

**THE MAIN CHALLENGES AFFECTING  
THE PERFORMANCE OF SMALL AND MEDIUM-SIZED ENTERPRISES (SMES):  
CASE STUDY OF THE SME ROADMAP OF AZERBAIJAN**

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for the Degree of Master of Business  
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*Statutory Declaration*

I hereby acknowledge that my master research paper has been written by myself without any external unauthorized assistance. All parts, arguments or ideas of the thesis, and including tables, figures, which are cited from other sources, have been acknowledged without exclusion.

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**Abstract:**

Small and medium-sized enterprises (SMEs) are important drivers for the health and sustainability of the economies. They are the primary source of productivity growth and job creation. The paper intends to find out the main challenges affecting the performance of SMEs and to what extent the SME Roadmap is being implemented in Azerbaijan. To achieve the goal, the study researches on the theory of “Business environment” and its limits, SME’s opportunities and challenges in a global context, especially in the European Union (EU) and Eastern Partnership (EaP) countries (in the example of Georgia). The study further analyses the current trends in the economic diversification strategy of Azerbaijan, its success and challenges, and influencing factors for the performance of SMEs in Azerbaijan, as well as evaluation of the short-term objectives of the SME Roadmap. The research design of the study is cross-sectional using a mixed approach: both qualitative and quantitative research methods. The primary data was collected through structured interviews and quantitative survey questionnaires among small-scale survey sample. The study used secondary data from the publications of various institutions through online sources. The study concludes that there are three main challenges affecting the performance of SMEs, which are limited access to finance and lack of skilled employees, and regulation, namely tax inspections and illegal demands by law enforcement bodies. While analysing the short-term achievements of the Strategic Roadmap, the study completes that the implementation is limited with the establishment of different state bodies, associations and centres. This research is inductive and expressive in nature. The researcher formed a model based on research findings, which could be statistically measured in the future.

**Keywords:**

Business Environment, Entrepreneurship, Small and Medium-sized enterprises, European Union, Eastern Partnership, Azerbaijan

## Contents

<b>List of Abbreviations</b> .....	7
<b>1. INTRODUCTION</b> .....	8
1.1. <u>Rational of the study</u> .....	8
1.2. <u>Research Questions</u> .....	9
1.3. <u>Research objective</u> .....	10
1.4. <u>Outline of the thesis</u> .....	10
<b>2. LITERATURE REVIEW</b> .....	12
2.1. <u>The theoretical concept “Business environment”</u> .....	12
2.2. <u>Entrepreneurship in the global context</u> .....	14
2.3. <u>Small and medium-sized enterprises in the global context</u> .....	16
2.3.1. <u>Contribution of SMEs to the Economic Growth and Employment in the global context</u> .....	16
2.3.2. <u>Challenges affecting the performance of SMEs in the global context</u> .....	18
2.3.3. <u>Access to Finance</u> .....	19
2.3.4. <u>Availability of skilled employees</u> .....	21
2.3.5. <u>Access to markets/Internalisation</u> .....	22
2.3.6. <u>Innovation</u> .....	22
2.4. <u>Azerbaijan and SME Development</u> .....	23
2.4.1. <u>Political and Geographical Background of Azerbaijan</u> .....	23
2.4.2. <u>Economic Background of Azerbaijan</u> .....	23
2.4.3. <u>Economic diversification strategy of Azerbaijan since 2014</u> .....	26
2.5. <u>Azerbaijan and European Neighbourhood Policy</u> .....	29
2.5.1. <u>Eastern Partnership Programme in the context of “Stronger Economy”</u> .....	29
2.5.2. <u>Overview of the Government policies toward the development of SMEs in the EaP countries: Case study of Georgia</u> .....	31
2.6. <u>SMEs in the context of Azerbaijan</u> .....	33
2.6.1. <u>Classification and distribution of SMEs in Azerbaijan</u> .....	33
2.6.2. <u>Contribution of SMEs to the economic growth and employment in Azerbaijan</u> .....	35
2.6.3. <u>Importance of SMEs to the Azerbaijan’s economy</u> .....	36
2.7. <u>The SMEs Roadmap of Azerbaijan: Case Study Project</u> .....	37
2.7.1. <u>Objectives of the SME Roadmap</u> .....	37
2.7.2. <u>Current Implementation status of SME Roadmap of Azerbaijan</u> .....	38
2.7.3. <u>Regularity environment</u> .....	39

2.7.4.	<u>Access to Finance</u> .....	41
2.7.5.	<u>Availability of skilled employees</u> .....	43
2.7.6.	<u>Internalization</u> .....	45
2.7.8.	<u>Innovation</u> .....	45
2.7.9.	<u>Conceptual model</u> .....	46
3.	<u>METHODOLOGY</u> .....	47
3.1.	<u>Research Strategy</u> .....	47
3.2.	<u>Data collection methods</u> .....	48
3.3.	<u>Data analyses</u> .....	49
3.3.1.	<u>Participants</u> .....	49
3.3.2.	<u>Quantitative data analyses</u> .....	49
3.3.3.	<u>Qualitative data analyses</u> .....	50
3.3.4.	<u>Limitations</u> .....	51
3.3.5.	<u>Ethical issues</u> .....	52
4.	<u>FINDINGS</u> .....	53
5.	<u>DISCUSSION</u> .....	64
5.1.	<u>Theoretical contribution of the study</u> .....	65
5.2.	<u>Practical contribution of the study</u> .....	65
6.	<u>EXECUTIVE SUMMARY</u> .....	67
	<u>BIBLIOGRAPHY</u> .....	70
	<u>APPENDIX A: Interview Protocol 1</u> .....	82
	<u>APPENDIX B: Interview Protocol 2</u> .....	90
	<u>APPENDIX C: Coding Table</u> .....	92
	<u>APPENDIX D: Survey Protocol</u> .....	96
	<u>APPENDIX E: List of Figures</u> .....	101

## List of Abbreviations

AZPROMO	Azerbaijan Export and Investment Promotion Foundation
BSOs	Business Support Organizations
DCFTA	Deep and Comprehensive Free Trade Area Agreement
EaP	Eastern Partnership
EC	European Commission
EU	European Union
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
ICD	Islamic Corporation for the Development
IFC	International Finance Corporation
ILO	International Labour Organisation
OECD	Organisation for Economic Co-operation and Development
SBA	Small Business Act
SDGs	Sustainable Development Goals
SME	Small and Medium-sized Enterprise

# 1. INTRODUCTION

## 1.1. Rational of the study

For many years now, many publications have been discussing that the large enterprises contribute to the economic growth more than small firms because of availability of mass production, access to finance and more specialized workforce (Varum and Rocha, 2013). In parallel, many other publications have been debating the contribution of small firms to the economic development and wellbeing of nations (Schiersch, 2013). While researching the history of small businesses, it became clear that until the 1970s, this field was not a very intensive researching field for academicians. However, after the global oil crisis in the 1970s, the contribution of small businesses to economic development started to be widely discussed (Piore and Sabel, 1984). Subsequently, the role of small companies enlarged with the introduction of changing technology to the societies (Acs, 1984). Birch (1981) said, “what else they are doing, large firms are no longer the major providers of new jobs for Americans” (p. 8). Therefore, in the following years, it is proved that Small to Medium-sized Enterprises (SMEs) are important actors for the health and wellbeing of the economy (Duarte, 2004). They are the main source of job creation (Clark and Moutray, 2004) and drivers of productivity growth (OECD, 2017). Although SMEs play a key role in the employment and economic growth of the countries, there are several factors that make challenges for their development. Consequently, the European Union strongly considered the needs of SME growth with different strategic papers (e.g. Lisbon Growth and Employment Strategy, Small Business Act for Europe), and followed by annual performance review reports to promote a business-friendly environment for SMEs operating in Europe. Doing so, SMEs are 99% of all businesses in the EU, and they have created around 85% of new jobs in the past five years (EC, 2018).

Despite the crucial role of SMEs in the global economy, Azerbaijan lags in the field of SME development. Azerbaijan's economy mainly depends on the oil price and trends in global oil markets. Following the economic shock in 2015-2016, Azerbaijan developed the Strategic Road Map on the production of consumer goods at the level of SME (SME Roadmap). Accordingly, a State Agency was created to support the SME sector to reduce dependence on oil revenues. Over the past three years, several reports have been prepared to report on large-scale economic reforms carried out in Azerbaijan. Latest reports indicate that Azerbaijan's position has hiked up to 25 among 190 countries in the “Doing Business – 2019” report for the ease of doing business, which is prepared by the World



Bank Group. According to the report, Azerbaijan is competing with countries such as Germany and Canada, while it has progressed further compared to France and Italy. However, another report (CESD, 2019) claims that despite extensive legal reforms and new incentive mechanisms, the growth in the real economy remains weak. In other words, there have been delays in the implementation of reforms and roadmap development strategies. Likewise, according to the assessment of the EU4Business regardless of the restoration of the economy in 2017, progress in the development of the private sector and the support to the job creation remain limited in Azerbaijan (2018).

Unfortunately, there are very few recent academic papers devoted to the field of SME in Azerbaijan. Back in 2009, the International Finance Corporation (IFC) with the support of the Swiss State Secretariat for Economic Affairs presented the results of the first survey of the business sector in Azerbaijan. According to the report, the main problems in the business sector in Azerbaijan were restriction of competition such as challenges over large or state-owned enterprises, tax, registration and legal burdens, which were settled through informal means. However, the large-scale reforms have been launched since 2009; therefore, problems identified in those years may not be relevant for today.

All in all, given the vital contribution of SMEs to the economy and job creation, and the fact that SME topic has not been intensively researched in Azerbaijan, the researcher devoted her master thesis to the study of factors affecting the development of SMEs in Azerbaijan.

## **1.2. Research Questions**

Selection of the research topic is the most exciting and the start point of the research proposal (Ghuri and Gronhaug, 2010; Smith and Dainty, 1991). However, there is little chance to achieve a successful project without spending sufficient time on a research topic (Raimond, 1993). As mentioned above, taking into consideration limited research in the existing academic literature, as well as the key areas of interests and career goals of the researcher, this study intends to find the answer of the following primary and minor research questions:

The main research question is “What are the main challenges affecting the performance of SMEs and to what extent the SME Roadmap is being implemented in Azerbaijan?”

Minor research questions:

1. What are the most current concerns, which affect the performance of SMEs in Azerbaijan?

2. To what extent were the short-term objectives of the SME Roadmap achieved/are likely to be achieved?
3. What are the most relevant implementation mechanisms “best practices” for SME performance to be applied in Azerbaijan?

### **1.3. Research objective**

In general, the main objectives of this study are to bridge on-going discussions on SME challenges in Azerbaijan and the impact of the SME Roadmap into a single paper. Additionally, it shows how the progress in this field fits into the theory of “Business Environment”. While doing so, the researcher will form a model based on research findings which could be statistically measured in the future. The research will be practically useful for business students, business owners, start-ups and ex-pats who prepare a mission to Azerbaijan to deliver capacity-building activities in the relevant fields. This research is thus inductive and expressive in nature (Blumberg, Cooper and Schindler, 2011).

### **1.4. Outline of the thesis**

This study consists of five chapters: (1) Introduction, (2) Extensive literature review, (3) Methodology, (4) Findings and (5) Executive summary.

Chapter 1 presents the rationale of the research, which also includes a problem statement, followed by primary and minor questions and objective of the study as well as the outline of the thesis.

Chapter 2 outlines the theoretical background of the thesis, which is an extensive literature review. The theory “Business environment”, its limits in academic research is studied. As a next step, SME’s contribution to economic growth and employment, as well as challenges affecting their performance in the global context, are explored. The study further investigates the current trends in the economic diversification strategy of Azerbaijan, analysing the speeches of the President of the Republic of Azerbaijan since 2014, its success and challenges. The chapter describes Azerbaijan’s participation in the European Neighbourhood Policy, short comparison with the example of Georgia and concludes with case study project, which is the SME Roadmap of Azerbaijan. The chapter also introduces a conceptual model of the study.

Chapter 3 presents the methodology that the study expresses the research strategy, data collection methods, tools and techniques applied to the data processing. It also discusses the challenges/limitations and ethical issues of the study.

Chapter 4 describes the findings of the study. It starts with analysing the recently executed short-term goals of the SME roadmap of Azerbaijan, its achievements / non-achievements. This chapter also includes more in-depth analyses of the survey and the results of interviews.

Chapter 5 is devoted to the discussion of the findings. This part summarises the significant findings and reaches to the aim of the study that finds the answers to the primary and minor questions of the thesis. Additionally, theoretical and practical contribution, as well as recommendation for future studies are made.

Chapter 6 is the executive summary.

## 2. LITERATURE REVIEW

### 2.1. The theoretical concept “Business environment”

Business decisions are usually influenced by the “business environment”. The business environment is a set of guidelines and business ethics, as well as judicial and legislative frameworks that have a positive or negative effect on the achievement of businesses (Essia, 2012). According to Ramos (2004), the business environment focuses on the external factors that may influence the functioning of the organization, positively or negatively affecting several of its internal structural components. According to the website of the European Commission<sup>1</sup>, the Business Environment is “an appropriate regulatory environment and public goods that support economic activity are important to enable businesses to play their role in creating jobs and well-being”.

Two factors may affect the business environment: external and internal factors. External factors are economic, political, social, technical, environmental and legal forces that constitute market threats and opportunities, and internal factors are the organization's capital, skills and reputation that define the firm's strengths and weaknesses. The internal factors are usually considered as controllable factors that are regulated by a business. The external factors are difficult to be controlled by a business, and they are divided into two categories such as micro-environment (supplier, business distribution etc.) and macro-environment (economic policy, socioeconomic status etc.). While the business environment, in a board context, refers to internal and external factors that are listed above; however, the term is mostly used to refer to outside factors (Cherunilam, 2010). For example, Aswathappa (2008) defined business environment: “Environment mainly refers to external factors that impact businesses” (p.15). Furthermore, William F. Glueck, Lawrence R. Jauch (1984) stated that “the environment includes outside the firm which can lead to opportunities and threats to the firm. Although, there are many factors, the most important of the sectors are socioeconomic, technological, supplier, competitors and government” (p.8).

In terms of external factors, political and economic environments are critical factors for business development. The political climate involves a form of government, and regulations of a country (Cherunilam, 2010). It refers to the role of political structures such as the legislative bodies, the executive administrations and the judiciary, influencing, improving and regulating business operations

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<sup>1</sup> European Commission: Definition of a business environment. Available at: [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/thematic-factsheets/business-environment\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/thematic-factsheets/business-environment_en) (consulted on 5 January 2020).

(Aswathappa, 2008). In his book "Business and Government", Marshal Dimock (1949) stated: "The most powerful institutions in as society today are business and government; where they meet on common ground-amicable or otherwise, together, they determine public policy, both foreign and domestic, for a nation" (p.30). In its turn, a country's economic environments, such as the degree of economic development, financial capabilities, and income level are the leading indicators for a business (Cherunilam, 2010). Enterprises are highly reliant on macroeconomic indicators. Over the last decade that was described as one of the most extended growing periods in the global economy, emerging and developing economies undergone several deep conflicts, economic crises and periods of regression, which had a negative impact on the businesses (Spivak, 2019).

For years, researchers have been studying the relationship between government structures and businesses. Autio and Fu (2015) researched the effectiveness of the countries' political structures and entrepreneurial characteristics. The study revealed that the powerful political structure encourages enterprises to participate in formal entrepreneurship and prevents enterprises from joining informal entrepreneurship. In this area, academic literature indicates that enhancing the efficiency in the legal environment contributes to improvement in the economic growth of a country (Aristovnik and Obadic, 2015). A more current study found empirical evidence that government initiatives were intended to promote entrepreneurship (Chowdhury et al. 2018). For example, according to the report by the World Bank (2010), policy structures take approximately 700 days to meet all the required criteria for starting a new business in Suriname, South America. In comparison, New Zealand entrepreneurs can do the same in a single day. This study indicates that the level of institutional environment on regulatory complexity represents an important obstacle to entrepreneurship. Besides these studies, the correlation between the external environment and entrepreneurship among countries was examined by Sambharya and Musteen (2014). This study revealed that the quality of regularity system was adversely associated with entrepreneurship. More importantly, they discovered that the institutional impact varies depending on the type of entrepreneurial activity. The evidence was that they identified certain relationships to be contradictory to those they hypothesized, and according to them, the correlation between the institutional climate and entrepreneurial activity is far more complicated and requires further research. Another study revealed a significant relationship between entrepreneurship and legislation, employment and business. However, researchers did not discover sufficient evidence to support the statistical significance of this correlation (Bosma et al. 2018).

The environments as mentioned above were a crucial component of business performance in both developing and developed countries. It was acknowledged that the obstacles to performing

business differ widely throughout regions and countries, and the business environment has been claimed to influence a business' overall performance. Yet, measuring the business environment in the academic literature has experienced considerable methodological challenges that may have produced skewed assumptions due to issues such as variables errors, omitted variables, and endogenous regressor. Many aggregate business environment studies indicate the correlation between business environment features and macroeconomic results rather than describe the causal effects of the output business environment (Commander, Svejnar, 2011).

## **2.2. Entrepreneurship in the global context**

According to Richard Branson (2014), founder of the Virgin Group, “running a business is often imagined as a smooth trajectory from struggling start-up to a fully-fledged global brand. But that’s never really the case; growing a company is all about overcoming a seemingly endless series of challenges, big and small”<sup>2</sup>. Paul Burns (2016), in his introduction to “Entrepreneurship and Small Business” book, noted how tense and awkward the 21st century was started for the world, while highlighting the damages of global crises to entrepreneurship. With the outbreak of the wars in Afghanistan and Iraq followed by the Arab Spring and its losses to the Middle East, as well as natural disasters and the Ebola virus in West Africa in 2014 has negatively affected all sectors, including entrepreneurship through the years. Currently, in 2020, the world is fighting with the pandemic COVID-2019. The UN trade agency forecasts (2020) that the world economy will lose about \$ 1 trillion due to the virus. “Not only is this pandemic costing lives, but its impact on economies and living standards will likely outlive the health emergency phase. By ensuring our clients sustain their operations during this time, we hope the private sector in the developing world will be better equipped to help economies recover more quickly<sup>3</sup>,” said Philippe Le Houérou, Chief Executive Officer of International Finance Corporation.

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<sup>2</sup> Statement by Richard Branson (8 December 2014), founder of the Virgin Group. Available at <https://www.virgin.com/richard-branson/companies-overcoming-challenges-creativity-and-camaraderie> (consulted on 5 January 2020)

<sup>3</sup> World Bank Group: [Statement by Philippe Le Houérou, Chief Executive Officer of International Finance Corporation](https://www.worldbank.org/en/news/press-release/2020/03/17/world-bank-group-increases-covid-19-response-to-14-billion-to-help-sustain-economies-protect-jobs). Available at: <https://www.worldbank.org/en/news/press-release/2020/03/17/world-bank-group-increases-covid-19-response-to-14-billion-to-help-sustain-economies-protect-jobs> (consulted on 31 May 2020).

Is there a globally accepted definition of entrepreneurship? Oxford English dictionary explains the entrepreneurship as “a person who attempts to profit by risk and initiative”<sup>4</sup>. Israel Kirzner (1973) explained the entrepreneurship as being alerted to opportunities and seeing unpredicted opportunities for profit. The theory argues that entrepreneurs reach market equilibrium by observing and identifying market deficiencies. Market deficiencies are initiated by information asymmetry. Information asymmetry refers to having different information from various entrepreneurs, and if one alternative entrepreneur uses the information advantage, he/she engage in opportunistic negotiating. Contrary to this theory, Schumpeter’s theory (1947) explains that entrepreneurs are innovative individuals who change the techniques of production and innovate a new product or new service. Followed by Venkataraman (1997), Shane (2003) gave a definition to entrepreneurship as “an activity that involves the discovery, evaluation and exploitation of opportunities to introduce new goods and services, ways of organizing, markets, processes, and raw materials through organizing efforts that previously had not existed” (p. 4).

Entrepreneurship skills are described as an entrepreneur's respective operations in coming up with new ideas that possess financial benefits, personal satisfaction and autonomy (Hisrich and Peter, 2002). According to Gomezelj and Antoncic (2008), intellectual ability, which also includes entrepreneurial skills, is essential for the achievement and efficiency of businesses. Nevertheless, entrepreneurs are not paying much consideration to the seriousness of knowledge. Generally, they lack some market-related knowledge and skills are usually an obstacle to success (Rowley, 2000).

For many years now, many publications have been discussing that the large enterprises contribute to the economic growth more than small firms because of availability of mass production, access to finance and more specialized workforce (Varum and Rocha, 2013). In parallel, many other publications have been debating the contribution of small firms to the economic development and well-being of the society (Schiersch, 2013). Before the 1880s, there were many small firms in trade, manufacturing, and service industries in the United States. However, after the second industrial revolution in the 1880s, the large enterprises started to dominate over small firms in some industries. In the following years, rapidly changing technology and developing market made small businesses the drivers of the economy (Blackford, 2003).

While researching the history of small businesses, it became clear that until the 1970s, this field was not a very intensive field for academicians. However, after the global oil crisis in the 1970s, the

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<sup>4</sup> Oxford English Dictionary: Definition of Entrepreneurship. Available at: <https://www.oed.com/public/freeoed/loginpage> (consulted on 10 January 2020).

contribution of small businesses to economic development started to be widely discussed. Some studies showed that as a result of the economic crisis of 1970, neither the leading politicians nor the large companies were able to maintain market stability, and especially the sustainability of mass production (Piore and Sabel, 1984). In those years, new small firms started to enter the steel industry in the United States and other countries; therefore, some large companies closed the industrial parks and reduced the number of employees. Subsequently, the role of small companies increased with the introduction of technology and software to the society (Acts, 1992). Birch (1981) said, “what else they are doing, large firms are no longer the major providers of new jobs for Americans” (p. 8). Following these changes, the small firms contributed to increased employment in many states of the Organisation for Economic Co-operation and Development (OECD) in the 1980s (Acts and Audretsch, 1993).

### **2.3. Small and medium-sized enterprises in the global context**

Despite the definition of entrepreneurship, there is no globally accepted definition for small firms. In 1996, the European Commission (EC) started using the term “Small and Medium-sized Enterprise” (SME), which is now more commonly used. One of the reasons that prevent the complete analysis of SME data between the countries is the lack of a globally accepted definition (Ardic et al., 2011). According to the OECD, SMEs are “non-subsidary and independent firms”<sup>5</sup> with a certain number of employees. This number may vary from country to country. For example, in the European Union (EU), SMEs should limit the employees up to 250 and turnover up to 50 million euros; however, some countries set a limit of 200 employees, while the United States limit the number up to 500 employees (1.500 in some industries). In addition to employee number and turnover, the EC differs SMEs in the EU countries with the size of the balance sheet (2005).

