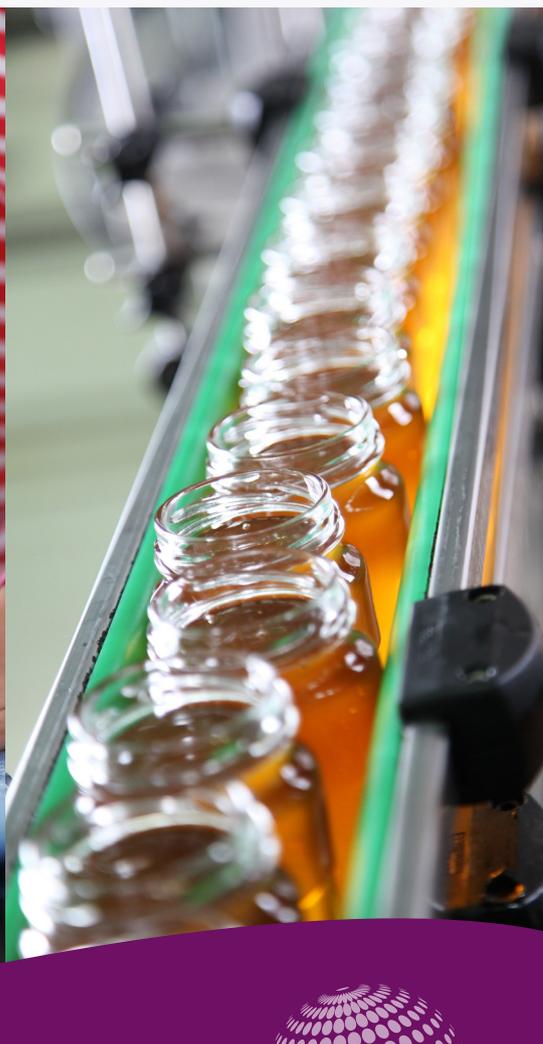




Azerbaijan

Driving Diversification through Strengthened Entrepreneurship



Policy Insights

Azerbaijan: Driving Diversification through Strengthened Entrepreneurship



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Please cite this publication as:

OECD (2019), *Azerbaijan: Driving Diversification through Strengthened Entrepreneurship*, OECD Publishing, Paris.

www.oecd.org/eurasia/competitiveness-programme/eastern-partners/Azerbaijan-Driving-Diversification-through-Strengthened-Entrepreneurship.pdf

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Foreword

In 2016, the Government of Azerbaijan adopted its *Strategic Road Map on Production of Consumer Goods at the Level of Small and Medium Enterprises in the Republic of Azerbaijan* (SME Roadmap) to promote SME development and stimulate diversification of the economy. The Ministry of Economy has requested the OECD's assistance in supporting the implementation of the SME Roadmap.

This assistance is being provided in the context of the multi-country project *EU4Business: From Policies to Action*, implemented by the OECD in the countries of the European Union's Eastern Partnership, with the financial support of the Union under its EU4Business initiative.

The overall objective of the project is to build capacity in Azerbaijan's institutions to implement and monitor the SME Roadmap. In order to meet this objective, the project focuses on the following activities:

- 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 main beneficiaries of this project are the Ministry of Economy, the Centre for Analysis and Communication of Economic Reforms, and the newly established Agency for the Development of Small- and Medium-Sized Enterprises ("SME Agency), as well as other SME stakeholders involved in the implementation and monitoring of Azerbaijan's SME Roadmap.

This note, which summarises project findings, served as a basis for discussion during the peer review of Azerbaijan at the OECD Eurasia Competitiveness Roundtable in Paris in November 2018. It focuses on supporting SMEs through the new SME Agency, increasing SME access to alternative sources of finance, improving private sector engagement in policy making, and establishing a results-based monitoring system for the SME Roadmap.

The work has involved regular meetings of a public-private working group to determine priorities and identify gaps for the implementation of the SME Roadmap. In addition, the OECD has carried out an enterprise survey, a private-sector focus group meeting, and a series of interviews with representatives of the private sector. A detailed description of the methodology can be found in Annex A.

Acknowledgements

This report summarises the work carried out by the OECD Eurasia Competitiveness Programme (ECP) under the authority of the OECD Eastern Europe and South Caucasus Initiative Steering Committee, in consultation with the government of Azerbaijan and with the participation of the private sector and international organisations in Azerbaijan.

Representatives from several Azerbaijani ministries, government agencies, private sector organisations, and other stakeholders should be acknowledged for their active participation in the Working Group meetings and their availability to meet with the OECD team and share valuable insights for the development of this note.

In particular, the OECD would like to extend its gratitude to the representatives of the Ministry of Economy: H.E. Mr Shahin Mustafayev (Minister of Economy), Mr Niyazi Safarov (Deputy Minister of Economy), Mr Sahib Mammadov (Deputy Minister of Economy), Mr Rufat Mammadov (Deputy Minister of Economy), Mr Ilgar Poladov (Head of Department for Development Policy and Regulation of Entrepreneurship), Mr Ruslan Rustamli (Head of Department for Co-operation with International Organisations) and Ms Mülâyim Axundova (Department for Co-operation with International Organisations).

The OECD is grateful as well to other representatives of the government of Azerbaijan, government agencies and other public institutions for their important contributions to the project: Mr Vusal Gasimly (Executive Director, Centre for Analysis of Economic Reforms and Communication), Ms Vusala Jafarova (Strategic Analyst and Planning Manager, Centre for Analysis of Economic Reforms and Communication), Mr Orkhan Mammadov (Executive Director, Agency for the Development of Small- and Medium-Sized Enterprises (SME Agency), Mr Elchin Ibrahimov (Deputy Director, SME Agency), Mr Elchan Gurbanov (Advisor to Executive Director, SME Agency), Mr Natig Heydarov (Head of SME Promotion Department, SME Agency).

Representatives of the private sector provided useful inputs to Working Group discussions and the report: Ms Kristina Mammadova (Acting Secretary General, Azerbaijan Entrepreneurs Confederation), Ms Jhale Hajiyeva (Executive Director, Azerbaijan Microfinance Organisation), Mr Tobias Bauman (Executive Director, German-Azerbaijan Chamber of Commerce), Mr Ramal Jafarov (Chairman of the Executive Board, MCB Leasing), Mr Elchin Ahmadov (President, Association of Leasing Companies of Azerbaijan).

A number of international experts provided valuable contributions to Working Group discussions and the report, including: Mr Ricardo Pinto (Managing Director, Pinto Consulting GmbH), Mr Giorgi Darchia (Enterprise Georgia), Mr Pavel Chovanec (Acting Director of Investments Department, CzechInvest) and Mr Salvatore Zecchini (Former Chairman of the OECD Working Party on SMEs and Entrepreneurship).

The European Union co-funded the project as part of the EU4Business initiative and its staff provided important guidance and support: Mr. Mathieu Bousquet (Head of Unit, DG NEAR, European Commission, Mr Jeroen Willems (Deputy Head of Unit, DG NEAR,

European Commission, Ms Raffaella Boudron (Programme Manager, DG NEAR, European Commission), and Ms Ulviya Abdullayeva (Programme Manager, EU Delegation to Azerbaijan).

This report was written under the guidance of Mr Andreas Schaal (Director, OECD Global Relations) and Mr William Tompson (Head, OECD Eurasia Division).

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Final editorial and visual support was provided by Ms Vanessa Berry-Chatelain (Communications Manager, OECD Global Relations Secretariat). Very valuable administrative support was provided by Ms Maria Ferreira and Ms Eugenia Klimenka from the OECD Eurasia Competitiveness Programme.

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Acronyms and abbreviations

ASAN	State Agency for Public Services and Social Innovations under the President of the Republic of Azerbaijan
ASK	Azerbaijan Entrepreneurs' Confederation
AZN	ISO 4217 code for the Azerbaijan manat (currency)
AZPROMO	Azerbaijan Export and Investment Promotion Foundation
BBTC	Baku Business Training Centre
CAERC	Centre for Analysis of Economic Reforms and Communication
EBRD	European Bank for Reconstruction and Development
EU	European Union
EUR	euro
FIMSA	Financial Markets Supervisory Authority
GDP	gross domestic product
ICT	information and communication technology
IFC	International Finance Corporation
IMF	International Monetary Fund
KPI	key performance indicator
OECD	Organisation for Economic Co-operation and Development
PPD	public-private dialogue
PPP	public-private partnership
R&D	research and development
SBA	Small Business Act for Europe
SMART	specific, measurable, achievable, relevant and trustworthy
SME	small and medium-sized enterprise
VEM	national network of business one-stop shops in Slovenia

Executive Summary

Since the late 1990s, the development of Azerbaijan's hydrocarbon resources has driven economic growth, with GDP per capita rising tenfold between 2001 and 2014, as oil exports fuelled Azerbaijan's transition to an upper-middle-income country. Infrastructure development and business environment reforms have helped to create favourable framework conditions for further economic growth. However, as the majority of the economy is associated with the oil sector, dependence on oil extraction has left the economy vulnerable to commodity price shocks. The consequences of this vulnerability became clear during 2014-2016, when the oil-price collapse led to a devaluation of the local currency (the manat) and a recession. Although the country has recovered relatively quickly, the crisis highlighted the need to diversify production and exports, and the government adopted 12 strategic roadmaps in 2016 with the aim of developing the non-oil sectors of the economy, including the SME sector.

Diversification can also help make growth in Azerbaijan more inclusive. The extractives sector is capital-intensive, employs relatively few workers and has limited technology and knowledge spill-overs to other sectors. Much of the workforce remains stuck in very low-productivity occupations, often in micro-enterprises with limited growth potential. Reforms that foster the emergence of new activities and export sectors can also help create more high-productivity jobs. Since top-down efforts to create new sectors are not promising, SMEs must be enabled to play a vital role in diversification, galvanising the development of the non-oil sector, as well as boosting innovation and productivity.

Currently SMEs' potential remains largely untapped. SMEs generated 6.4% of value added and 18.5% of employment in 2016, compared to 60% of total value added and 60-70% of employment in OECD countries. Government support for entrepreneurs has so far targeted micro-enterprises, often in agriculture, with a social development agenda. There is little emphasis on innovative start-ups and productive, growth-oriented SMEs. The new SME strategic roadmap and action plan offer the potential to reshape this uneven, oil-sector-driven economic structure, and to realise the potential of SMEs.

However, many challenges remain ahead. As oil prices recover, Azerbaijan must not lose its diversification momentum, and public institutions must work with each other and with the private sector if the SME contribution to GDP and employment is to reach 15% and 20% respectively by 2020, as targeted by the roadmap. This note outlines recommendations in four key areas to achieve this goal:

- Foster the competitiveness of SMEs through the newly established SME Agency by (a) adopting the most effective institutional role to deliver its mandate, (b) delivering tailored government-to-business (G2B) and business-to-business (B2B) services for SMEs based on analysis of SME needs, and (c) unlocking the demand for support services and capacity for service provision by the private sector.

- Improve SME access to alternative finance, particularly leasing, by (a) improving the legal and regulatory framework for leasing, (b) addressing supply-side barriers, and (c) stimulating SME awareness and demand for leasing.
- Strengthen private sector engagement in policy delivery and advocacy by (a) strengthening business associations, particularly those representing SMEs, and (b) establishing a formal and transparent public-private dialogue platform.
- Establish a sound results-based monitoring system by (a) establishing cross-government information gathering and reporting capabilities led by the Ministry of Economy and (b) establish process, results and impact indicators for each reform action.

1. SMEs as a driving force for Azerbaijan's diversification

Developing competitiveness in non-oil sectors is a policy priority for Azerbaijan

Following a period of strong growth that saw GDP per capita rise tenfold in real terms between 2001 and 2014, Azerbaijan experienced a recession in 2015 (World Bank, 2017^[1]). The drop in oil prices in 2014, together with an economic slowdown in key regional trade partners, brought about contraction that culminated in a 3.1% decrease in GDP in 2016. A modest recovery began in the final months 2017, driven by the modest increase in oil prices and tight macroeconomic policies, but the economy is still some way from returning to pre-crisis output levels. The devaluation of the local currency – the manat – in 2015-16 resulted in an increase in the rate of inflation from 1.4% in 2014 to 12.4% in 2016 (EBRD, 2017^[2]).

