strengths and areas of improvement. Yet again, the EU has failed in conducting such an analysis and given the primary data of this study, the programme has been a disappointment. However, this leads us to consider whether or not the EU has had unknown objectives, given the failure of East Invest 1 as an economic diplomatic instrument.

The introduction of different EU economic diplomatic instruments would also require clear aims and objectives. Yet again, the aims and objectives of its instruments have been too broad and vague, showing the fragile and unstable nature of EU economic diplomacy. Without identifying their areas of success and their problems, there is a clear disconnect between EU objectives and what happens on the ground when engaging with new actors, which also contributes to our previous argument, that the environment, although it aims to be inclusive, engaging with a variety of actors, it lacks inclusivity. Without clear objectives, it is difficult to assess the outcomes of the instrument and thus, assess and improve it, as we have previously argued. Therefore, the lack of a critical analysis and clear aims of EU economic diplomacy reveals another major pitfall in EU policy:

> **P5: Although EU economic diplomacy aims to be multi-instrumental, its instruments lack organisation, adequate monitoring and critical evaluation.**

Before moving forward to comparing the theoretical model and the practice of EU economic diplomacy, we shall now move forward to considering the advantages and challenges, as well as the achievements and failures of EU economic diplomacy.

6.2.2 EU economic diplomacy and communication

When considering the communication function of the EU economic diplomatic instrument, we have noticed communication difficulties at three different levels: (1) inter- and intra-institutional; (2) from SMEs as EU economic diplomatic actors towards the EU, and (3) from the instrument towards its different recipients and the society. Having considered the inter- and intra-institutional communication and collaboration gap (P1), communication from SMEs as EU economic diplomatic actors towards the EU has encountered significant difficulties. The EU has not been reflective enough in introducing different economic diplomatic instruments, which has resulted in East Invest 1 being poorly evaluated. The SME recipients have not been provided with an opportunity to communicate their feedback on the different stages of the programme, showing a lack of communication between the Moldovan firms and the EU. Yet, this matter is not a concern of the SMEs themselves, but rather of the EU as an institution, who did not assure appropriate systems in place in order to seek feedback.

Furthermore, SMEs have been reluctant to disclose their experiences and success stories for publication purposes, as highlighted in the previous chapter, showing a lack of communication from SMEs, as economic diplomatic actors. While sharing their success stories could increase the firms’ competition, SMEs should understand the benefits of expressing their views of the diplomatic instrument, being open to understanding the wider effect of their communication: although in the short-term, sharing their success stories as part of East Invest 1 might increase firms’ competition, in the long-run, this would benefit and foster a stronger entrepreneurial environment, leading to increased national economic growth and therefore, regional and EU economic growth. Therefore, this highlights the following important communication problem not only of the EU, but also of SMEs:

> **P6: Both state and non-state economic diplomatic actors have major communication difficulties between themselves and towards the national and European settings.**

Thirdly, communication difficulties have also been registered from the economic diplomatic instruments towards diplomatic actors and the greater society. While the extension of East Invest 1 has had a negative effect on the start and success of East Invest 2, leading to delays of the second programme, East Invest 2 showed poor communication with recipients, given the lack of an of an EU appointed communication officer for the first two years of the programme (NGO expert 2, 2016). Yet again, this highlights significant and clear problems of communication between different EU economic actors.

6.3 ADVANTAGES AND CHALLENGES OF EU ECONOMIC DIPLOMACY

6.3.1 Trade and Investment

An important advantage of EU economic diplomacy is trade and investment (Van Bergeijk and Moons, 2007), receiving attention from different diplomatic actors and instruments. In the case of the East Invest 1 programme as an economic diplomatic instrument, an increase in trade has been registered in the Republic of Moldova. Given the very scope of the instrument, the effect is minimal; with less than 0.5% of Moldovan SMEs participating in East Invest 1, and an even lower percentage engaging in new collaboration and exporting to EU countries. As a consequence, trade cannot be seen to be a significant advantage of the current EU economic diplomatic instruments.