#### **2.3.1 Contribution of SMEs to the Economic Growth and Employment in the global context**

As mentioned above, the attitude of governments towards the development of small firms has been changed since the 1970s. E. F. Schumacher (1973), one of the most famous economists in the

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<sup>5</sup> OESD: Definition of Small and Medium-sized entrepreneurship. Available at <https://stats.oecd.org/glossary/detail.asp?ID=3123> (consulted on 10 January 2020)



world, argued that “small is beautiful”. Therefore, the state policy was formed for the development of small companies in many countries. The reason for such state policies was that the economists and the leading politicians believed that small firms could contribute to better employment generation and economic growth rather than larger enterprises. Additionally, the development of rural and urban areas and potential for innovation could be established with the assistance of the small firms. The advantage of large companies indeed has more technical and material resources. Still, small companies are very flexible in using internal capabilities, and they can respond quickly to internal and external changes (Rathwell, 1989).

The OECD has been making for many years on important documents to increase the productivity of SMEs, reduce inequality among societies, as well as support the development of the positive aspects of globalization and technological progress (Menon, Criscuolo and Calvino, 2016). According to the OECD SME and Entrepreneurship Outlook, SMEs not only contribute to the strong economy and job creation as well as prepare the society for important digital transformations, globalization, and even for environmental changes (2019). One study found that SMEs contribute to job creation (71 %) in developing and transition economies (Ayyagari, Demirguc-Kunt, Maksimovic, 2011). Another study argues that poverty is still a major concern in the developing world (Kok, Deijl and Essen, 2013). More than 1 billion people around the world meet their daily needs at the cost of \$ 1.25 per day (Chen and Ravallion, 2010). The fight against poverty is possible with creating more jobs for the society.

Given that SMEs play an important role in job creation in developed countries, this strategy can be taken an example to other countries as well. According to the project of the International Labour Organisation (ILO) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), the private sector creates jobs regardless of its size. Additionally, most enterprises start with a small number of employees, and some of them grow rapidly and increase the number of employees in the following years (2013). As stated in the report, over the last 30 years, with the development of the private sector, poverty has fallen from 52% to 22% (Kok et al., 2013).

In the OECD area, SMEs represents 70% of total employment (OECD, 2017b). In 2003-2016, employment in the SMEs in 132 countries had almost been doubled, reaching from 79 to 156 million (ILO, 2017). OECD work shows that young and high-growth SMEs create more jobs than they destroy. Also, SMEs are not only for high-skilled staff, but also for low-skilled and young people where they can improve their skills (Key Issues Paper, SME Ministerial Conference, 2018). According to the annual report on European SMEs growing beyond borders 2017/2018, employment has been

increased by 2.5% during the period from 2008 to 2017. The number of SMEs in the EU countries is increased by 13.8 % in the last ten years. The report states that SMEs are 99% of all businesses in the EU, and they have created around 85% of new jobs in the past five years (EC, 2018).

SMEs play a very important role in the world's economy. As per the annual report on European SMEs, the gross value added of SMEs has been improved by 14.3% during the period from 2008 to 2017 SMEs in Europe constitute the bulk of the value-added increase (60 %). Micro enterprises accounted for 28.5% of this growth, while small and medium-sized enterprises contributed for 16.9% and 14.1%. SMEs have provided a substantially better contribution to the value-added growth from 2016 to 2018 compared to the 2013 to 2018 period. The growth in the small and medium-sized is attributed almost exclusively to micro-enterprises. During this time, the contribution of medium-sized SMEs was declining (EC, 2018).

Innovative SMEs are perceived as the instrument of achieving sustainable development. They may solve social and environmental problems (Kardos, 2012). Recalling the importance of the Sustainable Development Goals (SDGs), adopted by world leaders during the UN Summit in 2015, Professor of the Columbia University Jeffrey Sachs emphasized that achieving sustainable development is important for economic growth and environmental viability (VII Global Baku Forum, 2019). According to the 15-year plan of SDGs, countries will merge their efforts in order not to leave anyone behind. According to the Lamia Kamal-Chaoui, Director of the OECD Centre for Entrepreneurship and SMEs, these goals can only be achieved if countries succeed to build-up strong SMEs. SMEs are leading to sustainable economic growth, “decent work for all” (goal 8) and “promote sustainable industrial development and encouraging innovation” (goal 9) (OECD, 2017). Although the implementation of SDGs is not legally binding, governments are expected to implement the national action plans concerning the 17 goals, including Azerbaijan.

### **2.3.2. Challenges affecting the performance of SMEs in the global context**

Although SMEs play a vital role in the employment and economic growth of the countries, several factors make challenges for their development. The EU had thus strongly considered the needs

of small and medium-sized enterprises at the core of the Lisbon Growth and Employment Strategy<sup>6</sup>, especially using the partnership strategy, which has produced concrete results since 2005. In those years, despite this promising development, EU SMEs had lower productivity and were rising more slowly than their US peers. Therefore, in 2008, the Small Business Act (SBA)<sup>7</sup> was adopted to address the difficulties facing SMEs in the EU countries. The most important priorities of the SBA is to strengthen SME contributions to productivity and growth by finding methods how to promoting entrepreneurship (working on human capital), access to finance, getting access to markets, innovation as well as a much less regulatory burden. Additionally, after the economic crisis in 2011, it was decided to make revisions in the SBA, and SME Envoy Network<sup>8</sup>, which was set up in 2011. The main goal of setting up this network is to allow the small business owners to share their ideas and to have easy access to policymakers<sup>9</sup>.

According to the SAFE results of the EU on SME, the most critical concerns of the SMEs in the EU were access to finance, availability of skilled employees, finding customers and regulation (2018). The recent report of the EU says that access to finance was deliberated the least pressing concern for the European SMEs (2019).

### **2.3.3. Access to Finance**

The study by Beck, Demirguc-Kunt, Laeven and Maksimovic (2004) involving 10.000 enterprises from 80 countries, concluded that the fundamental barrier of an enterprise is its access to finance. Another study by Beck, Demirguc-Kunt and Maksimovic (2005) involving firms from 54 countries, concluded that SMEs are tackled with financial and legal burdens and corruption issues. Access to finance is one of the important factors for the development of SMEs. Consequently, SMEs with access to finance can innovate, provide efficient and effective work, increase access to new

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<sup>6</sup> Commission of the European Communities: Implementing the Community Lisbon Programme – Modern SME policy for Growth and Employment. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52005DC0551&from=EN> (consulted on 12 March 2020).

<sup>7</sup> Commission of the European Communities: Small Business Act for Europe. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008DC0394&from=EN> (consulted on 12 March 2020).

<sup>8</sup> European Commission: SME Envoy Network. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008DC0394&from=EN> (consulted on 12 March 2020).

<sup>9</sup> European Union: European Economic and Social Committee: Study on the assessment of the effectiveness of the EU SME policies 2007-2015. Available at <https://www.eesc.europa.eu/en/our-work/publications-other-work/publications/study-assessment-effectiveness-eu-sme-policies-2007-2015> (consulted on 12 March 2020).

markets and create new jobs. The positive relationship between access to finance and SME performance has been widely analysed in the economic literature (Kersten et al., 2017).

According to EC data, access to finance is the most challenging issue faced by 1 in 11 SMEs (EC, 2017). The Small Business Act for Europe recognises that governments “should facilitate SMEs’ access to finance, in particular, to risk capital, microcredit and mezzanine finance, and develop a legal and business environment supportive to timely payment in commercial transactions” (EC, 2008).

Access to finance is a key element in the growth of any enterprise, and it affects employee generation, productivity, exports and profits (Audretsch et al., 1999). Given the important contribution of SMEs to the economy, the World Bank Group reported that \$ 4.8 billion loans were given to 47 countries from January to May in 2018 to support businesses. However, SMEs are still facing financial barriers in many countries. Another study reported that about \$ 2 trillion is needed to finance all SMEs in the world through loans, which is equal to 14% of the GDP of developing countries (Stein, Goland and Shiff, 2010). Despite all the difficulties, the increase in the access of SMEs to finance result with the increased number of start-ups and innovative products (Beck, 2013).

As per the Small Business Act for Europe (2008), access to finance can be a big challenge for entrepreneurs and stands later in the ranking of their problems after the administrative burden. In general, small and medium-sized businesses also have poor capital status. Because, depending on the European country, on average, SMEs must wait between 20 and 100 days to get their invoices processed. One in four bankruptcies were triggered by delayed payment. This results in the loss of 450.000 jobs and 25 billion euros per annum. Therefore, there are many actions have been taken to develop financing programmes. As a result of the continuing reforms in the last years, the survey of the European Central Bank (2019) has reported that access to finance is the least concerning issue for the European SMEs.

One way to facilitate SMEs' financial challenges is to strengthen the legal infrastructure of the countries. The most crucial step is to enhance the laws and regulations for financial transactions (Beck and Demirguc-Kunt, 2006). The studies demonstrate that entrepreneurs have fewer financial problems in the economies, where the robust legal environment exist (Galindo and Micco, 2004).

#### 2.3.4. Availability of skilled employees

Human capital is given in the Oxford English Dictionary as “the skills the labour force possesses and is regarded as a resource or asset.”<sup>10</sup> Human capital in the workplace accounted for the use of the amount of knowledge and skills of employees. Human capital can be obtained during primary education, as well as through internships, vocational education, and development programs, as well as by other means after educational years. Various studies have shown that human capital affects the performance of firms. Therefore, large firms pay more attention to the level of education in the recruitment process. Small firms, on the other hand, pay less attention to the level of knowledge in the recruitment process and allocate less money to human capital development in continuing years (Kok et al., 2011).

Considering the innovative nature of the SMEs, human capital policy needs to be strengthened in the working environment of SMEs. The entry of SMEs into foreign markets is vital for the economic development of the countries. However, SMEs are challenging in participating independently in international markets due to lack of technical, as well as managerial and entrepreneurship skills (Lall, 2000). Since 1999, the OECD has been studying the positive effects of training and education programs on SME performance to improve employees’ skills, to increase competition among them, and to create opportunities for more lucrative jobs. (OECD, 2013)

According to a survey conducted in 2005, employers were less interested in organizing the development programs for employees in the SMEs, because employers believed that employees’ skills correspond to the needs or they recruited employees with the necessary skills. Other responses included time constraints and the high cost of training programs. Another survey says that about 7 million jobs will be created in Europe by 2020. Given that many of these jobs will require knowledge and skills, it is inevitable that skills should be enhanced (European Centre for the Development of Vocational Training Survey, 2009).

The World Bank recognizes that education has a severe input into high-quality human capital and for refining the society’s approaches toward entrepreneurship. Enriching human capital is an essential factor in entrepreneurial development. Hence, high-skilled entrepreneurs can involve more sophisticated business activities such as innovation, high-growth businesses in the technological

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<sup>10</sup> Oxford English Dictionary: Definition of Human Capital. Available at: <https://www.oed.com/public/freeoed/loginpage> (consulted on 5 February 2020).

industry (Acemoglu and Angrist, 1999). According to the SBA (2008), more than 60 per cent of companies responding to the survey claim that schools do not have the skills that entrepreneurs and their workers need. In particular, SMEs are struggling with a shortage of skilled labour (2008). According to the assessment of the implementation of the SBA (2020), governments need to identify policy reforms to ensure that human capital development policies are comprehensive and reactive to society's requirements. Therefore, European Economic & Social Committee is continuously working on the effectiveness of the SME policies in the EU countries.

### **2.3.5 Access to markets/Internalisation**

As per the Small Business Act for Europe, many small businesses in the EU are having issues with a fair and open trade framework to internationalize their business. Just 25% of EU-based small and medium-sized enterprises export outside the EU. The Commission is aimed at helping European companies to succeed, enter overseas markets, and consider new business opportunities outside. The Commission seeks to have a flexible regulatory framework to promote the tariff-free trade of products and to enable SMEs to reap the benefits of this. The 2008 Small Business Act and its "Access to markets" concept form a solid basis for the European policy on internationalization of SMEs. Several types of research have been published to clarify the issues that SMEs face while going to help them address those difficulties. One of the research on the internalization verified that business networks produce extra value for their participants. It also demonstrated that the European Commission has a significant role to help business networks transcend their regional and national borders and become European. Their probability of success expands when so-called "strategic alliances in the form of aggregations of companies" are created. The strategic alliances help them increase their numbers and extend to other markets. The training program of the European Business Network seeks to promote progress and considers specific requirements of business networks based on their growth stages. The educational programs such as face-to-face and e-learning training provide many techniques for the SMEs, which are willing to join foreign markets (Spanikova et al., 2014).

### **2.3.6. Innovation**

According to the SBA for Europe, in 2007, just about 3 out of 10 SMEs in the EU innovate new goods and services or gained profits from new items. The value of innovation as being among the

critical source by which a business can make sustainable growth as well as resolving problems and challenges facing enterprises in a highly competitive market (McEvily et al., 2004). Taking into consideration the role of SME in innovation, it is vital to promote the relations between educational institutions and small and medium-sized enterprises. As an example, from the EU, the Horizon 2020 is the most extensive research and innovation program, with almost € 80 billion of funding available for SME to innovate over 2014 - 2020. Through bringing brilliant ideas from the lab to the market, it offers more discoveries and inventions. Horizon 2020 strongly supports small and medium-sized businesses by providing both financial and technical assistance and support to expand their innovation potential.

## **2.4. Azerbaijan and SME Development**

### **2.4.1. Political and Geographical Background of Azerbaijan**

There are about five thousand years of Azerbaijani lands. Azerbaijan was the first Democratic Republic in the Muslim East, established in 1918. In 1920, Azerbaijan was occupied by Bolshevik Russia. During the Soviet times, Azerbaijan, Georgia and Armenia were united under the solo state, and thus the formal independence was destroyed. During the Soviet Union, part of Azerbaijan's territory was taken and given to Armenia. In 1991, with the collapse of the Soviet Union, Azerbaijan recovered its freedom. However, the conflict between Azerbaijan and Armenia, internal conflicts, and the destruction of the economy have significantly weakened the country. In addition to this, 20% of the territory of Azerbaijan was occupied by the Armenian army in early 1990th. Azerbaijani lands are still under occupation, and this blocks the regional economic development<sup>11</sup>.

### **2.4.2. Economic Background of Azerbaijan**

Azerbaijan has ranked 20th among the world countries rich with oil reserves (Global Firepower's report, 2020)<sup>12</sup>. Azerbaijan's position has hiked up to 25 among 190 countries in the

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<sup>11</sup> Website of the Presidential Administration of Republic of Azerbaijan: History of Azerbaijan. Available at <https://static2.president.az/media/W1siZiIsIjIwMTg0MDMvMDk0M2gzNXhqNTJxY19UYXJpeF9FTkcucGRmI1Id?sha=06c685bf9ebde10c> (consulted on 10 March 2020).

<sup>12</sup> Global Firepower (2020): Proven Oil Reserves by Country. Available at <https://www.globalfirepower.com/proven-oil-reserves-by-country.asp> (consulted on 10 March 2020).

"Doing Business – 2019"<sup>13</sup> report for the ease of doing business, which is prepared by the World Bank Group. According to the report, Azerbaijan was competing with countries such as Germany and Canada, while it has progressed further compared to France and Italy. Despite the country's declined position to 34 from 25, the country is still competing with France, while it has developed further compared to Switzerland. Positioning 34th globally, Azerbaijan remains behind only Georgia among Eastern Partnership (EaP) countries in the Doing Business ranking in 2020<sup>14</sup>.

**Figure 1:** Azerbaijan's place in the ease of doing business ranking in last 6 years



*Source: World Bank's Doing Business reports 2015-2020*

Azerbaijan economy enjoyed the revenues from the oil and gas industry between 2001 and 2014. However, the country's dependency on hydrocarbon resources became clear during 2014-2016, while the oil price crisis resulted in a devaluation of the currency. The collapse underlined the necessity to diversify production, and the government approved 12 new roadmaps in 2016 to promote non-oil

<sup>13</sup> World Bank Group Flagship Report. Doing Business 2019. Available at [https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report\\_web-version.pdf](https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf) (consulted on 10 March 2020).

<sup>14</sup> World Bank Group Flagship Report. Doing Business 2020. Available at <http://documents.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf> (consulted on 15 March 2020)



sectors, including the SME sector. The government improved e-government services such as registration of the company, getting license, procurement and customs procedures. (OECD, 2019)<sup>15</sup>.

According to the CESD report, the drop-in oil price in the second half of 2014 harmed the dynamics of Azerbaijan's economic development. With the sharp fall in oil price, the country's economic diversification policy has also been slowed down. As stated by the report, the country decided to devalue the national currency by 25.1% to prevent the depletion of state reserves. This devaluation mainly affected the business sector with the increase of debts in the foreign currency. Besides, entrepreneurs faced minimal lending due to declining state financial support to banks.

Given that the state calculated its economic policy at the beginning of the year with an oil price of 90 US dollars, which resulted with imbalance, and therefore the second devaluation took place at the end of 2015. With this devaluation, the national currency lost its value about 49.4% within a year. As a result, devaluation reduced the ability of citizens to repay loans to banks, which led to a crisis in the banking sector (2017). Only four years later, in 2019, the interests of citizens and the banking sector were restored by the decree on the loans<sup>16</sup> of the President of Azerbaijan.

The implementation of extensive reforms in Azerbaijan has been noted in the reports of influential organizations such as the World Bank. However, these reforms are not reflected in real economic indicators. For example, 0.1% growth was registered in Azerbaijan in 2017, and 1.4% in 2018. The reason for the high growth in 2018 was the increase in state spending compared to the previous year. Investment in the non-oil sector in Azerbaijan in 2018 decreased by 15.5% compared to last year. The effectiveness of reforms, in particular, blocks the development of SMEs. In 2017, the contribution of SMEs to the country's economy was 5.9%. However, the average rate in OECD countries is 50-60% (CESD, 2019).

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<sup>15</sup> OECD (2019), Azerbaijan: Driving Diversification through Strengthened Entrepreneurship. Available at <https://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Azerbaijan-Driving-Diversification-through-Strengthened-Entrepreneurship.pdf> (consulted on 5 March 2020)

<sup>16</sup> Website of the Presidential Administration of the Republic of Azerbaijan: The decree by President of the Republic of Azerbaijan "On additional measures to resolve problem loans of individuals in Azerbaijan". Available at: <https://president.az/articles/32092> (consulted on 10 March 2020).

### 2.4.3. Economic diversification strategy of Azerbaijan since 2014

According to the speech<sup>17</sup> by the President of Azerbaijan at the meeting on the socio-economic development in the first nine months of 2014, GDP, non-oil sector and population income increased by 2.5 %, 6%, and 5.4%. The main goal of the country was to reduce the economy's dependence on oil revenues and to strengthen the non-oil sector and to generate more jobs for the society. In the meeting on the results of socio-economic development in 2014<sup>18</sup>, the President of the Republic of Azerbaijan stressed that decrease in oil price by more than twice at the end of 2014 harmed budget revenues and would be a challenge for the country.

Many of the President's speeches in the second half of 2014 were devoted to strengthening the non-oil sector and aid to entrepreneurs. At the conference dedicated to the first year of implementation of the state program of socio-economic development in the regions for 2011-2018<sup>19</sup>, the President of Azerbaijan noted that over the past 11 years, the National Fund for Entrepreneurship Support had provided \$ 2 billion loans to entrepreneurs. It was emphasized that government agencies should create a system of incentive programs among entrepreneurs for the promotion of the business environment in the country. According to President Aliyev, the reason for not prioritizing such a strategy until 2014 was the goal to reduce the country's dependence on imports.

In one of his first speeches in 2015<sup>20</sup>, the President of Azerbaijan noted that the overall development of the country's economy would depend on the further development of entrepreneurship. In 2015, the reforms were continued to promote the non-oil sector, and especially the private sector. With this regard, gas and electricity fees were reduced in Azerbaijan compared to other countries. The goal was to increase product competitiveness and to decrease the prices of local products. Additionally, the entrepreneurs have been provided with political and financial support and methodological advice. From 2015, industrial zones were established in the regions, and Neftchala

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<sup>17</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Opening speech by the President of Azerbaijan at the meeting of the Cabinet of Ministers dedicated to the results of socioeconomic development in nine months of 2014 and objectives for the future. Available at <https://en.president.az/articles/13182> (consulted on 10 March 2020)

<sup>18</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Closing speech by the President of Azerbaijan at the meeting of the Cabinet of Ministers dedicated to the results of socioeconomic development in nine months of 2014 and objectives for the future. Available at <https://en.president.az/articles/13185> (consulted on 11 March 2020).

<sup>19</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Speech by the President of Azerbaijan on the results of the first year of implementation of the state program of socio-economic development in the regions for 2011-2018. Available at <https://president.az/articles/14135> (consulted on 11 March 2020)

<sup>20</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Speech by the President of Azerbaijan at the meeting of the Cabinet of Ministers dedicated to the results of socioeconomic development in the first quarter of 2015 and objectives for the future. Available at <https://en.president.az/articles/14805> (consulted on 11 March 2020)

region was selected as a pilot project. The President of the country declared 2015 as the Year of Agriculture. The previous year - 2014 was marked as the Year of Industry in Azerbaijan. At the same conference, there was another critical issue stressed by the President that the reforms for the electronic registration of lands were inevitable to increase transparency, and to ensure food security of the country. According to him, in some cases, the maps do not coincide with the images obtained from satellites, and the land allocated for cultivation is later changed or retained as property.

The meeting held by the Cabinet of Ministers on the results of socio-economic development in the first half of 2015<sup>21</sup>, the President noted that the non-oil sector grew by 9.2% in the half-year as a result of the reforms by the Government and the successful work done by entrepreneurs. According to the President, for the first time in recent years, foreign investment has surpassed domestic investment. The main reason for this unstable situation was the decline in domestic investment in early 2015. Considering this, he instructed the relevant agencies to reassess the reserves. In his speech, the President stressed a culture of paying taxes of entrepreneurs and the importance of addressing this issue. According to him, unfortunately, the Ministry of Taxes, law enforcement bodies and local executive authorities create conditions for entrepreneurs in Baku and other regions of the country to evade tax obligations of entrepreneurs. The head of state stated that the country is developing at the expense of entrepreneurs, but some people who are eager to get rich cause the bankruptcy of entrepreneurs. Consequently, he stressed to stop unfounded demands from entrepreneurs and to prevent bribe.

