

Chapter 8. Azerbaijan: Small Business Act country profile

Following a global drop in commodity prices, Azerbaijan underwent a sharp recession in 2015-16. As part of its response to the downturn, the government launched an ambitious plan to implement reforms in 12 strategic sectors, including the SME sector, with the objective of diversifying the economy and improving the business environment. Under the umbrella of the “Strategic Roadmap for the Production of Consumer Goods at the Level of Small and Medium Entrepreneurship”, the main guiding document for SME development, the government launched a number of programmes and initiatives – from setting up a dedicated SME development agency and a credit guarantee fund, to measures supporting entrepreneurial learning and women’s entrepreneurship. Since the previous assessment in 2016, significant progress has also been made in improving the operational environment for SMEs and in expanding the provision of export support and promotion services.

Going forward, Azerbaijan could take further steps to ensure a level playing field for both SMEs and large enterprises by promoting a more competitive business environment, strengthening the rule of law and improving business integrity. Building on the revitalised SME support infrastructure, future priorities would be to ensure effective co-ordination of newly created entities and initiatives and to build capacities in key institutions, such as Azerbaijan’s new SME development agency, to help them effectively deliver on their mandate. Limited access to finance continues to be a significant barrier for SMEs, and it is important to ensure that recently adopted reforms are fully and effectively implemented.

Key findings

Figure 8.1. SME Policy Index scores for Azerbaijan

Country scores by dimension, 2020 vs. 2016

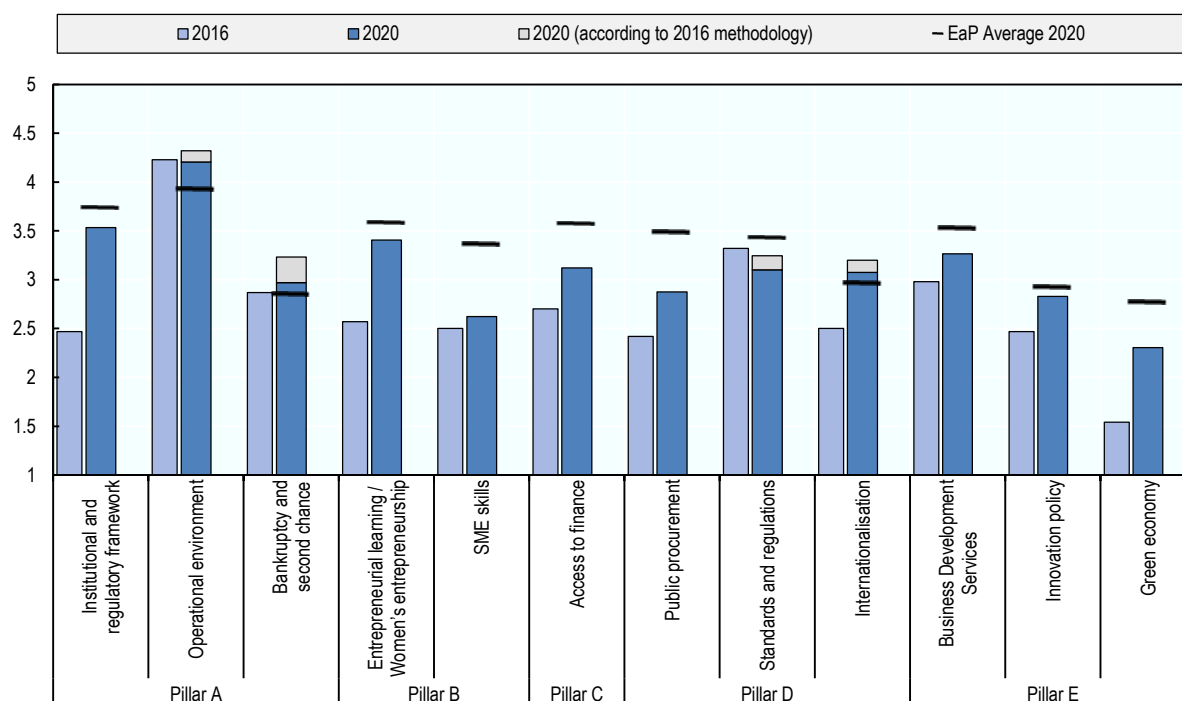
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Table 8.1. SME Policy Index scores for Azerbaijan, 2020 vs. 2016

Pillar	Dimension	AZE 2020	AZE 2016	EaP average 2020	AZE 2020 (2016 methodology)
A	Institutional and regulatory framework	3.53	2.47	3.74	3.53
	Operational environment	4.20	4.23	3.92	4.32
	Bankruptcy and second chance	2.97	2.87	2.85	3.23
B	Entrepreneurial learning / Women's entrepreneurship	3.41	2.59	3.58	n.a.
	SME skills	2.62	2.94	3.36	n.a.
C	Access to finance	3.12	2.70	3.57	3.08
	Public procurement	2.87	2.42	3.49	2.87
D	Standards and regulations	3.10	3.32	3.43	3.25
	Internationalisation	3.08	2.50	2.96	3.20
E	Business development services	3.27	2.98	3.53	3.27
	Innovation policy	2.83	2.47	2.92	2.82
	Green economy	2.31	1.54	2.77	2.31

Table 8.2. Implementation progress on SME Policy Index 2016 priority reforms – Azerbaijan