In comparison to trade, investment has been an even more difficult advantage of EU economic diplomacy to measure, without having any specific information regarding the FDI in the Republic of Moldova within the East Invest 1 instrument. Despite the programme's aim to promote Moldova as an investment destination, EU SMEs have been reluctant to invest in the EaP countries, given these countries' political, economic and social environment past and present; this particular challenge of economic diplomacy could be overcome through increased dialogue between EU SMEs and the EU institutions involved in EU economic diplomacy, providing EU SMEs with more information upon the importance of their investment within the EaP countries in their role of diplomatic actors. With trade between the EU and EaP region being, to an extent, an advantage of economic diplomacy, while investment proved to be more challenging in the economic diplomacy area, we argue that trade and investment have not been major advantages of EU economic diplomacy.

6.3.2 Building Relationships and Establishing New Networks

Another ***advantage of EU economic diplomacy is the creation of relationships and establishment of new networks***. Within the East Invest 1 instrument, we can discuss building relationships at two different levels: (1) within the institutional framework and with SME recipients; and (2) between EaP SMEs and EU SMEs, as economic diplomatic actors. Having already established in the previous sections that new relations have beet created between different institutions, given the multi-actor nature of EU economic diplomacy, this has also led to the creation of the East Alliance, one of the main objectives of economic diplomatic instrument, establishing new networks previously mentioned in the last chapter. In terms of new relationships and networks between EaP and EU SMEs, the increase in trade as a result of East Invest 1 participation, although small, has resulted in the creation of new relationships between non-state economic actors. As a result of their participation, Moldovan SMEs as diplomatic actors have built partnerships with EU SMEs, resulting in increased exports, as suggested by NGO expert 1 (2016) and further economic collaborations, although small in number.

Hence, building relationships and establishing networks has been a major advantage of EU economic diplomacy and EU policy in the case of the East Invest 1 instrument. Yet, it is important to also consider the challenges economic diplomacy has faced.

6.3.3 High Number of Institutional Players

One of the main challenges of economic diplomacy within the East Invest 1 instrument represents the wide variety of institutional players and their internal collaborations. Given the large number of BSOs and NGOs involved in the programme, together with DG NEAR, Eurochambres and the Chamber of Commerce and Industry of the Republic of Moldova acting as national focal point, there has been a clear lack of communication between the state and non-state diplomatic actors, which could also be a result of the high number of actors involved. Taking into consideration the effects of globalization as highlighted by Friedman (2007), communication is highly important in today's world, being facilitated by new technologies and innovations in the IT sector. Yet, despite the increase in communication means over the past decades, the various institutions involved in the instrument have failed to communicate to each other, leading to dissatisfaction and divided collaborations. ***The involvement of too many institutional players in the programme***, as in the present case, ***represents a major challenge for EU economic diplomacy***, given the lack of communication and inclusivity.

6.3.4 Competitive Economic Environment

Furthermore, ***another key challenge of EU economic diplomacy*** under East Invest 1 ***represents the (lack of) competitive economic environment*** of the various states involved in the diplomatic instrument, in our case, the Republic of Moldova. While a competitive environment leads to the development of the local industries through increased competition and therefore, innovations and product developments (Bailey *et al*, 2005), the lack of a competitive economic environment, and more specifically entrepreneurial environment, for Moldova has proven to be a challenge for SMEs as diplomatic actors. Participant SMEs have been reluctant at sharing their success stories and discussing their participation in East Invest 1, given their concerns that this could lead to increased competition on the national market (NGO expert 1, 2016; Republic of Moldova official 2, 2016).

6.3.5 Diverse Political, Economic and Cultural Settings

The differences in the political, economic and cultural environment of the countries involved in economic diplomatic instrument, and more specifically, the East Invest 1 programme, prove to be another difficulty of EU economic diplomacy. As in the case of Moldova, the country's former political environment as a post-soviet state had a direct impact upon the current economic and social environment. From an economic perspective, the entrepreneurial setting of the Republic of Moldova is a new feature in the country's economy, and therefore, non-state economic diplomatic actors do not have the required business knowledge, skills or experience, which impacts upon their day-to-day performance and the success of diplomatic instruments (NGO expert 1, 2016). From a societal perspective, non-state diplomatic actors might not have the required language skills and cultural awareness when forming collaborations with other EU actors. Yet, while some of the economic and social differences can be minimized through increased targeted training of non-state diplomatic actors, ***diverse political, economic and social settings still represent a major challenge for EU economic diplomacy.***

Hence, given the advantages and challenges of EU economic diplomacy highlighted above, we identify another major pitfall of EU policy:

> **P7: At present, EU economic diplomacy has registered fewer advantages than challenges, exposing its weak and non-agile nature.**

Yet, before being able to draw the conclusions on EU economic diplomacy in practice, we shall consider its achievements and failures, following Van Bergeijk and Moons' (2003) consideration of economic diplomacy.