At the meeting on the results of socio-economic development in 2016<sup>22</sup>, the President noted that the decline in the country's GDP was due to 3-4 times drop in oil price; nevertheless, the production increased by 5% from January to December 2016. Along with the successes, the President of the country had a critical note in the meeting. According to him, local wine factories with a production capacity of 100 million bottles of wine produce only 20 million bottles. According to him, the entrepreneurs either do not know the value of money, or despite a large amount of production, the volume of output is not appropriately registered. In the 1970s, the villagers received quite good money from vineyards, and it is necessary to investigate such issues to restore vineyards, he added.

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<sup>21</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Speech by the President of Azerbaijan at the meeting of the Cabinet of Ministers dedicated to the results of socioeconomic development in the first half of 2015 and objectives for the future. Available at <https://en.president.az/articles/15823> (consulted on 15 March 2020)

<sup>22</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Speech by the President of Azerbaijan at the meeting of Cabinet of Ministers dedicated to results of socioeconomic development of 2016 and objectives for future. Available at <https://en.president.az/articles/22415> (consulted on 15 March 2020).

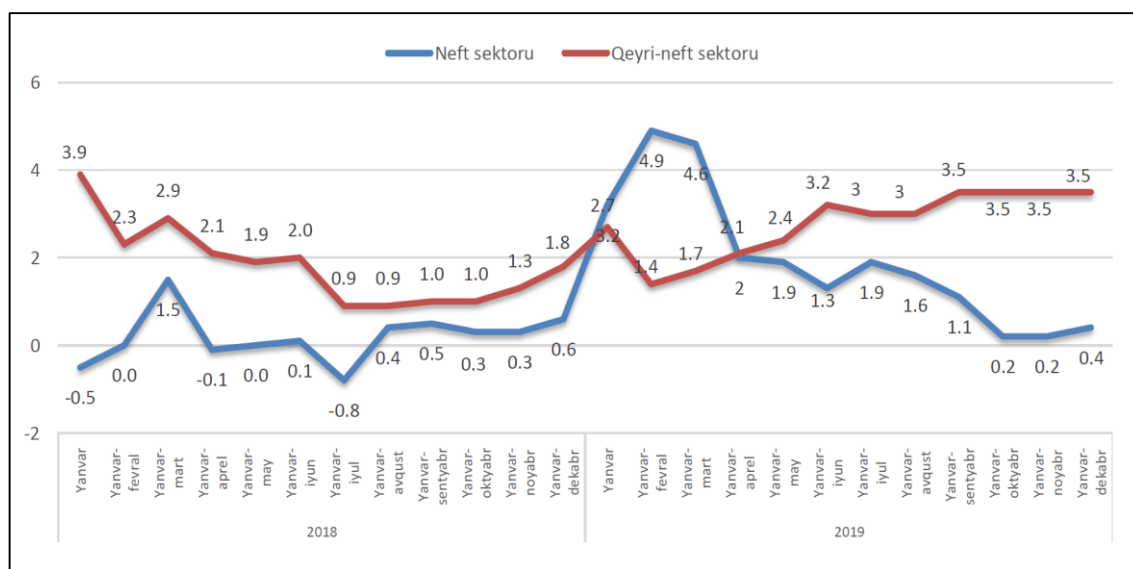
The main issues highlighted at the Republic meeting of non-oil exporters in 2017<sup>23</sup> were to stimulate export-oriented enterprises, to participate in international exhibitions actively and to study the needs of entrepreneurs through the “Azexport” portal. Also, other highlighted issues were increasing advertisement campaigns on tourism and local products on the media, to construct new hotels in Baku and the regions. The President said that the creation of logistics centres and farms could stimulate fruit and vegetable production and farming.

In parallel, the Ministry of Economy of Azerbaijan reports that in recent years, multifaceted economic reforms have been executed in the course of sustainable and competitive development of the economy, including support for small and medium enterprises. As a result of the actions undertaken, GDP grew by 2.2 per cent in real terms in 2019 and contributed to 81.7 billion manats in current market rates. GDP per capita reached to 8247.0 manats. In 2019, the non-oil sector increased GDP by 3.5 per cent in real terms relative to the same timeframe last year. During this period, non-oil industry increased by 14.5%, information and communication sector by 15.9%, tourist accommodation and catering by 6.4%, trade by 3.6%, agriculture by 7.3%, transport and warehousing by 1.0%. In the oil and gas sector, an increase of 0.4% was recorded in 2019 compared to the same period in 2018. The share of this sector in GDP was 38.3%. In 2019, 68.1% of total investments in fixed assets in the country were used in the development of the non-oil industry, and 31.9% in the oil sector. Reforms related to the development of the non-oil area have had a positive impact on the Azerbaijani economy, and non-oil export revenues have increased. As of November 2019, the size of loans provided to the economy by financial and credit organizations grew by 20.3% compared to the corresponding period of 2018 and amounted to 15116.4 million manats. In parallel, the volume of loans in national currency increased by 24.2% compared to the same period in 2018, and the size of investments in foreign currency increased by 13.8% (Ministry of Economy Azerbaijan, 2019).

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<sup>23</sup> Website of the Presidential Administration of the Republic of Azerbaijan: Opening speech by the president of Azerbaijan at the republican conference of non-oil exporters in 2017. Available at <https://en.president.az/articles/23377> (consulted on 15 March 2020).

**Figure 2: Real growth rate (%) of oil (blue) and non-oil sector (red) in 2018-2019**



*Source: Ministry of Economy of Azerbaijan, Report on macroeconomic development of the Republic of Azerbaijan for 2019*

To increase economic activity in 2016-2019, 421 investment promotion documents were submitted to 355 business entities. At the expense of the Entrepreneurship Development Fund of the Ministry of Economy in 2019, 175 million manats were given to 1573 entrepreneurs with a total cost of 638 million manats, including 40.3 million manats for 1527 small and medium-sized projects. Due to these loans, 5363 new jobs were generated<sup>24</sup>.

## 2.5. Azerbaijan and European Neighbourhood Policy

### 2.5.1. Eastern Partnership Programme in the context of “Stronger Economy”

In 2009, the European Union introduced a unique collaborative platform with six eastern neighbourhood countries. These countries are Ukraine, Moldova, Georgia, Azerbaijan, Armenia and Belarus. The aim was to strengthen cooperation between the European Union and the six mentioned

<sup>24</sup> Webpage of the Ministry of Economy of the Republic of Azerbaijan: Report on macroeconomic development of Azerbaijan for 2019. Available at <https://www.economy.gov.az/article/esas-iqtisadi-gostericiler-2019/30175> (consulted on 17 March 2020)

countries. The Eastern Partnership envisions a new institutional type of ties, such as Association Arrangements, enhanced economic relations and the completion of Deep and Comprehensive Free Trade Area Agreement (DCFTA), expanded flexibility in the form of visa liberalization and the promotion of regional cooperation<sup>25</sup>.

At the Eastern Partnership Summit in 2013, Association Agreements for European Integration was discussed with the partnership countries. At the end of 2014, Ukraine, Georgia and Moldova signed and ratified the DCFTA Agreement with the EU. By joining this agreement, these countries gained free access to the European market by receiving political and financial assistance from the EU. However, the Azerbaijani government showed no incentive to join the agreement<sup>26</sup>.

EU4Business report claimed that 11 projects with a budget of 12.4 million euros had been implemented in Azerbaijan, and one of the main goals of these projects is to improve the business environment for SMEs. However, since Azerbaijan has not signed the DCFTA agreement of the EU, the country is benefiting less from those projects compared to DCFTA countries<sup>27</sup>. According to the Eastern Partnership Index 2015-2016, the main priority of the Azerbaijani government is to maintain political stability, and this stability is based on oil revenues. The decline in oil revenues in 2014-2015 slowed the country's development, corruption persisted, and the country's EU integration weakened<sup>28</sup>.

Despite the difficulties listed above, the Eastern Partnership has planned 20 deliverables to be accomplished by its members by 2020 to achieve concrete results. In terms of an economic corporation, the following deliverables have been designed:

“Stronger economy:

- improve the investment and business environment and unlock Small and Medium-sized Enterprises’ (SMEs) growth potential;
- address gaps in access to finance and financial infrastructure;
- create new job opportunities at the local and regional level;
- harmonise digital markets;

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<sup>25</sup> European Union, European Council, Council of the European Union: Eastern Partnership. Available at <https://www.consilium.europa.eu/en/policies/eastern-partnership/> (consulted on 17 March 2020).

<sup>26</sup> European Union, Eastern Partnership, Civil Society Forum: European Integration Index 2014. Available at [https://eap-csf.eu/wp-content/uploads/European-Integration-Index\\_2014.pdf](https://eap-csf.eu/wp-content/uploads/European-Integration-Index_2014.pdf) (consulted on 17 March 2020)

<sup>27</sup> European Union, EU4Business, Investing in SMEs in the Eastern Partnership: EU4Business Annual Report 2019. Available at <https://eu4business.eu/medias/investing-smes-eastern-partnership-eu4business-annual-report-2019> (consulted on 1 June 2020)

<sup>28</sup> European Union, Eastern Partnership, Civil Society Forum: EaP Index 2015-2016. Available at <https://eap-csf.eu/wp-content/uploads/EaP-Index-2015-16.pdf> (consulted 1 June 2020)

- support intra-regional trade among partner countries and the EU.”<sup>29</sup>

Consequently, the introduction of 20 deliverables linked to the anticipated concrete outcomes is an optimistic move that will help to clarify the effectiveness of the framework for member countries, including Azerbaijan in the future.

### **2.5.2. Overview of the Government policies toward the development of SMEs in the EaP countries: Case study of Georgia**

In 2019, the 10th anniversary of the Eastern Partnership Program was celebrated. In the report dedicated to the 10th anniversary, Johannes Hahn, Commissioner for European Neighbourhood Policy and Enlargement Negotiations says: “In those ten years, our partnership is geared towards the future, and what matters is to make a difference in our everyday lives: to be able to work, to travel, to start a business, to give an education to our children, to live in a safe and secure environment. Economic development plays an essential role in achieving this, and all through the past decade, we have been working to develop stronger, diversified and vibrant economies across the region” (p. 2). According to him, the development of SMEs in terms of carrying SME policies and regulation in line with the SBA in EAP countries is one of the priorities for the economic development of the region<sup>30</sup>.

The achievement and non-achievements concerning the improvement of the business environment in the EaP countries within the EU flagship initiative are reviewed and taking into consideration that Azerbaijan remains behind only Georgia among Eastern Partnership (EaP) countries in the Doing Business ranking in 2020, the case of Georgia is analysed to draw some possible lessons learned “best practices” for Azerbaijan.

Georgia carries leadership within EaP countries in the WB Doing Business rankings (positioned 9th globally) for the ease and cost of business regulations. SMEs play a crucial role in Georgia’s economy with 94.1% of active companies, 67.7% of jobs and 58.4% of value-added in 2016,

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<sup>29</sup> European Union, Eastern Partnership, 20 Deliverables for 2020: Bringing tangible results for citizens. Available at: [https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/eap\\_20\\_deliverables\\_for\\_2020.pdf](https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/eap_20_deliverables_for_2020.pdf) (consulted on 1 June 2020).

<sup>30</sup> European Union, EU4Business: Investing in SMEs in the Eastern Partnership: EU4Business Annual Report 2019. Available at <https://eu4business.eu/medias/investing-smes-eastern-partnership-eu4business-annual-report-2019> (consulted on 2 June).

compared to the OECD average of 99.8%, 70.7% and 66.7%<sup>31</sup>. According to the EU4Business country reports (2018), there are several factors for this achievement:

- Georgia has dealt with corruption in a range of ways in the last decade. As demonstrated by the Transparency International Corruption Perception Index, Georgia ranked at 56<sup>32</sup> (Azerbaijan's score is 30<sup>33</sup>) out of 180 countries in 2019 (100 being the highest and 1 the worst).
- Georgia has several Business Support Organisations (BSOs) that are deeply involved in monitoring the business environment, representing them in the government sector. However, as per the same period report by the EU4Business highlights that Azerbaijan should work on the establishment of BSOs or other associations that are closer to the business owners.
- Georgia also made substantial progress in establishing the private-public dialogue to track the implementation of the SME Development Strategy. Nevertheless, there is still a lack of communication between business representatives and policymakers in Azerbaijan. EU4Business recommends that Azerbaijan should involve international experts, local stakeholders, and the OECD to enhance public-private discussion through regular working.

As mentioned above, one of the concerns that prevent the complete analysis of SME data between the countries is the lack of a globally accepted definition. However, in 2017, the National Statistics Office of Georgia introduced a new definition of small and medium-sized enterprises in line with the EU standards (Eurostat) for statistical purposes. This framework is expected to enhance the business environment for the SMEs, operating in Georgia.

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<sup>31</sup> European Union, EU4Business: Investing in SMEs in the Eastern Partnership: Georgia, Country Report. Available at <https://eu4business.eu/georgia> (consulted on 2 June)

<sup>32</sup> Transparency International Corruption Perception Index for Georgia. Available at <https://www.transparency.org/en/countries/georgia> (consulted on 2 June 2020).

<sup>33</sup> Transparency International Corruption Perception Index for Azerbaijan. Available at <https://www.transparency.org/en/countries/azerbaijan> (consulted at 2 June 2020)



## 2.6. SMEs in the context of Azerbaijan

### 2.6.1. Classification and distribution of SMEs in Azerbaijan

In 2017, the Law of the Republic of Azerbaijan “On Entrepreneurial Activity” was amended, and the classification of business entities was started to be measured by micro, small, medium and broad criteria. In previous years, micro-entrepreneurship was registered as a small business. As of 2018, by the decision on approval of “Criteria for the distribution of micro, small, medium and large businesses” of the Cabinets of Ministers<sup>34</sup>, the following classification of SMEs has been entered into force in Azerbaijan:

**Table 1:** Classification of SMEs in Azerbaijan

Categories by size of business entities	Average number of employees (per person)	Annual income (AI) (thousand manats)
Micro entrepreneurship	1-10	$AI \leq 200$
Medium entrepreneurship	11-50	$200 < AI \leq 3\ 000$
Small entrepreneurship	51-250	$3000 < AI \leq 30\ 000$
Large entrepreneurship	251-over	$30\ 000 < AI$

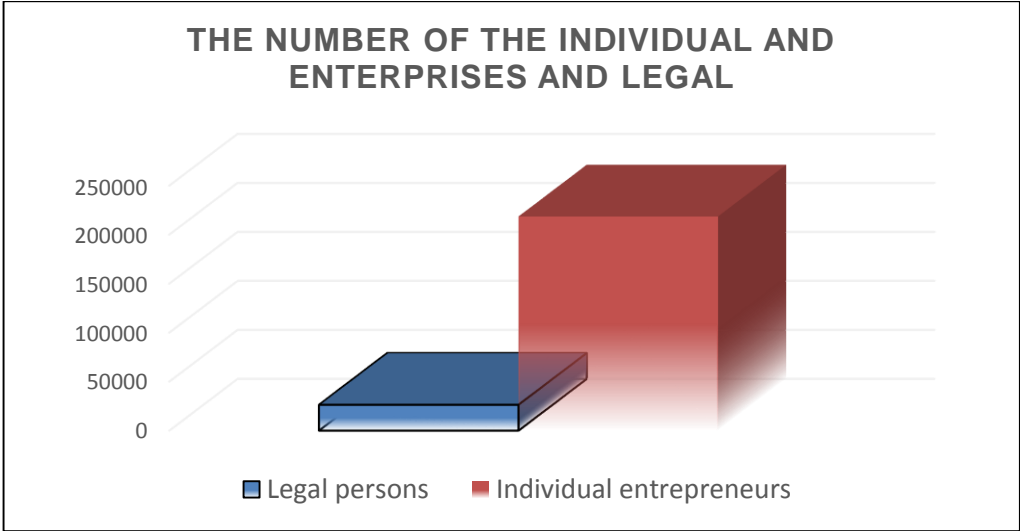
According to the data<sup>35</sup> received from the Ministry of Economy of the Republic of Azerbaijan, Entrepreneurial activity can be carried out by an individual (without establishing a legal entity) or as a legal entity. Full partnerships, Limited partnerships, Limited Liability Company, Joint Stock Company and Cooperative are all considered as legal entities. Individual enterprises have the same rights as legal entities in carrying out an entrepreneurial activity. However, the number of individual entrepreneurs in Azerbaijan exceeds the number of legal entities is since the process of registration

<sup>34</sup> Website of the Cabinet of Ministers of the Republic of Azerbaijan: Decision on approval of “Criteria for the distribution of micro, small, medium and large businesses”. Available at <https://cabmin.gov.az/az/document/3251/> (consulted on 20 March 2020).

<sup>35</sup> Website of the Ministry of Economy of the Republic of Azerbaijan: Enterprises as individual and legal entities. Available at <https://cabmin.gov.az/az/document/3251/> (consulted on 21 March 2020)

and termination of entrepreneurial activity is faster, registration costs are lower, and tax inspectors are less burdened compared to legal entities (CESD, 2017).

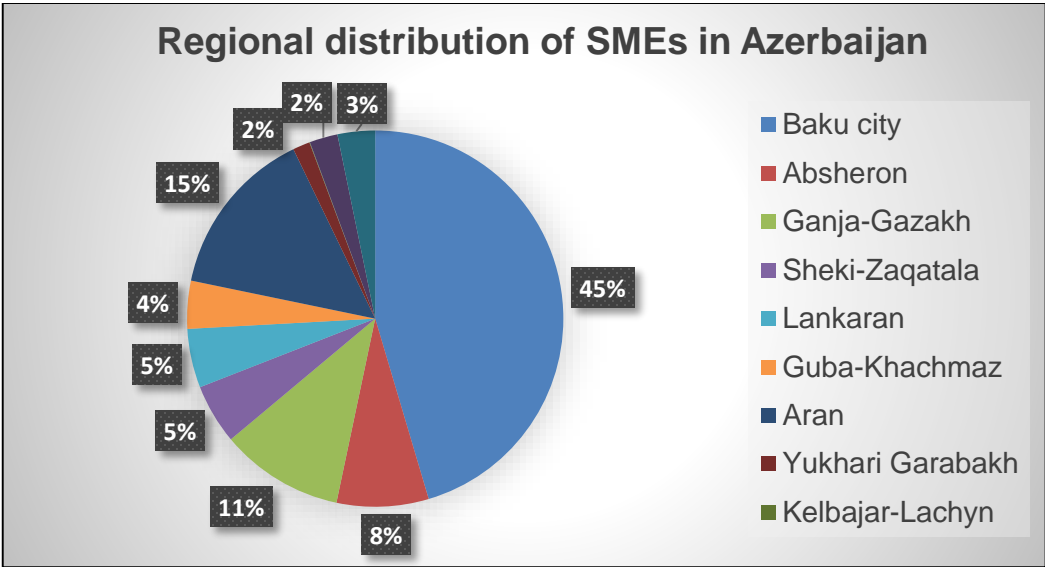
**Figure 3:** Statistics on the number of the individual and enterprises and legal entities in 2018



*Source: State Statistical Committee of the Republic of Azerbaijan*

As per the State Statistics Committee, SMEs are predominant in Baku. The reason for this imbalance distribution is that most of the population lives and works in Baku compared to other economic regions (CESD, 2017).

**Figure 4:** Regional distribution of SMEs in Azerbaijan in 2018

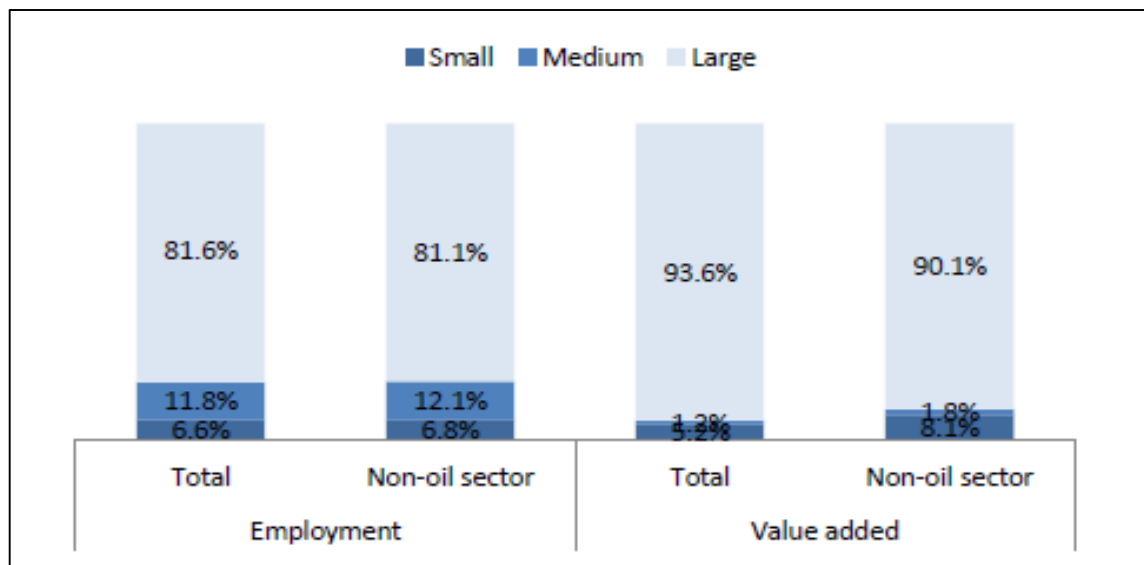


*Source: State Statistical Committee of the Republic of Azerbaijan*

## 2.6.2. Contribution of SMEs to the economic growth and employment in Azerbaijan

As stated by the State Statistical Committee of Azerbaijan, the SMEs in Azerbaijan made 6.4% of value-added and 18.5% of employment in 2016; however, the large enterprises contribute a more prominent part to the economy of Azerbaijan.