Priority reforms outlined in SME Policy Index 2016	Key reforms implemented so far
<u>Pillar A – Responsive government</u>	
Consider adopting a comprehensive SME strategy (potentially including an SME implementation agency)	2016-2020 SME strategy adopted and under implementation
Finalise the development of an RIA framework and improve the frameworks for licenses and permits	SME Development Agency established in 2017
	Licencing processes streamlined
	E-government services improved
<u>Pillar B – Entrepreneurial human capital</u>	
Establish a dedicated working group to develop the entrepreneurship key competence (across all levels of formal education) and a monitoring and evaluation framework	Well-functioning formal policy partnership in the area of women's entrepreneurship
Increase training and mentoring for high-potential women entrepreneurs	Policy partnership on entrepreneurial learning established, led by the SME Agency's Lifelong Learning Commission
	The country's SME agency mandated with co-ordinating stakeholders involved in skills intelligence collection and analysis
<u>Pillar C – Access to finance</u>	
Complete ongoing work on the draft legal frameworks for a private credit bureau, movable collateral registry and secured transactions; consider regulation on leasing	Private credit bureau and movable collateral registry in place
Continue capital market development under current state programme	Credit guarantee fund established
	Public-sector Entrepreneurship Development Fund and Credit Guarantee Fund established (will help ease access to finance)
	National Financial Literacy Strategy launched (under the auspices of the Central Bank of Azerbaijan)
<u>Pillar D – Access to markets</u>	
Develop and implement targeted support measures for exporting SMEs, including an enabling environment for trade finance	Export Promotion Centre established and information support and e-services for exporting SMEs expanded
Increase compliance of national technical regulations and standards with international and EU standards	Law on public procurement amended
	Standardisation and accreditation infrastructure strengthened
<u>Pillar E – Innovation and Business Support</u>	
Develop a comprehensive innovation strategy that encourages ICT uptake in all sectors of the economy (relying on locally developed ICT skills) and offer targeted SME support measures	National Innovation Agency established
Improve support for growing a business development support market	Three technology parks established
	SME agency tasked with designing and implementing a wide range of business development programmes

Context

Economic snapshot and reform priorities

Following an extended period of strong growth in 2001-14, Azerbaijan was hit hard by a drop in oil prices, coupled with an economic slowdown in regional trade partners, that resulted in a contraction of GDP in 2016-17. A modest recovery began in mid-2017, with growth reaching 1.4% the following year, supported by an increase in oil prices and more favourable economic conditions in the region.

Economic instability and depreciation of the local currency, which led to a sharp increase in inflation in 2016 and 2017 (12.4% and 12.8%, respectively), triggered a banking crisis. Twelve banks exited the market and credit to the private sector fell from 38.5% of GDP in 2015 to 20.8% in 2018, well below the respective EaP and OECD averages of 38.3% and 93.9% (World Bank, 2019^[1]).

The stock of foreign direct investment (FDI) has grown over the past two decades, reaching 70% of GDP in 2017 (UNCTAD, 2018^[2]). The oil and gas sector has received most FDI, while manufacturing has received only about 10% of total greenfield investment since 2003. The oil and gas sector accounted for 38% of GDP in 2018, and crude oil, petroleum

gas and refined petroleum continue to represent more than 90% of total exports (The State Statistical Committee of the Republic of Azerbaijan, 2019^[3]). As the authorities have long recognised, this leaves the economy vulnerable to commodity price shocks. The diversification of economic activity, employment and exports has thus become an important policy priority.

Agriculture is the largest sector in terms of employment (34% of the total active population and 5.6% of GDP in 2017) but suffers from low productivity and investment, in part owing to the fragmentation of the sector. In 2017, manufacturing accounted for just 5.2% of total employment and 4.7% of GDP and remains to be further developed (The State Statistical Committee of the Republic of Azerbaijan, 2019^[3]).

Table 8.3. Azerbaijan: Main macroeconomic indicators, 2013-18

Indicator	Unit of measurement	2013	2014	2015	2016	2017	2018
GDP growth*	Percentage, y-o-y	5.8	2.8	1.1	-3.1	-0.3	1.4
Inflation**	Percentage, average	2.4	1.4	4.0	12.4	12.8	2.3
Government balance ¹ **	Percentage of GDP	1.6	2.7	-4.8	-1.1	-1.4	5.6
Current account balance*	Percentage of GDP	16.5	13.6	-0.4	-3.6	4.1	12.9
Exports of goods and services*	Percentage of GDP	48.4	43.3	37.8	46.4	48.5	54.3
Imports of goods and services*	Percentage of GDP	26.3	26.2	34.8	43.6	41.9	37.7
FDI net inflows*	Percentage of GDP	3.5	5.9	7.6	11.9	7.0	3.0
General government gross debt**	Percentage of GDP	6.2	8.5	18.0	20.6	22.5	18.8
Domestic credit to private sector*	Percentage of GDP	25.2	30.6	38.5	32.9	22.1	20.8
Unemployment ² *	Percent of total active population	5.0	4.9	5.0	5.0	5.0	5.2
Nominal GDP*	USD billion	74.2	75.2	53.1	37.9	40.9	46.9

¹ General government net lending/borrowing.

² Modelled ILO estimates.

Source: *World Bank (2019^[1]), *World Development indicators*; **IMF (2019^[4]), *World Economic Outlook*, both accessed on December 2019

As a response to the diversification challenge, the government has launched an ambitious reform agenda to modernise the economy and enable a transition to a new economic model. In December 2016, the government adopted 12 “Strategic roadmaps for the national economy and main economic sectors”, detailing short- and medium-term goals for such sectors as oil and gas, agriculture, tourism, financial services and SMEs. The Center for Analysis of Economic Reforms and Communication (CAERC) has a mandate to oversee the implementation and monitoring of these roadmaps.

Business environment trends

In pursuit of the objectives outlined in the SME Roadmap, the government has streamlined administrative requirements, expanded e-government services and launched a number of policy initiatives aimed at stimulating private. As a result, the country ranked 34th in the 2020 World Bank *Doing Business* assessment. The most notable improvements have been recorded in the *getting credit* and *protecting minority investors* indicators (World Bank, 2019^[5]).

