

STRONGER ECONOMY

#eu4business



EU4Business

Investing in SMEs in the Eastern Partnership

Azerbaijan

COUNTRY REPORT
JUNE 2019



10 YEARS 
EaP | Eastern
Partnership

1. Recent economic developments in the country

Azerbaijan's economy started reviving in 2018 after decline and near stagnation in the previous two years. GDP expanded by 1.4 per cent in 2018, supported by an increase in the oil price and rises in gas production and exports. The non-oil sector recorded 1.9 per cent growth. Output in transport, real estate, non-oil industry, trade, agriculture, and information and communication services all increased.

The loan portfolio contraction levelled off in February 2018 and grew by 12.2 per cent in nominal terms in the following year. Loan and deposit dollarisation has been declining, but remains high at 37.1 per cent and 65.0 per cent respectively, as of February 2019. External and fiscal balances recovered on the back of rising oil prices. The current account surplus widened from 4.1 per cent of GDP in 2017 to 12.9 per cent in 2018, as receipts from the oil and gas sectors increased by 37.3 per cent. The consolidated budget moved from a deficit of 1.5 per cent of GDP in 2017 to a 5.9 per cent surplus in 2018.

On the back of a stable exchange rate, supported by growing oil prices and tight management of the manat against the US dollar, inflation declined from an average of 12.9 per cent in 2017 to 2.3 per cent in 2018, allowing for further monetary policy relaxation.

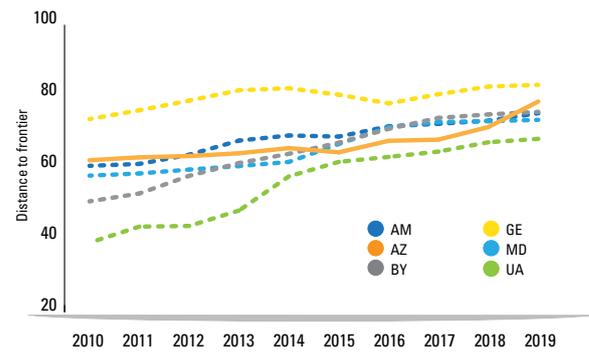
According to preliminary estimates, GDP grew by 3 per cent year-on-year in the first two months of 2019. The outlook in the near term is shaped by the expected increase in the output of the combined oil and gas sectors. The economy is forecast to grow by 3.5 per cent in 2019 and 3.3 per cent in 2020.

(<https://www.ebrd.com/where-we-are/azerbaijan/overview.html>)

2. Business environment: Azerbaijan and the EaP

The six Eastern Partner countries have been making steady progress in improving the business climate for SMEs. This overview of the Doing Business indicator of the World Bank shows how Azerbaijan has improved over the years, gradually closing the gap with the best performing countries of the world ('distance to frontier'). Azerbaijan has been a steady performer through the years, starting off at more than 60% with a more recent spike that brought it to the current almost 80%.

Doing Business - Distance to frontier, EaP

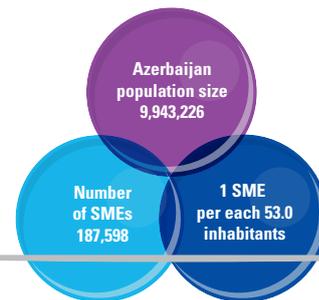


Source: Doing Business, World Bank, www.doingbusiness.org¹

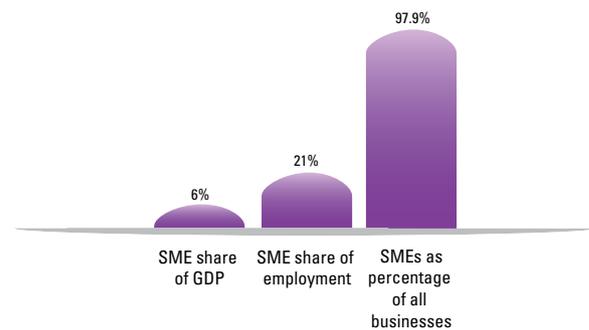
3. National SME performance

a. Share of SMEs in the economy

Azerbaijan has an average number of SMEs per capita in relation to the other Eastern Partner countries, but certainly the lowest share of employment generated by the SME sector. Likewise, their share in GDP represents just a small fraction of national economic output, otherwise dominated by the oil sector.