**Figure 5:** Contribution of SMEs to the Azerbaijan's economy

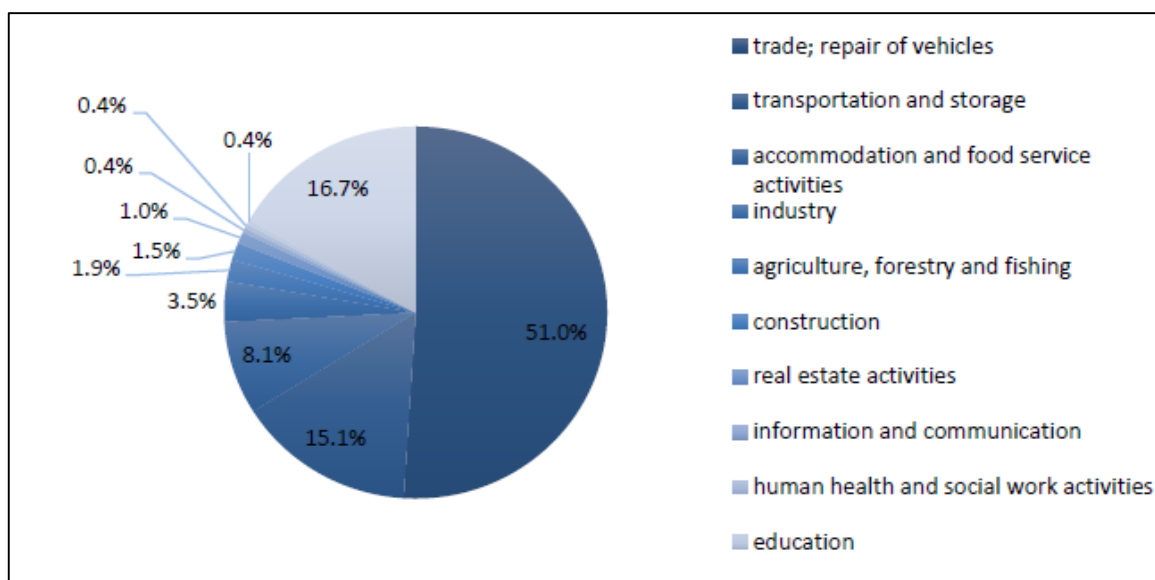


Source: OECD: *Azerbaijan Driving Diversification through Strengthened Entrepreneurship*, 2017

SMEs operated in Azerbaijan are mainly focused on relatively low value-added activities such as trade and repair of transport means (51.0 per cent), transportation and storage (15.1 per cent), accommodation and food service activities (8.1 per cent) and other businesses (16.7 per cent). Additionally, the Azerbaijan government's support for entrepreneurs has mainly focused on micro-businesses in agriculture. Unfortunately, there is limited support given to start-ups and productive, growth-oriented SMEs (OECD, 2019)<sup>36</sup>.

<sup>36</sup> OECD: *Azerbaijan Driving Diversification through Strengthened Entrepreneurship*, 2017. Available at <https://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Azerbaijan-Driving-Diversification-through-Strengthened-Entrepreneurship.pdf> (consulted on 27 March 2020)

**Figure 6:** Sectoral distribution of SMEs in Azerbaijan, 2016



Source: OECD: *Azerbaijan Driving Diversification through Strengthened Entrepreneurship*, 2017

### 2.6.3. Importance of SMEs to the Azerbaijan's economy

The development of SMEs in Azerbaijan is especially crucial in terms of diversification, economic growth, competitiveness and employment. As discussed earlier, one of the essential economic strategies of Azerbaijan is to develop the non-oil sector and to reduce reliance on oil and gas sector. Additionally, the oil and gas sector does not have a significant role in creating new jobs and reducing unemployment. Considering SMEs contribution to the GDP and total employment in developed countries, SMEs development should be one of the main central focuses of the country (CESD, 2017). In light of the increasing number of SMEs in Azerbaijan, their contribution to the country's economy is pitiful. Despite the initiatives and goals of the government to support SME development, they cannot make the necessary contributions to the economy. As stated by the State Statistics Committee of Azerbaijan, SMEs contribution to the GDP is 5.9%, and share in job creation is 20.8% (2018). Therefore, Azerbaijan cooperates with leading international organizations to promote the non-oil sector. In an interview<sup>37</sup> with the World Bank's Vice President for Central Asia and Europe

<sup>37</sup> World Bank Group: Azerbaijan: The Crisis Will Have a Negligible Effect: Interview with the World Bank's Vice President for Central Asia and Europe, Laura Tuck 2014. Available at <https://www.worldbank.org/en/news/opinion/2014/12/02/azerbaijan-the-crisis-will-have-a-negligible-effect> (consulted on 27 March 2020).

in 2014, Laura Tuck said that over the past 20 years, the World Bank allocated loans worth 3.9 billion dollars to assist the government of Azerbaijan on different economic issues and to conduct researches and made recommendations for the further development of the economy. There are about 70 projects (some of them have been completed) in Azerbaijan are funded by international donors. The biggest donors are EU, USAID, WB, ADB, Swiss, German development agencies and UNDP. Most of these projects have been developed to assist the government of Azerbaijan in establishing implementing strategies for SME sector (EU4business, Country report, 2018).

As of 2016, the small and medium-sized enterprises have been included in the country's development program. The meeting organized by the Cabinet of Ministers on the results of socio-economic development in the first half of 2016, the President said that Azerbaijan should follow the best practices from developed economies and consider the promotion of small and medium-sized enterprises for economic development and sustainability of the country. On the data of the Ministry of Economy, the strategic roadmaps were approved in 2016 in various directions to ensure the sustainability of economic reforms in the country. The strategic roadmaps cover the economic development strategy for 2016-2020, the long-term vision for the period up to 2025, and the target vision for the period after 2025. The purpose of the document is to diversify and strengthen the competitiveness of the Azerbaijani economy, eliminate dependence on oil, increase the non-oil sector and quality exports, further increase the level of employment and welfare of the population.

## **2.7. The SME Roadmap of Azerbaijan: Case Study Project**

### **2.7.1. Objectives of the SME Roadmap**

The Strategic Roadmap establishes the national policy for immediate, medium, and long-term economic change and SME growth perspectives. This Roadmap is composed of clear objectives for 2020, long-term objectives for 2025 and post-period aims for 2025. Successful short-term implementation of the targeted goals is foreseen consistent and efficient implementation, which will lay the groundwork for future medium to long-term initiatives. The below mentioned national objectives for SME growth in Azerbaijan in terms of achieving the Strategic Roadmap's specific strategic goals have been identified:

- ✓ To strengthen the country's business environment and legislation with a view to the long-term contribution of SMEs to Azerbaijan's economy;

- ✓ To further develop SME's access to finance;
- ✓ To promote internationalize/access to foreign markets in order to grow reserves and develop local goods and services with accordance with international standards;
- ✓ To give a particular focus on the development programs for skilled employees and to train the SME skills;
- ✓ To support innovations to improve competitiveness and to strengthen R&D in this sector.

Achieving these strategic goals would carry an added value of AZN 1 260 million and 34,240 jobs in the field<sup>38</sup>.

The Ministry of Economy of the Republic of Azerbaijan has requested the OECD's assistance in the implementation of the SME Roadmap. Therefore, the project has been started to implement in Azerbaijan with the support of International Organizations. The key objectives of the project are to build the capacity of Azerbaijan's different agencies, to implement and evaluate the Roadmap, to create public-private dialogue while involving international experts, national stakeholders and representatives of OECD. Additionally, the project aimed to set up recommendations and result-based monitoring system.

### **2.7.2. Current Implementation status of SME Roadmap of Azerbaijan**

As the first objective of the Roadmap, the Small and Medium Enterprises Development Agency of Azerbaijan was approved by the rule of the President of the country dated December 28, 2017. The Presidential Decree dated June 26, 2018, approved the Charter and structure of the Agency. The Agency is a public legal entity, operates under the Ministry of Economy that supports the development of SMEs in the country, provides several services to SMEs, coordinates and regulates the functions of government agencies. Over the past few years, Azerbaijan has undertaken a range of steps to promote entrepreneurial growth, which are as follows:

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<sup>38</sup> The Strategic Road Map on the production of consumer goods at the level of SME (SME Roadmap). Available at [https://iqtisadiislahat.org/news/azerbaycanda\\_kicik\\_ve\\_orta\\_sahibkarliq\\_seviyyesinde\\_istehlak\\_mallarinin\\_istehsalina\\_dair\\_strateji\\_yol\\_xeritesi\\_aciqlanib-164](https://iqtisadiislahat.org/news/azerbaycanda_kicik_ve_orta_sahibkarliq_seviyyesinde_istehlak_mallarinin_istehsalina_dair_strateji_yol_xeritesi_aciqlanib-164) (consulted on 30 March 2020).

### 2.7.3. Regularity environment

In 2018, with the creation of an electronic licensing portal, entrepreneurs had begun to obtain licenses online. In addition to the ease of the licensing, this portal was created to increase transparency in the provision of public services. Secondly, the creation of e-government portal with a large number of services has made an additional contribution to the development of the business environment and regularity framework for SMEs. From 2015 to 2021, inspections in the field of entrepreneurship have been suspended to protect the rights of entrepreneurs, to prevent inappropriate interference by different bodies to entrepreneurial activities. According to the economic reform package, the number of licensed activities has been reduced from 59 to 37, state fees for issuing licenses by two times in Baku, by four times in the regions have been decreased, and licensing procedures have been simplified<sup>39</sup>.

Additionally, one of the mandates of the SME State agency is to study the domestic market and to assist in overcome those challenges. Therefore, according to the order of the President of the Republic of Azerbaijan dated 29 May, 2019, the Agency has started receiving applications from business owners to study the domestic market and promote business environment accordingly. The primary objective of such initiative is to provide business-friendly environment, financial and analytical support to small and medium-sized enterprises in reviewing the current condition of the local market, to stimulate competitive development, increasing output in the private sector and developing new enterprises and facilities generating competitive goods<sup>40</sup>. In addition to the central agency, SME Houses (assists with entrepreneurs' concerns) were established in Baku and other regions of the country<sup>41</sup>. The availability of "ASAN Service" and its continually improving work on public service activities promote the business environment and regularity framework for SMEs (OECD, 2019). The work of the "ASAN Service" is highly important in terms of business environment and regularity, and its work has already been valued in the international community. Azerbaijan received the UN Public Service Award for the activities of the "ASAN Service" (Eastern Partnership Index for 2015-2016, 2017). Additionally, Afghanistan perceived the Service's activities as the best

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<sup>39</sup> National Confederation of Entrepreneurs Organizations of the Republic of Azerbaijan (ASK), 2019: 25 April – the Day of Entrepreneurs. Available at <http://ask.org.az/biznes-heyati-jurnali/> (consulted on 14 April 2020).

<sup>40</sup> Order of the President of the Republic of Azerbaijan dated May 29, 2019: Assessment of domestic market. Available at <http://www.e-qanun.az/framework/42551> (consulted on 15 April 2020).

<sup>41</sup> The Small and Medium Business (SMB) Development Agency of the Republic of Azerbaijan: SME Houses. Available at <http://smb.gov.az/nav/smb-houses> (consulted on 15 April 2020).

practice, therefore recently introduced a national “one-stop-shop system” called “Asan Khedmat” based on a mutual agreement with Azerbaijan (Huseynli, 2016)<sup>42</sup>.

Giving background information regarding the ASAN service, it is essential to mention that the Service with its centres in Baku and other regions, are institutions that ensure the implementation of services provided by government agencies in a unified and coordinated manner. These centres serve for a new approach to the activities of civil servants to ensure the satisfaction of the population. The activities of the centres are based on the “principles of efficiency, transparency, courtesy, responsibility and convenience”<sup>43</sup>. Through its legal and creative program that assists all citizens across the country via physical centres and “Mobile Services” with busses, ASAN Service has maintained to establish a system that prevents any possible corruption or illegal demand from the population. The advantage of ASAN Service is that it serves all its citizens, regardless of where they live. The reason for the creation of mobile services, in the beginning, was not to restrict the access of citizens to the Service due to location (Huseynli, 2016). Thus, since its establishment, it has been serving citizens in Baku, with five and in the region with 13 centres<sup>44</sup>.

The contribution of the ASAN Service to the business environment is valuable. However, there are still unresolved issues in the business environment in terms of regularity, which affects the performance of entrepreneurs during unexpected crises. As an example, according to CESD, the fire incident in one of the shopping plaza, in Baku, in 2019, is perceived as a test of the country’s current business environment, including political-economic power structures. As stated in the report, the accident addresses a range of deficiencies in the business environment, as well as provide to interpret the challenges associated with implementing programs in the economic climate. Answering the questions, “What is the root of this problem?” and “Why have investors not reacted to the reforms implemented?”, the study finalized that “Lack of quality of management - the quality of public administration is low and does not meet new challenges”, “The rule of law - the principle of the rule of law is not fully respected”, “The availability and effectiveness of institutions - challenges to improve existing economic institutions have been formulated” (2019)<sup>45</sup>.

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<sup>42</sup> UNDP: One-stop-shop: Public Service Delivery Model: The Case of Azerbaijan. Available at [http://www.astanacivilservicehub.org/uploads/case\\_studies/Azerbaijan\\_case-study.pdf](http://www.astanacivilservicehub.org/uploads/case_studies/Azerbaijan_case-study.pdf) (consulted on 15 April 2020).

<sup>43</sup> ASAN Service: Vision. Available at <https://asan.gov.az/az/about> (consulted on 20 April).

<sup>44</sup> ASAN Service: Centers. Available at <https://asan.gov.az/az/service-centers/asan-xidmetler> (consulted on 30 April 2020).

<sup>45</sup> CESD: The Business Environment: Economic Reforms in the Context of Institutional Shortcomings. Available at <http://cesd.az/new/?p=11724> (consulted on 15 March 2020).



Another large-scale crisis is the damage caused to entrepreneurs on the eve of the COVID-2019 pandemic, and future research should include the extent to which the government and regularity protect the owners of businesses. To provide general information and emphasize the importance of research on this topic in the post-pandemic period, it may be useful to share a public post on Facebook by the Founder of EDU Co. Management & Consulting company:

“From 3 March to 29 May 2020

Our business has been suspended for three months or 90 days.

During this period, our income was zero.

About 200 workers lost their jobs during this period.

During this period, about 200 workers received only 125 AZN from the state.

During this period, our profit was 0.

During this period, the income of the owners of 8 facilities was zero.

During this period, the income of 4 investors was 0.

During this period, expenditures for the next year have increased.

What should we do? Where to go? To whom should we express our grief?<sup>46</sup>”

All in all, as discussed throughout the study, enhancing legal environment contributes to improvement in the economic growth of a country. The studies in this field demonstrate that the entrepreneurs have fewer financial problems in the economies, where the robust legal environment exist (Galindo and Micco, 2004).

#### **2.7.4. Access to Finance**

The Islamic Corporation for the Development (ICD) noted that the most critical challenges faced by SMEs in Azerbaijan are access to finance, taxes and corruption. According to a survey conducted by the ICD, the issue of accessing to finance of SMEs in Azerbaijan is 9% higher than the world average (ICD, 2012). According to the CESD report, the main concerns on accessing to finance of SMEs in Azerbaijan are high-interest rates by banks and a lack of interest of banks in providing short-term loans to SMEs. Despite the support of Azerbaijani legislation in recent years, banks do not simplify loan terms based on movable and immovable assets. Hence, in other countries, banks provide loans to entrepreneurs based on both movable and immovable assets. In Azerbaijan, the practice is

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<sup>46</sup> Public post on Facebook by the Founder of EDU Co. Management & Consulting company. Available at <https://www.facebook.com/rasif.dunyamali/posts/10157174625477231> (consulted on 3 June 2020).

that loans can only be granted based on registered movable assets, such as cars, ships and mostly fixed assets in Baku (2017).

In line with the implementation of the SME Roadmap, the Mortgage and Credit Guarantee Fund was established in 2017 to carry out monitoring of loans, and the use of funds in accordance with their purpose, as well as to check the credit history of the enterprises by the accredited banks. Another objective of the creation of the Fund was to provide consulting services to entrepreneurs in the field of debt management and risk assessment (CESD, 2017). According to the report<sup>47</sup> of the Ministry of Economy of Azerbaijan, the Entrepreneurship Development Fund was established under the Ministry of Economy in 2018. According to the new rules, the annual interest rate on loans was reduced from 6% to 5%, and the limits on medium-sized loans were increased from AZN 50,000 to AZN 1,000,000. As a continuation of the reforms, the Azerbaijan Credit Bureau and the Real Estate Encumbrance Registry was launched in 2018 to increase the access of SMEs to financial resources. As per the report of the National Confederation of Entrepreneurs (Employers) Organizations of the Republic of Azerbaijan, the number of funds allocated for lending was increased in 2018. The loan portfolio was increased from 4 billion 804 million manats to 4 billion 947 million manats from 2017 to 2018.

Furthermore, the Entrepreneurship Development Fund of the Ministry of Economy has so far provided AZN 2.3 billion in soft loans to 36,000 entrepreneurs. These loans have created more than 166,000 new jobs. In 2019, it was planned to provide 160 million manats in soft loans to entrepreneurs (2019).

The report<sup>48</sup> on the implementation of the Strategic Roadmap of SMEs noted that the Government has already implemented (78 % - completed; 22% in the process) the targeted strategic goals to increase the efficiency of SMEs' SMEs' access to finance (2017). Despite the extensive implementation of the Roadmap, other reports claim that access to finance is still a significant concern for the SMEs. According to a survey conducted in 2018, 76% of representatives of SMEs responded that they are funded through the internal resources and claimed that they don't have access to external resources (OECD, 2019). According to the Azerbaijan Leasing Companies Association, in 2018, Azerbaijan's leasing portfolio fell from AZN 125 million to AZN 60 million compared to 2012.

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<sup>47</sup> Website of the Ministry of Economy of the Republic of Azerbaijan: The report on reforms and work done in the field of entrepreneurship development in 2018. Available at <https://economy.gov.az/uploads/fm/2018-ci-il-sahibkarlik-biq.pdf> (consulted at 27 April 2020)

<sup>48</sup> Monitoring.az: The report on the implementation SME roadmap in 2017. Available at [https://monitoring.az/assets/upload/files/2\\_Kicik\\_ve\\_orta\\_sahibkarliq\\_opt%281%29.pdf](https://monitoring.az/assets/upload/files/2_Kicik_ve_orta_sahibkarliq_opt%281%29.pdf) (consulted on 11 April 2020).

According to a survey conducted by the OECD, 58% of SMEs have problems with access to finance in Azerbaijan (2019).

### 2.7.5. Availability of skilled employees

In 2016, the State Agency for Vocational Education under the Ministry of Education of the Republic of Azerbaijan<sup>49</sup> was established. The principal activities of the Agency to organize primary vocational education institutions, to increase their competitiveness, and to develop the methods for the recognition of skills acquired through informal and formal methods. According to the result<sup>50</sup> of the defined targets in the “Strategic Roadmap for the Development of Vocational Education and Training in Azerbaijan”, 52% of the planned part of the measures has been completed, 40% has been partially implemented and 8% not executed, reported in 2017. The construction of a specialized vocational training centre has started in Baku under the project “Establishment of a Vocational Training Centre”, which is implemented with the financial aid of the Korea Foundation for Economic Development and Cooperation. With the assistance of the UNDP, 18 textbooks were developed and published with the cooperation of British Petroleum and the British Council.

However, according to Uluchay Social-Economic Innovation Centre, even though the government achieved specific steps in the direction of the development of vocational education and development programs, there is still much to do in this area. The centre reports that while in developed countries, 40-60% of the population is interested in vocational education, in Azerbaijan this figure is very low. In 2017-2018, only 20% of young people in Azerbaijan showed interest in vocational education, and part of them are those who could not pass university exams and end-up at vocational school due to low results (2020)<sup>51</sup>.

Legislation in Azerbaijan does not create any obstacles for women to engage in individual entrepreneurship. Also, the country’s strategic roadmap sets strategic goals to increase the skills of women in the private sector. In 2016, with the support of the President’s Reserve Fund, 6 million

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<sup>49</sup> Ministry of Education of the Republic of Azerbaijan: Information about State Agency for Vocational Education under the Ministry of Education. Available at <https://vet.edu.gov.az/az/content/1/> (consulted on 11 April 2020).

<sup>50</sup> Ministry of Education of the Republic of Azerbaijan: Result in the implementation of the “Strategic Roadmap for the Development of Vocational Education and Training in the Republic of Azerbaijan” for 2017. Available at [https://vet.edu.gov.az/uploads/6\\_Pese\\_tehsili\\_opt.pdf](https://vet.edu.gov.az/uploads/6_Pese_tehsili_opt.pdf) (consulted on 11 April 2020).

<sup>51</sup> “Uluchay” Social-Economic Innovation Center: Development of Vocational Education in Azerbaijan: Analysis and Recommendations (2020). Available at <http://uluchay.org/development-of-vocational-education-in-azerbaijan-analysis-and-recommendations/> (consulted 13 April 2020).

manats were allocated for the organization of professional training with the participation of 1,767 (322 participants were women) unemployed people in 76 regions of Azerbaijan. (UNDP Gender Assessment Report, 2018). In addition to government support, the EU funded a project, named “Women in Business” within the Eastern Partnership Initiative under the slogan “Stronger Women – Stronger Azerbaijan”. The program provides business guidance, training activities and mentoring for women SME owners.

Despite the initiatives as mentioned above, there is a large number of informal jobs due to the lack of educated employees in the labour market in Azerbaijan, which leads to structural problems. The majority of the population in Azerbaijan is young (30%), and they make up the majority of the unemployment in the country (UN, 2018).

Concerning entrepreneurial and management skills, the ASK publication dedicated to the Day of Entrepreneurs includes an interview with Fakhri Agayev, who has worked as a head of various companies for a long time, is now a business consultant to entrepreneurs and regularly writes articles on entrepreneurship on his blog. According to him, improving the quality of courses taught at the higher education institutions is an essential contribution to business developments. The cooperation between business sectors and higher education institutions is a must for business development. He stated that companies are unable to find employees for different positions; on the other hand, unemployed graduates complain about limited workplaces. The primary reason is that young people with higher education are often not ready for a working environment. Companies find it challenging to hire graduates of universities of Azerbaijan, because sometimes the knowledge and skills they obtained at the universities is not relevant to the working environment.

For this reason, the higher education institutions need to work closely with business sectors, and one of the most effective tools is to attract practical business people to teach at the universities, because they provide young people with more accurate and specific business knowledge and prepare them to a working environment. Moreover, he added that the large companies and holdings usually invite consultants from abroad to develop the capacities of the local specialists, but SMEs do not have this capability. For this reason, national mechanisms must be designed to promote entrepreneurial skills in Azerbaijan (2019).

### **2.7.6. Internalization**

To promote access to a foreign market, the government started to strengthen the activities of the Azerbaijan Export and Investment Promotion Foundation (AZPROMO), which is a joint public-private initiative to contribute to the economic growth through external investments and inspiring exports in the non-oil sector. There are other sites (Azexport.az, Enterprise Azerbaijan) available to promote exports and stimulate local and foreign investors into the SME Sector. In 2018, the Law of the Republic of Azerbaijan “On Alat Free Economic Zone” was adopted. This Law determines the legal regime of activity, development and management of the Alat Free Economic Zone of Azerbaijan. The new zone in Alat will play a leading role in international cargo transportation and the Eurasian logistics chain, as well as the promotion of local production and the global recognition of the “Made in Azerbaijan” brand.

According to the EU4Business report, international trade in Azerbaijan is controlled by large, often state-owned enterprises. Despite the improvement in export initiatives, there is limited financial support for exporting SMEs in Azerbaijan (EU4Business, 2017). Another issue is the lack of knowledge of entrepreneurs in the foreign market requirements (CESD, 2017). There is a need for training programs on standardization and certification among SMEs to increase exports (EU4Business, 2019).