Azerbaijan ranks 58th out of 141 countries analysed by the 2019 World Economic Forum’s Global Competitiveness Index (GCI), showing considerable progress compared to 2018

(World Economic Forum, 2019^[6]). While GCI ratings confirm Azerbaijan's strength on a number of dimensions, such as inclusion and infrastructure, as well as business dynamism and the regulation of labour and product markets (areas of overlap with *Doing Business*), it also points to potentially serious constraints with respect to skills, and the financial system.

Business perceptions of the implemented reforms have been positive, with over 50% of businesses that participated in a 2018 OECD Enterprise Survey of Azerbaijan considering most reforms "good" or "very good" (OECD, 2019^[7]). The findings of the 2019 *EU Business Climate Report* for Azerbaijan suggest that while there is an overall satisfaction with the reforms implemented since 2016, more can be done in the areas of tax, judicial transparency and competition (AHK Azerbaijan, 2018^[8]). Interviews with local and international companies also indicate that the lack of a skilled labour force is a growing issue and the government could increase its efforts to match the outcomes of higher and vocational education with labour market needs.

SME sector

A new definition of SMEs was introduced in December 2018 with the objective of eliminating differences in the methodologies applied by the State Statistical Committee and the Ministry of Taxes. The new definition distinguishes between micro, small, medium and large enterprises, and is partially aligned with the EU definition, synchronising the criteria related to the number of employees.

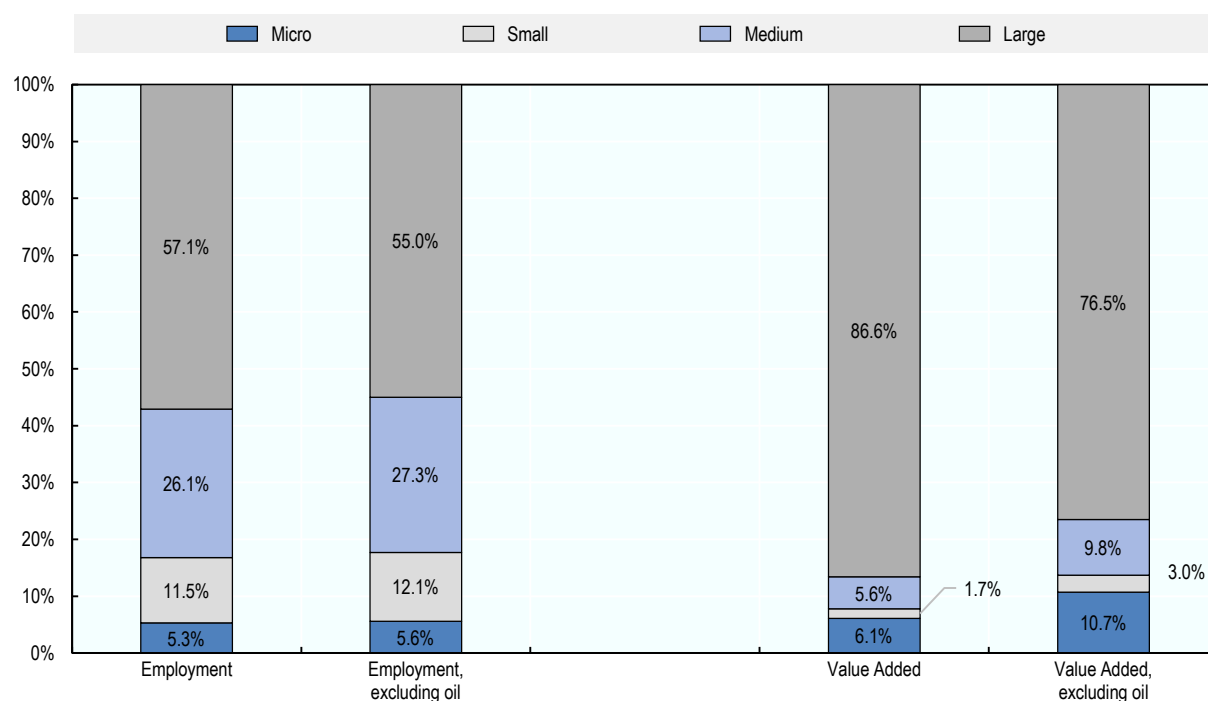
Table 8.4. Definitions of SMEs in Azerbaijan

	Micro	Small	Medium
Number of employees	< 10 employees	< 50 employees	< 250 employees
Turnover	< AZN 200 000 (EUR 104 000)	< AZN 3 000 000 (EUR 1 056 000)	< AZN 30 000 000 (EUR 15 690 000)

Note: Exchange rates as of October 2019, <https://www1.oanda.com/lang/it/currency/converter/>

Source: Cabinet of Ministers of the Republic of Azerbaijan, <https://cabmin.gov.az/az/document/3251/>