Crude oil, petroleum gas and refined petroleum represented 90.8% of total exports in 2016, somewhat down on the levels of previous years as a result of the fall in oil prices coupled with a 24% increase of non-oil exports. The oil-price drop also hit demand in Azerbaijan's main non-oil external market. The shocks of 2014–15 have thus highlighted the importance of diversifying economic activity and, in particular, exports. The main export destinations for non-oil exports in 2017 were Russia (35.93%), Turkey (18.99%), Switzerland (9.33%), Georgia (8.95%) and Italy (3.67%).

Diversification also offers Azerbaijan an opportunity to move to a more inclusive growth model. The hydrocarbon sector is highly capital intensive: while it generated just over 32% of GDP in 2016, official data show that it employed a mere 2% of the working population. At the same time, around 37% of the working population is employed in sectors where average productivity is less than *half* the national average. The growth of a flourishing non-resource urban sector is likely to be crucial to broad-based prosperity over the long run.

Responding to this diversification challenge, the government has launched an ambitious reform agenda to catalyse the competitiveness of the non-oil sector. In December 2016, the President adopted 12 “Strategic roadmaps for the national economy and main economic sectors”, detailing short-, medium-, and long-term goals in key sectors of the economy, including oil and gas, agriculture, tourism, financial services, and SMEs. Corresponding action plans for 2016-20 were also adopted, and the Centre for Economic Reforms Analysis and Communication mandated to oversee their implementation and monitoring.

Azerbaijan has also been active in reforming the business environment. It has made significant progress in the World Bank's 2019 *Doing Business* report, reaching 25th position, up from 57th in 2018 (Box 1). There have been significant efforts to streamline administrative requirements, with the number of licensed activities reduced from 59 to 37 and the number of permits reduced from 330 to 86. E-government services have been expanded significantly, allowing company registration, business licensing, public procurement, customs and visa application procedures to be completed online, ensuring their ease and transparency. A moratorium has also been placed on certain business inspections until 1 January 2021, reducing the regulatory burden on businesses.

Box 1. World Bank's Ease of Doing Business in Azerbaijan 2019

The World Bank's *Doing Business* report presents quantitative indicators on business regulation and the protection of property rights across 190 economies. It covers 11 areas affecting all stages of the life of a business that are crucial to the domestic SME sector. Indicators based on case scenarios refer to the situation in the largest business city of the economy, i.e. to Baku in the case of Azerbaijan.

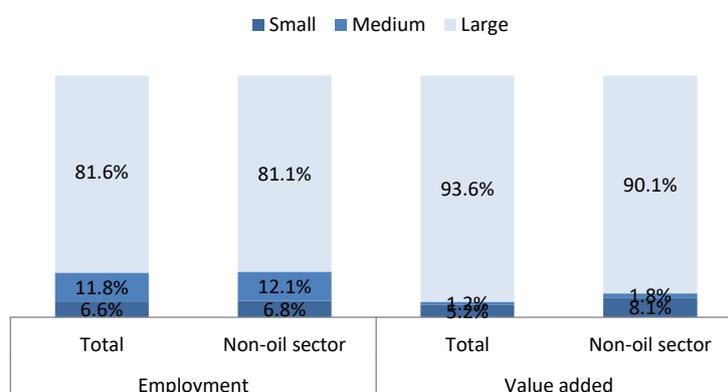
The 2019 edition lists Azerbaijan as one of the top 10 improvers. The country now ranks 25th in terms of "ease of doing business", having improved by 32 positions compared to the previous year's assessment. Reforms in Azerbaijan took place in eight relevant areas and often involved institutional changes.

Azerbaijan improved its ranking by 100 positions in both the "dealing with construction permits" and the "getting credit" indicators, moving up to positions 61 and 22 respectively. Noticeable progress was also observed in "getting electricity". All three areas benefitted from the creation of one-stop shops or other new institutions. Moreover, Azerbaijan now ranks 2nd in the world in terms of protecting minority investors, having previously ranked 10th.

Source: World Bank (2018), *Doing Business 2019: Training for Reform*, <http://www.doingbusiness.org>

SMEs in Azerbaijan can be an engine for job creation and sustained growth

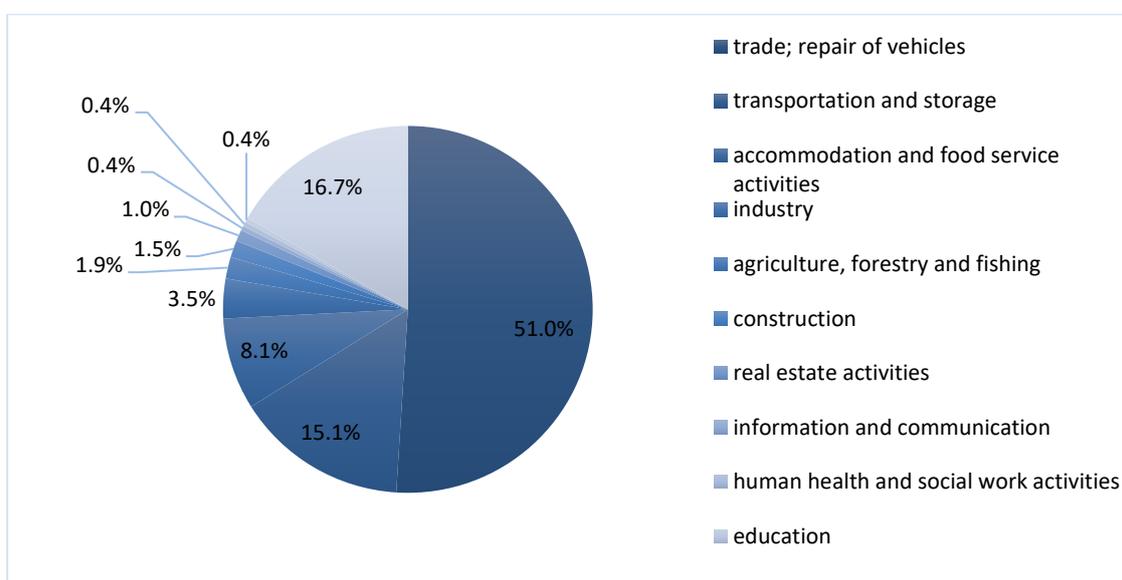
Set in the context of Azerbaijan's diversification challenge, SME development is a critical policy goal. SMEs can be an engine for job creation and sustained growth – by facilitating the shift to a more diverse economy, galvanising the development of the non-oil sector, and boosting innovation and productivity. Currently, the potential of SMEs remains untapped in Azerbaijan. SMEs generated 6.4% of value added and 18.5% of employment in 2016, compared to 60% of total value added and 60-70% of employment in OECD countries.

Figure 1. Contribution of SMEs to the Azerbaijan's economy

Note: According to Decision of the Cabinet of Ministers No. 215 of 5 June 2015, small firms/entrepreneurs are defined as those having less than 25 employees and less than AZN 200 000 of annual turnover. Medium-sized firms/entrepreneurs are defined as those having between 25 and 125 employees and between AZN 200 000 and AZN 1 250 000 of annual income.

Source: Azerbaijan State Statistical Committee (database).

Most Azerbaijani SMEs are concentrated in relatively low value added activities such as trade and repair of vehicles (51.0%), transportation and storage (15.1%), accommodation and restaurants (8.1%) and other services (16.7%). This accounts for their overall low contribution to the economy.

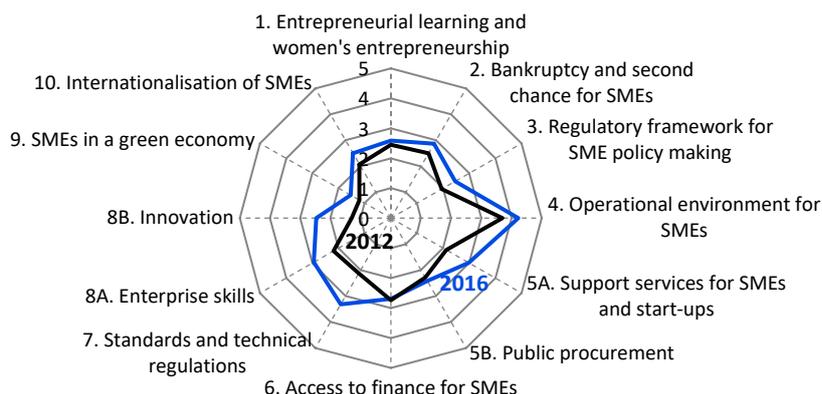
Figure 2. Sectoral distribution of SMEs in Azerbaijan, 2016

Source: Azerbaijan State Statistical Committee (database).

Azerbaijan's most recent results in the Small Business Act for Europe (SBA) assessment are summarised in the OECD's *SME Policy Index: Eastern Partner Countries 2016* (2015_[3]). The report found significant improvements since the 2012 assessment. It highlights the improved business-enabling environment, with the country becoming a top

performer in some dimensions of the World Bank's *Doing Business* report (e.g. starting a business, registering property). The e-government portal was identified as a best practice in the region, significantly expanding online services to SMEs. In addition, there were improvements to the SME innovation framework through both infrastructure (e.g. industrial parks, technology parks and business incubators) and financial support (through the creation of a dedicated fund for the information and communications technology [ICT] sector).

Figure 3. SBA assessment scores for Azerbaijan, 2012-16



Source: OECD/European Union/EBRD/ETF (2015), *SME Policy Index: Eastern Partner Countries 2016: Assessing the Implementation of the Small Business Act for Europe*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264246249-en>

A key recommendation of the SBA assessment was to adopt a comprehensive government strategy to guide SME policy, as well as to establish a centralised implementing agency and strengthen cross-government co-ordination on the implementation of SME support policies.

Recently launched roadmap aims to galvanise SMEs' potential

Since 2015, when the most recent SBA assessment was completed, Azerbaijan has made significant progress in bringing the SME agenda to the forefront of government reforms and addressing the recommendations set forth in the SME Policy Index. On 6 December 2016, the *Strategic Roadmap for the Production of Consumer Goods at the Level of Small and Medium Enterprises in the Republic of Azerbaijan* (SME Roadmap) was adopted by presidential decree, demonstrating a strong government commitment to the SME sector. The stated objective of the SME Roadmap is to further improve the investment and business environment in the country, improve the regulatory framework for entrepreneurial activity, increase the role and competitiveness of SMEs in the economy, adapt the management system to modern requirements, enhance access to financial resources, and institutionally support SMEs through the new Agency for the Development of Small- and Medium-Sized Enterprises (SME Agency) under the Ministry of Economy of the Republic of Azerbaijan.

The SME Roadmap, one of twelve strategic roadmaps to jumpstart Azerbaijan's diversification agenda, includes an action plan for implementation. It addresses five strategic targets that are essential to SME development: (1) improving the business environment and regulatory framework for SMEs, through the establishment of an SME agency, improved public-private dialogue and reforms to business licensing and tax

administration; (2) ensuring efficient access to finance for SMEs, through reforms to the insolvency framework, the establishment of a credit guarantee fund and the development of alternative finance instruments; (3) increasing the internationalisation of SMEs, through the expansion of export finance and the establishment of sector-based export associations; (4) increasing SME skills, through the development of business incubators and training programmes; and (5) promoting SME innovation, through incentive mechanisms and innovation-oriented regional clusters (CAERC, 2018^[4]). This ambitious reform agenda aims to increase SMEs' contribution to GDP and employment to 15% and 20%, respectively, by 2020. It also aims to diversify Azerbaijan's export basket and increase SMEs' contribution to non-oil exports to 10%.

Strategic target 1: Improve the business environment and regulatory framework for SMEs

The SME Roadmap recognises the need for an institutional and regulatory framework that reduces the transaction costs of economic activities, provides incentives for individuals to engage in entrepreneurial activity, enables SMEs to build internal capacities and allows them to maximise their profit. The reform priorities under this strategic target encompass simplification of the regulatory framework, the establishment of an SME agency and other programmes to foster SME growth in Azerbaijan. This strategic target includes 35 policy actions.