### **2.7.8. Innovation**

State programs and policy documents, “Azerbaijan 2020 Vision” and “National Industrial Strategy 2015-2020” have been designed to promote innovation in Azerbaijan. At the same time, several state agencies and institutions, such as the Ministry of Economy, the Ministry of Communications and High Technology and the National Academy of Sciences, are promoting innovation initiatives. However, there is no official cooperation agreement between the structures as mentioned above, and therefore, in practice, efforts are disorganized and inefficient to appear (OECD, 2017).

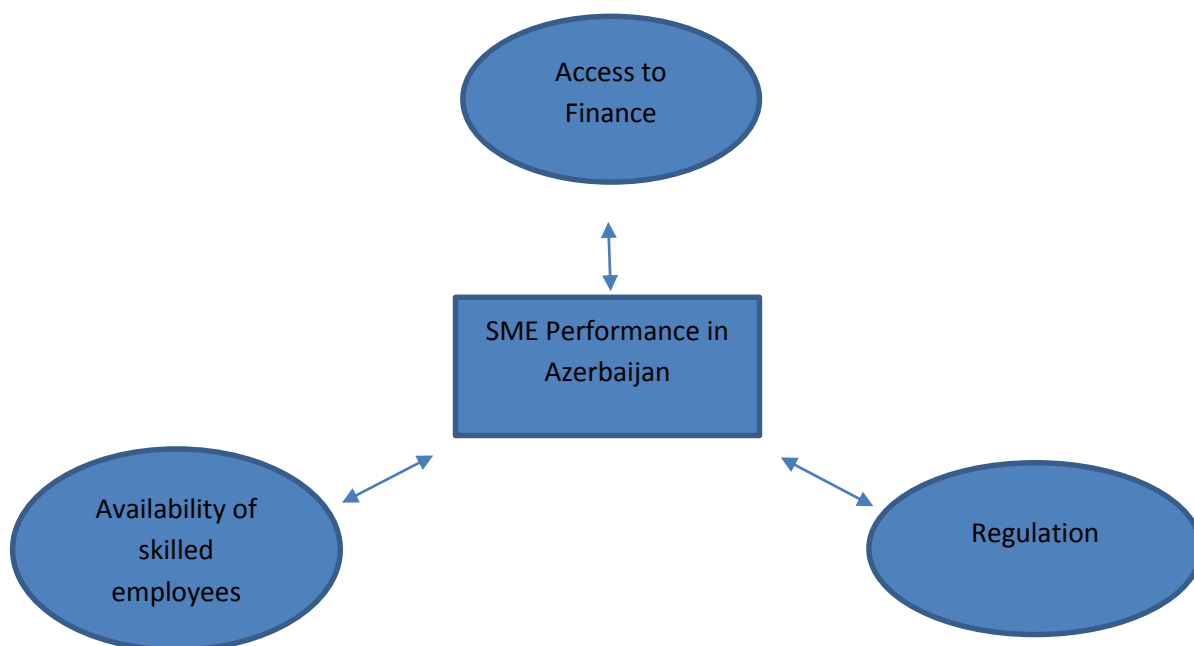
In 2017, the Scientific Research Institute of Economic Reforms of the Ministry of Economy of the Republic of Azerbaijan prepared proposals and recommendations for the establishment of innovation centres based on international experience. After that, the “Innovation Centre” started to operate under the “State Agency for Citizen Services and Social Innovations under the President of

the Republic of Azerbaijan”. In 2018, the Innovation, Education and Consulting Department of SME Agency was established. The functions of the department are to study the application of innovations in entrepreneurship and to develop training programs accordingly. Also, it promotes the sustainable development of start-ups, family businesses, entrepreneurship among women and youth, people with disabilities.

### 2.7.9. Conceptual model

The conceptual model below is developed based on the literature review. From the above discussions, the researcher concludes that all mentioned five factors such as regularity, access to finance, availability of skilled employees, internalization and innovation are influencing factors for the performance of SMEs in Azerbaijan. Nevertheless, as widely discussed above, challenges on regulation, such as registration and licensing, have been relatively eliminated in Azerbaijan with the help of the “one-stop-shop - ASAN services”, however the regulation burdens are still hampering issue for the performance of the SMEs. Furthermore, the development of internalization and innovation at this stage highly depends on access to finance and availability of skilled employees. Therefore, the researcher concluded the discussions with the following model: there are three main challenges affecting the performance of SMEs, which are limited access to finance and lack of skilled employees, and regulation.

**Conceptual model from literature research**



### 3. METHODOLOGY

#### 3.1. Research Strategy

Blumberg, Cooper, & Schindler (2011) state that the research strategy is always focused on the research question and the collection of different types of information and informs the methods being used to gather data to address the research question. As mentioned in the introductory, the aim of this study is highly linked with the career goals of the researcher. In this context, the main focus is to answer the research question with evaluation technique. There is an increasing awareness that evaluation can lead to better efficacy of development strategies and has become a well-established and powerful tool and technique to help change the way institutions produce results (Goetz et al., 2010). Moreover, it is predicted that, with a new and diverse agenda set out in the SDGs, evaluation can play a more significant role and help to achieve better outcomes for growth (Segone, 2016). Taking into consideration the importance of the evaluation in the development programs, the researcher used method of the international organisation to evaluate the impact of the SME Roadmap and find answers to the main and minor questions of the study. Thus, the study will apply the OECD DAC Criteria for Evaluation Development Assistance that has five principles of evaluation: relevance, effectiveness, efficiency, impact and sustainability<sup>52</sup>. Since the time of its introduction, the formation of the DAC criteria can be seen as a big step forward in enhancing the standard of construction evaluations (Chianca, 2008). The measurement method is widely used to assess policies, national development programs, thematic areas, initiatives for peacebuilding, etc. This method has a collection of questions which allows achieving the set objectives. Taking into consideration the argument of the thesis and the time limit for evaluation of all targets, two targets “access to finance” and “availability of skilled employees” are defined to be evaluated. The work done in this study does not contain statistical testing of the hypothesis. However, it refers to a real case study with evaluation, which prepares the researcher to the working environment, and, in parallel, develops a model from the research findings that could be statistically tested in the future.

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<sup>52</sup> OECD, DAC Principles for Evaluation of Development Assistance. Available at <https://www.oecd.org/dac/evaluation/49756382.pdf> (consulted on 20 May 2020)

### 3.2. Data collection methods

The research design of the study is cross-sectional using mix approach: both qualitative and quantitative research methods. The primary data is collected through an online structured interview, as well as an online survey among SME owners/founders or executive directors. The study used secondary data from various publications through online sources.

The SME Performance Analysis is one of the principal instruments used by the European Commission to track and to evaluate the success of countries in the implementation of the Small Business Act on an annual basis<sup>53</sup>. As the study discussed earlier, despite the different definitions for the SMEs in the different countries, the strategy papers of the European Commission and Azerbaijan are very similar. Therefore, the survey was prepared based on the questionnaires of the European Commissioner used to assess the SME performance in the EU countries. The survey consists of 21 self-administered with open-ended and close-ended questions. Taking into consideration the first language of the SME owners, the questionnaire was prepared in Azerbaijani language and promoted by telephone calls, emails, social media accounts such as Facebook, Instagram, LinkedIn and WhatsApp. Additionally, the State Agency for SMEs kindly agreed to provide the list and contact details of the SMEs, which helped to reach to respondents.

Regarding the sampling, probability-based quantitative method of data collection, more specifically stratified random sampling method has been used. The purpose of using stratified random sampling is to organize potential samples into small groups and to give an equal chance of being selected. The homogeneous groups have been organized by economic activity of the entrepreneurship taken from the State Statistical Committee of Azerbaijan, such as “agriculture, forestry and fishing”, “industry”, “construction”, “trade; repair of transport means”, “transportation and storage”, “accommodation and food service activities”, “information and communication”, “real estate activities”, “education, human health and social work”, and “other branches”. The survey data were collected within 12 days, from 1 to 12 May 2020. The questionnaire has been reached to 257 possible respondents, and shared in different platforms; however, only 100 replies have been received (Appendix D).

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<sup>53</sup> European Union, EU4Business: SME Performance Review. Available at <https://www.eubusiness.com/topics/sme/performance-review> (consulted on 22 May 2020)



The primary qualitative data was collected through structured online interview from the national expert, Mr Vugar Bayramov, Member of Parliament of the Republic of Azerbaijan, Chairman of the Centre for Economic and Social Development and e-mail exchange with Ms Ulviyya Abdullayeva, Programme Manager of the Delegation of the European Union to the Republic of Azerbaijan.

Regarding secondary quantitative and qualitative data, the study used the data and findings of previous researches and reports of the state agencies, national research centres, International Organisations, e.g. EC, OECD, WB etc.

### **3.3. Data analyses**

#### **3.3.1. Participants**

Following the practice in the academic literature, the online survey's first questions were designed to find out the gender, age, and education category of the respondents. Given that SMEs in Azerbaijan differ in the number of employees and annual turnover, as well as the type of activity, the questions in the survey were designed to measure the classification of the audience (Appendix E). Independence analyses have been conducted before and during data collection to make sure that each contributor participated only once in the survey. As mentioned earlier, there are two participants of the interviews, one is a representative of the research centre and currently elected Member of Parliament of the Republic of Azerbaijan, the second interviewee is a representative of the EU Delegation to the Republic of Azerbaijan, who stressed that “replies provided by her depend on assessment of the overall situation, it could not be considered as EU Delegation or EC official position”.

#### **3.3.2. Quantitative data analyses**

The questions were selected to measure SME's real challenges and their improved, unchanged or deteriorated conditions. The possible problems have been identified based on the literature review such as (1) regulation, (2) access to finance, (3) availability of skilled employees, (4) internalisation, and (5) innovation. This question aims to study how well the Strategic Roadmap has been achieving to its short-term targeted goals. The measurement was executed based on the Likert-type scale 1 to

10, where one means it is not at all vital problem and ten means it is a critical problem. A question was dedicated to the business environment and regularity framework, where the SME owners were asked to assess the work of the “one-stop-shop – ASAN service”.

To measure SME’s accessibility to finance, seven questions were selected from the EC’s survey. Before the publishing questionnaire, possible financial sources in Azerbaijan were studied, and the answers were adapted to Azerbaijan. Firstly, the survey tried to measure which type of financing sources is relevant to SME owners, which they have used in the past or considered using them in the future. The respondents were also asked to provide information regarding the size and interest rate of financing, as well as the purpose was funding used. Moreover, the outcome was asked if they applied and tried to negotiate the financing (e.g. credit line/bank loan, a soft loan provided at the funds of the state budget, leasing based on assets, trade credit - that means paying your suppliers at the later agreed date or friends/family members). Finally, the most critical limiting factor for financing was asked from entrepreneurs to measure if there is any obstacle in this regard.

Moreover, seven-question were selected to analyse a lack of availability of skilled employees. Firstly, the survey tried to measure if SMEs have hired any first-time job seekers in the last year. This question measured how well employees had been prepared for work. Taken into consideration the turnover of employees in the SMEs, a question was asked to analyse how hard-to-fill positions affect the performance of the enterprises. Finally, the last two questions devoted to employee development in which the SME owners was asked to answer if employers have organized any external or internal training courses recently, if not what was the reason behind it.

The selection of the online survey can be explained by the fact that it was the only way to reach to SME representatives under the current quarantine regime due to COVID-2019. An online survey can also avoid possible bias replies, since the registration has not been requested to start the survey. Descriptive analyses are followed.

### **3.3.3. Qualitative data analyses**

An online structured interview took place with the economist, Mr Vugar Bayramov, Member of Parliament of the Republic of Azerbaijan, Chairman of the Centre for Economic and Social Development who is a researcher of numerous papers dedicated to SME development in Azerbaijan (coded as INT01). The interview took place for about 20 minutes in Azerbaijani language. The audio

recording was conducted based on initial agreement. The transcription was prepared in original language of the interview, followed by translation into English (Appendix A). The content analyse was used to code the interview (Appendix C). The second contribution was made by a representative of the EU Delegation in Azerbaijan, Programme Manager, Ms Ulviyya Abdullayeva via email exchange (coded as INT02). The correspondence was in English. The interview protocol was prepared and attached to the thesis (Appendix B) The content analyse was used to code the interview (Appendix C).

### **3.3.4. Limitations**

This research was conducted in the first months of 2020, during the months when the world was fighting the COVID-2019 pandemic. The initial limitation began with a lack of access to the University and other libraries. Despite the completion of the literature review, access to entrepreneurs and experts to collect primary data became to be a problem. The list of entrepreneurs and contact details provided by the SME Agency was partially useless because the whole country was in the lockdown mode. Entrepreneurs those contacted trough online platforms said that “they don’t not have time because they were currently dealing with employee issues”. For this reason, data collection took place only with a partial easing of the quarantine regime and the establishment of access to entrepreneurs through social media. Despite the fact that the survey reached 257 entrepreneurs and was intensively promoted on various platforms, a total of 100 responses were received. Given the fact that the study survey was conducted among a small sample, its results cannot be over-generalized. The research methods of the survey are valid, but it loses reliability. The participants of the survey had almost from Baku. The researcher had little chance to hear about the thoughts of SME representatives operating in the regions and rural areas.

The initial plan for the interviews was the semi-structural format with national experts, representatives of the SME Agency, UNDP Office in Azerbaijan, and SME Associations. However, it was only successful in reaching to the national expert, Mr Vugar Bayramov, and a representative of EU delegation. On 2 June 2020, the researcher received a written reply to interview questions addressed to the SME Agency of Azerbaijan; however, time limit did not allow to proceed with the data. The online interview with Mr Bayramov was structured without a video call, so the researcher

could not observe any non-verbal expression and could not give any other question based on the development of the interview.

### **3.3.5. Ethical issues**

The registration was not required by entrepreneurs to start the survey. It was made clear to the entrepreneurs while promoting the survey by telephone calls or social media that anonymity will be protected respectively. Also, permission was obtained before the interview with Mr Bayramov, and audio recording was made to avoid data loss. Transcription was prepared in Azerbaijani language with un-official translation based on the audio recording and added to the study. Permission was obtained to add the identity of the interviewees to the study. However, I would like once again to mention that the representative of the EU Delegation in Azerbaijan stated that “her replies depend on assessment of the overall situation, it could not be considered as EU Delegation or EC official position”.

## 4. FINDINGS

The Strategic Roadmap envisages the implementation of development in three stages: short-term vision until 2020, long-term vision until 2025 and beyond. Therefore, the researcher will make the assessment based on the executed targets, notably short-term vision until 2020.

“Relevance

The extent to which the aid activity is suited to the priorities and policies of the target group, recipient and donor.

- ✓ To what extent are the objectives of the programme still valid?
- ✓ Are the activities and outputs of the programme consistent with the overall goal and the attainment of its objectives?
- ✓ Are the activities and outputs of the programme consistent with the intended impacts and effects?” (OECP, 2017 p. 1)

In terms of the relevance of the targets of the Strategic Roadmap to ensure the SMEs’ access to finance cost-effectively and efficiently and to enhance SME awareness and skills, it is possible to state that the objectives are still relevant and valid both for the government and SME owners. The successful implementation of the first target, which is “access to finance”, would contribute to the SMEs operating in Azerbaijan, to be financed easily with credits and loans and to recovery after failure and give a second chance to the business owners who are willing to start over the business. These activities would also help to increase competitiveness and access to international markets. Taking into consideration that the overall goal of the Roadmap, strengthening SMEs’ access to finance in Azerbaijan would eventually contribute to better employment and economic growth in Azerbaijan.

However, speaking about the activities to ease SME’s access to finance in the regions of Azerbaijan, the relevance factor needs to be improved. While analysing the Strategic Roadmap activities, the researcher could not reveal any activity targeted to ease SMEs’ access to finance operating in the regions. Moreover, the interviewee, Mr Vugar Bayramov, mentioned that the SME Roadmap should also focus on regional development in terms of access to finance. According to him, the SMEs operating in the regions have poor access to financial resources than in Baku. Even though the loan portfolio in Azerbaijan is 15.2 billion manats, there is 80% of this portfolio falls on entrepreneurs and citizens living in Baku and only 20% in the regions. The banks in Azerbaijan require property located in Baku as collateral, when deciding on lending to entrepreneurs. This mechanism

limits the SMEs' access to financial resources in the regions. Therefore, there is a need to improve the mechanism and make it relevant to the needs of all stakeholders (INT01).

The successful implementation of the second target, which is “availability of skilled employees” would contribute to growing understanding, awareness of business processes, rising unemployment among young people, enhancing the current management practices. Consequently, the introduction of the Roadmap was anticipated to accelerate the motivation to become an entrepreneur, the development of regions, the advancement of innovation, and the establishment of favourable circumstances for start-up ventures. These objectives are still relevant and consistent with the overall goal.

#### “Effectiveness

A measure of the extent to which an aid activity attains its objectives.

- ✓ To what extent were the objectives achieved / are likely to be achieved?
- ✓ What were the major factors influencing the achievement or non-achievement of the objectives?” (OECD, 2017, p. 1).

The SME Credit Guarantee Fund was founded in 2017, as envisaged in the target activity of the SME Strategic Roadmap. As per the plan, the Fund would provide maximum protection to the export-oriented small and medium-sized enterprises in terms of loans and limited support to home market enterprises. The Government would have to start its support to medium-sized enterprises and followed by micro-SMEs. Given that the researcher's assessment is based on the results that have already been achieved, in particular, the short-term vision up to 2020, this criterion is difficult to analyse, expect the establishment of the Fund and other state bodies (Progress report, 2017)<sup>54</sup>.

Secondly, the main reason of establishing the SME State Agency is for the coordination among stakeholders, such as state authorities, banks, SME associations to promote SME's growth, including easing their access to finance. According to Mr Vugar Bayramov, the establishment of the SME Agency is accompanied by an increase in state support to SMEs, which can be perceived as a positive achievement (INT01).

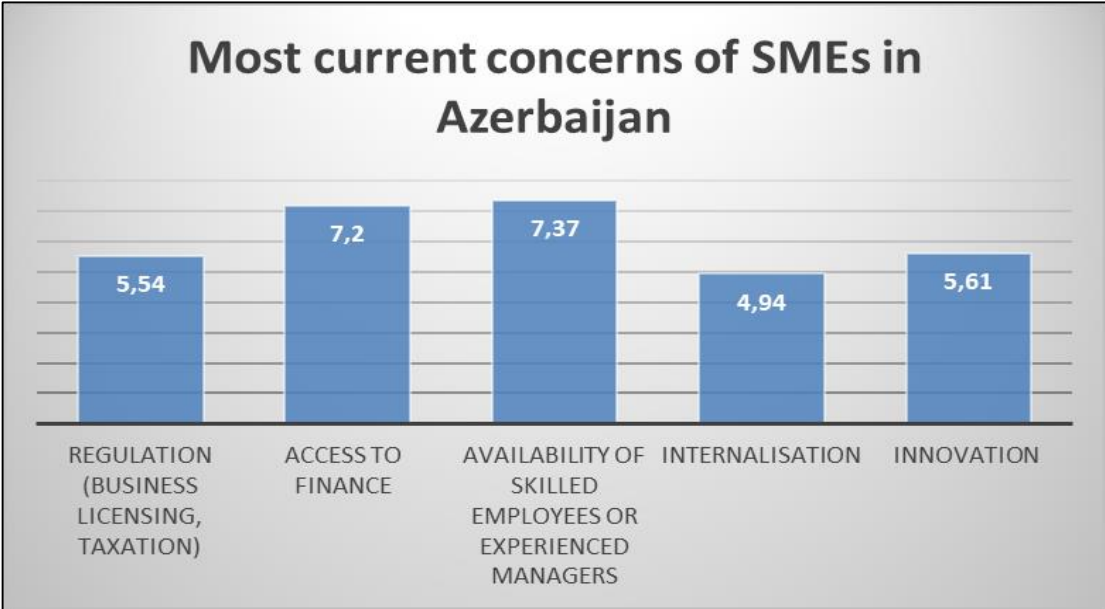
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<sup>54</sup> SME Roadmap Progress report, 2017. Available at [http://www.iqtisadiislahat.org/store//media/documents/islahatlar\\_icmali/SME\\_eng.pdf](http://www.iqtisadiislahat.org/store//media/documents/islahatlar_icmali/SME_eng.pdf) (consulted on 25 May)

In addition to the newly established institutions names mentioned above, the SME Associations was established as per planned activities. However, SME associations are not sufficiently active bodies to act as a bridge between the state agencies and entrepreneurs. The primary mission of those associations is to represent SMEs' concern to the government agencies; however, they are not active enough to meet with their real duties. Mr Bayramov stated that they need to be proactive to achieve set objectives (INT01). Moreover, as analysed in the overview of the government policies towards the development of SMEs in EaP countries: case study of Georgia (chapter: 2.5.2), one of the reasons of Georgia's success on private sector is linked with an active role of BSOs in Georgia that are deeply involved in monitoring the business environment, representing them in the government sector. The country is also made substantial progress in establishing the private-public dialogue to track the implementation of the SME Development Strategy. This can be perceived as a best practice from the neighbourhood country.

The effectiveness of the activities can also be measured by the result of the thesis survey. As for the result of the survey, the most pressing challenges for entrepreneurs are the limited access to finance and lack of skilled employees. The innovation, regulation and internalisation are not extremely important challenges faced by SMEs in Azerbaijan.