6.4 EU ECONOMIC DIPLOMACY: ACHIEVEMENTS AND FAILURES

As presented in the conceptual framework of this study (chapter 2), Van Bergeijk and Moons (2003) identified economic diplomacy as comprised of three main activities, as reviewed in chapter 2 of this study: (1) the use of *political* influence and relationships in order to promote and influence trade, the way the market functions and/or address market failures; (2) the use of economic assets and relations in order to boost economic security; and (3) means to consolidate the appropriate political environment and collaborations in order to institutionalise these objectives.

To begin with, the first economic diplomacy activity has been, to some extent, achieved through the East Invest 1 instrument, with the EU representing the main diplomatic regional actor in the EaP. The different activities under the economic diplomatic instrument have been achievable for delivery through the management of political relationships between the EC and the Republic of Moldova Chamber of Commerce and Industry, as well as other NGOs involved in the programme. The already-existing political relationships between the EU and the Republic of Moldova have not only set the grounds for the collaboration of the two regional actors within the economic diplomatic instrument, but have also led to the creation of economic relationships between different non-state actors (e.g.: BSOs and SMEs), showing not only political power, but more importantly, economic influence. The existence of these relationships has led to an increase in trade, although small, as well as improved access to market for SMEs, giving the firms, as economic diplomatic actors, the opportunity to further develop, reform and build networks and collaborations with EU non-state diplomatic actors.

Additionally, political and economic influence also resulted in influencing the way the Moldovan economy and market work, aiming to stimulate the national economy of the Republic of Moldova, through the various activities organized under the East Invest 1 instrument. This would indirectly lead to an increase of the economy the EU, building relationships developing the partnerships between the EU and EaP business sectors, and managing alienation between the EU and its Eastern neighbours, influencing and promoting economic developments and collaborations for mutual benefits. Yet, it is imperative to mention that although it exists, ***political influence and relationships represent only a minor advantage for EU economic diplomacy***, which could be improved through increased inter- and intra- institutional communication as well as increased inclusivity.

Secondly, the EU's use of economic assets and relations in boosting EaP and EU economic security is most visible in the total budget of the €7 million of East Invest 1 as an economic diplomatic instrument. The management of the economic relationships between the different state and non-state actors (as seen in Figure 5.1, p.80) involved in the instrument, allowed for the establishment and delivery of the different stages of East Invest 1. This encouraged non-state diplomatic actors, in particular SMEs, to build relationships and initiate business transactions, which would then result in their increased business performance, having an impact upon the economic growth and security of the Republic of Moldova and the EU.

While this economic diplomatic activity has shown concrete results in the form of an increased number of exporting SMEs, it is important to consider the extent of these results and the challenges behind them. The difficulties incurred within the institutional framework, the East Invest 1 instrument and the SME recipients, as presented in the previous chapter, does not allow us to perceive significant economic developments or important increases in economic security. All of these difficulties, independently and jointly, have led to reduced results of East Invest 1, and consequently, reduced economic security in comparison to its full potential. Hence, improvements in the development of

economic assets and relations has not been a major achievement of EU economic diplomacy.