Table 1. Priorities under strategic target 1

• Establish a centralised SME agency	• Improve the inspection and licensing mechanism
• Improve the regulatory framework and introduce regulatory impact analysis	• Expand public-private dialogue (PPD) and strengthen institutions representing SMEs
• Deepen public-private partnerships (PPPs)	• Improve alternative dispute settlement options
• Establish SME industrial zones and clusters	• Introduce a standardised approach to SMEs
• Improve the competitive environment for SMEs	

Source: SME Roadmap

In 2017, the government of Azerbaijan made significant progress in implementing the reforms outlined under the first strategic target of the SME Roadmap. The establishment of a dedicated SME Agency in December 2017 represented a major milestone in shaping the SME support infrastructure in Azerbaijan. The Agency has a mandate to provide its services along five strategic directions: 1) promoting entrepreneurship, (2) protecting entrepreneurs, (3) facilitating SME financing, (4) providing training and consultancy services and (5) serving as a one-stop shop. It is also tasked with establishing regional "SME Houses" operating within the regional ASAN centres or the regional offices of the Ministry of Economy. To promote public-private partnerships (PPPs), Azerbaijan identified the construction of a university campus as a pilot project that will be implemented under the PPP framework. To improve SMEs' access to public procurement opportunities, the government has prepared draft regulations to require that a minimum proportion of procurement opportunities be awarded to SMEs. Additionally, in co-operation with the private sector, the Ministry of Economy has prepared draft legislation to clarify the role of business associations, in particular those established to represent SMEs.

In 2017, the government reduced the number of licences that businesses are required to obtain from 59 to 37 and made the process of issuing licences more efficient. In addition,

the moratorium on inspections has been extended until 1 January 2021, allowing for additional time to review existing regulations in this field. The Licences and Permits Portal (<https://lisenziya.gov.az>) was launched in March 2018, providing the possibility of applying for licences and permits online. Through Presidential Decree No. 1885 of 14 March 2018 “On Electronic Government Development and Transition to Digital Government”, Azerbaijan has established an “e-government portal” which provides access to over 500 government services for both physical persons and legal entities in the area of social protection, social security, education, health, communication, online payments, customs, legal, tax and other services.

To further support investment, companies and individual entrepreneurs that have received a so-called “investment promotion document”, issued by the Ministry of Economy based on a set of criteria set out in a Presidential Decree of 18 January 2016, are exempted from paying property tax, land tax, 50% of corporate and personal income tax, VAT and custom duties for imported equipment for seven years. The Ministry of Taxes has also established 57 Service Centres in a number of regions to ease taxpayers' access to the tax service.

Through Presidential Decree No. 923 of 1 June 2016 “On the simplification of the issuance of electronic visa and the establishment of the ASAN visa system”, the State Agency for Public Services and Social Innovations introduced the Azerbaijan Service and Assessment Network (ASAN) Visa system, which became operational on 10 January 2017. It allows foreigners to obtain a visa within three hours (urgent procedure) and significantly simplified the visa application process, thus creating new opportunities for both tourism and business travel.

Finally, the Ministry of Economy has taken initial steps to implement a regulatory impact analysis for legislation related to entrepreneurship and investment and has proposed amendments to the Competition Code to further promote healthy competition and create a level playing field for SMEs.

Strategic target 2: Improve SME access to finance

In order to improve SME access to finance, the SME Roadmap aims to implement policies and programmes to tackle information asymmetries with regards to SME lending, improve insolvency procedures, provide credit guarantees, enhance SME access to alternative sources of finance and increase financial literacy among SMEs.

Table 2. Priorities under strategic target 2

<ul style="list-style-type: none"> • Reform bankruptcy procedures 	<ul style="list-style-type: none"> • Facilitate SME access to leasing and alternative sources of finance
<ul style="list-style-type: none"> • Establish a credit guarantee fund for SMEs 	<ul style="list-style-type: none"> • Improve the property registration system and increase financial accessibility

Source: SME Roadmap.

A number of policy actions outlined under the second strategic objective have already been implemented. A Mortgage and Credit Guarantee Fund was established by presidential decree on 25 December 2017 which aims to provide guarantees for entrepreneurs' loans provided by authorised banks. The recently established Entrepreneurship Development

Fund,¹ which replaced the National Fund for Entrepreneurship Support, will provide loans at preferential rates, as well as consulting services and training.

In March 2018, the first private credit bureau in Azerbaijan, which is notably accessible to leasing companies, was established, pulling together credit information from various sources, including utility companies. In addition, the State Registry of Movable Assets has been established, allowing SMEs to pledge moveable assets (e.g. consumer goods and machinery equipment) as collateral.

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. In addition, a working group has been created that brings together the government, international organisations and business to determine the measures and programmes needed to promote factoring as an alternative source of financing for SMEs.

To improve the financial literacy of SMEs, the Baku Business Training Centre of the Ministry of Economy has enhanced the provision of training to strengthen SMEs' capacity for financial planning and risk management as well as their overall investment readiness. Furthermore, new legislation is currently being drafted which aims to stimulate the application of international accounting standards by SMEs.

Strategic target 3: Increase SME access to foreign markets

Increasing the internationalisation of SMEs and helping them to access foreign markets is one of the objectives of Azerbaijan's export diversification agenda. The SME Roadmap foresees the implementation of policies aiming to improve access to finance for exporting SMEs and the implementation of programmes supporting SMEs' compliance with international standards and regulations. In addition, the SME Roadmap envisages the establishment of export associations and the implementation of measures to strengthen the "Made in Azerbaijan" brand, an initiative that promotes products and services produced in Azerbaijan.

Table 3. Priorities under strategic target 3

• Improve financial services for the foreign trade operations of SMEs	• Establish export associations
---	---------------------------------

Source: SME Roadmap.

The Ministry of Economy has jump-started implementation of strategic target 3 by establishing 15 export associations with the objective of increasing production in a number of sectors such as agriculture, textile and tourism. In addition, a programme currently implemented by the Azerbaijan Export and Investment Promotion Foundation (AZPROMO) aims to strengthen the exporting capacity of SMEs, particularly those that are members of export associations. AZPROMO also financially supports SMEs' participation in international trade fairs and exhibitions.

¹ <http://anfes.gov.az/en>.

Through a presidential decree dated 21 September 2016, the online trading portal Azexport.az² was created under the Centre for Analysis of Economic Reforms and Communication (CAERC) to provide information about products of Azerbaijani origin. Established as an e-commerce platform to connect Azerbaijani producers with buyers under the brand “Made in Azerbaijan”, Since 2016. The portal has facilitated more than 10,000 quotation requests and orders from more than 150 countries. At the same time, more than 200 Free Sales Certificates have been obtained by Azerbaijani companies since the portal began operation. In addition, a “Single Window” export promotion centre offers complex services for Azerbaijani exporters such as issuance of certificates necessary for export and custom clearance as well as delivery of consultancy.

To stimulate investments into the SME sector, CAERC launched another portal, Enterprise Azerbaijan,³ to foster investments and increase options for alternative sources of funding. The portal aims to channel investments into the SME sector and provide investors with aftercare and support services. To improve SME access to international markets, Azerbaijan has conducted a survey to determine SME barriers to trade; based on the results of the survey, new legislation and regulations with respect to SME internationalisation is currently being drafted.

Strategic target 4: Increase SME skills

Azerbaijan recognises the central role of entrepreneurial skills and capabilities in fostering SME development. The SME Roadmap sets out a number of policy actions to promote entrepreneurship as a career choice and foster skills development among existing and future entrepreneurs. It envisages a comprehensive reform plan encompassing the provision of vocational education and training that reflect the needs of SMEs and the labour market, a complex support system for start-ups and the establishment of a support framework for women’s entrepreneurship.

Table 4. Priorities under strategic target 4

<ul style="list-style-type: none"> • Develop business incubators and start-up projects 	<ul style="list-style-type: none"> • Improve education and learning opportunities for SMEs
<ul style="list-style-type: none"> • Promote entrepreneurial thinking 	<ul style="list-style-type: none"> • Support women’s entrepreneurship

Source: SME Roadmap.

Following a presidential decree dated 7 April 2016, Azerbaijan began implementing a new programme to support the establishment of micro and family-run businesses, primarily in the agriculture sector. As a result, more than 1 200 people have received government support in establishing a small family farm. The programme aims to increase the income of people in the less developed regions by improving their skills and employability.

In 2017, the State Agency for Vocational Education launched a new mentoring programme for providers of vocational education, to build their capacities to promote entrepreneurship and entrepreneurial thinking. In addition, the Gabala State Vocational Training Centre, in co-operation with Junior Achievement Azerbaijan, launched “The Education for Career” project, which aims to improve financial literacy and entrepreneurship skills among young

² <https://www.azexport.az>.

³ www.enterpriseazerbaijan.com.

people. The Ministry of Economy also launched new business incubators in the Guba-Khachmaz and Aran economic regions.

To support women's entrepreneurship, a number of dedicated training events were organised for women entrepreneurs to build their skills in several areas, including marketing research, access to finance and compliance with regulations. In addition, the Ministry of Economy has begun preparatory work to establish more dedicated business incubators in Baku and in the regions.

Strategic target 5: Promote SME innovation

The SME Roadmap aims to increase SMEs' capacity to introduce and adopt innovations, with a view to upgrading the economy and increasing SME productivity. To achieve this objective, it envisages the implementation of policies designed to improve the national innovation system, including updates to the legislative and regulatory framework for innovation. It also outlines a plan for developing regional innovation clusters and providing support services to boost SME innovation.

Table 5. Priorities under strategic target 5

• Improve the national innovation system	• Promote the innovation activities of SMEs and improve the innovation infrastructure
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Source: SME Roadmap.

The Ministry of Economy, together with the Ministry of Transport, Communication and High Technologies, conducted a SWOT (strengths, weaknesses, opportunities and threats) analysis of the existing innovation infrastructure in Azerbaijan and developed proposals to improve existing legislation and regulations. In addition, initial steps have been taken towards establishing research and development centres in Baku and in the regions.

While the scope and ambition of the SME Roadmap are commendable, they require equal ambition in implementation and monitoring. The action plan requires the engagement of 25 government ministries and agencies, with many actions to be led by the newly established SME Agency (see next chapter). Expansion of institutional capacity, creation of effective co-ordination mechanisms, and building collaboration among existing and newly established government entities will be essential to effective implementation and monitoring. So will consistent and transparent dialogue with the private sector, including and especially SMEs, which do not appear to have been formally consulted throughout this policy process.

This note provides guidance on four key areas of the SME Roadmap, as identified by the project Steering Group: establishing a dedicated SME agency; increasing SME access to alternative sources of finance; strengthening private sector engagement in policy making, delivery and advocacy; and establishing a results-based monitoring system for the SME Roadmap and the co-ordination of the monitoring process among existing institutions.

2. Supporting SMEs through a dedicated SME agency

While SMEs are not unique in facing informational, skill-related and regulatory barriers, their small size and limited access to resources put them at a unique disadvantage in overcoming such challenges. SMEs face disproportionately higher costs complying with regulations, are not sufficiently adept at seeking out regulatory and market intelligence, and lack the financial resources to dedicate to productivity-enhancing services and training. These barriers provide a rationale for public-sector-led SME support mechanisms to correct market failures and realise the economic potential of SMEs.

SME support can take many forms, including financial support (in the form of grants, subsidised loans, and loan guarantees) and non-financial support (including information on regulations, training, and business advisory services). While these support mechanisms can be delivered by different institutions and housed within government departments, the experiences of many OECD and non-OECD countries attest to the efficiency of establishing a dedicated agency in charge of SME development. A dedicated agency provides a focal point for SME support, both in terms of co-ordinating the delivery of programmes and in terms of creating a “single window” for SMEs to access what they need. In addition, separating policy design (typically carried out by the ministry of economy) and policy implementation will promote transparency and accountability.

In Azerbaijan, in line with the strategic objectives set out by the SME Roadmap, the Agency for the Development of Small- and Medium-Sized Enterprises (SME Agency) was created by presidential decree in December 2017 under the purview of the Ministry of Economy. Both the decree and the recently drafted SME law provide a strong mandate for the SME Agency, which will be responsible for five areas: 1) promoting entrepreneurship, (2) protecting entrepreneurs, (3) facilitating SME financing, (4) providing training and consultancy services and (5) serving as a one-stop shop. In addition to its central office, the SME Agency will operate through a network of soon-to-be-created “SME Houses”.