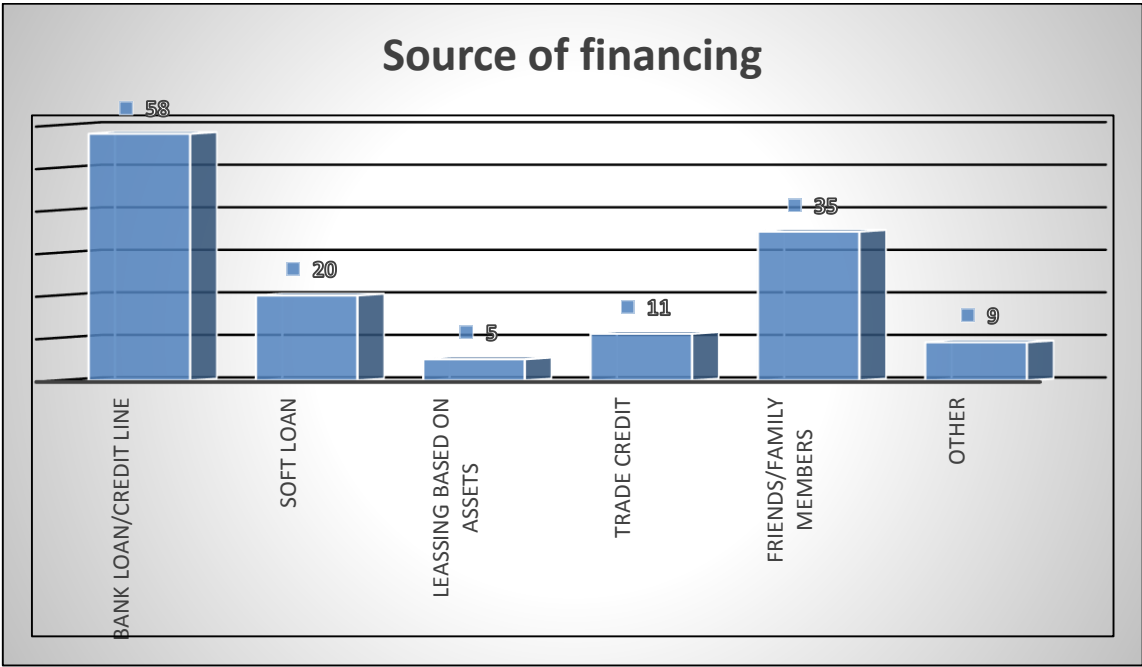
**Figure 7:** Most current concerns of SMEs in Azerbaijan



*Source: Compiled by researcher as a result of survey*

Establishment of the Real Estate Encumbrance Registry in 2018 would increase the access of SMEs to financial resources in terms of lower collateral requirements such as movable and immovable assets. However, according to the result of the thesis survey, leasing based on assets is the least funded source for entrepreneurs. On the contrary, entrepreneurs prefer the bank loan and credit line (58% of respondents) with a high-interest rate (average 18.36%). Borrowings from friends and family members (35% of respondents), as well as trade credit (11% of respondents) that means paying the supplier at the later, agreed date are mostly preferred by SME owners. The soft loan provided at the funds of the state budget is the third most accessible source of funding (20% of respondents), which can be perceived as a positive achievement. In addition to the factors mentioned above, entrepreneurs (76%) point out to high-interest rates as the most critical limiting factor in obtaining financing. Insufficient collateral (33%) and too much paperwork (21%) are also limiting factors for finance.

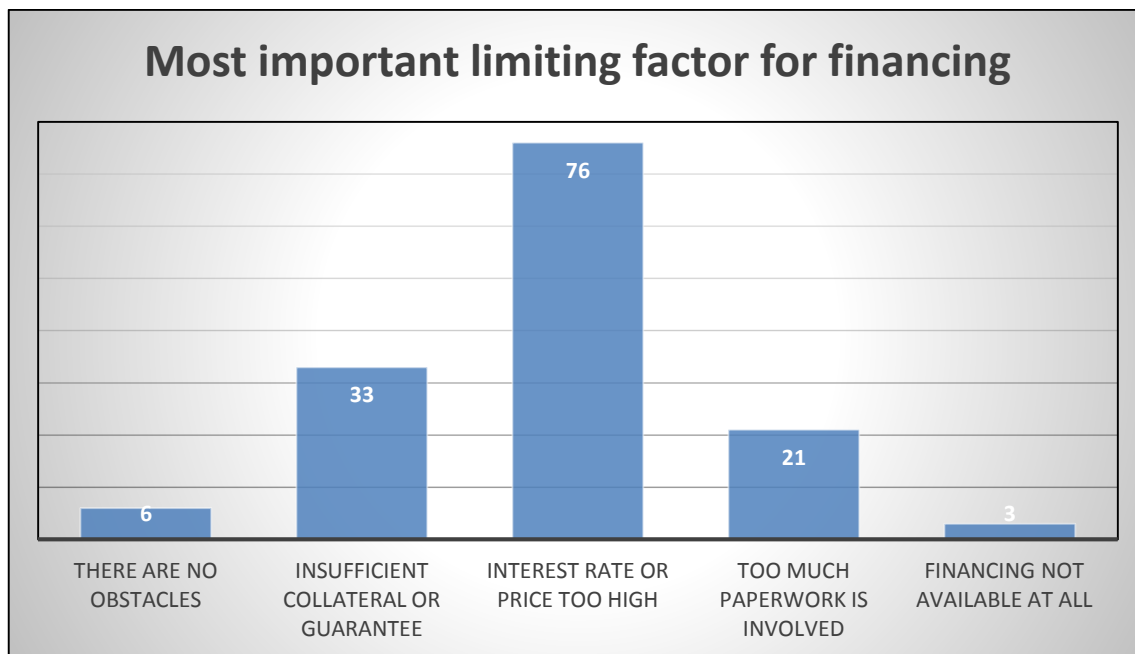
**Figure 8:** Source of financing of SMEs in Azerbaijan



*Source: Compiled by researcher as a result of survey*



**Figure 9:** Most important limiting factors for financing of SMEs in Azerbaijan

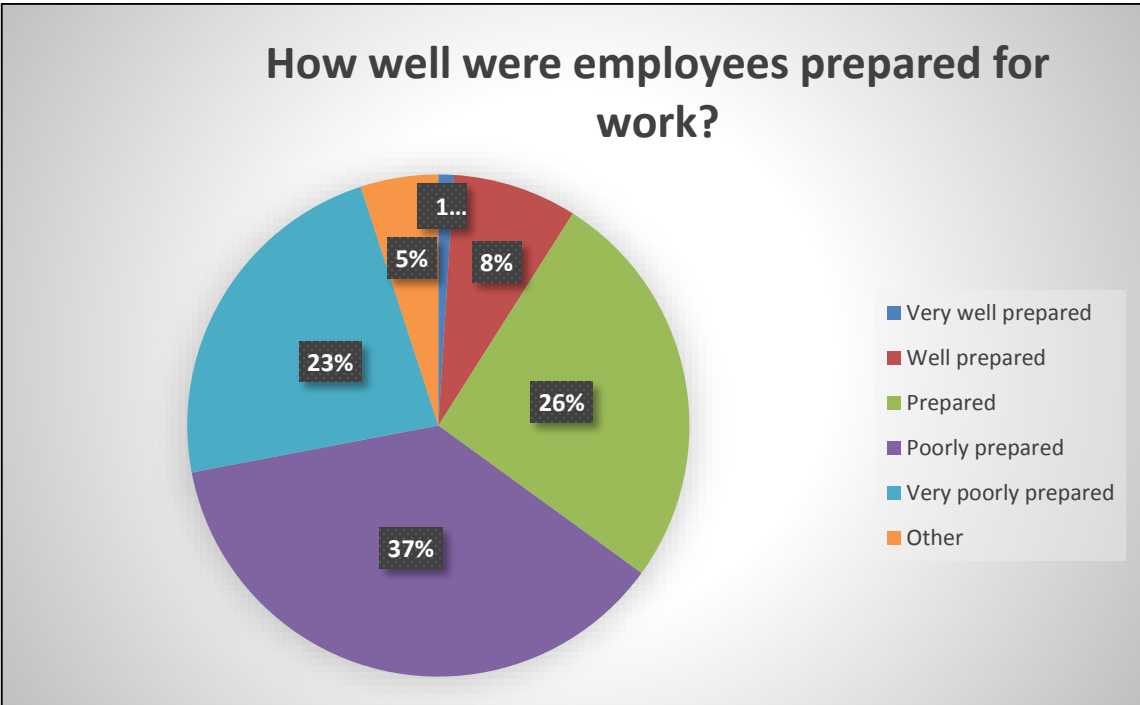


*Source: Compiled by researcher as a result of survey*

In 2016, the State Agency for Vocational Education under the Ministry of Education of the Republic of Azerbaijan was established. A study was carried out by the Government of Azerbaijan with the participation of international experts to consider the requirements of employers and the current status of vocational education institutions. As a result, ten pilot vocational education institutions were established. In addition to vocational education, university-SME partnerships have been started (Progress report, 2017).

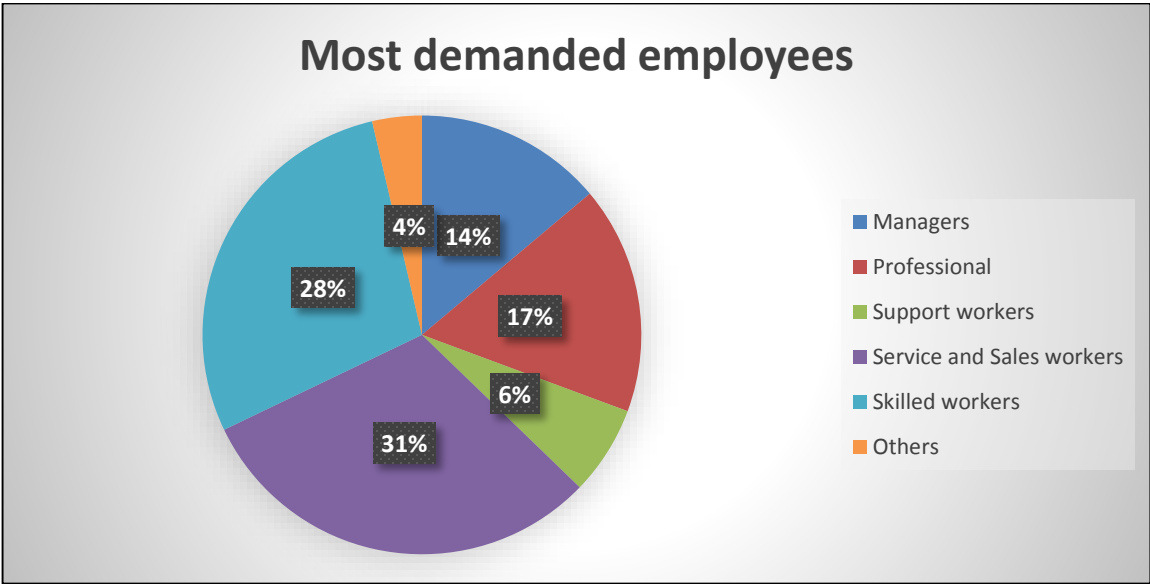
However, as a result of the thesis survey, the availability of skilled employees is the most challenging factor for the employers. According to SME owners, employees whom they hired in recent years were poorly prepared for work. The most demanded employees are skilled workers who work in the service and sales sector.

**Figure 10:** Preparation of population for work from the point of view of entrepreneurs



*Source: Compiled by researcher as a result of survey*

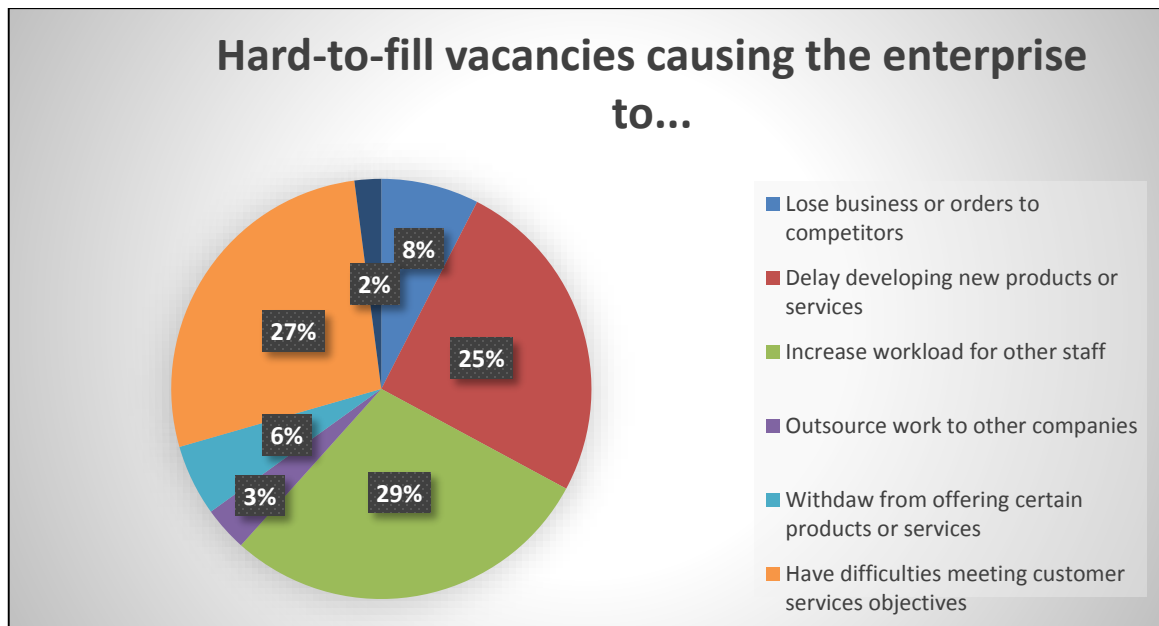
**Figure 11:** Most demanded employees in the SMEs of Azerbaijan



*Source: Compiled by researcher as a result of survey*

Thus, the employee mentioned above challenges increase the workload of other staff in the enterprise, as well as cause difficulties in meeting customer service goals and delaying the development of new products or services.

**Figure 12:** Causing factors of lack of employees in the SMEs of Azerbaijan



*Source: Compiled by researcher as a result of survey*

As for the general context, representative of the EU delegation in Azerbaijan, Ms Abdullayeva stated that there is a low motivation to become entrepreneur among the population and little information at secondary schools on entrepreneurship culture (INT02).

To conclude, there are positive achieving factors, such as establishing several responsible bodies to deal with targeted goals, however, “it is important to have a clear vision, not so ambiguous, but realistic” as stated by the representative of EU delegation in Azerbaijan (INT02).

“Efficiency

Efficiency measures the outputs - qualitative and quantitative - in relation to the inputs. It is an economic term which signifies that the aid uses the least costly resources possible in order to achieve the desired results. This generally requires comparing alternative approaches to achieving the same outputs, to see whether the most efficient process has been adopted.

When evaluating the efficiency of a programme or a project, it is useful to consider the following questions:

- ✓ Were activities cost-efficient?
- ✓ Were objectives achieved on time?
- ✓ Was the programme or project implemented in the most efficient way compared to alternatives?" (OECD, 2017, p. 1)

In addition to the expected result and outcome indicators until 2020, the strategic roadmap has specified the required investment. It is projected that about 700 million manats will be invested by 2020 to achieve all set strategic goals, including "SME's access to finance" and "development programs for skilled employees" (SME Roadmap, 2016). As a result of the successful execution of the targeted goals, the contribution of SMEs to GDP and jobs will boost by 15 % and 20 %, whereas the proportion of non-oil exports is projected to hit 10 per cent by 2020 (Ecoreforms, 2017).

However, these figures are very general, and it is difficult to analyse the efficiency factor of the roadmap, as it was not possible to find a financial statement of expenditures through secondary data and these results are very specific to ask from interviewed bodies.

## “Impact

The positive and negative changes produced by a development intervention, directly or indirectly, intended or unintended. This involves the main impacts and effects resulting from the activity on the local social, economic, environmental and other development indicators. The examination should be concerned with both intended and unintended results and must also include the positive and negative impact of external factors, such as changes in terms of trade and financial conditions.

When evaluating the impact of a programme or a project, it is useful to consider the following questions:

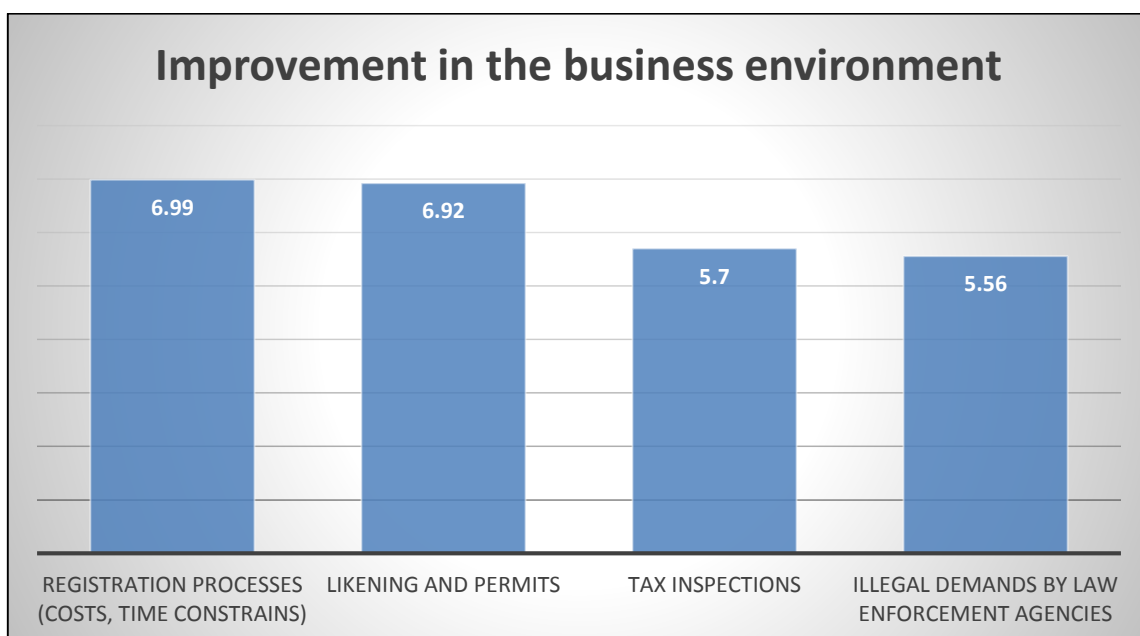
- ✓ What has happened as a result of the programme or project?

- ✓ What real difference has the activity made to the beneficiaries?
- ✓ How many people have been affected?" (OECD, 2017, p. 2)

In general, according to the priorities of the strategic map, diversification is a priority in 3 macroeconomic indicators (GDP, fiscal revenues, total exports). According to Mr Bayramov, the share of the non-oil sector in GDP (3.2%) is currently higher than the oil sector (3.1%). This indicates that the structure of GDP is diversified. As for fiscal revenues, compared to 2015, the share of the non-oil sector in the state budget increased from 20% to 46%, which is a positive impact. Nevertheless, according to the State Statistics Committee, 81% of the exports are crude oil products. Mr Bayramov reaffirmed the dominance of the oil sector in total exports and stressed that from 2025, dependence on oil would be significantly reduced (İNT01).

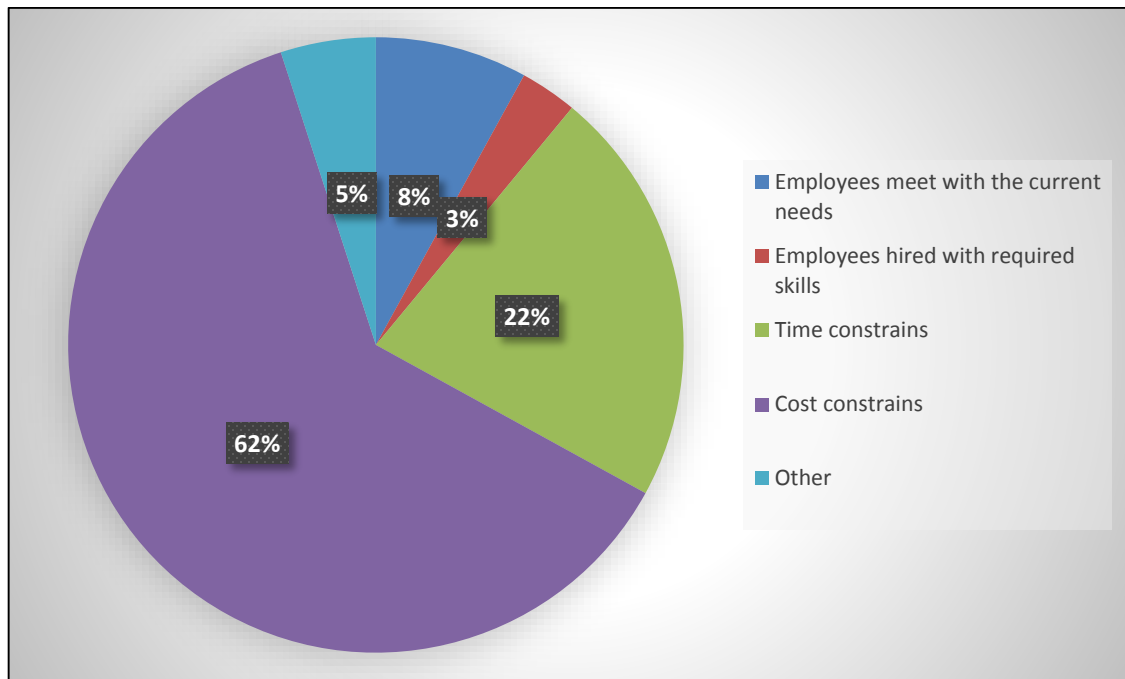
As for the scope of the survey, speaking about the impact of the reforms to the SME society, even though restrictions on the registration process, licenses and permits have been lifted to some extent, tax inspections and illegal demands by law enforcement agencies are still hampering the business environment. These limitations lead to the financial weakening of SMEs, which in turn affects other processes. For example, 62% of survey respondents indicate that cost constrain is the reason not organising internal and external training for employees.

**Figure 13:** Improvement in the business environment in Azerbaijan



Source: Compiled by researcher as a result of survey

**Figure 14:** Influencing factors for not investing on employee skills in SMEs of Azerbaijan



Source: Compiled by researcher as a result of survey

## “Sustainability

Sustainability is concerned with measuring whether the benefits of an activity are likely to continue after donor funding has been withdrawn. Projects need to be environmentally as well as financially sustainable.

When evaluating the sustainability of a programme or a project, it is useful to consider the following questions:

- ✓ To what extent did the benefits of a programme or project continue after donor funding ceased?
- ✓ What were the major factors which influenced the achievement or non-achievement of sustainability of the programme or project?” (OECD, 2017, p. 2)

As for the criteria of sustainability, international experience shows that continuation of the state support is important for sustainable development in the field of entrepreneurship. For example, even though European SMEs have already achieved tangible results and share the vital part in the European

economy, there are still different programmes are currently in the process to address various challenges of them. The strategic roadmap is a living document to be monitored by the relevant bodies by assessing their needs. Doing so, some activities have to be adjusted, and not implemented at all. Therefore, it is crucial to conduct regular performance reviews to measure its sustainability, as the best practice taken from Europe and other states.

To conclude, the researcher would like to state the opinion of the interviewed representative of the EU delegation in Azerbaijan that the Government of Azerbaijan should further continue to support the SME Agency to work more closely with SMEs, attract cheap credits, provide regular training to SMEs, support young generation (creative start-ups) and strengthen the Agency using international models/practices (INT02).