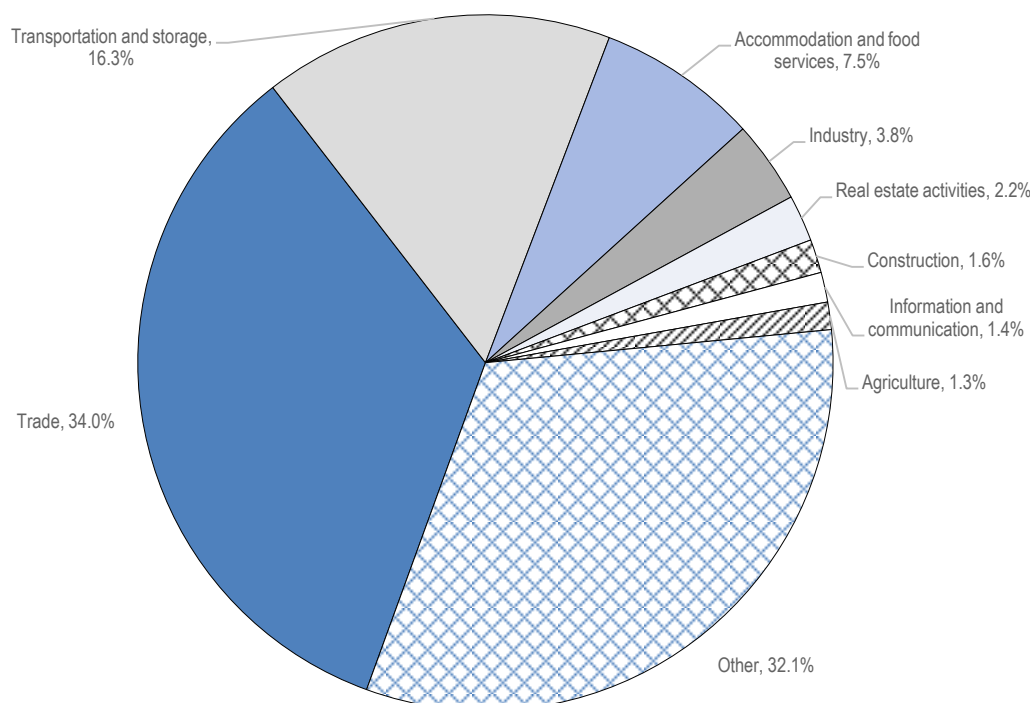
The economic potential of SMEs in Azerbaijan remains largely untapped. SMEs generated 13.4% of value added and 42.9% of total employment in 2018, compared to 60% of value added and 60-70% of employment in OECD countries. Regarding the non-oil economy of Azerbaijan, SMEs generated 23.5% of value added and 45% of employment.

Figure 8.2. Business demography indicators in Azerbaijan, by company size, 2018

Source: Azerbaijan State Statistical Committee.

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Most Azerbaijani SMEs are concentrated in relatively low value added activities, such as trade and repair of vehicles, transport and storage, and accommodation and food service activities (Figure 8.3).

Figure 8.3. Sectoral distribution of SMEs in Azerbaijan, 2018

Note: "Other" includes the mining industry, electricity gas and steam production, distribution and supply, water supply, wastes treatment and disposal, financial and insurance activities, education, information and communication, public administration, human health and social work, arts and entertainment.

Source: OECD calculation based on data from Azerbaijan State Statistical Committee.

StatLink  <http://dx.doi.org/10.1787/888934087344>

SBA assessment by pillar

Level playing field pillar

Competition

Azerbaijan has adopted a full set of competition provisions that should provide the basic building blocks for an effective competition law regime. The law prohibits anti-competitive agreements and abuses of dominant positions, and provides for merger control Figure 8.4. It also seems to provide all the necessary investigatory tools to request and compel information, and to sanction non-compliance with agency requests and interventions. All rules have been in place since the 1990s. The competition authority is the State Service for Antimonopoly Policy and Consumer Rights Protection (SSAPCRP), operating under the Ministry of Economy.¹ In addition to competition enforcement, the SSAPCRP is in charge of consumer rights protection and public procurement. Most, if not all, of SSAPCRP's efforts seem to focus on consumer protection. Application of competition law provisions remains limited.

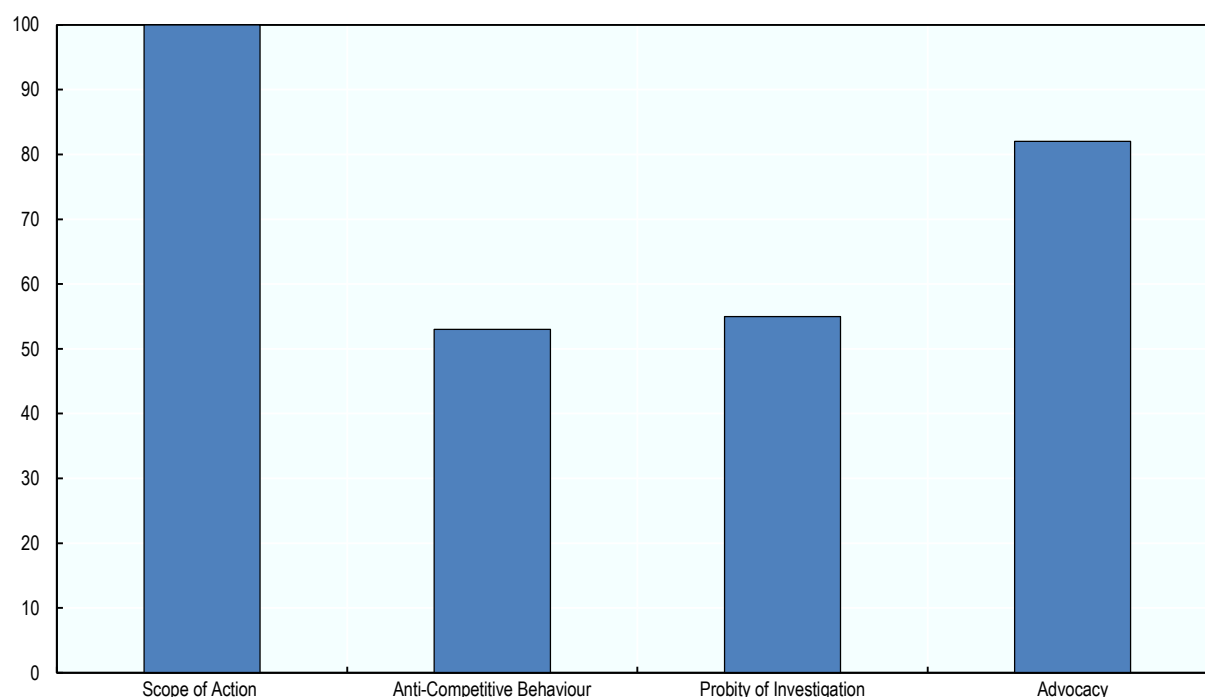
SSAPCRP has never intervened in a merger, and the total number of notified concentrations is low compared to the size of the economy. During 2016-18, the competition authority did not identify any signs of cartels and, hence, imposed no sanctions. While the law allows

for surprise on-site inspections (so-called “dawn raids”), this instrument has rarely been used, possibly because of the law on suspension of enterprise inspections.