Given the broad nature of its mandate, and the ambition of the new SME development agenda, the SME Agency has a sizeable task ahead of both identifying the areas of market failure and developing the necessary institutional structure, capacity and strategy to cater effectively to SME needs and increase the contribution of SMEs to the economy. In undertaking this task, it should first take stock of the limitations of existing SME support mechanisms and the common barriers facing Azerbaijani SMEs.

A variety of support services for SMEs in Azerbaijan are already in place

The Ministry of Economy currently oversees a number of SME support initiatives. One of them is the Baku Business Training Centre (BBTC), which provides training and seminars on a range of topics through seven regional centres and organises more than 120 training events and workshops annually, engaging both local and international experts. Another major initiative is the creation of a new Entrepreneurship Development Fund, replacing the previous National Fund for Entrepreneurship Support. The Fund will provide loans at

preferential rates, as well as consulting and training services. There are also two business incubators under the BBTC, operating as regional development centres, mostly serving micro-enterprises in the food processing, textiles and rural tourism sectors. Moreover, the Ministry of Economy recently opened new business incubators in the Guba-Khachmaz and Aran economic regions. The Ministry of Economy is also in charge of issuing investment promotion documents, which exempt companies and individual entrepreneurs from a number of tax and custom duties.

In addition to support provided by the Ministry of Economy, a network of so-called ABAD (Simplified Support for Family Business) centres is operated by the State Agency for Public Services and Social Innovations (ASAN), providing support for the establishment of family businesses in arts and crafts, and agriculture. These centres also provide a “single window” from which to obtain product certification, and they operate retail sales on behalf of family-owned businesses. Highly rated by users, these centres perform the valuable role of reducing informality among micro-enterprises. The ABAD projects provide support services to SMEs in various stages of development and play an important role in the creation of small and medium-sized businesses in the country.

Export-oriented SMEs can benefit from AZPROMO, the export promotion agency under the Ministry of Economy; the online trading portal [Azexport.az](https://www.azexport.az),⁴ which provides information about products of Azerbaijani origin; and the “Single Window” export promotion centre under CAERC, which offers complex services for Azerbaijani exporters such as issuance of the certificates necessary for export and custom clearance as well as delivery of consultancy.

Three recently launched websites provide further important services for SMEs. The Licences and Permits Portal⁵ was launched in March 2018, allowing users to apply for licences and permits online. Meanwhile, the Enterprise Azerbaijan⁶ portal provides foreign and local investors with information on investment opportunities, creating the potential for linkages between investors and local SMEs seeking financing. In addition, based on the Presidential Decree of 24 June 2018, the government of Azerbaijan will establish an “e-SME house” portal to provide information for entrepreneurs on a number of issues, such as licences, permits and taxation.

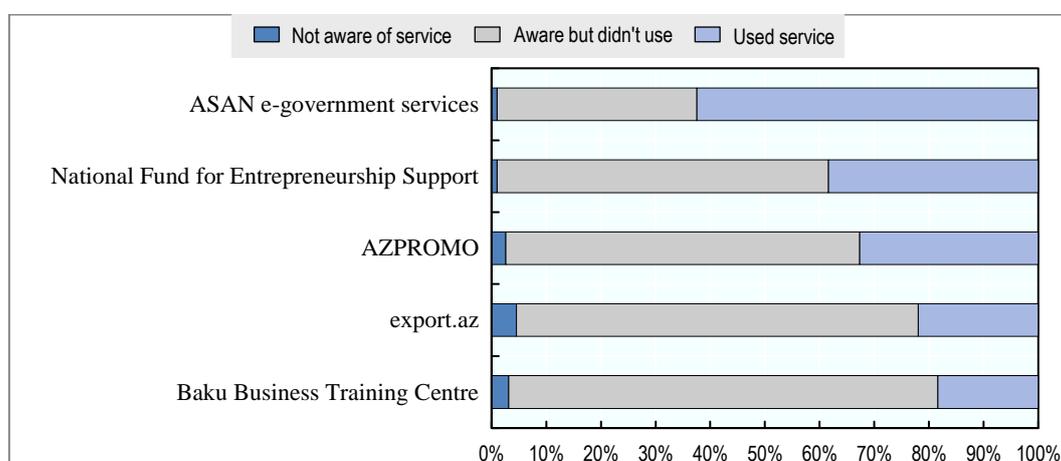
Need to further promote the uptake of SME support services

In March-May 2018, as part of the work done to prepare this note, the OECD conducted an enterprise survey of 201 companies in Azerbaijan. Its findings suggest that although most (60-80%) of the country’s SMEs are aware of the support infrastructure and services provided by the government, not all of them take advantage of the support offered (Figure 4). The major exception is ASAN services, which are highly popular with SMEs – more than 60% of surveyed companies have used the service in the last two years.

⁴ <https://www.azexport.az>.

⁵ <https://lisenziya.gov.az>.

⁶ <https://www.enterpriseazerbaijan.com>.

Figure 4. Usage of SME support services in Azerbaijan

Note: The sample of the survey is not representative of the general population in Azerbaijan

Source: OECD, Enterprise Survey of Azerbaijan (2018). See Annex A for details on the survey methodology.

One of the reasons for limited usage of the services might be that SMEs do not see the government as a natural recourse in addressing problems and may not understand the value of advisory services, even – or especially – when they are provided free of charge. In addition, SMEs often lack an awareness of their own needs and do not see the immediate benefits of seeking external assistance. This may explain why SMEs would rather rely on internal resources, failing to seek out support even where it exists.

There is also scope to further stimulate the use of advisory services provided by the private sector and business associations. While prominent consulting firms serve large enterprises and the public support infrastructure provides basic support to micro-enterprises, there is scope for privately-provided advisory services for growth and export-oriented SMEs. Currently, the limited supply of private-sector-led support services creates the danger of overdependence on public support programmes, particularly as the ambitious agenda of the SME Roadmap is implemented.

Furthermore, where business associations play an important role in helping SMEs with certification, training, and access to foreign markets, such associations are underdeveloped and underrepresent SMEs in Azerbaijan. Currently, the Azerbaijan Entrepreneurs' Confederation (ASK) and 15 Producers and Exporters Association provide members with support activities. However, most SMEs do not participate in, or benefit from, associations at all, largely because they are not convinced of the immediate benefits of being an association member. To address this, the Ministry of Economy has recently led the creation of 15 new sectoral associations, along the lines defined by the SME Roadmap.

Recommendations

Recommendation 1: Leverage the new agency to provide one-stop-shop support for SME needs

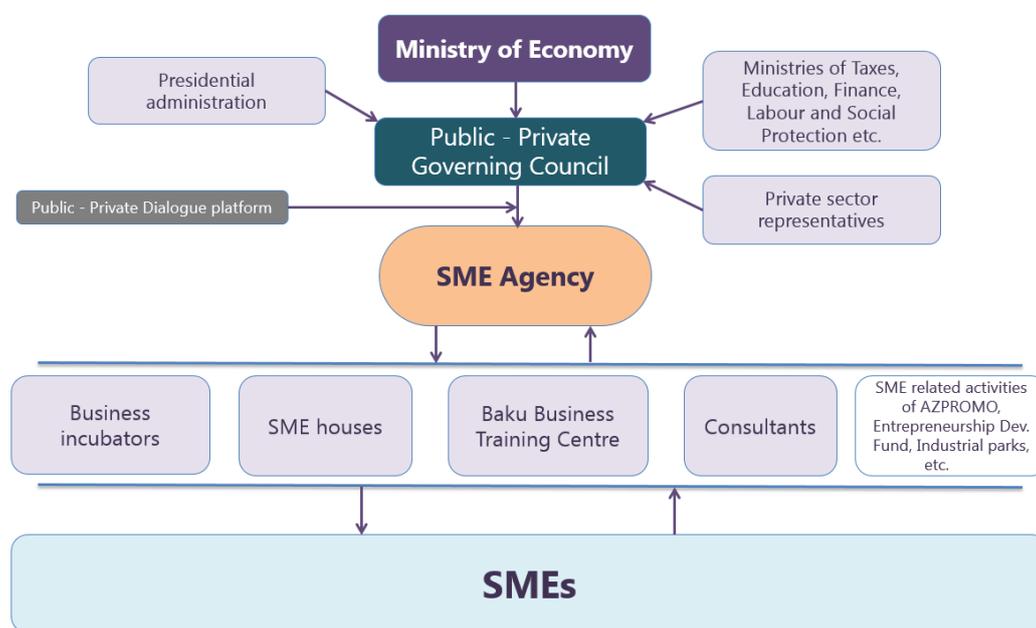
As an essential first step, the SME Agency will need to undertake a feasibility study, such as that completed by other countries establishing SME agencies. It should start by taking stock of existing public and private support infrastructure, identifying SME stakeholders at

national, regional and local levels, analysing the needs of SMEs, and outlining its role in relation to all of these.

The agency should play the role of a one-stop shop, channelling different types of government support through a central body, and presenting a go-to government institution for SMEs. This will require reassessing the quality and role of some existing support infrastructure to ensure it is better aligned with the goals of the SME Roadmap. For example, expanding the number of business incubators, as outlined in the action plan, will require an assessment of existing incubators and the connection of physical infrastructure with the necessary business development services and financing opportunities. The SME Agency should also play a role in co-ordinating donor funded SME initiatives to minimise overlaps and maximise their effectiveness.

The composition of the Governing Council (management board) of the SME Agency should be balanced between private-sector representatives and government institutions that design or implement policies with an impact on the business environment. The agency will also need to co-operate with other public institutions and private-sector actors on a regular basis through the establishment of public-private dialogue, in order to be aware of, and react to, SMEs' evolving regulatory and other needs. Given its private-sector orientation and the proximity it will have to SMEs, particularly in the regions, the agency will be uniquely well-placed as a public institution to act as a conduit between public and private sectors, informing SMEs of the latest regulatory changes and representing them on their behalf.

Figure 5. Example of the governance structure of the SME Agency



Source: Author's own work based on the Working Group meetings.

It is essential that the agency is adequately resourced, obtains suitably qualified staff, and implements a customised capacity-building programme, based on a training needs analysis to identify knowledge and skill gaps.

Recommendation 2: Deliver tailored services based on an analysis of SME needs

Developing an understanding of SME needs and tailoring services accordingly are prerequisites for the delivery of effective support. There is a tendency in many countries for public institutions to deliver supply-driven services to SMEs; this has traditionally been the case in Azerbaijan, as well. A feasibility study using qualitative and quantitative data on SME needs and priorities should be the first step in designing support services and programmes. This analysis could be conducted through a combination of tools, such as online surveys, case studies or focus groups, and formal consultations with the business community. In addition to this initial analysis, regular studies and surveys should be carried out to understand how SMEs are responding to the services and whether adjustments are needed.

SMEs require different types of services at different stages of their life-cycles or according to their priorities. For example, the needs of a start-up will not be the same as those of a medium-sized, growth-oriented firm; and the needs of export-oriented SMEs differ from those focused on the domestic market. Increasing SMEs' contribution to GDP and employment requires addressing growth and export barriers, in addition to providing for basic needs. Currently, Azerbaijan's support infrastructure is too focused on the latter, and one of the primary goals of the SME Agency should be to increase the quality and targeting of advisory services. Table 1 provides some examples of services that the agency could provide or facilitate depending on the category or life-cycle of the enterprise.