## 5. DISCUSSION

As discussed earlier, the main aim of the study is to answer the main and minor questions. As the result of the literature review, as well as quantitative and qualitative data analyses, the study concluded that the most current concerns of the SMEs in Azerbaijan are regularity, limited access to finance, availability of skilled employees, internalization and innovation and all those concerns affect the performance of the SMEs. However, the availability of ASAN service is relatively improved the regularity conditions, such as registration and licensing. Despite this improvement in the business environment context, tax inspections, and illegal demands by law enforcement agencies are still hampering factors for them. The survey and the result of interviews dictate that limited access to finance and availability of skilled employees are the main challenges affecting the performance of SMEs in Azerbaijan, among other concerns.

In terms of the short-term objectives of the SME Roadmap achievements, it can be concluded that Azerbaijan has been making many institutional reforms to build a strategy of economic diversification in recent years. In a country where progressive reforms are taking place, the realities and circumstances are also changing, therefore if the tools used to implement the Strategic Roadmap for SMEs have had little effect in the past. Still, in dynamic changing conditions, this effect may be more substantial in the future. Analysing the current achievements, the implementation of the Strategic Roadmap until 2020, the study concludes that it is limited with the establishment of different state bodies, associations and centres. Calling back to the argument of the interviewed EU representative, "it is important to have a clear vision, not so ambiguous, but realistic". Therefore, there is an essential need for R&D programs to study the implementation process frequently and adjust the requirements to the changing conditions. Doing so, the targeted results by 2025 and beyond can strengthen the economic diversification strategy of the country, which is indeed expected result, as mentioned by interviewee Mr. Bayramov. It is crucial to invest in human capital by increasing their education and skills and strengthen SMEs' access to finance, regardless of its classification to achieve tangible results. By strengthening these two factors, it is possible to eliminate other identified concerns, such as internalization and innovation. However, the business environment in term of tax inspections, and illegal demands by law enforcement agencies should be forgotten while implementing different strategies to promote private sector in Azerbaijan.

While carrying out domestic reforms, Azerbaijan uses international experience to make these reforms more sustainable. Given that the business environment is increasingly discussed and



researched by international organizations, the cooperation with international organizations can yield positive results. As mentioned by Mr Vugar Bayramov, the most suitable model for Azerbaijan is the EU model; therefore, Azerbaijan's corporation with the EU within the Eastern Partnership Program can continue to bring positive achievements. As a result of the brief overview of the case of Georgia (the country carries leadership within EaP countries in the WB Doing Business rankings), the study recommends few lessons learned “best practise” from Georgia example to Azerbaijan. It is recommended to deal with corruption issues in a range of ways to reduce problems on tax inspections, and illegal demands by law enforcement agencies. Moreover, it is suggested to continue stimulating the work of BSOs or other associations that are closer to the business owners and more familiar real concerns of SMEs, and increase private-public dialogue to track the implementation of the SME Development Strategy for better society, economic growth and employment.

### **5.1. Theoretical contribution of the study**

The study contributes to the ongoing discussions in the academic literature, especially to the theory of “Business Environment”. The findings of the thesis support the arguments of academicians (Autio and Fu, 2015; Aristownik and Obadic, 2015; Chowthury et al. 2018) that government initiatives were intended to promote entrepreneurship. Moreover, as it is known, international organizations (WB, OECD, EU and others) regularly contribute to the existing literature on the business environment, achievements and non-achievements in Azerbaijan by publishing regular country reports. However, a comprehensive approach - diversity of sources used throughout the study without any exclusion makes this research special. The study analysed the speech of the President of the country since 2014, while bridging the information among government bodies, research centres, international organization, SME representatives and interviewed people, which provides full picture about the business environment of Azerbaijan for future studies. Despite the inductive and expressive nature of the study, it develops a model, which might be useful for future statistical studies. The researcher agrees with the argument by Sambharya and Musteen (2014), the relationship between the institutional environment and entrepreneurial activity is much more complex and needs more studies.

### **5.2. Practical contribution of the study**

The research will be more practically useful for business students, business owners, start-ups and ex-pats who prepare a mission to Azerbaijan to deliver capacity-building activities in the relevant fields. While conducting a survey, the researcher has already received inquiries for a copy of the research from SME representatives. Many of them mentioned that this is the first time that they were asked to share their opinions and to look forward to seeing the results. As per the ex-pats, the information in this industry is mostly is in Azerbaijani and having different information in a single paper and being in English will contribute to their preparation for a trip.

## **6. EXECUTIVE SUMMARY**

For many years now, many publications have been discussing that the large enterprises contribute to the economic growth more than small firms because of availability of mass production, access to finance and more specialized workforce. In parallel, many other publications have been debating the contribution of small firms to the economic development and wellbeing of nations. After the global oil crisis in the 1970s, the contribution of small businesses to economic development started to be widely discussed in the academic literature. Subsequently, the role of small companies enlarged with the introduction of changing technology to the societies. In the following years, it is proved that Small to Medium-sized Enterprises (SMEs) are important actors for the health and wellbeing of the economy. They are the main source of job creation and drivers of productivity growth.

The OECD has been working for many years on important documents to increase the productivity of SMEs, reduce inequality among societies. Although SMEs play a vital role in the employment and economic growth of the countries, several factors make challenges for their development, such as regularity, access to finance, availability of skilled employees, internalisation and innovation. Consequently, the European Union strongly considered the needs of SME growth with different strategic papers, followed by annual performance review reports to promote a business-friendly environment for SMEs operating in Europe. Doing so, SMEs are 99% of all businesses in the EU, and they have created around 85% of new jobs in the past five years.

Despite the crucial role of SMEs in the global economy, Azerbaijan lags in the field of SME development. Azerbaijan's economy mainly depends on the oil price and trends in global oil markets. Following the economic shock in 2015-2016, Azerbaijan developed the SME Roadmap. Accordingly, a State Agency was created to support the SME sector to reduce dependence on oil revenues. Over the past three years, several reports have been prepared to report on large-scale economic reforms carried out in Azerbaijan. Latest reports indicate that Azerbaijan's position has hiked up to 25 among 190 countries in the “Doing Business – 2019” report for the ease of doing business, which is prepared by the World Bank Group. According to the report, Azerbaijan is competing with countries such as Germany and Canada, while it has progressed further compared to France and Italy. However, another report claims that despite extensive legal reforms and new incentive mechanisms, the growth in the real economy remains weak. In other words, there have been delays in the implementation of reforms

and roadmap development strategies. Likewise, according to the assessment of the EU4Business regardless of the restoration of the economy in 2017, progress in the development of the private sector and the support to the job creation remain limited in Azerbaijan.

Taking into consideration limited research in the existing academic literature, as well as the key areas of interests and career goals of the researcher, this study intends to find the answer of the following research question: “What are the main challenges affecting the performance of SMEs and to what extent the SME Roadmap is being implemented in Azerbaijan?”

The research design of the study is cross-sectional using a mixed approach: both qualitative and quantitative research methods. The primary data was collected through structured interviews and quantitative survey questionnaires among small-scale survey sample. The study used secondary data from the publications of various institutions through online sources. The study applied the OECD DAC Criteria for Evaluation Development Assistance to evaluate the impact of the short-term objectives of the SME Roadmap, which is the case study of the research.

The researcher concluded in the literature review that there are five factors, such as regularity, access to finance, availability of skilled employees, internalization and innovation as the current influencing factors for the performance of SMEs in Azerbaijan. Nevertheless, the results of the survey and interviews presents that challenges on regulation, such as registration and licensing, have been relatively eliminated in Azerbaijan with the help of the “one-stop-shop - ASAN services”, except tax inspections and illegal demands by law enforcement agencies. Furthermore, the development of internalization and innovation at this stage highly depends on access to finance and availability of skilled employees. Thus, the researcher answered the main question of the research as follows: there are four main challenges affecting the performance of SMEs, which are limited access to finance and lack of skilled employees, tax inspections and illegal demands by law enforcement bodies.

In terms of the short-term objectives of the SME Roadmap achievements, it can be concluded that Azerbaijan has been making many institutional reforms to build a strategy of economic diversification in recent years. In a country where progressive reforms are taking place, the realities are also changing, therefore if the tools used to implement the Strategic Roadmap have had little effect in the past. Still, in dynamic changing conditions, this effect may be more substantial in the future. However, analysing the achievements of the Strategic Roadmap until 2020, the study concludes that the implementation is limited with the establishment of different state bodies, associations and centres.

Recalling the argument of the interviewed EU representative “it is important to have a clear vision, not so ambiguous, but realistic” (*EU representative’s replies depend on assessment of the overall situation, it could not be considered as EU Delegation or EC official position*)\*.

Azerbaijan's corporation with EU within the Eastern Partnership Program brings positive achievements. As a result of the brief overview of the case of Georgia (the country carries leadership within EaP countries in the WB Doing Business rankings), the study recommends few lessons learned “best practise” for Azerbaijan. It is recommended to deal with corruption issues to reduce problems on tax inspections, and illegal demands by law enforcement agencies, stimulate the work of BSOs that are closer to the business owners, and increase private-public dialogue to track the implementation of the SME Development Strategy for better society, economic growth and employment.

The study contributes to the ongoing discussions in the academic literature, especially to the theory of “Business Environment”. The findings of the thesis support the arguments of academicians (Autio and Fu, 2015; Aristownik and Obadic, 2015; Chowthury et al. 2018) that government initiatives are intended to promote entrepreneurship.

The research will be more practically useful for business students, business owners, start-ups and ex-pats who prepare a mission to Azerbaijan to deliver capacity-building activities in the relevant fields.

The work done in this study does not contain statistical testing of the hypothesis. However, it refers to a real case study with evaluation, which prepares the researcher to the working environment, and, in parallel, develops a model from the research findings that could be statistically tested in the future.

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### **Interviews:**

Interview with Mr Vugar Bayramov, Member of Parliament of the Republic of Azerbaijan dated on 10 May 2020

Interview with Ms Ulviya Abdullayeva, Programme Manager, Delegation of the European Union to the Republic of Azerbaijan dated on 19 May 2020

## APPENDIX A

### (1) INT01 - Interview Protocol

#### Transcription of the interview with Mr Vugar Bayramov, Member of Parliament of the Republic of Azerbaijan

Date: 10 May 2020

Language: Azerbaijani

#### *1. Azərbaycanın hazırkı iqtisadi diversifikasiya strategiyasını necə təhlil edirsiniz?*

Azərbaycan üçün 3 makro iqtisadi göstəricidə diversifikasiyanın gücləndirməsi prioriteti, məhz həmin iqtisadi göstəricilər üzrə neftdən asılılığın mərhələli şəkildə aradan qaldırılması strateji hədəfdir. Söhbət ümumi daxili məhsul, büdcə gəlirləri və ümumi ixracatdan gedir. Ümumi daxili məhsulda qeyri-neft sektorunun payı neft sektorunun payı ilə nisbətdə daha çoxdur. Belə ki, ümumi daxili məhsulun təxminən 3-də 2-si qeyri-neft sektorunun 3-də 1-i neft sektorunun payına düşür. Və nəticə etibarlı ilə bu əslində ümumi daxili məhsulun strukturunun şaxələndiyindən xəbər verir, diversifikasiya olduğundan xəbər verir. Eyni zamanda digər makro iqtisadi göstərici büdcə yəni fizikal gəlirləridir. Fizikal gəlirlərə gəldikdə isə son xüsusən 2015-ci ildən sonra qeyri neft sektorunun payının artması müşahidə olunur. Artıq 2020-ci ilin dövlət büdcəsində fizikal gəlirlərimizin 46%-i qeyri-neft sektorunun payına düşəcək. Yenə də neft sektorunun payı çoxdur. Amma yenə də neft sektorunun daxil olmalarının 84%-i dövlət neft fondunun payına düşür. Praktiki olaraq biz fizikal gəlirlərdə mərhələli şəkildə diversifikasiya müşahidə edirik. Amma təbii ki, strateji olaraq 2025-ci ilədək fizikal gəlirlərimizi neftdən asılılığın daha hiss edilən səviyyədə azaldılması nəzərdə tutulur. Nəzərə alsaq ki, qlobal neft şokundan əvvəl Azərbaycanın büdcə gəlirlərində neft sektorunun payı 80%-dən artıq idi və cəmi 20% qeyri-neft sektorunun payına düşürdü. Amma artıq bu rəqəm 2 dəfə bənd qeyri-neft sektorunun payı 2 dəfə bənd artıq və praktik olaraq 46% qeyri-neft sektorunun payına düşür və növbəti mərhələdə illərdə də bu strategiya davam edəcək. İxracatda qeyri-neft sektorunun payının artması müşahidə olunur. Amma təbii ki, yenə də neft sektoru əsas ixrac məhsulumuzdur, neft məhsulları əsas ixrac məhsullarımızdır. Dövlət Statistika Komitəsinin məlumatına görə ixracımızın 81%-i xam neft məhsullarıdır. Və bu, amma qeyri-neft ixracatımız üçün ümumi payında artımlar var. Qlobal neft şokundan sonra Azərbaycanın 2019-cu ildə 2014-ci illə müqayisə etsək Azərbaycanda qlobal Azərbaycan ixracatında qeyri-neft məhsullarının payı 2 dəfədən çox artıb. Bu da ondan xəbər

verir ki, qeyri-neft məhsullarımızda da ümumi ixracatda qeyri-neft məhsullarımızın payı artır. Amma ümumiyyətlə hər üç bənddə xüsusilə də ixracatda diverifikasiya təbii ki, yenə də strateji yol xəritəsinə uyğun olaraq. 2-ci 2020-2025-ci illərdə daha sürətli şəkildə şaxələnməsi nəzərdə tutulub. Və güman olunur ki, 2025-ci il hədəflərində də biz ixracatda qeyri-neft sektorunun payının artmasını müşahidə edə biləcəyik.

## ***2. Azərbaycanda Kiçik və Orta Sahibkarlığın (KOS) inkişafı istiqamətində həyata keçirilən islahatların (dövlət dəstəyi tədbirləri) real nəticələri barədə məlumat verə bilərsiniz?***

Kiçik-orta sahibkarların dəstəklənməsi ilə bağlı artıq xüsusən də həm pandemiya əvvəl yəni pre-pandemiya və pandemiya dövründə eləcə də pos-pandemiya dövründə xüsusi tədbirlər həyata keçiriləcək, və bəziləri artıq həyata keçirilib. İqtisadi paket kiçik-orta sahibkarların və eləcə də mikro sahibkarların dəstəklənməsini həyata keçirdi. Belə ki, nəzərə alsaq ki, 300 min fərdi və mikro sahibkar dövlət dəstəyindən faydalana bildi. Onlar minimum 250 manat maksimum 500 manat həcmində dövlət yardımını ala bildilər. Məqsəd də pandemiyanın bu kateqoriya sahibkarlara təsirləri minimumlaşdırmaq idi. Eyni zamanda muzzdlu işçilərin çalışdığı sahibkarlıq subyektlərinin bir qismi də kiçik-orta sahibkarlardır və dövlət həmin sahibkarlar üçün praktik olaraq yardım həyata keçirdir. Bütövlükdə həmin sahibkarlar üçün 215 milyon manatlıq bir yardım paketi təqdim olundu. Fərdi və mikro sahibkarlar üçün bu 80 milyon manat idi. Bütövlükdə 300 milyon manata yaxın yardım paketinin məhz sahibkarlıq subyektlərinin dəyən ziyanın bir başa qarşılınması üçün ayrılması müşahidə olundu. Sahibkarın inkişaf fondu var və güman olunur ki, növbəti dövrdə bu istiqamətdə maliyyələşmə genişlənəcək. Pos-pandemiya dövründə 500 milyon manatlıq əlavə güzəştli kredit paketi təqdim olunacaq və dövlət həmin kreditin 60%-nə zəmanət verəcək. O baxımdan pos-pandemiya dövründə təbii ki, kiçik-orta sahibkarların daha yaxından dəstəklənəcəyi strateji hədəfdir və dəstəklənməsi, vergi güzəştləri artıq parlamentdə təsdiq olundu. Bu da təbii ki, kiçik-orta sahibkarların faydalanmasına xidmət edəcək. O baxımdan biz növbəti dövrdə kiçik-orta sahibkarlara həm ayrılan birbaşa yardım, həm də təşviq tədbirlərinin güclənməsini müşahidə edəcəyik.

## ***3. KOS-lar Azərbaycanın iqtisadi inkişafına hansı töhfəni verir?***

Kiçik-orta sahibkarlar iqtisadi inkişaf baxımından vacibdir. Kiçik-orta sahibkarlar məşğulluğun təmin edilməsi baxımından vacibdir, rəqabətin gücləndirilməsi baxımından vacibdir.

Praktiki olaraq kiçik-orta sahibkarların iqtisadiyyata birbaşa, hətta innovasiyanın tapılması, innovativ məhsulların istehsalı baxımından da təsir imkanları var. Azərbaycan iqtisadiyyatında hələlik kiçik-orta sahibkarın ümumi daxili məhsuldakı payı az olsa da belə, amma biz son illərin tendensiyasının müsbət istiqamətdə dəyişməsinə müşahidə edirik. Kiçik-orta sahibkarlar üçün xüsusən də məşğulluğun və xüsusən də part-time məşğulluğun təmin edilməsində rolunun artması müşahidə olunur. Ümumi daxili məhsulda kiçik-orta sahibkarların Nazirlər Kabinetinin son təsnifatından sonra payında artımlar var. O baxımdan təbii ki, baxmayaq ki, Azərbaycan neft ölkəsidir, amma KOS-ların mərhələli şəkildə Azərbaycan iqtisadiyyatındakı töhfəsinin artması müşahidə olunur.

#### ***4. Azərbaycanda KOS-ların qarşılaşdığı ən çətin məsələlər hansılardır?***

KOS-lar üçün təbii ki, maliyyə resurslarına çıxış imkanları əvvəlki dövrlərdə əsas çətinliklərdən biri olub. Xüsusən də regionlarda fəaliyyət göstərən kiçik-orta sahibkarlar üçün. Çünki onlarda biz bunu ümumiyyətlə kredit portfelinə diqqət yetirsək, Azərbaycanda ümumi kredit portfelini 15.2 milyard manatdır və bu kredit portfelinin cəmi bütövlükdə kredit portfelinin 80%-i Bakının payına düşür. Cəmi 20%-i regionda fəaliyyət göstərən sahibkarlar, eləcə də orada yaşayan vətəndaşlarımız həmin kreditlərdən faydalanırlar. Mexanizmin təkmilləşməsinə ehtiyac var. Çünki kiçik-orta sahibkarlardan kredit alan zaman əmlak olaraq girov tələb olunur, girov olaraq daha doğrusu əmlak tələb olunur və əmlakda paytaxtda olması tələb olunur. Regionda fəaliyyət göstərən kiçik-orta sahibkarların bu girovları təklif etmə imkanları məhduddur. Bu baxımdan maliyyəyə çıxış “Access to finance” kiçik-orta sahibkarlar üçün əsas çətinliklərdən biridir. Bunun üçün təbii ki, girov mexanizminin təkmilləşdirilməsinə və nəzərə alsaq pos-pandemiya dövründə bu istiqamətdə daha çox vəsait ayrılacaq və KOS-ların güzəştli vəsaitlərə çıxış imkanlarının daha da genişləndirilməsinə ehtiyac var.

#### ***5. Sizin fikrinizcə, dövlət qurumları KOS-lara ən çox hansı yardım və dəstəyi göstərməlidir?***

Kiçik-orta sahibkarlıq ilə bağlı xüsusi qurum yaradılıb və fəaliyyət göstərir. Etiraf etmək lazımdır ki, həmin qurum yaradıldıqdan sonra kiçik-orta sahibkarlıq subyektlərinin dəstəyin artması müşahidə olunur. Yəni innososional olaraq həm də İqtisadiyyat nazirliyi təbii ki, son illər xüsusən son 2019 və 2020-ci illərdə kiçik-orta sahibkarlıq ilə bağlı daha çox təşviq tədbirləri həyata keçirir və həm innososional olaraq dövlət tərəfindən dəstək nümayiş etdirilir. Digər istiqamətlərdə də güman olunur

ki, pos-pandemiya dövründə xüsusən öncədə qeyd etdiyimiz kreditlərə çıxış imkanları, yəni maliyyə çıxış imkanları girov sisteminin təkmilləşdirilməsi kimi çətinliklərində aradan qaldırılması istiqamətində işlər aparılır. Eyni zamanda təbii ki, kiçik-orta sahibkarlar assosiasiyaların da aktiv olması vacibdir. Onların o, assosiasiyaların dövlətlə, kiçik-orta sahibkarlar arasında bir körpü rolunu oynamasına ehtiyac var. Assosiasiyalaşma və assosiasiyaların yaradılması eyni zamanda strateji yol xəritəsində də nəzərdə tutulub və artıq o assosiasiyalar yaradılıb. Təbii ki, daha məqsədə uyğun olardı ki, həmin assosiasiyalar aktiv şəkildə kiçik-orta sahibkarların qayğılandırıcı məsələləri dövlət qurumlarına mütəmadi təqdim etsinlər.

**6. Oxşar iqtisadiyyatlardan ən yaxşı təcrübələri misal göstərə bilərsiniz?**

Azərbaycan üçün ən yaxşı model Avropa birliyi modelidir, düşünürəm ki, bizim üçün uyğun olan modeldi. Çünki Avropa birliyində məşğulluğun eləcə də, bütövlükdə iqtisadiyyatın 60%-nin çoxu kiçik-orta sahibkarların payına düşür. Qeyd etmək istərdim ki, kiçik-orta sahibkarlıqla bağlı bizim ayrıca bir hesabatımız var və onun CESD-in saytında, internet səhifəsində ordanda biz bir neçə ölkənin təcrübəsinə diqqət etmişik və təbii ki, ondan da faydalana bilərsiniz.

**7. Azərbaycanda KOS-larının sahibi və işçiləri kimdir? Onları necə təsvir edərdiniz (təhsil səviyyəsi, təcrübəsi və s)**

Bu sualla bağlı bizim araşdırmamız yoxdur. Ona görə o sualı cavabsız buraxmaq məcburiyyətindəyəm. Çünki birbaşa təhsillə bağlı biz, xüsusilə də kiçik-orta sahibkarlıq subyektlərin təhsil səviyyəsi ilə bağlı tədqiqat aparmamışıq.