Thirdly, the consolidation of the appropriate political environment and collaborations in order to institutionalise the objectives of trade promotion, market failures and economic security boosts represents one of the most challenging activities of EU economic diplomacy, and in particular, the East Invest 1 instrument. Given the institutional framework presented in the previous chapter, there has been a strengthening of EU and EaP economic collaborations through their involvement in East Invest 1. Indirectly, this economic consolidation could possibly lead to further collaborations not only at an economic level, but also at a political level, with economic growth influencing the present and future political environment of the different regional economic diplomatic actors. Given the two different tracks of the discussed economic diplomatic instrument, it is highly challenging to discuss about a direct consolidation of political environments and collaborations within the multilateral cooperation track through the SME Flagship Initiative and the East Invest 1 programme. Hence, we argue that ***consolidation of the political environment and collaborations between the different state and non-state actors still represents a failure of EU economic diplomacy.***

Having reviewed Van Bergeijk and Moons's (2003) activities of economic diplomacy, we conclude that EU economic diplomacy had minor achievements in the areas of political influence and economic assets, whereas EU economic diplomacy in practice has registered a disappointment in terms of political environment and collaborations consolidation. This shows that the EU is still a weak actor in international politics, highlighting the EY's inability to communicate and speak with one voice, which is consistent with Melissen's (2005) view of the EU as a diplomatic actor and disagrees with Bàtora's (2003) and Hocking and Spence's (2005) views of the EU as a strong regional diplomacy actor.

The theoretical assumptions of the new face of diplomacy have given us a novel perspective on EU economic diplomacy, aiming to engage at different levels with new state and non-state actors, having new structures and instruments within its inclusive environment. Yet, the empirical analysis of this study has shown major discrepancies between the ideal, theoretical model of EU economic diplomacy, and the disappointing reality of the model. EU economic diplomacy undeniably presents a far more versatile environment, with more actors within the EU and the Eastern Partnership countries, with new structures and instruments such as the SME Flagship Initiative, and in particular East Invest 1. Yet, the EU has not been agile and transparent in engaging its own structures to reach out to all its different actors, showing a considerable lack of inter- and intra-communication, and has failed to conduct critical monitoring and evaluation of its instruments, which is reflected in the achievements and failures of the EU economic diplomatic instruments. While the EU has been prolific at introducing new actors, it has failed to identify their successes and problems. Although EU economic diplomacy aims to be inclusive, engaging with different state and non-state actors, given its structural problems, it lacks inclusivity. Hence, there is a major disconnect between EU objectives and the reality of EU economic diplomacy, leaving room for considerable improvements until we can discuss about a collaborative, inclusive and forthcoming type of EU economic diplomacy.

CHAPTER 7. CONCLUSIONS

With the world becoming more complex, connected and contested (European External Action Service, 2015), we can observe the ascent of various important regional players, one of which is the European Union (EU), which this study has focused on. These changes had a direct impact upon diplomacy, which has been moving away from political statecraft to a new type of diplomacy, more complex, inclusive and agile in theory. While the heart of diplomacy lies at its engagement with the outside world, the EU has evolved and become a complex system, responding to world changes by introducing new diplomatic structures, instruments, functions and welcoming new actors, all of which aim to reduce alienation and manage relationships between state and non-state diplomatic actors in order to further economic and political integration and cooperation. Within the EaP countries, the SME Flagship Initiative represented the main economic diplomatic instrument, aiming to improve access to market and increase trade between the EU and its eastern region, through a variety of programmes, such as East Invest 1. While the East Invest 1 diplomatic instrument aimed to involve more and new diplomatic actors, placing a strong emphasis on SMEs, in order to further economic growth and manage relationships between the EU and its eastern neighbours, the EU economic diplomatic model in the context of the East Invest 1 programme in Moldova has proven to have major pitfalls, without registering important success.

This study aimed to assess how effective the EU is as an actor in economic diplomacy by looking at its structures and instruments, as well as asses the effectiveness of the EU in engaging with new diplomatic actors such as SMEs, by assessing the impact of East Invest 1 upon SMEs' business performance in the Republic of Moldova. In essence, the study aimed to analyse if the EU economic diplomacy has indeed become complex, inclusive and agile.

The empirical analysis of this thesis has shown that the EU economic diplomatic model has indeed become more complex, introducing new diplomatic instruments and structures.

EU economic diplomacy has welcomed new instruments such as the SME Flagship Initiative and its various programmes, aiming to further economic growth and manage EU-EaP relationships, under an extensive institutional framework, as highlighted in Figure 5.1 (p.80).