Table 6. SME Agency: Potential business support services, by target group

	Start-ups	Micro-enterprises	High-growth enterprises	Potential exporters	Innovators
General information	<ul style="list-style-type: none"> Assessment of business feasibility Company registration 	<ul style="list-style-type: none"> Company diagnosis Licencing and certification 	<ul style="list-style-type: none"> HR management good practice Suppliers 	<ul style="list-style-type: none"> Export financial support Export regulations 	<ul style="list-style-type: none"> Patents, copyrights, IP rights
Training	<ul style="list-style-type: none"> Presentation and networking skills 	<ul style="list-style-type: none"> Financial planning Bookkeeping and accounting standards 	<ul style="list-style-type: none"> Leadership training Safety standards 	<ul style="list-style-type: none"> Export intelligence Trading 	<ul style="list-style-type: none"> Technology transfer and commercialisation
Mentoring and continuous support	<ul style="list-style-type: none"> Legal services Equity financing 	<ul style="list-style-type: none"> Early warning services Quality management 	<ul style="list-style-type: none"> Workforce skills development Financial and tax advice 	<ul style="list-style-type: none"> Market trips and meetings Market entry 	<ul style="list-style-type: none"> Investment Co-operation with academia

Basic services – such as information on company registration, permitting and licensing procedures, and preparation of business plans – should be provided for free to all interested entrepreneurs through regional one-stop shops. In addition to providing this information through SME Houses, the agency should lead the creation of a single portal for SMEs (the Czech Business Web Portal, www.businessinfo.cz, is one such example). However, the agency should take into consideration that many entrepreneurs will lack the basic computer skills to rely entirely on online services, so physical and online infrastructures should be thought of as necessary complements rather than as substitutes.

Tailored support programmes for start-ups can be relatively generic, focusing on entrepreneurship skills, business regulations, and financing and grant applications. They should typically involve training and getting clients to think through their business ideas. Growth-oriented support programmes and business accelerators, on the other hand, will require the identification and nurturing of a small number of companies with intensive and differentiated support, leveraging the knowledge of sectoral experts. In this regard, SME internationalisation programmes can focus on exporting procedures, technical standards and the creation of supplier linkages with foreign direct investment.

Training programmes should not be thought of as one-off public offerings; rather, they should engage SMEs in follow-up support and continued mentoring. Public support should also be provided as a way to unlock demand for privately-provided consulting services which go beyond the scope of the SME Agency in terms of depth and sophistication. For example, free diagnostics can be provided to help SMEs understand where their needs are and what kind of support they may need. Part of the goal of the SME Agency will be to create awareness of the benefits and availability of external assistance which is considered in its charter.

Finally, systematic monitoring and occasional evaluations of support programmes should be undertaken. Concrete criteria should be developed to measure the effectiveness of support delivered, such as survival rates, increases in turnover and employment, and increases in exports and linkages. In addition, feedback should be collected from beneficiaries, both at the time of training and in the medium term, to understand the extent to which they feel they benefited from the support.

Box 2. Enterprise Georgia’s success in unlocking the potential of Georgian SMEs

Enterprise Georgia, established in 2015 under the Ministry of Economy and Sustainable Development, plays a leading role in Georgia’s SME landscape. The agency delivers a range of business support programs, easing access to finance and offering consulting, capacity-building and business intelligence services. Enterprise Georgia is considered an international good practice due to a number of success factors:

- **Strong co-ordination:** Enterprise Georgia’s mandate covers three pillars of business support: entrepreneurship development, export promotion and investment facilitation. The concentration of all three pillars under one umbrella gives Enterprise Georgia the mandate to define the objectives of each pillar, and allows for greater co-ordination to ensure that all programmes are complementary, providing a complete “package” of services for local and foreign companies.
- **Provision of targeted high-end services:** Enterprise Georgia identified the movie and tourism sectors as having a high growth potential. In this context, the incentives programmes “Film in Georgia” and “Host in Georgia” provide high-quality and continuous support to companies that either already operate in, or are considering expanding their activities to, these two sectors.
- **Client orientation:** To better satisfy SME needs, Enterprise Georgia has involved business-minded people with private sector experience in the design

and delivery of support services. This has not only increased the quality of support programmes, but also boosted the private sector's confidence in Enterprise Georgia's brand.

- **Comprehensive support package for SMEs:** Entrepreneurs seeking external assistance can find a broad palette of financial (grants, leasing) and non-financial (training, mentoring) support services under one roof. This all-encompassing approach increases demand and awareness, and facilitates the provision of support programmes.
- **Private sector engagement in delivery of support services:** A number of specialised services are delivered through private sector providers and consultants. This increases the quality of services provided and enables the agency to focus on its other roles. In addition, by providing training to private sector providers, Enterprise Georgia stimulates development of the market for such services.

Source: Enterprise Georgia, <http://enterprisegeorgia.gov.ge>

Recommendation 3: Unlock the demand and capacity for service provision by the private sector

While the SME Agency will be a one-stop shop for SME support, this does not mean that it should be delivering everything itself and on a free basis. The agency's role should be to deliver general information, basic training, early advice, and other services that the private sector is not better placed to deliver effectively. It should avoid engaging in the free or below-market-rate delivery of more-sophisticated consulting services, for which there is or will be a growing market. To do so would risk distorting the market or obstructing the development of the private sector. Continuous monitoring and close engagement with private-sector actors will be important in defining the appropriate boundaries of public intervention.

On the demand side, limited resources and a reluctance among SMEs to pay for high-quality support services are key barriers constraining the development of the private support-services market. The SME Agency, in co-operation with other relevant institutions and donors, could consider providing vouchers or other limited financial assistance to SMEs, particularly early-stage SMEs, to support uptake of private-sector services. Slovenia's grant-based "voucher" system could be a model to consider adapting to Azerbaijan's conditions (Box 3). Such grants should be designed to encourage initial use of support services and should not compete with schemes operated by donors, for example with the Advice for Small Business programme operated by the EBRD.

On the supply side, although the high-end private consulting market in Azerbaijan is well developed, there is a need to further expand the market of affordable offerings tailored to SMEs. The SME Agency could help by providing capacity building and by funding training programmes to improve the skills of support-service providers. A voucher programme could also be designed in such a way that it aims at building the capacity of support-service providers in the SME segment. Furthermore, the establishment of a national consultancy association could play a key role in both raising standards and encouraging the uptake of internationally recognised certification and re-certification (such as AACSB International – the Association to Advance Collegiate Schools of Business).

Box 3. SME Voucher System for Consultancy and Training Services in Slovenia

Between 2001 and 2009, the Slovenian government developed and operated an SME Voucher System for Consultancy and Training Services. The scheme was administered by the Public Agency for Entrepreneurship and Foreign Investment, and delivered through the national network of business one-stop shops (VEM). The programme's main objectives were to:

- Address the low demand for consultancy services;
- Encourage entrepreneurship, self-employment and rural development; and
- Maintain and increase the existing number of SMEs, and thus positively impact employment opportunities.

SMEs interested in the scheme contacted VEM, which then conducted diagnostic interviews with the SMEs to identify the area of consultancy needs and assess the SMEs' eligibility for a voucher. Voucher sizes ranged from EUR 2,500 to EUR 4,000 for SMEs and EUR 1,500 for potential entrepreneurs. Between 2001 and 2009, the Voucher System provided 30,000 vouchers worth EUR 15 million to more than 9,000 SMEs.

In 2009 the portfolio of vouchers offered in Slovenia was reformed to focus on innovation. This scheme started with a pilot project in 2009 and replaced the previous scheme in 2010.

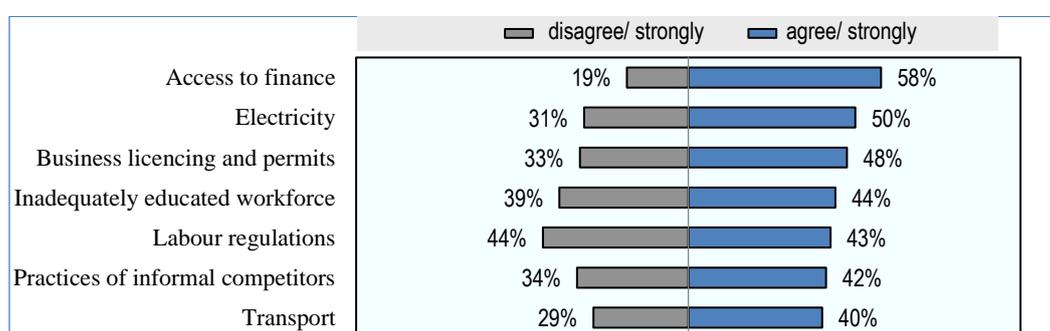
Source: OECD (2013), *Implementing a Pilot SME Voucher Scheme in Montenegro*, <https://www.oecd.org/south-east-europe/programme/Montenegro%20English%20Version.pdf>

3. Improving SME access to alternative finance

External financing is an important resource for SMEs, allowing them to expand their operations, modernise their equipment and access new markets. Due to their high-risk profiles and limited credit histories, SMEs face strict collateral requirements and high interest rates, causing them to become credit constrained. Complex application procedures and the inability of many SMEs to produce sophisticated financial statements further exacerbate the problem.

Limited access to external finance presents a barrier to SME growth in Azerbaijan. According to a 2015 World Bank survey of SMEs, 51% of SMEs consider limited access to finance the biggest obstacle to doing business in Azerbaijan (World Bank, 2015^[5]). This was confirmed by the findings of the 2018 OECD enterprise survey of Azerbaijan, where 58% of surveyed SMEs considered insufficient access to finance a barrier to their growth (Figure 6; see Annex A for details on the survey methodology).

Figure 6. SME perception of growth barriers



Note: The survey sample is not representative of the general business population in Azerbaijan.

Source: OECD, enterprise survey of Azerbaijan (2018). See Annex A for details on the survey methodology.

While bank lending is the most common form of external finance for SMEs, there are also a range of alternative financing instruments that can complement traditional credit markets. These include asset-based finance (e.g. leasing, factoring), equity finance (e.g. crowdfunding, venture capital) and alternative debt instruments (e.g. corporate bonds, securitised debt) (OECD, 2015^[6]). In a context of limited debt finance, asset-based finance instruments, particularly leasing, can be viable sources of alternative financing for SMEs that struggle to meet banks' collateral or credit history requirements.

Leasing is generally defined as a contract between two parties wherein the lessee (a business owner) uses the asset (owned by the leasing company) for a fixed period of time, while making payments on a set schedule. At the end of the lease, the lessee buys the asset for a nominal fee, giving the lessee the opportunity to make a capital investment. Leasing companies can serve as a significant source of finance for small firms wanting to invest in equipment, and investment in leasing companies can yield attractive returns if conditions

are right (World Bank, International Monetary Fund, 2005^[7]). A survey conducted by the European Central Bank among European SMEs shows that 20% of surveyed companies benefited from leasing services in 2016, while an additional 23% considered leasing to be a “relevant” source of financing (European Central Bank, 2017^[8]).

While governments should not directly be providing leasing services, they can facilitate the development of a competitive private market for it by: (a) creating a legal environment that limits uncertainty and protects the right of both the lessor and the lessee; (b) addressing information asymmetries through information infrastructure (e.g. credit and assets registries); and (c) raising awareness and building capacity among leasing companies and SMEs.

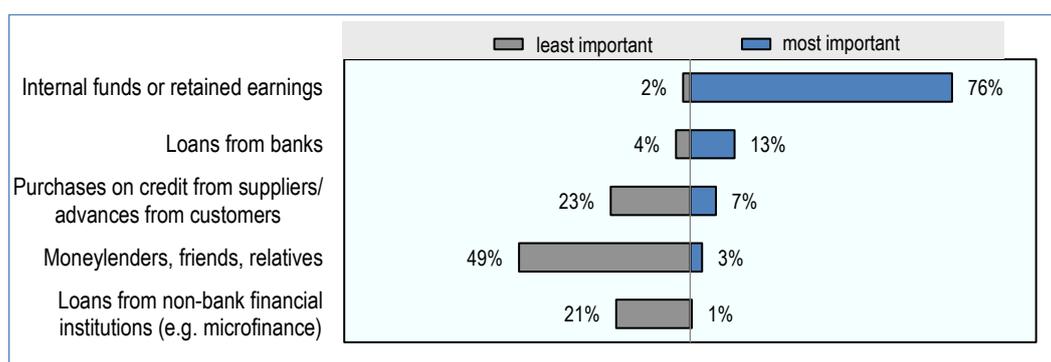
Azerbaijani SMEs rely mostly on internal funds

Most SMEs in Azerbaijan do not use external financing, leaving them with limited resources to expand, innovate or internationalise. The 2018 OECD enterprise survey of Azerbaijani SMEs finds that a large majority (76%) of respondents consider internal funds their most important source of financing (Figure 7). Furthermore, domestic credit to the private sector in Azerbaijan in 2016 represented only 26% of GDP, lower than the averages for the economies of both the European Union’s Eastern Partnership (40%) and OECD (140%) (World Bank, 2017^[11]).