**Language: Unofficial translation into English (Interview with Mr Bayramov)**

**1. How do you analyse the current economic diversification strategy of Azerbaijan?**

The priority for Azerbaijan is to strengthen diversification in 3 macroeconomic indicators, and the gradual elimination of dependence on oil on these economic indicators is a strategic goal. We are talking about gross domestic product, budget revenues and total exports. The share of the non-oil sector in GDP is higher than the share of the oil sector. Thus, about 2 out of 3 of the gross domestic

product falls on the non-oil sector and 1 in 3 on the oil sector. And as a result, it actually indicates that the structure of the gross domestic product is diversified. At the same time, another macroeconomic indicator is the budget, i.e. physical revenues. As for physical income, the share of the non-oil sector has been increasing, especially since 2015. Already in the state budget for 2020, 46% of our physical revenues will fall to the non-oil sector. Again, the share of the oil sector is large. However, the state oil fund still accounts for 84% of the oil sector's revenues. In practice, we observe a gradual diversification in physical income. But, of course, the strategy is to reduce our physical income to a more noticeable level of dependence on oil by 2025. If we take into account that before the global oil shock, the share of the oil sector in Azerbaijan's budget revenues was more than 80%, and only 20% fell to the non-oil sector. However, this figure has already doubled the share of the non-oil sector, and the share of the non-oil sector is practically 46%, and this strategy will continue in the next years. The share of the non-oil sector in exports is increasing. But, of course, the oil sector is still our main export product, oil products are our main export products. According to the State Statistics Committee, 81% of our exports are crude oil products. And this, but there are increases in the total share of our non-oil exports. After the global oil shock, the share of non-oil products in global Azerbaijani exports in Azerbaijan more than doubled in 2019 compared to 2014. This indicates that the share of non-oil products in total exports of our non-oil products is growing. But in general, diversification in all three items, especially in exports, is, of course, still in line with the strategic roadmap. The second is expected to diversify more rapidly in 2020-2025. And it is expected that in the targets of 2025 we will be able to see an increase in the share of the non-oil sector in exports.

***2. Could you please provide information on the real results of the reforms (state support measures) carried out in the development of Small and Medium-sized Enterprises (SME) in Azerbaijan?***

Special measures will be taken to support small and medium-sized businesses, especially in the pre-pandemic and pandemic periods, as well as in the post-pandemic period, and some have already been implemented. The economic package supported small and medium enterprises, as well as micro-entrepreneurs. Thus, if we take into account that 300,000 individual and micro-entrepreneurs were able to benefit from state support. They were able to receive a minimum of 250 manats and a maximum of 500 manats of state aid. The aim was to minimize the impact of the pandemic on this category of entrepreneurs. At the same time, some of the business entities employed by employees are small and medium-sized enterprises, and the state provides practical assistance to all three of these

entrepreneurs. In total, an aid package worth 215 million manat was presented to these entrepreneurs. For individual and micro entrepreneurs, this was 80 million manat. In general, it was observed that the aid package of about 300 million manat was allocated to cover the damage caused to businesses. Entrepreneur has a development fund, and it is expected that funding in this area will expand in the next period. During the post-pandemic period, an additional preferential loan package of 500 million manat will be provided and the state will guarantee 60% of the loan. From that point of view, in the post-pandemic period, of course, it is a strategic goal to support small and medium-sized businesses more closely, and their support, tax breaks have already been approved by parliament. This, of course, will benefit small and medium-sized businesses. From this point of view, in the next period we will see the strengthening of both direct assistance and incentives for small and medium-sized businesses.

### ***3. What contribution do SMEs make to economic development in Azerbaijan?***

Small and medium entrepreneurs are important for economic development. Small and medium entrepreneurs are important in terms of providing employment, in terms of strengthening competition. In practice, small and medium-sized businesses have the opportunity to directly influence the economy, even in terms of finding innovation and producing innovative products. Although the share of small and medium enterprises in the GDP of Azerbaijan is still small, we see a positive trend in recent years. There is an increase in the role of small and medium-sized enterprises in providing employment, especially part-time employment. There is an increase in the share of small and medium enterprises in GDP after the final classification of the Cabinet of Ministers. From this point of view, of course, Azerbaijan is an oil country, but there is a gradual increase in the contribution of SMEs to the Azerbaijani economy.

### ***4. What are the most challenging issues faced by SMEs in Azerbaijan?***

Naturally, access to financial resources has been one of the main challenges for SMEs in the past. Especially for small and medium entrepreneurs operating in the regions. Because if we pay attention to the loan portfolio in general, the total loan portfolio in Azerbaijan is 15.2 billion manat, and Baku accounts for 80% of the total loan portfolio. Only 20% of entrepreneurs operating in the region, as well as our citizens living there, benefit from these loans. The mechanism needs to be improved. Because when taking a loan from small and medium entrepreneurs, collateral is required

as property, or rather property is required as collateral, and the property is required to be in the capital. Small and medium-sized businesses in the regions have limited opportunities to offer these collaterals. In this regard, access to finance is one of the main challenges for small and medium-sized businesses. For this, of course, more funds will be allocated in this direction in the post-pandemic period, given the need to improve the collateral mechanism, and to further expand the access of SMEs to concessional funds.

***5. In your opinion, what kind of assistance and support should government agencies provide to SMEs' concerns (including best practices, may be example from similar economies?)***

A special body (SME Roadmap) for small and medium enterprises has been established and is functioning. It must be acknowledged that after the establishment of this body, there has been an increase in support for small and medium-sized businesses. In other words, the Ministry of Economy, of course, has been implementing more incentives for small and medium-sized businesses in recent years, especially in 2019 and 2020, and the state has been supporting it in an individual way. In other areas, it is assumed that in the post-pandemic period, work is being done to eliminate the difficulties, such as access to finance, such as improving the collateral system. At the same time, of course, it is important for small and medium-sized business associations to be active. They need these associations to act as a bridge between the state and small and medium-sized businesses. Associations and the creation of associations are also envisaged in the strategic roadmap, and those associations have already been established. Of course, it would be more appropriate for these associations to actively present the concerns of small and medium-sized businesses to government agencies on a regular basis.

***6. Can you give an example of best practices from similar economies?***

The best model for Azerbaijan is the European Union model, I think it was the right model for us. Because 60% of employment in the European Union, as well as the economy as a whole, falls on small and medium entrepreneurs. I would like to note that we have a separate report on small and medium-sized businesses, and on its website, cesd, we have focused on the experience of several countries, and, of course, you can benefit from it.



***7. Who is the owner/entrepreneur and employees of SMEs of Azerbaijan? How would you describe them?***

We have no research on this question. Therefore, I have to leave that question unanswered. Because we have not conducted research on direct education, especially on the level of education of small and medium enterprises.

## APPENDIX B

### (2) INT02 – Interview Protocol

**Transcription of the email exchange with Ms Ulviya Abdullayeva, Programme Manager, Delegation of the European Union to the Republic of Azerbaijan**

“replies depend on assessment of overall situation, it could not be considered as EU Del or EC position”.

**Date: 19 May 2020**

**Language: English**

#### ***1. How do you analyse the current economic diversification strategy of Azerbaijan?***

Current economic diversification analyzed as neither positive nor so extremely negative.

Strategic Road Map's signed by the President on Dec 2016 should be updated according to current after pandemic realities.

#### ***2. Could you please provide information on the real results of the reforms (state support measures) carried out in the development of Small and Medium-sized Enterprises (SME) in Azerbaijan?***

I can advise to read chapter on AZE: <http://www.oecd.org/publications/sme-policy-index-eastern-partner-countries-2020-8b45614b-en.htm>

#### ***3. What are the most challenging issues faced by SMEs in Azerbaijan?***

- ✓ access to finance, cheap credits/loans for SME's banking crisis;
- ✓ low motivation to become entrepreneur among population;
- ✓ low information at secondary schools on entrepreneurship culture, start-ups, possibilities for young generation to use their creativity;

***4. In your opinion, what kind of assistance and support should government agencies provide to SMEs' concerns (including best practices, may be example from similar economies?)***

Establishment of the SME Agency of Azerbaijan 2 years ago, which is very positive as there was no SME Agency in Azerbaijan before. The Government should further continue to support SME Agency (KOBIA) to work more closely with SME's, attract cheap credits, provide trainings to regional SME's, support young generation (creative start-ups) and develop and strengthen the Agency using best international models/practices. It should have clear road map (vision), not so ambitious but realistic.

## APPENDIX C

### Coding Table

Coding before interview	Category Description	Explanatory notes	INT01	INT02
Results of reforms	Implementation of SME Roadmap	<u>Achievements</u>	<p>a. share of the non-oil sector in GDP is higher than the share of the oil sector;</p> <p>b. about 2 out of 3 of the gross domestic product falls on the non-oil sector and 1 in 3 on the oil sector;</p> <p>c. the structure of the gross domestic product is diversified;</p> <p>d. the share of the non-oil sector has been increasing, especially since 2015;</p> <p>e. the oil sector is still our main</p>	a. diversification analyzed as neither positive not so extremely negative;

		<p><u>Milestones</u></p> <p>export product, oil products are our main export products;</p> <p>f. in the next period we will see the strengthening;</p> <p>g. Azerbaijan is an oil country, but there is a gradual increase in the contribution of SMEs to the Azerbaijani economy;</p> <p>h. enterprises in the GDP of Azerbaijan is still small;</p> <p>i. it is important for SME associations to be active;</p> <p><u>Non-achievement</u></p>	<p>b. the SME Roadmap should be updated according to current pandemic realities;</p> <p>c. road map (vision), not so ambitious but realistic.</p>	
Regulation	Main challenges of SMEs		x	x

<p>Access to finance</p>	<p>Main challenges of SMEs</p>		<p>a. Entrepreneur has a development fund, and it is expected that funding in this area will expand in the next period;</p> <p>b. access to financial resources has been one of the main challenges;</p> <p>c. collateral is required as property, and the property is required to be in Baku to get loan;</p> <p>d. SMEs in the regions have limited opportunities to offer these collaterals;</p> <p>e.</p>	<p>a. access to finance, cheap credits/loans for SME's banking crisis</p>
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Availability skilled employees	Main challenges of SMEs			<p>a. low motivation to become entrepreneur among population;</p> <p>b. low information at secondary schools on entrepreneurship culture, start-ups, possibilities for young generation to use their creativity;</p> <p>c. to provide trainings to regional SME's;</p> <p>d. support young generation (creative start-ups);</p>
Internalization	Main challenges of SMEs		x	x
Innovation	Main challenges of SMEs		x	x
Other country models	Best practices		a. the best model for Azerbaijan is the European Union model	

## APPENDIX D

### Survey Protocol

(Data gathering from 1 to 12 May 2020)

Welcome to the Survey!

Your answers to this voluntary survey will be treated in strict confidence, used for statistical purposes and published in aggregate form only.

1. What is your gender?

- ✓ Male
- ✓ Female

2. Which age group describe you?

- ✓ 15-24 years old
- ✓ 25-34 years old
- ✓ 35-44 years old
- ✓ 45-54 years old
- ✓ Over 55 years old

3. What is the highest degree or level of school you have completed?

- ✓ High school degree or equivalent
- ✓ Vocational school degree
- ✓ Bachelor's degree
- ✓ Master's degree
- ✓ Doctorate
- ✓ Other

4. How many people does your enterprise currently employ either full or part-time at all its locations in Azerbaijan? Please do not include unpaid workers.

- ✓ Up to 25
- ✓ 25-125



5. What is the main activity of your enterprise?

- ✓ Agriculture, forestry and fishing
- ✓ Industry
- ✓ Construction
- ✓ Trade; repair of transport means
- ✓ Transportation and storage
- ✓ Accommodation and food service activities
- ✓ Information and communication
- ✓ Real estate activities
- ✓ Education
- ✓ Human health and social work
- ✓ Others

6. How important have the following problems been for your enterprise? Please answer on a scale of 1-10, where 1 means it is not at all important and 10 means it is extremely important.

- ✓ Regulation (business licensing, taxation)
- ✓ Access to finance
- ✓ Availability of skilled employees or experienced managers
- ✓ Internalisation
- ✓ Others

7. What regulation do you consider an obstacle to the success of your business?

- ✓ Registration process (costs, time limit, etc.)
- ✓ Licenses and permits
- ✓ Tax audit
- ✓ Illegal requirements of law enforcement agencies
- ✓ These problems are no longer relevant

8. How do you assess the work of the ASAN service in overcoming mentioned regulation burdens? Please answer on a scale of 1-10, where 1 means "restriction not removed" and 10 means "restriction completely removed".
- ✓ Registration process (costs, time limit)
  - ✓ Licenses and permits
  - ✓ Tax audit
  - ✓ Illegal requirements of law enforcement agencies
9. Are the following sources of financing relevant to your enterprise, that is, have you used them in the past or considered using them in the future?
- ✓ Credit line or bank loan
  - ✓ Soft loan provided at the funds of the state budget
  - ✓ Leasing based on assets
  - ✓ Trade credit (that means paying your suppliers at the later agreed date)
  - ✓ Friends/Family members
  - ✓ Other:
10. If you applied and tried to negotiate for this type of financing, what was the outcome?
- ✓ Received everything
  - ✓ Received 75% and above
  - ✓ Received below 75%
  - ✓ Refused because the cost was too high
  - ✓ Was rejected
  - ✓ Application is still pending
  - ✓ Other
11. What is the size of the last credit line or bank loan that your enterprise obtained?
- ✓ Up to 10.000 AZN
  - ✓ 10.000-50.000 AZN
  - ✓ More than 50.000 AZN
12. What interest rate was charged for the loan for which you applied recently?

13. For what purpose was financing used by your enterprise?

- ✓ Investments in property, plant or equipment
- ✓ Hiring and training of employees
- ✓ Developing and launching of new products or services
- ✓ Refinancing or paying off obligations
- ✓ Other

14. For each of the above mentioned types of financing, would you say that their availability has improved, unchanged or deteriorated over the past 5 years?

- ✓ Credit line or bank loan
- ✓ Soft loan provided at the funds of the state budget
- ✓ Leasing based on assets
- ✓ Trade credit (that means paying your suppliers at the later agreed date)
- ✓ Friends/Family members
- ✓ Other:

15. What do you see as the most important limiting factor to get this financing?

- ✓ There are no obstacles
- ✓ Insufficient collateral or guarantee
- ✓ Interest rates or price too high
- ✓ Too much paperwork is involved
- ✓ Financing not available at all
- ✓ Other

16. In the last year has your company hired any first time job seekers?

- ✓ Yes
- ✓ No

17. How well were they prepared for work?

- ✓ Very well prepared
- ✓ Well prepared

- ✓ Prepared
- ✓ Poorly prepared
- ✓ Very poorly prepared

18. Could you please tell us in which occupations do you frequently have the most vacancies?

- ✓ Managers
- ✓ Professionals
- ✓ Support workers
- ✓ Service and sale workers
- ✓ Skilled workers
- ✓ Others

19. Are hard-to-fill vacancies causing this enterprise to...

- ✓ Lose business or orders to competitors
- ✓ Delay developing new products or services
- ✓ Increase workload for other staff
- ✓ Outsource work to other companies
- ✓ Withdraw from offering certain products or services altogether
- ✓ Have difficulties meeting customer services objectives
- ✓ None

20. Have your employees participated in any external or internal training courses recently?

- ✓ Yes
- ✓ No

21. What is the reason not organising frequent external or internal training courses?

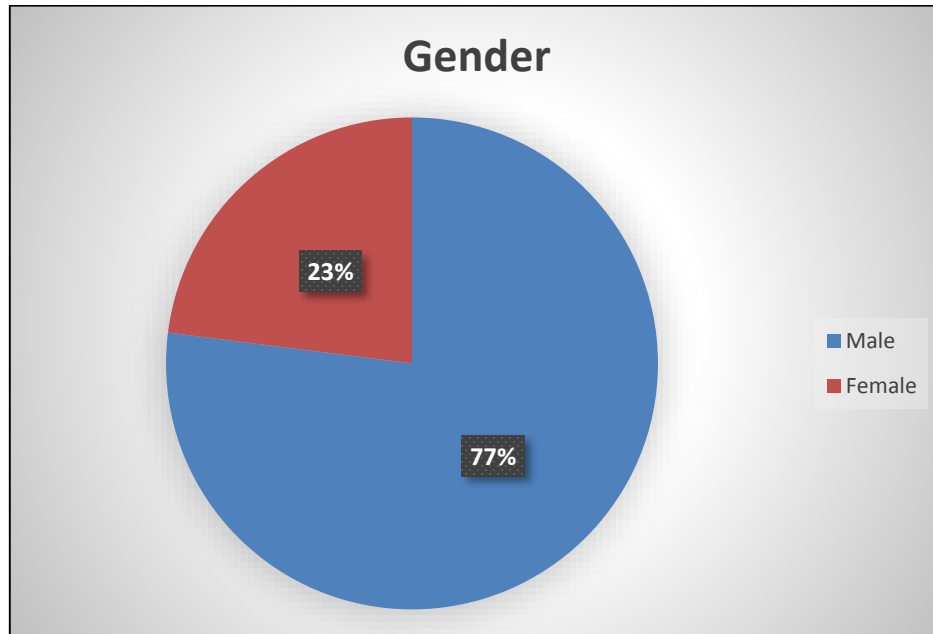
- ✓ Employees meet with current needs
- ✓ Employees hired with required skills
- ✓ Time constrain
- ✓ Cost constrain
- ✓ Other

**APPENDIX E.**

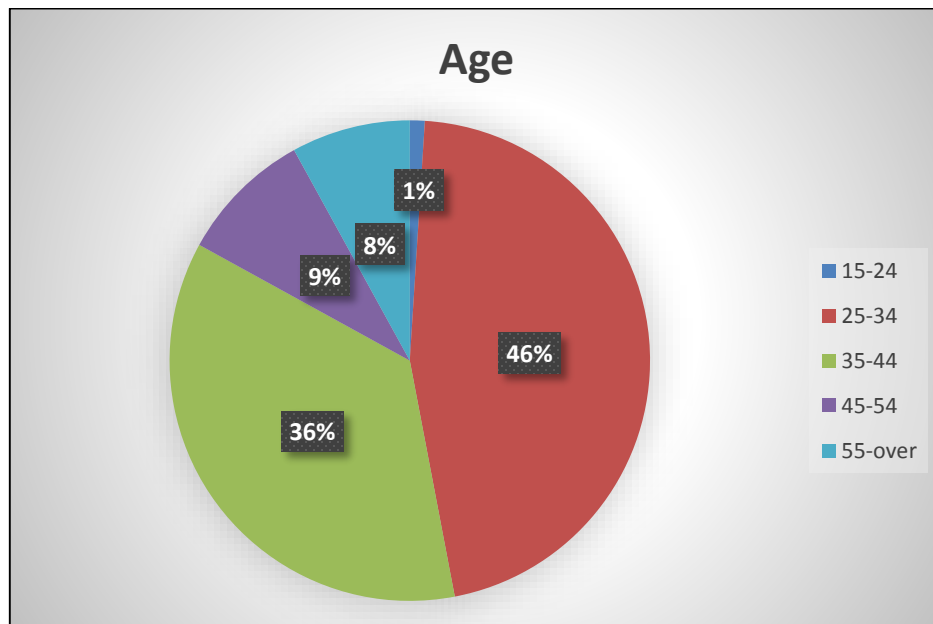
**List of figures from the Survey**

**Participants of the Survey**

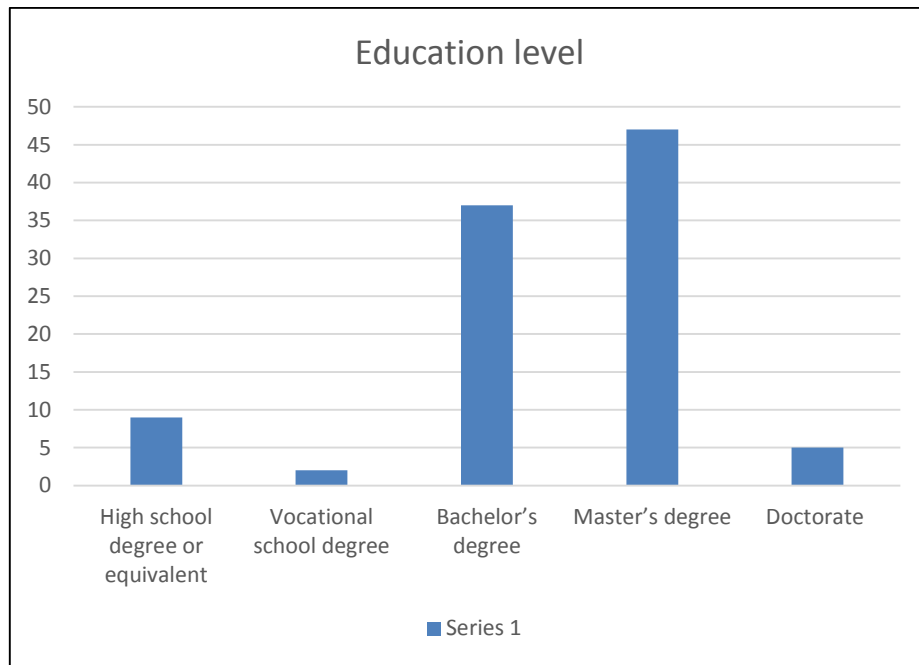
**Figure a: Gender**



**Figure b: Age**



**Figure c:** Education level



**Figure d:** Type of Enterprise

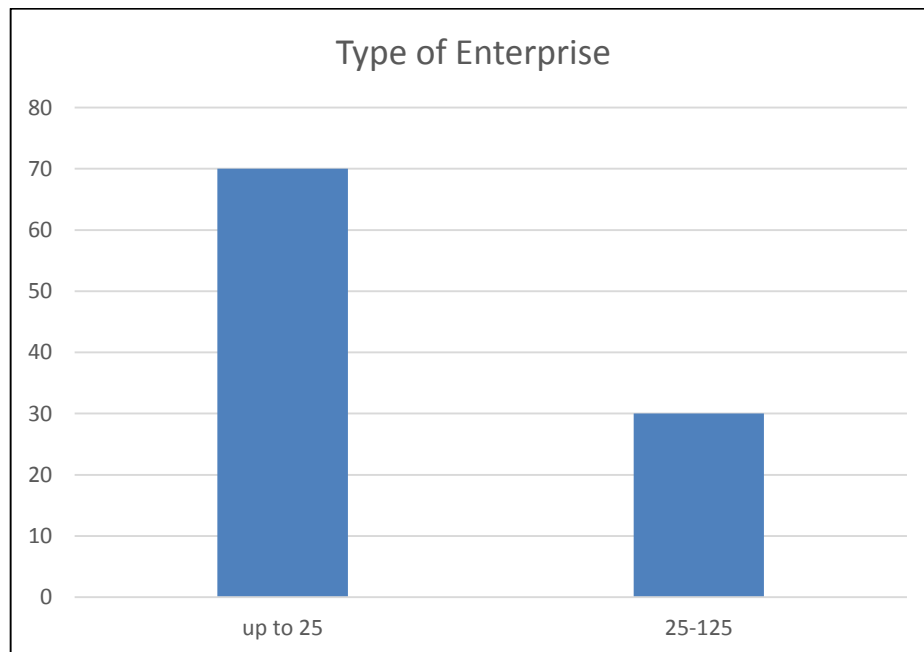


Figure e: Type of Activity