State of affairs of SMEs in 2017



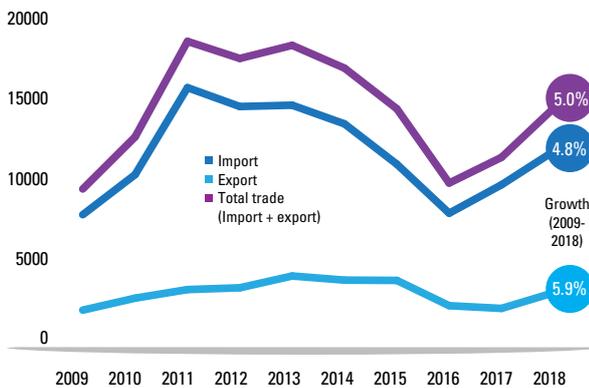
Source: OECD Eurasia Competitiveness Programme and Official Yearbook of the National Statistics Institute, 2018

¹ An economy's ease of doing business score is reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance. For example, an ease of doing business score of 75 in Doing Business 2018 means an economy was 25 percentage points away from the best regulatory performance constructed across all economies and across time.

b. Trade with the EU

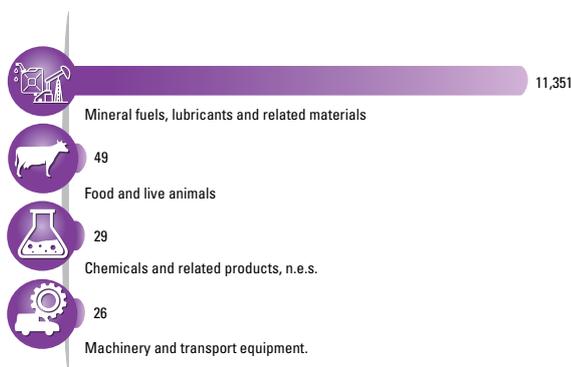
There has been a faster growth in imports from the EU than exports to it, although trade in both directions has been on the rise. Azerbaijan currently imports EUR 2.7 billion and exports 11.5 billion worth of goods and services from and to the EU respectively, making it the only EaP country to have a trade surplus with the EU.

Trade figures (EUR million)

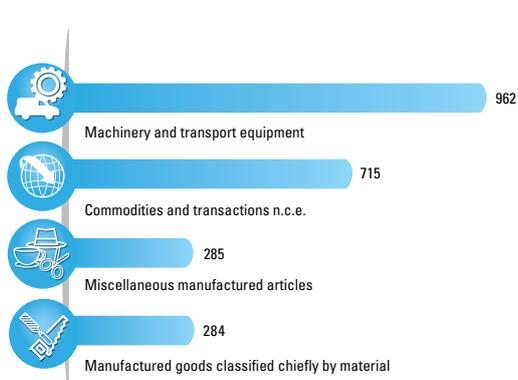


Below are the top products exported from Azerbaijan to the EU and those imported the other way.

Top exported products in 2018 (EUR million)



Top imported products in 2018 (EUR million)



All trade data from DG trade

(https://webgate.ec.europa.eu/isdb_results/factsheets/country/).

4. SME legislation and institutional framework

In 2016, the Government of Azerbaijan adopted its Strategic Roadmap on Production of Consumer Goods at the Level of Small and Medium Enterprises (SME Roadmap) to promote SME development and the diversification of the economy.

Key SME legislation in the country

- Presidential Decree (No. 1771) on improvement of governance in small and medium sized enterprises, adopted in December 2017
- Presidential Decree on ensuring the activities of the Agency for Development of Small and Medium Enterprise of the Republic of Azerbaijan, adopted in June 2018

Name and date of establishment of the SME agency

The Agency for Development of Small and Medium Enterprises (under the Ministry of Economy), 27 June 2018

Achievements in improving the SME climate

- With regards to the **institutional framework**, the establishment of the SME Agency in December 2017 under the responsibility of the Ministry of Economy represents a major milestone in shaping the SME support infrastructure in Azerbaijan.
- Azerbaijan implemented a number of reforms to improve **access to finance for SMEs**. In particular, the Mortgage and Credit Guarantee Fund was established in 2017 back-to-back with the first private credit bureau in Azerbaijan, which is accessible to leasing companies, pulling together credit information from various sources. To encourage the uptake of leasing services, the Financial Markets Supervisory Authority (FIMSA), in co-operation with the Ministry of Economy and the Association of Leasing Companies of Azerbaijan, is currently drafting a new law on leasing services that will replace the current regulation.
- To support export diversification, Azerbaijan established the online trading portal www.azexport.az, an e-commerce platform to connect Azerbaijani producers with buyers under the brand "Made in Azerbaijan". In addition, the Ministry of Economy has established 15 export associations with the objective of increasing production and export in a number of sectors, such as agriculture, textile and tourism.

EU4Business: From Policies to Action progress (OECD)

The OECD supports the government in the implementation of the SME Roadmap, working primarily with the Ministry of Economy and the Centre for Analysis of Economic Reforms and Communication:

- At the **country level**, throughout 2018, the OECD helped build capacity of Azerbaijan's institutions to implement and monitor the SME Roadmap by:
 - strengthening public-private dialogue through regular Working Group meetings involving international experts, Azerbaijani stakeholders and the OECD;
 - developing recommendations for a better implementation of the SME Roadmap and design of SME support measures; and
 - providing support in establishing a results-based monitoring system for the SME Roadmap.