In addition, the findings of a 2015 World Bank survey indicate that high collateral requirements are the main barrier for SMEs seeking external finance, followed by complex application procedures. According to the survey, 45% of microenterprises do not seek credit due to high collateral requirements (World Bank, 2015^[5]).

The recent banking crisis has exacerbated SME financing limitations. The manat’s devaluation hit the heavily dollarised balance sheets of the banks, exposing capital shortfalls. Double-digit inflation rates and uncertainty on financial markets further increased risk-aversion and reduced availability of long-term financing opportunities, particularly for SMEs.

Figure 7. Sources of financing for SMEs



Note: The sample is not representative of the general business population in Azerbaijan.

Source: OECD enterprise survey of Azerbaijan (2018). See Annex B for details on the survey methodology.

Sources of external financing for SMEs could be further diversified

For the small proportion of SMEs that do use external financing, bank loans are the predominant form of financing. For micro and small enterprises, micro-finance institutions

are an important source of debt finance, serving mostly rural areas that do not have access to bank financing (OECD, 2015^[3]). According to estimates by the Azerbaijan Micro-Finance Association, more than 400 000 entrepreneurs have benefited from loans offered by micro-finance institutions. The World Bank survey finds that a small portion of SMEs in Azerbaijan use supply chain financing (World Bank, 2015^[5]), which also reported to be in use by 7% of companies interviewed in the 2018 OECD enterprise survey.

Other forms of external finance, such as asset-based financing, alternative debt, or equity instruments, are in a nascent stage of development, and only a fraction of Azerbaijan's SMEs have used them (World Bank, 2015^[5]). The findings of the World Bank survey of SMEs in Azerbaijan suggest that only 4% of SMEs used leasing services in 2013 and less than 2% used factoring (World Bank, 2015^[5]). Leasing transactions currently represent 0.5% of Azerbaijan's GDP, well below the EU average of 2% (White Clark Group, 2018^[9]).

Leasing operations were also negatively affected by the 2015 banking crisis. The manat's devaluation resulted in financial difficulties for leasing companies, causing many of them to exit the market. According to estimates by the Association of Leasing Companies of Azerbaijan, the value of Azerbaijan's leasing portfolio dropped from AZN 125 million in 2012 to AZN 60 million in 2018. Moreover, leasing companies provide services almost exclusively to medium-sized and large enterprises. Due to their higher risk profiles and lack of credit histories, micro and small-sized firms need to provide prohibitively large down payments and face high interest rates

The limited nature of information on the existing landscape of alternative financial instruments and their use by SMEs prevents policy makers from prioritising policies to address market failures. While the central bank and the State Statistical Committee collect data on financial markets and lending to the private sector, statistics by size-class of the enterprise are often missing. In addition, data on the use of alternative sources of finance by SME are mostly unavailable.

Leasing companies in Azerbaijan are often small and do not have sufficient internal resources to finance their operations. OECD interviews with leasing companies reveal that lack of external finance (in local currency) is often perceived as the main barrier to the supply of leasing services. Even if they acquire bank credit, the high interest rates they face prevent their services from being competitive with bank lending. Leasing companies also indicated that in the absence of a risk-sharing mechanism for leasing services, such as a guarantee fund, risk premia are too high for micro and small enterprises. In addition, limited availability of financial resources prevents leasing companies in Azerbaijan from investing in skills upgrading and product innovation.

Leasing companies report a lack of awareness and understanding among SMEs about the possibility of financing their operations through leasing. Where SMEs may be aware of the existence of leasing, they are also reluctant to utilise it due to a lack of confidence in leasing companies or misconceptions with respect to collateral requirements, down payments and application procedures.

SMEs face challenges in adequately identifying their financing needs, assessing the palette of available financing options, and navigating often-complex application procedures. The 2015 World Bank survey of SME financing practices found that most SMEs in Azerbaijan do not keep financial records or prepare financial reports; in addition, the vast majority have no written business plan or strategic vision (World Bank, 2015^[5]). A 2016 World Bank survey found that only 35% of adults had an account at a formal financial institution,

only about 10% used money transfer operators, and surveyed adults achieved an average score of 3.9 out of 7 in financial knowledge questions (World Bank, 2016_[10]).⁷

Implementation of measures to improve SME access to finance are underway

Improving SME access to finance is one of the four strategic objectives of the SME Roadmap, which aims to (a) improve the insolvency regime by establishing an insolvency court for SMEs and a bankruptcy registry, (b) enhance the credit information infrastructure, (c) improve financial literacy levels among SMEs, and (d) foster SME access to alternative finance through a new regulatory framework and support programmes (CAERC, 2018_[4]). In addition to the SME Roadmap, the Strategic Roadmap for Development of Financial Services in the Republic of Azerbaijan sets out targets to increase the sustainability of the financial system, improve the quality of risk management processes and strengthen the financial system infrastructure (Center for Analysis of Economic Reforms and Communication, 2017_[11]).

In response to the recent banking crisis, the Central Bank of Azerbaijan withdrew six banks from the sector; after the Financial Markets Supervisory Authority (FIMSA) started its operations, six more banks (which had no potential for a capital increase) were closed, and two banks went through a process of voluntary consolidation. These measures have yielded results: during the first 7 months of 2018, the loan portfolio of banks increased by 5.6% (amounting to AZN 11.8 billion) and banks in Azerbaijan issued almost AZN 2 billion in new loans. Azerbaijan's banks have resorted to higher mortgage claims to hedge their risks, mainly pledging real estate as collateral.

In March 2018, the first private credit bureau in Azerbaijan, open also to leasing companies, was established, pulling together credit information from various sources, including utility companies. In addition, the State Registry of Movable Assets has been established, allowing SMEs to pledge moveable assets (e.g. cars, machinery equipment) as collateral. Azerbaijan has also established a Credit Guarantee Fund which aims to provide collateral support to entrepreneurs operating in non-oil sectors. It also provides interest rate subsidies which can significantly lower interest rates for SMEs. These programmes have great potential to support the uptake of external financing, especially for SMEs without a sufficient credit history.

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. The draft law aims at determining the rights, duties and responsibilities of both the lessor and the lessee and at introducing a risk sharing mechanism for leasing services. In addition, a newly drafted Securitisation Law aims at improving access to finance for leasing companies by determining the legal and economic basis for regulation and control of securitization activities.

Finally, in co-operation with the Asian Development Bank, Azerbaijan has established a working group bringing together the government, international organisations and businesses with the objective of determining measures and programmes to promote factoring as a viable alternative for SME financing.

⁷ The OECD conducted a cross-country financial literacy survey in 2017-18 as part of its technical assistance project. The results will be launched at an OECD/Russia high-level symposium in Moscow on 4-5 October 2018. A. Atkinson (forthcoming), "Levels of Financial Literacy in CIS countries".

Recommendations

Recommendation 1: Improve the legal and regulatory framework for leasing

As a first priority, the government should use the new law on leasing as an opportunity to improve the legal framework by clearly defining what constitutes a lease contract, leased assets and the responsibilities and rights of parties to a lease contract or a lease transaction. For example, it should establish the priority of lessors' claims to leased assets over other creditors' claims over lessees in case of bankruptcy; recognise the lessee's responsibility as the custodian of the leased equipment; create a level playing field between leasing, debt financing and other credit instruments; and introduce supervisory and licensing procedures where required. Furthermore, the legal framework should permit non-court repossession, so that lessors can repossess leased assets without burdensome court procedures (World Bank, 2004_[12]).

In this regard, the establishment of the State Registry for Encumbrance of Movable Assets is a step in the right direction to protect rights of the lessors and enable SMEs to put forward their movable assets as collateral. To support the development of the leasing market, the government should create a level playing field between leasing and debt financing. For example, this includes equal treatment of the interest payable on leasing and on bank loans (which are usually VAT deductible) or the inclusion of the leased assets on the balance sheets of entrepreneurs (IFC, 2009_[13]). To encourage new market entrants into the leasing sector, the government could promote fair competition in the leasing market. They should in particular ensure that the state-owned Agroleasing Open Joint-Stock Company does not offer underpriced products that distort the competitive landscape in Azerbaijan's leasing market.

To inform future policy making, and also monitor the impact of recently introduced policies and programmes, Azerbaijan should collect qualitative and quantitative data on SME financing. The OECD SME Financing Scoreboard (Box 4) provides a set of core indicators assessing SME access to banking and non-banking finance; these could form the basis for this data collection exercise, and would allow Azerbaijan to benchmark itself against OECD countries (OECD, 2018_[14]). Indicators include the percentage of short- and long-term loans to SMEs, government guaranteed loans to SMEs, interest rates and collateral requirements for SMEs, and loan rejection rates for SMEs.

Box 4. OECD SME FINANCING SCOREBOARD

Published annually, the report *Financing SMEs and Entrepreneurs – an OECD Scoreboard* helps fill the knowledge gap with regard to SME finance trends and conditions. It collects base data on debt-, equity- and asset-based finance, as well as on financing framework conditions, complemented by information on recent public and private initiatives to support SME access to finance. It constitutes a comprehensive framework for evaluating the financial needs of SMEs and determining whether they are being met. By collecting this information, it supports the design and evaluation of reforms on access to finance for SMEs.

The 2018 report covers 43 countries. Indicators describe and monitor developments in five areas: (1) the allocation and structure of bank credit to SMEs, (2) the extent of public support for SME finance, (3) credit costs and conditions, (4) non-bank sources of finance and (5) financial health.

Source: OECD (2018), *Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard*, OECD Publishing, Paris, http://dx.doi.org/10.1787/fin_sme_ent-2018-en.

Recommendation 2: Address supply-side barriers

Lack of external finance is a major impediment to the development of the leasing market, itself composed of SMEs. However, experience from other countries suggests that direct subsidisation of leasing companies can be harmful to the development of the industry (IFC, 2009^[13]). In this respect, the government – in co-operation with international donors, the central bank and commercial banks operating in Azerbaijan – could explore ways to encourage investment in the leasing sector. It could also enhance access to funding for leasing companies by providing guarantees, issuing bonds or securitising portfolios of leased receivables.

One way to promote leasing services and reduce the high risk premia facing SMEs would be to establish a risk-sharing mechanism. For example, in Lithuania, the Agricultural Leasing Guarantee Fund provides guarantees to leasing companies of up to 60% of the unpaid portion of the price of the new asset, manufactured not later than two years before the conclusion of a leasing contract, established in a leasing agreement. Azerbaijan could consider establishing such a leasing guarantee fund, or expanding the functions of the recently established Credit Guarantee Fund to cover leasing services (Agricultural Credit Guarantee Fund, 2018^[15]).

To improve financial and management skills of leasing companies, the central bank, in co-operation with the Financial Market Supervisory Authority could facilitate technical assistance programmes in the forms of training or advisory services. Such programmes should aim to support managerial skills, the development of new leasing products, and the ability of leasing companies to access new markets and increase their service-delivery capacity.

Recommendation 3: Improve financial literacy and stimulate SME demand for leasing

The government should help SMEs and entrepreneurs improve their financial literacy, so that they can accurately assess their options and prepare applications. The Central Bank of

Azerbaijan has been implementing the National Strategy for Financial Education since December 2016, but implementation remains at an early stage. The OECD/INFE *National Strategies for Financial Education* policy handbook (OECD, 2015) recommends a clear leadership and co-ordination structure, while also listing a number of case studies of successful structures of governance for national strategies that could be adapted to reflect the specific conditions of Azerbaijan. Financial literacy programmes for entrepreneurs should address and promote alternative finance instruments, such as leasing.

In addition to financial literacy programmes, the Ministry of Economy, the Central Bank and the SME Agency can carry out information campaigns and training to raise SMEs' awareness of alternative finance instruments and encourage them to seek the ones that fit their risk-profiles and growth needs. An SME information portal, if established, should also provide information and direction on identifying appropriate financing tools and navigating application procedures for different financing instruments.