The EU economic diplomacy has also become more inclusive, welcoming new diplomatic actors, with focus on SMEs, in order to initialise and target its new instruments and structures as the model has become more complex. We have observed a rise in non-state diplomatic actors and their involvement, in particular SMEs, given their key role in the EaP's SME Flagship Initiative. However, while targeting these different actors, there is an important need for better consideration and a tailored approach towards helping SMEs in the eastern region improve their business performance in order to then further national and regional economic growth, as highlighted in chapter 4:

> **P4: The EU has attempted to engage with different actors. However, there is a significant need for better consideration and a tailored approach towards achieving SMEs needs and the individual country economic environment when implementing instruments, as *one size does not fit all*.**

Yet, while becoming more complex and more inclusive, the EU diplomatic model has not become agile in terms of engaging its own structures in reaching out to all the different actors, failing to be reflective enough of its different instruments, and lacking the full consideration of their different actors:

> **P1: The EU is not agile and transparent in terms of engaging its own structures to reach out to all its different actors.**
>
> **P2: The EU has not been reflective enough in evaluating the effects of the SME Flagship Initiative.**

By failing to be agile in engaging its own structure, the EU economic diplomatic model has also failed to be transparent: in engaging with more actors, there is a need for transparency in order to ensure programme success and ultimately, economic growth in the region, which the East Invest 1 as a diplomatic instrument has failed to be. Both state and non-state diplomatic actors have had major communication difficulties between themselves and towards the national and European settings, which reveals an even bigger weakness of the EU with regards to communication, a vital function of diplomacy in today's global context. With Hill (2003) stressing the vital role of communication in diplomacy, the application of his analysis to the realities of diplomacy today does not match: while the EU has elaborate structures and instruments, these do not speak to today's diplomatic functions, an area which clearly needs more improvements in order to ensure the management of alienation to further economic growth. This weakness of the EU economic diplomatic model has been clearly reflected in the East Invest 1 participant SMEs' business performance, which has registered little, if any, positive changes given their participation in the programme.

These problems have reflected in the overall success of the EU economic diplomatic system. While this new face of diplomacy has become more issue-focused, more complex (with more instruments, structures and agencies to accommodate the global changes) and more inclusive (engaging with new actors, in particular SMEs), the model has failed to be agile, responsive and transparent. While you need to see change occurring, it is harder to follow more diplomatic actors and therefore, there is a need for grater transparency, which misses from the current economic diplomacy. The new EU economic diplomatic model fails to be connected in order to become more effective, missing agility, transparency, connectivity and evaluation in becoming more effective. Hence, the EU machinery still has a long way to go in engaging with its actors and being more agile, before we can discuss about an agile and integrated model of EU economic diplomacy that welcomes evaluation and improvements.

7.1 POLICY RECOMMENDATIONS AND FUTURE RESEARCH

Given the challenges identified during this study, there is extensive scope for policy improvement, as previously highlighted. The EU has definitely become more diverse and inclusive. However, at the same time, having proliferated its instruments and actors, it lacks transparency, agility and connectivity. In order to for EU economic diplomacy to be more efficient, a lot more needs to be done prior to the rolling out of programmes. EU policy should be more agile in engaging with its different structures, ensuring appropriate evaluation and change implementation of its different instruments, in order to be able to have a significant positive impact in terms of political integration and economic growth in the eastern region. Furthermore, EU policy should be transparent and better connected, in order for its implementation to be successful and have positive effects upon the EU and eastern region economic environment.

The current research has identified the need for more extensive EU programme evaluation in order to identify areas for further improvement and the development of evaluation ought to form part of the development of the programme, being an integral part of policy design if it is to be assessed effectively. Hence, there is scope for future research to go beyond SMEs' business performance assessment as a result of EU instruments, assessing the economic diplomatic model within the larger scale, looking at the economic diplomatic models of International Financial Institutions (IFI), such as the International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD) and the World Bank. Further research would therefore enrich the understanding of how SME business performance has changed as a result of IFI intervention through project participation in the eastern region and beyond, looking at the EU's southern neighbours in order to provide a comparative study on the economic diplomatic model.