The OECD summarised the project findings in two policy papers on **Driving Diversification through Strengthened Entrepreneurship in Azerbaijan** and **Linking Domestic Suppliers with Foreign Investors in Azerbaijan**. The reports provided a basis for discussion during the peer review of Azerbaijan at the OECD Eurasia Competitiveness Roundtable, which took place in Paris at the end of 2018.

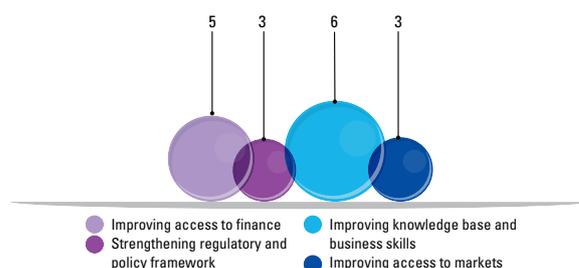
- At the **regional level**, Azerbaijan participates in the third round of the SBA Assessment, which will result in a regional benchmark to be published by March 2020. The new exercise is more ambitious than the previous editions, and relies on a new methodology that goes beyond the scope of SME policy to capture overall business environment conditions, including core elements in the areas of competition, business integrity and contract enforcement. An important milestone in this process took place in Baku on 16 May 2019, consisting of a public-private reconciliation meeting to discuss preliminary findings and progress in SME policy since the 2016 assessment. For this activity, the OECD is working closely with the Ministry of Economy of Azerbaijan to support the government in strengthening its public-private dialogue activities.

5. EU4Business portfolio for the country

The total number of projects in Azerbaijan is 17, of which the largest group focuses on improving knowledge base and business skills. Of these 17, six have been closed and the others are ongoing, for a total value of almost EUR 16.4 million.

a. Impact to date

Projects by priority area - Azerbaijan



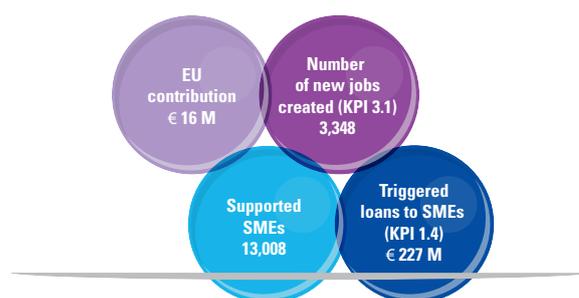
Azerbaijan country portfolio



b. Implementation progress - 10 years of EU4Business in the country

The funds invested by the European Union have triggered additional loans and financial assistance in the country, effectively increasing the assistance a staggering 13-fold. This benefitted 13,008 SMEs and created an estimated 3,348 jobs, beyond the jobs that were sustained. The number of projects in the country, and with it the EU's assistance, has been on the steady rise over the 10 years of EU4Business's operation.

Implementation progress



Number of projects in Azerbaijan



Source: EU4Business Secretariat project database

6. Stakeholder assessment

a. Findings from the SMEs - Focus group assessment, Baku, 06 May 2019

i. Key issues

Participants in the meeting have had very patchy access to information about EU4Business programmes – their visibility remains very low, even more so outside the capital Baku. Most firms encounter EU4Business in their quest for financial or technical assistance. The largest number of SMEs learned of the programme through the engagement of the ITC in Azerbaijan. The ongoing inability to access financial programmes makes SMEs very vulnerable and their existence fragile. The perception is that only large businesses can access funds, while smaller firms, and particularly those who do not have the backing of the authorities, stand little chance of market survival. SMEs recognise the shortage of

entrepreneurial and management skills, and are looking for assistance that combines financial products with access to such knowledge and training.

There is a growing acknowledgment that certification and standards are important for successful business development, particularly when aspiring to exports. While AzPromo (Azerbaijan Export & Investment Promotion Foundation) supports certain training schemes, these are seen as generalist and aimed at a larger number of businesses in the form of collective education. Nonetheless, education opens up the eyes of business owners and they increasingly start realising other shortcomings, such as adequate labour skills, business support services, expansion to new markets/export etc. Participants acknowledge that the more ‘business literate’ they are, the better they can plan their borrowing and the financial products they want to access. SMEs are still troubled by widespread favouritism whereby selected companies enjoy advantageous treatment, and the others must often cope with such hurdles.



ii. SMEs' own needs assessment/priorities

SMEs would greatly appreciate some resolution to the suspension of financial programmes, so that lending to SMEs can resume in Azerbaijan after a long pause. They would see options combining loans with technical assistance as optimal, given significant deficiencies in skills and understanding of markets, especially abroad. This suspension of financial operations has created a lengthy vacuum in the SME sector, which needs monitoring, support, adequate responses and tailored assistance. Support to national programmes for strengthening the entrepreneurial climate, such as the establishment of the SME Agency, are encouraged by the SMEs.