4. Strengthening private sector engagement in policy making, delivery and advocacy

Implementing business climate reforms and creating a level playing field for enterprises requires co-operation between the government and the private sector. A government that listens to and co-operates with the private sector is more likely to design policies that address the needs of the business community, while also ensuring buy-in from businesses for their policies (Herzberg and Sisombat, 2016^[16]). This co-operation usually takes the form of a structured public-private dialogue (PPD), which allows discussion of policy priorities to improve the business environment and ensures their proper implementation (OECD, 2007^[17]).

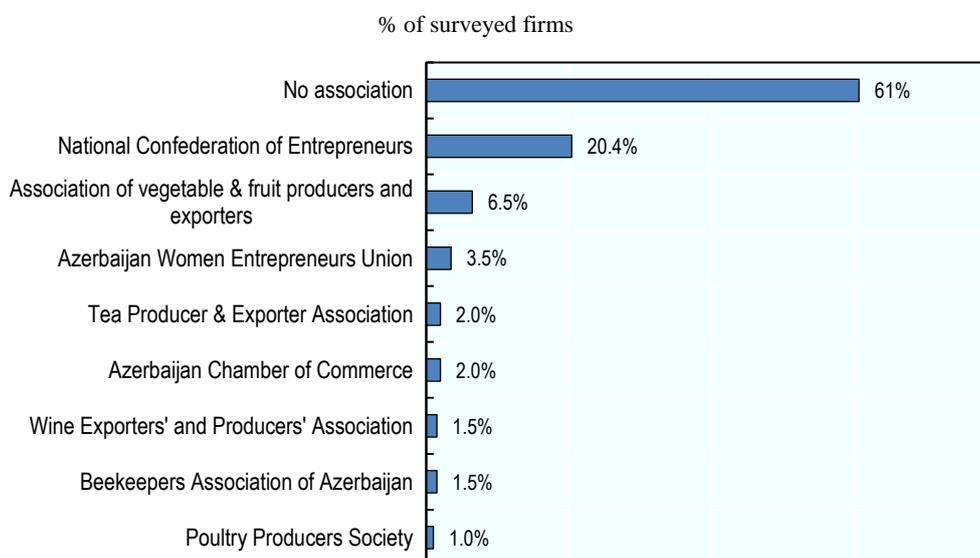
Without a formalised structure, private-sector actors are often unable to identify which part of the government administration should be contacted to address issues that arise in the course of business operations. This is especially the case for SMEs, since large enterprises are more likely to have access to alternative, informal communication channels, through which they can lobby for their interests. A formalised PPD platform also represents the government's commitment to involve the business community in the policy process and can build trust between the private and public sectors (OECD, 2007^[17]).

The heterogeneity of the private sector – which includes multiple actors with often diverse goals and priorities – can pose a barrier to the creation of such a dialogue. In this respect, business associations such as chambers of commerce and industry, trade and export associations and employers' confederations can play an important role. Business associations can help to identify, communicate and partially address the shared priorities of a diverse business community by undertaking various functions including: (a) engaging in policy advocacy with the government, (b) providing access to information and capacity building, (c) facilitating co-ordination among businesses (for example on production decisions that impact multiple firms), and (d) setting industry-specific standards and supporting quality upgrading (Bennet, 2007^[18]).

Azerbaijan's SME Roadmap sets out a strong commitment to improve co-operation between the government and the private sector by (a) improving the regulatory framework for public-private dialogue, (b) strengthening business associations representing SMEs by improving their financial sustainability and amending their legal status, and (c) expanding the services provided by chambers of commerce to enable them to serve as a bridge between the government and the private sector (CAERC, 2018^[4]).

There is scope to further develop business associations' membership and services

Business associations in Azerbaijan are still at an early stage of development. The most prominent business organisation is the Azerbaijan Entrepreneurs' Confederation (ASK), which has over 5 000 members, mostly medium-sized enterprises, and is recognised as an official policy partner through a Tripartite General Collective Agreement with the Cabinet of Ministers and the Trade Unions Confederation.

Figure 8. Membership in business associations

Note: The sample of the survey is not representative of the general business population in Azerbaijan

Source: OECD enterprise survey of Azerbaijan (2018). See Annex A for details on the survey methodology.

Constraints on the development of a wider variety of representative business associations in Azerbaijan remain. Private sector lobbying is not recognised, and many businesses rely on the government to provide the support infrastructure which effectively reduces the demand for services provided by business associations.

Measures to strengthen business associations are underway

The SME Roadmap envisages a revision of business associations' legal status that would reposition them within the existing legal framework and recognise their role and importance. This official recognition could increase the credibility of business associations and encourage SMEs to join them.

The low financial and skills capacity of business associations to provide their members with support services such as information support, training, and standard setting limits their ability to win SMEs' confidence and attract paid members. This in turn jeopardises the financial sustainability of business associations and their ability to invest in enhancing their internal capacities. As a result, most business associations in Azerbaijan either rely on public funds to finance their activities or are simply inactive.

In the long run, meaningful public-private dialogue would benefit from the emergence of business associations that can raise funds from their members and that are capable of providing effective representation and quality services in return. Otherwise, the risk is that such dialogue will be led by unaccountable "grantpreneurs" who rely on government funding and donor grants, and whose agendas may not accurately reflect the concerns of those they claim to represent.

The government has taken some steps to promote business associations among SMEs through the establishment of 15 sector-based export associations, including in agriculture, textiles, construction materials, furniture and tourism. Because these associations were

created recently, however, they still lack the capacity and know-how necessary to attract membership and provide support services.

Public-private dialogue could be further strengthened

Although public-private dialogue in Azerbaijan is regulated by the Law “On Public Participation”, it currently takes place in an *ad-hoc* manner. The private sector is not systematically consulted in the policy-making process and there are no requirements for new legislation to undergo a public consultation process. As a result, the private sector is not always given a formal opportunity to provide comments on business-related legislation, and where comments may be given there is no requirement for the government to take them into consideration or even to respond. Consultations with the private sector tend to be done mostly on an ad hoc basis, usually with the participation of ASK, which is the recognised policy partner. Where consultations do take place, their results are generally not made publicly available.

Recommendations

Recommendation 1: Improve the financial sustainability and expand the role of business associations

The new draft law on business associations provides a good opportunity for the government to endorse its role in the policy-making and SME-support space, and to provide legitimacy to its activities. The law should clarify the status of the business associations, their role in policy advocacy, their overall mandate, and the eligibility criteria for them to receive public support. In this respect, the Ministry of Economy should engage in a dialogue with existing business associations to identify their needs – although the new law should aim not only to support existing associations, but also to promote the creation of new ones.

Temporary public financing could be provided to the newly created export associations to promote their financial sustainability as they build up their membership. This type of support should be explicitly limited in duration, to avoid dependence on public support and to create strong incentives for them to serve their members and establish their independence.

In addition, the government could consider delegating certain government functions (such as the issuance of export certificates, permits, and certificates of origin) to business associations, to help build up their role and supplement the fees they receive from membership. Once the business associations have built sufficient internal capacity, the SME Agency could consider sub-contracting the delivery of certain services to business associations, such as geographical outreach, information provision, and provision of certain types of training. Technical assistance could be provided as an initial step to help the associations, particularly the newly established export associations, to develop the skills and capacity necessary to undertake these activities.

Recommendation 2: Establish regular public-private dialogue

The government should consider establishing a formalised public-private dialogue (PPD) platform with a mandate to determine policy priorities and consult on new legislation. Chaired at a high level (e.g. deputy minister or above), the platform should bring together representatives of public institutions responsible for the design and implementation of business environment policies (e.g. the Ministry of Economy, the Ministry of Taxes, the

SME Agency, the Customs Committee, FIMSA, AZPROMO), and the business associations representing various groups of enterprises (e.g. chambers of commerce, ASK, trade and export associations, international chambers of commerce). It should also ensure that the interests of SMEs are adequately represented. All business-related policies should be submitted to the members of the PPD platform for their review and feedback, *starting at an early phase of the policy process*. In addition, the platform could allow SMEs to express their views and contribute to the discussion remotely (e.g. via an online platform). The discussions and concerns raised should be communicated to the wider public and business community.

The PPD platform should promote trust and open dialogue, with the objective of discussing barriers to SME development that are not too sensitive or politicised and have the prospect of attainable results. In this regard, it can be useful for the PPD platform to prioritise the discussion of less contentious topics, for example business registration rather than land registration, or improving tax administration rather than revising tax rates (OECD, 2007^[17]). The platform should also be clearly linked to the existing working groups and the co-ordination council established by the government to oversee the implementation and monitoring of the SME Roadmap. Some general good practice principles on PPD platforms are outlined in Box 5.

The Georgian Private Sector Development Advisory Council presents one such example of a PPD platform. Established under the wing of the Ministry of Economy and Sustainable Development, the board of the Council is composed of representatives of the economy-oriented ministries as well as business associations. The Council is chaired by the Deputy Minister of Economy, with a deputy from the private sector. The Council meets on a quarterly basis and has a mandate to review and propose amendments to existing and proposed legislation, and to government support programmes for entrepreneurs. (Ministry of Economy and Sustainable Development of Georgia, 2018^[19])

Box 5. Good practice principles for establishing a public-private dialogue platform

1. **Create a legal mandate for PPD**, formalising its role and structure, while remaining cautious not to over-regulate.
2. **Establish a secretariat** to call meetings, determine the agenda, prepare minutes, run working groups, ensure the input is directed to the relevant bodies, and co-ordinate progress on decisions made during the consultation process.
3. **Allow open membership** with a strong emphasis on SME participation, and a clear understanding of the specific policy issues and the potential roles of different stakeholders (e.g. chambers of commerce, business associations, export associations).
4. **Create the capacity** for both sides to determine the agenda. Consultations should give both sides an opportunity to have an influence on the decision-making process. Policy makers should evaluate stakeholders' contributions and inform them about how they have been considered.
5. **Hold regular meetings**, especially when developing new policies, providing as much time as possible for the PPD platform to give feedback. New legislative proposals aside, the PPD should aim to meet on at least a quarterly basis.
6. **Create a two-way engagement** providing the opportunity for SME stakeholders to engage with the public sector on their priorities. Giving early informal feedback after consultation is a good way to maintain commitment and pass the message that stakeholders' contributions have been evaluated and taken into consideration.
7. **Assign a budget and establish a secretariat** to organise meetings, conduct research and analysis, and promote the meetings and their outcomes.

5. Establishing a results-based monitoring system

Monitoring is a continuous process of assessing the progress of a policy intervention against the plan – tracking inputs, direct outputs for beneficiaries, and ultimate economic impact. In addition to providing a measure of progress towards targets and objectives, it allows policymakers to obtain an early warning on potential problems, and to make the necessary adjustments to ensure that the plan remains dynamic and on-track. Monitoring should be embedded into the policy cycle and conducted on a regular basis, depending on the nature and time frame of the reform agenda.

Monitoring systems typically have the objective of evolving towards a results-based monitoring system that takes into consideration both resources (inputs and activities) and results (outputs, outcomes and impacts). More broadly, monitoring can be broken down into three categories: a) process-based, b) result-based and c) impact-based (this last category is often classified as “evaluation”). Monitoring is conducted through a set of quantitative and qualitative indicators, so-called key performance indicators (KPIs), which measure progress against the implementation plan, the immediate results of each reform action, and the long-term economic impact of reforms. KPIs provide an analytical basis for decision-making, help focus attention on what matters most, guide the collection of statistics, and increase the transparency of reform process.

The cross-cutting nature of SME policy reforms and the multiplicity of stakeholders create a need for a systematic and co-ordinated approach to the collection of information. Typically, the lead institution responsible for the implementation of SME policy reforms (e.g. ministries of economy, ministries of commerce, and others) has responsibility for this process, although the inadequacy of qualifications, experience, skills and resources dedicated to monitoring often means that it exists as an afterthought in most transition economies. Inconsistent data collection, particularly on outcomes and impact, further hinders the monitoring process. Often monitoring is limited to a reporting on how state resources are used, rather than on achievement of objectives and targets.