SSAPCRP’s activity is comparatively opaque: its decisions are not publicly available, and SSAPCRP does not publish any procedural or substantive guidelines.

Figure 8.4. Competition policy in Azerbaijan

Percentage of formally adopted competition criteria, as of June 2019



Note: The chart above refers to the percentage of competition policy criteria formally adopted in the legal framework. It gives equal weight to all criteria. This does not illustrate actual enforcement activity in terms of relevance or quantity, and about the relevance of the criteria lacking or met.

Source: SBA questionnaire, interviews with SSAPCRP and business associations.

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Pending changes to the Competition Code are meant to address some of these issues. The anticipated new Competition Code will provide for a leniency programme, introduce a procedure for unannounced inspections, and provide a new method for calculating fines based on the annual revenue of the offenders. Moreover, the creation of a more independent competition authority is planned.

These changes will be most welcome and will bring Azerbaijan more into line with international practice. SSAPCRP’s almost exclusive focus on consumer protection will not address structural problems in markets that can enable some firms to exercise unfair business practices. The instruments that can address these problems, and help to prevent or remedy concentrated or collusive market structures, are merger control and a determined fight against cartels. Lack of enforcement comes at a high cost to the society and benefits the powerful few. Consumers pay higher prices, SMEs are discouraged from entering markets, and investment, innovation, productivity and growth suffer. Rigorous application of the new amendments to the Competition Code will be critical to realising their potential.

Serious competition enforcement requires an independent enforcement body endowed with sufficient resources to carry out its mandate. Businesses will only trust in an independent enforcer if they are confident of its political independence and its integrity. Apart from structural independence, this requires the agency to be able to attract and retain highly qualified staff, and to have adequate IT and other resources.

The creation of a competition culture is an enduring task in all jurisdictions, regardless of their experience and enforcement level. In order to generate widespread support and respect for competition law rules, the SSAPCRP needs to make society aware of both the existence of the rules and the benefits of their implementation. This requires constant communication with all layers of society, and both transparency and enforcement of the rules.

Contract enforcement and alternative dispute resolution

Contract enforcement in Azerbaijan has been recently reinforced through establishment in 2019 of specialised courts to treat cases related to entrepreneurship disputes. In addition, the government has made significant efforts to improve the efficiency and transparency of contract enforcement procedures by introducing court automation. Following the Presidential Decree “On establishment of the Electronic Judicial Information System” in 2014, the automated random distribution of cases to judges was put in place and is now operational in 60% of courts across the country. Court infrastructure has undergone modernisation since 2015 to welcome the new electronic judicial information system (AZEMIS). Other important developments have been introduced with amendments to the Code of Civil Procedure, such as simplified procedures for small claims, e-court proceedings for commercial disputes, e-payment of court fees and electronic document flow within the courts. The challenge now is to ensure that these very welcome measures are fully implemented and that a monitoring system is put in place to address the potential vulnerabilities of the e-case assignment system. In addition, the implementation of the 2019 President’s Decree on deepening the reforms in judicial system is expected to contribute to a more conducive environment for entrepreneurs.

Intellectual property rights (IPR) protection in Azerbaijan remains weak – the WEF Executive Opinion Survey (part of the Global Competitiveness Report) shows an average score of 5.2 out of a possible 7 in 2019, ranking the country 30rd of 141 (World Economic Forum, 2019^[6]). IPR-related cases are treated within the general court system. Specialised courts, or arrangements for ensuring judges with strong IP experience and expertise, could do much to strengthen such protection.

Private-to-public litigation needs to be strengthened when it comes to ensuring protection of SME property rights. Evidence shows that in cases when a business appeals administrative decisions affecting its property rights and wins a court decision in its favour, the enforcement of such a decision, against public authorities, tends to be long and insufficiently supervised by the judge; often, such judgements are simply not enforced (Council of Europe, 2016^[9]). In this regard, the establishment of an efficient mechanism (e.g., a business ombudsman) for protecting legitimate business interests against the actions of public authorities could significantly strengthen property-rights protection for SMEs.

Alternative dispute resolution (ADR) mechanisms are relatively new to Azerbaijan. The 2019 Law on Mediation regulates the status of mediators in commercial and administrative dispute resolution, and will enter into force in 2020. In order to improve the effectiveness of international commercial arbitration procedures and ensure proper training of judges treating administrative disputes in the area of taxes, customs and social insurance, the Ministry of Justice has requested an EU support that would be provided through a dedicated

EU technical assistance project. Furthermore, the recent establishment of the Office of Tax Ombudsman² helps taxpayers resolve issues that arise when dealing with the tax authorities without going to court. The institution is also responsible for supporting the dialogue between taxpayers and the tax administration. This is a welcome development that can be seen as a first step towards the establishment of a more evolved institution in charge of representing private sector interests in case of unlawful action or inaction of the public authorities.

Business integrity

Although Azerbaijan does not yet have a risk-based business integrity policy,³ business integrity was indirectly addressed by the National Action Plan on the Promotion of Open Government (2016-2018) through measures directed at preventing corruption and promoting transparency and accountability in the private sector. Overall, the government's efforts to improve the business environment and promote public sector transparency have had a positive effect on reducing corruption (ACN, OECD, 2016^[10]). Going forward, the government could work closely with business associations to conduct surveys or studies to assess corruption risks in the business sector and to measure the impact of existing business integrity measures (ACN, OECD, 2019^[11]).