SMEs say the state can be more supportive by relieving businesses of excessive bureaucracy and administrative requirements that, despite the reforms, still remain a significant burden on the private sector. The SME Agency should take an independent role in fostering the creation of such a climate.

b. Views of the implementers - Azerbaijan EU4Business Roundtable, Baku, 08 May 2019

i. Key issues

The EU4Business Initiative in Azerbaijan is seen by implementers as having picked up the pace of its activities. For a long time only a couple of technical assistance projects were active and working closely with SMEs. The EBRD is particularly planning to revive lending to SMEs through intermediary banks (loans of up to AZN 3 million). Access to finance for SMEs nonetheless remains very fragmented and awareness on existing programmes is very low.

The recently formed SME Development Agency of the Republic of Azerbaijan (SMBDA), reported on current activities and programmes (e.g. national classification of SMEs, clusterization and tax incentives, work in the regions of Azerbaijan, SME house and SME boutiques, online seminars conducted in cooperation with local universities, SME friends, online consultancy programmes and plans to assist more than 2,000 SMEs per year), and the ways of cooperation with donor agencies.

Most implementers have already been in touch with the Agency and have made plans to collaborate further on specific projects.

Participants discussed the low level of SME awareness of programmes and initiatives supporting SME development, but worryingly also the lack of entrepreneurial culture and education, as well as financial literacy.

This is matched on the supply side by the irrelevance of many trainings provided to SMEs by various institutions and initiatives, and the absence of an elaborate SME development strategy. Demand is highest for training and expert advice on certification and standards needed to operate abroad, particularly to export.

ii. Suggestions of the Roundtable going forward

Given that many assistance projects in Azerbaijan do not sufficiently push SMEs to problem-solve beyond their comfort zone, there is a need to map what and why this is needed for SMEs in order to increase the efficiency of programmes. Such projects should gradually build up the whole value chain covering selected areas of high potential in the country.

If these efforts were channelled or at least communicated through a single platform for SME services in Azerbaijan, SMEs would have much easier access to experts experienced in those business sectors with potential for growth. This would make trainings a lot more focused and tailored to actual business needs. The Roundtable also welcomed plans by the EU Delegation to start a twinning project on business statistics in order to create centralised, up-to-date and reliable database of SME sector activities in Azerbaijan.

c. Summary of recommendations for next planning cycle

Both SMEs and implementers agree that support is needed in the following areas:

- As the stragglers in EU4Business programmes, Azerbaijani SMEs would benefit most from combined financial and technical assistance.
- The relatively new SME Agency can support the enhancement of the business climate and support further reforms.
- Mapping of the actual needs of SMEs and support programmes to assess the capacity building gaps.
- Creation of a single platform for SME services in Azerbaijan, providing detailed information of what technical assistance is available, where and under what conditions.
- Improve business statistics through a new centralised, up-to-date and reliable database of the SME sector.



Azerbaijan:
Advice leads to success



“

Thanks to the expert consultation, we've successfully managed the stock and returned our debt on time. We learned how to organise the right sales tactics oriented at different customer categories and how to set up effective teamwork.”

Aydin Aliyev
Co-owner of Sermar LLC

Advice for Small Businesses

Support from an EBRD consultant helped Sermar LLC, a seller of ceramic tiles and accessories, to overcome the 2016 crisis, developing a crisis management plan and providing training for management and staff. Aydin Aliyev says that thanks to the advice of European experts and the economic reforms being implemented in Azerbaijan his business has started to recover, and now they cooperate with major developers.



Azerbaijan:
The sweet taste of success



“

Thanks to the project support, we have standards that guarantee that all the products in our shops are fresh and stored in a safe way. When the consultant was invited, we had 14 shops, and now we have 54.”

Rahman Abdurahmanov
General Director of AZZA Cake House

Advice for Small Businesses

AZZA Cake House today boasts the largest network of cake shops in the country. Ten years ago, the idea was born from the delicious cakes served at a café in Baku: since then, EU4Business support has helped the business achieve ISO 22000 certification, while EBRD consultancies from top international experts have helped transform production and sales.



© European Union



THIS PROJECT IS FUNDED BY THE EUROPEAN UNION

This publication has been produced with the financial support of the European Union. The contents of this publication are the sole responsibility of the Consortium led by EY and can in no way be taken to reflect the views of the European Union.