Systematic monitoring established through the central delivery unit

In Azerbaijan, the monitoring and evaluation of the SME Roadmap (as well as all other strategic roadmaps) has been entrusted to the Centre for Analysis of Economic Reforms and Communication (CAERC), which is also responsible for conducting economic analysis and forecasts, disseminating information and appraising the economic efficiency of state programs and investment projects. Under the SME Roadmap, a working group has been established, led by the Ministry of Economy and with the participation of other implementing ministries and agencies. The working group holds quarterly meetings to discuss implementation of the SME Roadmap.

Until now, CAERC has published two monitoring reports thoroughly analysing progress in the implementation of the SME Roadmap in the first half of 2017 and the full year 2017, respectively. The monitoring reports provide detailed information on the implementation

progress of each reform action, assess the performance of all implementation institutions and provide recommendations on how to further accelerate the implementation of the SME Roadmap. These reports are comprehensive, well structured, visually accessible and relatively easy to understand. Furthermore, the monitoring reports include an institutional ranking of implementing government agencies, and are widely disseminated and accessible to the general public.

The SME Roadmap has given a strong emphasis to monitoring, and a sound monitoring framework (with quarterly meetings and detailed reporting requirements) has been established on the basis of international good practices. Since the Roadmap is at an early stage of implementation, the current monitoring is mostly related to process rather than results. However, CAERC envisages conducting results-based monitoring starting from 2020.

Azerbaijan, in co-operation with experts from the World Bank, has developed a Result Framework for the SME Roadmap which identifies 11 KPIs, divided across five strategic objectives, covering 72 actions to be carried out by 25 public institutions. For example, four KPIs are assigned to innovation and research and development (R&D), and none to internationalisation of SMEs. However, the SME Roadmap does not distinguish between process, result and impact indicators, with most of the KPIs being related to immediate outputs only. In addition to the 11 KPIs, the Action Plan identifies a number of “result indicators”, which vary between generic process indicators (e.g. establish new industrial clusters) and overall reform targets (e.g. creation of 23,300 new jobs by 2020).

The relevance of these KPIs and “result indicators” could be improved: many are too vague to be measurable (e.g. creating a more favourable environment for women entrepreneurs); some are not specific to the actions to which they have been assigned (e.g. increasing GDP, ensuring skilled and highly qualified personnel in SMEs); and some will be driven more by the activity of large firms than that of SMEs (e.g. increasing the proportion of the non-oil economy by 5%).

Recommendations

Recommendation 1: Establish cross-government information gathering and strengthen reporting capabilities

While CAERC is clearly well positioned and equipped to conduct a sound monitoring of the overall SME Roadmap, the reporting capabilities and analytical capacity of implementing institutions could be further strengthened with the objective of embedding the monitoring process into the policy cycle. This would enable the Ministry of Economy to closely monitor the implementation of activities carried out by subordinated agencies (such as the SME Agency) on an ongoing basis, analyse their performance, assess the results of support programmes, and design complementary support measures in response to emerging needs.

CAERC would continue to be responsible for consolidating inputs received, verifying data, carrying out evaluations, and communicating reform progress to the government and general public, but could rely on more detailed and results-oriented reporting provided by implementing institutions.

Recommendation 2: Establish process, result and impact indicators for each reform action

The Ministry of Economy and CAERC, together with other relevant institutions and the private sector, could consider expanding the set of KPIs to ensure that progress along each action can be assessed using process and result indicators relevant to that action. For example, in the case of the credit guarantee fund, the amount of credit guarantees provided and success rates of loans could be added as result indicators. New impact indicators could also be identified, although they would often not be action-specific and could be assigned to each strategic objective; for example, “increase in SME exports” could be added as a new impact indicator on SME internationalisation.

New key performance indicators should be “SMART”: (a) **S**pecific – it should be clear what the indicator measures; (b) **M**easurable – the indicator should ideally be expressed in numerical terms (e.g. values, ratios, growth rates); (c) **A**chievable – the indicator should be realistic; (d) **R**elevant – the indicator should be closely linked to the objectives of individual measures; and (e) **T**rustworthy – the indicator should be based on reliable and replicable data. The limited availability of data is one of the main constraints to selecting better KPIs, and the Ministry may need to work with the National Statistics Office and the Central Bank (in the case of financing statistics) to produce more detailed and relevant SME performance indicators.

Using the above criteria as guidance, Table 7 provides examples of key performance indicators to monitor the process, results and impact of SME policies, according to the five strategic directions of the SME Roadmap. The proposed indicators are by no means exhaustive, nor prescriptive. They are intended to stimulate and inform a discussion on expanding the set of appropriate KPIs for the SME Roadmap.

Table 7. Examples of KPIs to monitor the results and impact of SME policies

Strategic targets	Priorities	Result indicators	Impact indicators (priority)	Impact indicators (strategic target)
<i>Improve business environment and regulatory basis for SMEs</i>	Establish centralised SME Agency	Number of supported SMEs	Performance of SMEs that received support	Annual growth of investment by SMEs Total early-stage entrepreneurial activity Growth of entrepreneurial activity by region
	Improve legislative basis for SME and implement regulatory impact analysis	Share of new SME-related legislation challenged by RIA	Number of amendments in legislation (as a result of RIA)	
	Deepen public-private partnership (PPP)	Number of PPP projects with SME participation	Share of SMEs on PPP projects	
	Improve the competitive environment	Number of competition sector studies conducted	Perception of SMEs on unfair competition practices	
	Improve the inspection and licensing mechanism and implement the tax reform	Complexity of the application process and time required to obtain licences	Time required to start a business	
	Establish special industrial zones and clusters for SMEs	Number of SME residents/members of industrial zones	Performance of SME residents and members of zones/ clusters (employment, turnover)	
	Widen public-private dialogue (PPD) and strengthen organisations representing SMEs	Number of formal consultations held	Results of dialogue taken into account (e.g. number of legislative pieces amended)	
	Improving alternative dispute resolution	Average cost of alternative dispute resolution	Number of SMEs having resorted to alternative dispute resolution	

<i>Ensure cost-effective and efficient access to financial sources for SMEs</i>	Reform bankruptcy and closure activities	SME bankruptcy recovery rate (cents per euro)	Time and costs to resolve bankruptcy	Annual growth rate of loans to SMEs
	Establish the credit guarantee fund for SMEs	Share of outstanding loans to SMEs (serviced by the credit guarantee scheme)	Performance of companies that received	Average interest rates for loans to SMEs
	Improve property registration system and increase financial accessibility	-	Acceptance of movable collateral by banks (share on total collateral)	Percentage of firms citing access to finance as an obstacle
	Facilitate SME access to finance by developing the leasing market and alternative financial instruments	Availability and accessibility of alternative financial instruments vs bank financing	Share of SMEs using alternative sources of finance	
<i>Increase SME access to foreign markets</i>	Improve financial services for foreign trade operations of SMEs and promote FDIs of foreign direct investment	Number of SMEs participating at fairs	SME export growth	Share of exporting SMEs
	Establish export associations for different sectors	Number of association members	Export growth of associations' members	Annual growth rate of SME exports
<i>Increase knowledge and skills of SMEs, accelerate introduction of best practices</i>	Develop business incubators and start up projects, establish model companies	Number of residents of business incubators	Performance of current and former residents	Share of enterprises citing "Inadequately educated workforce" as an obstacle do business
	Increase education and learning opportunities for SMEs	Number of VET students	Employment rate of VET graduates (1 year after graduation)	
	Promote entrepreneurial thinking	Reach of activities that promote entrepreneurship	SME birth rate	
	Develop women's entrepreneurship	Number/share of women participating in training programs	Share of new enterprises established by women	
<i>Promote SME innovation</i>	Improve national innovation system	Number of "triple-helix" projects involving academia, private sector and public sector	Share of SMEs introducing product innovation	Share of SMEs introducing product innovation
	Create innovation infrastructure stimulating innovation activities of SMEs	Number of innovation cluster members	Innovation performance of residents of the innovation clusters	Number of patents registered by SMEs

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Annex A. Methodology

The OECD's assistance to the government of Azerbaijan is being provided in the context of the multi-country project EU4Business: From Policies to Action, implemented by the OECD in the countries of the European Union's Eastern Partnership, with the financial support of the Union under its EU4Business initiative.

The overall objective of the project in Azerbaijan is to build the capacity of the country's institutions to implement and monitor the SME Roadmap.

The first step of the project was for the OECD, the Ministry of Economy of Azerbaijan, and other project partners to identify priority areas of the SME Roadmap for implementation. The project partners agreed that to focus on: (a) supporting establishment of the SME Agency, (b) improving SME access to alternative sources of finance and (c) encouraging co-operation between public and private sectors in policy making and implementation. A separate stream of work focused on supporting linkages between large enterprises and local SMEs (OECD, 2018).

The second step was to establish a Steering Group and a public-private Working Group, chaired by Deputy Minister of Economy Sahib Mammadov and Deputy Minister of Economy Niyazi Safarov, as the two main bodies guiding the project implementation. The purpose of the Steering Group, which is composed of high-level representatives from public sector, was to set the project priorities and endorse the proposed recommendations. The public-private Working Group, which comprises representatives from government, the private sector and international organisations, contributed to the analysis and discussed findings and recommendations.

The following project activities led to the analysis and recommendations included in this report:

- **Desk research:** The OECD carried out a review of existing policies, regulations and support programmes facilitating SME development in the country.
- **Enterprise survey:** A face-to-face survey of Azerbaijani companies was carried out in March-May 2018 by a survey management company based in Baku. Of the 201 enterprises that participated, 61% were based in Baku and 39% in the regions. The sample of the survey is not intended to be representative of the general population of firms and sampling was not random. Sectors of strategic importance were over-sampled, while many sectors were left out. Company details were in large part retrieved from a publicly available database⁸ of companies branded and promoted as "Made in Azerbaijan", and published on the Ministry of Economy's website.

⁸ http://www.economy.gov.az/media/pdf/katalog_ru.pdf

- **Semi-structured interviews and focus group:** A series of interviews were carried out with SMEs, and a private sector focus group was held in December 2017, organised and chaired by the National Confederation of Entrepreneurs (ASK).

The following meetings of the Steering and Working Group were held throughout the project implementation:

- **17 September 2017:** Formal launch of the project.
- **7 December 2017:** First Steering Group meeting and the first Working Group meeting to discuss (a) the role of SMEs in the economic diversification agenda, (b) monitoring of the SME Roadmap, and (c) the draft OECD Enterprise Survey of Azerbaijan.
- **6 June 2018:** Second Working Group meeting to discuss (a) initial survey results and (b) the roles and functions of the SME Agency.
- **26 September 2018:** Third Working Group meeting to discuss (a) linkages between SMEs and large enterprises and (b) SME access to alternative finance. The second meeting of the Steering Group served the purpose of discussing (a) draft recommendation provided and (b) a peer review of Azerbaijan during OECD Eurasia Week 2018.

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The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies. The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

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The OECD Eurasia Competitiveness Programme, launched in 2008, helps accelerate economic reforms and improve the business climate to achieve sustainable economic growth and employment in two regions: Central Asia (Afghanistan, Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan and Uzbekistan), and Eastern Europe and South Caucasus (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine). The Programme contributes to the OECD outreach strategy implemented by the Global Relations Secretariat.

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EU4BUSINESS

The EU4Business Initiative covers all EU support for small and medium-sized enterprises (SMEs) in the region of the Eastern Partnership, which brings together the EU, its member states and six partner countries: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.

www.eu4business.eu



AZERBAIJAN

DRIVING DIVERSIFICATION THROUGH STRENGTHENED ENTREPRENEURSHIP

In 2016, the Government of Azerbaijan adopted the *Strategic Road Map on Production of Consumer Goods at the Level of Small and Medium Enterprises in the Republic of Azerbaijan* (SME Roadmap) to promote SME development and stimulate economic diversification. In this context, the Ministry of Economy requested the OECD's support for implementing the SME Roadmap.

This Policy Insights report focuses on supporting SMEs through the newly established Agency for the Development of Small- and Medium-Sized Enterprises (SME Agency), increasing SME access to alternative sources of finance, improving private sector engagement in policy making, and establishing a results-based monitoring system for the SME Roadmap.

The main beneficiaries of this project are the Ministry of Economy, the Centre for Analysis of Economic Reforms and Communication, and the SME Agency as well as other SME stakeholders involved in the implementation and monitoring of Azerbaijan's SME Roadmap.

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