The recent introduction of criminal liability of legal persons for corruption offences is an important step towards stronger corruption prevention in the private sector. At the same time, disclosure of beneficial owners of companies – another important element for greater private sector transparency – is obligatory only for companies operating in the financial sector. Other businesses, including SMEs, are not currently obliged to disclose their final beneficiaries.

When it comes to reporting corruption, despite rising demand from civil society and business associations, the government has not yet adopted whistle-blower protection legislation. The existing channels for reporting corruption seem to be rarely used by the private sector and the statistics on the number of corruption reports by businesses are not available.

Azerbaijan has conducted several awareness-raising activities on corruption prevention in the public sector (e.g. the development of its National Corruption Barometer), namely through co-operation between the Azerbaijan Anti-Corruption Academy and the Commission on Combating Corruption. However, little has yet been done to promote business integrity measures, including through collective action involving companies, business associations and government (ACN, OECD, 2019^[11]). The government could consider expanding the scope of awareness-raising activities on business integrity, including through introduction of dedicated sessions on SME-related issues, introducing financial and other incentives for adoption of compliance mechanisms by companies (i.e. tax reductions, integrity awards, use of compliance programmes as mitigating defence, etc.) and working more closely with business associations to support business integrity initiatives.

Pillar A – Responsive government

Institutional and regulatory framework

Since the 2016 SBA assessment, Azerbaijan has made major progress in putting in place the main building blocks of a proactive SME policy and in mobilising the necessary human

and financial resources to support it. Such major improvements are reflected in a substantial increase of the score for this dimension (+ 1.06 points).

A comprehensive Strategic Road Map for the Production of Consumer Goods at the Level of SMEs (the “SME Roadmap”) addresses five strategic targets for SME development: 1) improving the business environment and regulatory framework for SMEs, 2) ensuring access to finance for SMEs, 3) increasing internationalisation of SMEs, 4) increasing SME skills, and 5) promoting SME innovation. The SME Roadmap includes a set of time-bound (2020) quantitative targets for the SME sector, such as a higher share of SME contribution to GDP (15%), employment (20%) and non-oil exports (10%), complemented by key performance indicators. The document comes close to being a medium-term SME strategy and is an essential component of the country’s economic diversification strategy.

The establishment of a dedicated Small and Medium-Sized Business Development Agency (SMBDA) in 2017 represents a major milestone in shaping the SME support infrastructure. 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. Currently in an early operational phase, the agency is expected to have a staff of 240 and to operate through its headquarters in Baku and a network of regional offices called, respectively, SME House in the capital and SME Friends in the regions. However, it is now important to make sure that the newly established agency has appropriate resources to fulfil its mission. Additionally, a demand-driven, collaborative approach to designing support programmes should be adopted to ensure a better fit between public action and SME needs. Finally, the agency could consider leveraging the private sector for the delivery of support programmes which could boost the efficiency of the SME support ecosystem.

The establishment of the CAERC, which reports directly to the Presidential Administration, was another important institutional development. The CAERC is in charge of conducting economic analysis and elaborating proposals for economic reforms supporting the implementation of the country’s 12 Strategic Road Maps and transformation strategy.

Box 8.1. Monitoring of the SME Roadmap

To monitor the implementation of the 2016-2020 SME Roadmap, Azerbaijan has established a dedicated Working Group under the Ministry of Economy that meets on a quarterly basis to discuss the implementation of the SME Roadmap and agree on the next implementation priorities. The CAERC has been entrusted with conducting detailed monitoring of the SME Roadmap’s implementation. Since 2017, the Centre has published three monitoring reports, which provide detailed information on progress made in each reform action, assess the performance of all institutions involved, and recommend ways to further accelerate implementation. These reports are comprehensive, well-structured and accessible to the general public.

While much has been done to simplify existing regulations and reduce the administrative burden, Azerbaijan can do more to ensure that new laws and regulations do not reverse the progress achieved. Azerbaijan is at a very early stage with respect to the introduction of RIA for new laws and regulations. The CAERC is working on this and has conducted a series of workshops on the subject, but no formal government decision has been taken in this direction. The CAERC may in due course be tasked with a particular RIA function,

since this would ensure that impact analysis is conducted at arm's length from the ministries and other bodies responsible for adopting new rules and regulations.

To date, the reform process in Azerbaijan has largely been driven from the top, with modest involvement of private sector organisations in policy making. This is partly due to the relative weakness of private sector organisations (particularly those representing SMEs) and partly due to the country's economic structure, in which a number of large conglomerates playing a leading role. It also reflects relatively underdeveloped formal channels for public-private dialogue. However, individual ministries have started to conduct informal consultations with the business community – as in the case of the Ministry of Taxation, following extensive changes to the Tax Code and the Ministry of Economy, through the “Open Door Day” initiative. Such developments are promising and should be built on.

Operational environment for SMEs

Since the previous SBA Assessment was completed in 2016, Azerbaijan has advanced in the dimension related to the operational environment for SMEs, despite having started from a relatively high base.

Due to considerable investments in its IT infrastructure, Azerbaijan has built an advanced e-government system with many open government practices, following the implementation of a National Action Plan for the Open Government Initiative, which was completed in 2018. Currently over 450 e-government services are available through a new web portal (www.digital.gov.az), including those closely related to enterprise activity (tax filing, property registration, company registration, etc.). Both e-signature and m-signature systems are in place and data show that usage by enterprises and individuals is growing. To better co-ordinate the provision of e-government services by the different branches of the public administration, the government has established the E-Government Development Centre, operating under the State Agency for Public Service and Social Innovations and reporting to the Presidency.

Company registration procedures are becoming simpler and are now mostly conducted online. According to the 2020 *Doing Business* report, it takes three procedures and 3.5 days to complete the process of starting a business, at a cost equivalent to 1.2% of the country's income per capita (World Bank, 2019^[5]). Applications are channelled through a single-window/one-stop shop and each newly established company receives a unique identification number. The system for issuing licences has been simplified and a full set of information on licensing requirements and application procedures has been placed on a single web portal (<https://lisenziya.gov.az/az>).