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APPENDICES

APPENDIX 1. QUALITATIVE DATA RESEARCH QUESTIONS

Qualitative Data Gathering – DG NEAR, DG Internal Market, Industry, Entrepreneurship and SMEs, EU delegation in Moldova

1. What are the objectives of the East Invest initiative? How has it come about?
2. How were they operationalised and were there any difficulties connected to this?
3. Have you had success stories? Why were they successful? How do you plan to build on them?
4. What are the major difficulties and barriers to running of the programme?
5. Do you feel the programme has achieved the originally set aims and objectives? How did SMEs perceive the programme? Do you feel they have registered significant benefits as a result of their participation?
6. Do you think the programme could be improved? If YES, how?

APPENDIX 2. QUANTITATIVE DATA RESEARCH QUESTIONS

Quantitative Data Gathering – Online questionnaire to participant SMEs (target sample of 100 Moldovan SMEs)

1. In which state do you reside?
2. How did you hear about the East Invest programme?
3. In what stage(s) of East Invest did you participate?
4. Did you have any other SME partners?
5. Have you participated in similar programmes before? If YES, please specify.
   ☐Yes; ☐No
6. How many employees does your company have?
   ☐1-9; ☐10-49; ☐50-249; ☐250+
7. Is your company located in the urban area or the rural area?
   ☐Urban area; ☐Rural area; ☐Urban and rural areas
8. Is your company female-led or male-led?
   ☐Female-led; ☐Male-led
9. Is your company business-to-business (B2B) or business-to-consumer (B2C) faced?
   ☐B2B ; ☐ B2C
10. When was your company started?
    ☐Before 2006; ☐After 2006
11. Is your company offering services or products?
12. Does your company export and/or import?
    ☐Export; ☐Import; ☐Export and import
13. Did employees in your company receive any training prior to the company's participation in East Invest (e.g. business skills, leadership, industry-specific training)? If YES, please specify.
14. Do you think that overall, your company has benefitted from East Invest participation?
    ☐Yes; ☐No
15. To what extent did you company experience a change in **GROWTH** in the past 3 years?

☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

16. To what extent did you company experience a change in **OVERALL PROFITS** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

17. To what extent did you company experience a change in **SALES** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

18. To what extent did you company experience a change in **INVESTMENT** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

19. To what extent did you company experience a change in **EMPLOYEE TURNOVER** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

20. To what extent did you company experience a change in **PRODUCT/SERVICE DEVELOPMENT** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

21. To what extent did you company experience a change in **INNOVATION** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

22. To what extent did you company experience a change in **NETWORKS AND/OR BUSINESS LINKS** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

23. To what extent did you company experience a change in **EMPLOYEE SKILLS** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

24. To what extent did you company experience a change in **ACCESS TO MARKET** in the past 3 years?

    ☐-5; ☐-4; ☐-3; ☐-2; ☐-1; ☐0; ☐1; ☐2; ☐3; ☐4; ☐5

25. Do you perceive the above changes in GROWTH, OVERALL PROFITS, SALES, INVESTMENT, EMPLOYEE TURNOVER, PRODUCT/SERVICE DEVELOPMENT, INNOVATION, NETWORKS, EMPLOYEE LINKS AND ACCESS TO MARKET of your firm a result of your East Invest participation? If so, please specify which and why.

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26. Have you identified any other benefits as a result of your participation in East Invest? Please specify.

    ………………………………………………………………………………………
    …………………….

27. Has your company reviewed its strategy, vision or mission as a result of East Invest participation? If YES, please specify the changes.
28. Has your company used the Balanced Scorecard or any other modern performance measurement frameworks as management tools to assess and review performance?

    ☐YES, ☐NO *The Balanced Scorecard is a management tool assessing both financial and nonfinancial performance measures from at least 4 perspectives: financial, customers, internal business processes, innovation.*

    If YES, please provide more details: why was the framework chosen, the results of using the chosen framework etc.

    ……………………………………………………………………………
    ………………..

29. What disadvantages or difficulties did you experience as a result of East Invest participation?
30. On a scale from 0 to 10, do you feel that participation in East Invest has been beneficial for your company?

    ☐1; ☐2; ☐3; ☐4; ☐5; ☐6; ☐7; ☐8; ☐9; ☐10

31. Having experienced East Invest participation, is there anything you would like to see changed about the organization and delivery of the programme?

    ………………………………………………………………………………………
    ………………….