Azerbaijan has also achieved considerable progress in the area of tax compliance procedures. The government has significantly curtailed the rights of the tax authority to directly withdraw payments for tax liabilities from company accounts without a court order, a practice severely criticized by private sector organisations. It has also introduced a number of amendments to the Tax Code, which entered into force on 1 January 2019, aimed at supporting entrepreneurship, innovative companies and activities in the non-oil and gas sectors, while enlarging the tax base and reducing informality. All of this is reflected in the 2020 *Doing Business* indicator on paying taxes. The number of yearly tax payments is nine, while the number of hours required to fulfil tax administration procedures per year is 159, well below the regional average of 220 hours. The post-filing index, covering VAT reimbursement and tax auditing procedures, is also slightly higher than the regional average at 83.8/100.

Bankruptcy and second chance

The Law on Insolvency and Bankruptcy (1997), the Civil Code (2001) and the Civil Procedure Code (1999) continue to be the main legislative documents regulating insolvency and bankruptcy procedures. Since the previous SBA assessment, major improvements have been introduced to the insolvency framework (51 amendments since 2015; new Law on Secured Transaction with Movable Property in 2017), notably enhancing the protection of creditors' rights, extending the scope for restructuring of financially distressed businesses and strengthening the obligations for bankruptcy administrators. Such legislative changes are reflected in *Doing Business 2020*, in which Azerbaijan significantly improved: it now holds the 47th rank in resolving insolvency – compared to the 94th rank in 2015 (World Bank, 2019^[5]). Nevertheless, it is not yet clear whether the insolvency framework is efficiently used in practice, as bankruptcy cases remain very rare. Most owners sell all their assets or reach an amicable agreement with the creditors before the initiation of bankruptcy. Of course, that does not mean the reforms have had no effect, since such sales and negotiations are shaped from the outset by the parties' awareness of their expected returns in the event of liquidation. It does, however, make it harder to assess the impact of the new framework.

In addition, the law continues to focus on liquidation procedures while placing little emphasis on restructuring or mediation procedures. This might explain entrepreneurs' continuing reluctance to engage in formal procedures. Although out-of-court settlements (mediation) were recently introduced in the legislation, the Ministry of Justice reports that the procedures are not yet applied. The absence of simplified or pre-packaged in-court proceedings specifically targeting SMEs also prevents small businesses from engaging in costly formal insolvency proceedings. Moreover, bankruptcy administrators are not yet properly overseen – the legislation contains no registration or licensing requirements and no provisions on ethics or work standards for administrators. Finally, the lack of specialised courts for insolvency cases, and the suboptimal nature of the credit reporting institutions, add to the structural weaknesses of the insolvency framework. Further improvements to the insolvency framework in the areas outlined above would do much to bring it fully into line with international standards.

Prevention measures to support financially distressed entrepreneurs, an area assessed by the SBA assessment for the first time, have yet to be introduced and implemented in Azerbaijan. Although SMBDA provide financially distressed companies with consulting advice and information, systematic pre-insolvency tools (websites/call centres), training and early-warning systems are key practices that Azerbaijan could consider adopting, together with a dedicated policy strategy or information campaign to promote second chance for entrepreneurs seeking a fresh start.

Pillar B – Entrepreneurial human capital

This section focuses on the human capital dimensions of the Small Business Act for Europe. First, it examines how entrepreneurial learning is addressed in the education system, with an emphasis on entrepreneurship as a key competence – a factor in Azerbaijan's wider drive for competitiveness, growth and employment. It then describes recent developments in women's entrepreneurship. Finally, both policies and support for SME training are addressed.

Since 2016, progress has been made, but impact is yet to be seen as reforms only started in 2018. A structured national partnership for entrepreneurial learning has been set up, strategic roadmaps and state programs ensure guidance, education-business co-operation

in VET and Higher Education remains intact, and practical entrepreneurial experience is compulsory in selected VET and higher education specialities. Still, the narrow focus on financial and economic literacy remains, not covering all aspects of the entrepreneurship key competence. A structured partnership in women's entrepreneurship has been established and policies developed. Support has been mainstreamed into national action plans, but co-operation with NGOs and communication actions are to be improved. SME skills intelligence is weak, and no evidence of systematic training-needs analysis has been identified. The SME agency should build on the policy measures that worked well in the past.

Entrepreneurial Learning

Entrepreneurial learning is important to efforts to tackle youth unemployment, which is higher than for the whole population (12.9% in contrast to 5% for the age group of 15+ in 2017) – especially in VET because secondary vocational education graduates underperform those from secondary general education in finding work. Also, high levels of self-employment driven by family businesses show the potential of entrepreneurial learning. The SME Agency's Lifelong Learning Commission leads a structured policy partnership, coordinating the activities of government and non-government actors. Official documents like strategic roadmaps create a transparent and supportive policy background.

However, the learning module, materials, guidebooks, and online sources for VET and higher education cover only parts of the key competence, like financial and economic literacy, planning, idea creation, market analysis or legal aspects. Primary, lower and upper secondary education are not involved. Practical entrepreneurial experience is compulsory in selected VET and higher education specialities, e.g. through student companies, company visits, participation in fairs and events or, for higher-education students, in factories and techno-parks. Secondary education is excluded. Bachelor programs like Commerce, Business Management and Economy or secondary vocational schools in some specialties include 14 weeks of practice.

Self-employment is a career option in career guidance in initial and secondary vocational education and higher education, according to the State Standards of Initial Technical Vocational Education and the Career Guidance Action Plan for Initial Technical Vocational Education Schools. Education-business co-operation supports this; e.g. Memoranda of Understanding between the VET agency and about 100 enterprises facilitate company visits, practical training and exchange. Co-operation between higher education and business is based on bilateral agreements to establish techno-parks, incubators, innovation centres or labs within universities or branches in companies. Co-operation between SMEs and general secondary education is reduced to ad hoc actions like "open door" days.

National action plans implementing strategic roadmaps have clear allocated funds and include the promotion of formal and non-formal entrepreneurial learning in VET. Monitoring and evaluation are part of roadmaps clarifying responsibilities, reporting, monitoring, deadlines and budget sources. VET students (school level) and general secondary students (national level) are tracked, as school management reports to the Ministry of Education annually about graduates' employment.

Looking forward, in the short term, there is a need to introduce annual work plans for the Lifelong Learning Commission and to develop an agreed understanding of what the entrepreneurship key competence means for Azerbaijan – considering, for example, the 2018 Recommendation of the European Parliament and of the Council on key competences for lifelong learning. Subsequently, a dedicated strategy defining the key competence and

reform path should be created. In the medium term, entrepreneurship as key competence should be developed at all education levels, through the use of active teaching and learning methods and training for pre- and in-service teachers as well as school and university managers. Teacher-qualification standards to introduce a key competence approach are required. Also in the medium term, a system-level approach to education-business co-operation also for general secondary schools is needed, e.g. by extending the Career Guidance action plan and introducing incentives for businesses, e.g. on taxes (ETF, 2016^[12]). Monitoring and evaluation should be enhanced by focusing on progress and performance in implementing entrepreneurial learning, by involving non-government organisations and by sharing the results of reforms with the public. Finally, student tracking should be extended to at least two years to determine impact on employability.

Women's entrepreneurship

The share of women among self-employed is more than 50%, whereas only 39.4% of women are employers, showing potential for creating employment opportunities and contributing to growth. The social commission of the SME agency leads a structured policy partnership and involves all stakeholders in the country – like the Women Entrepreneurship Development Association, a non-government organization uniting companies owned and managed by women. Official policy documents like strategic roadmaps for the production of consumer goods at the level of small and medium entrepreneurship (2016), and for the production and processing of agricultural products (2016) as well as the state program for socio-economic development of regions (2019-2023) provide clear orientation on management, coordination and monitoring and evaluation.

The roadmaps include actions like developing incentive mechanisms for lending, taxation and other privileges for women entrepreneurs with the focus on women in rural areas, or, the establishment of women's business incubators, or, providing consulting services for young people including young women (self-employment and family business) in rural areas.

Box 8.2. Promoting women's entrepreneurship in Azerbaijan

Azerbaijan's strategic roadmaps are ensuring the continuation of the country's well-developed support for women's entrepreneurship, which was already evident in the previous SBA assessment. They clearly define key and co-implementers, frequency of meetings, deadlines and resources. The key responsible body establishes a working group with relevant government and non-government organizations in charge of implementation. Roadmaps ensure cross-linking between ministries and the three human capital development dimensions and set the basis for progress monitoring, whereas evaluation of specific women's entrepreneurship support policies and government programmes needs yet to be ensured.

Support for women's entrepreneurship is mainstreamed into the action plans of ministries of economy, labour and social protection, youth and sport as well as business associations. It covers actions like sharing the good practices of successful women entrepreneurs through international and national events, e.g. the "SHE Congress" or the "New Opportunities on the Horizon: Green Light for Women Entrepreneurs" conference. A strong monitoring and evaluation system is in place. The working group on women's entrepreneurship monitors

progress and CAERC evaluates, analyses and provides recommendations. Each Ministry also has a gender focal point.

Looking forward, there is a need to develop a dedicated communication plan for women's entrepreneurship and to integrate it in action plans of roadmaps. In the short-term, annual work plans for the Social Commission should be introduced, also to facilitate information sharing, especially with non-government organisations. Female role models from regions should be identified in a multi-stakeholder approach based on predefined selection criteria (good practice). Capacity building for NGOs and business associations is required to improve their performance in supporting women's entrepreneurship and to participate in monitoring and evaluation exercises of the Centre of Analysis of Economic Reforms and Communication. Support for NGOs should be extended to services like the provision of equipment and offices.

SME skills

The majority of businesses are SMEs, and most SMEs are individual entrepreneurs who lack the resources necessary to be involved in skills intelligence collection and analysis. But although the SME sector's contribution to the economy is small, it offers important employment opportunities. A big step ahead to support SMEs in improving the quality of human capital was the foundation of the SME agency, which coordinates stakeholders involved in skills intelligence collection and analysis, including training-needs analysis surveys. However, the agency has been active only since June 2018. Currently, the training centres of various ministries follow their own approaches, and training offers are driven more by supply than demand.

On the other hand, the government already financially supports relevant training for SMEs. Also, SME participation in international fairs, study visits and events to facilitate business to business and people to people contacts is supported by the SME agency, the Export and Investment Promotion Foundation, the Ministry of Economy, the Council on state support for NGOs, NGOs, and international donors. The support efforts reach out to family businesses, youth, women, start-ups and SMEs with potential for growth, internationalisation and participation in global supply chains. Special emphasis is given to helping SMEs participate in the evolving digital economy. At an initial stage, training for SMEs in the green economy and online training for SMEs are also offered.

Roadmaps, state programs and their action plans clearly define the monitoring and evaluation approach; they clarify reporting and monitoring against objectives as well as deadlines and available budget sources. An SME Registry is currently being formed to record statistical data on SME training, including data on training participation disaggregated by sex.

There is a need to build on the skills intelligence approach used in previous years, which included training needs assessment and stakeholder coordination, e.g. by the Baku Business Training Centre (BBTC) and its regional offices. Data collection instruments should target the needs of specific groups, like women entrepreneurs or specific sectors, and be complemented with other instruments, like focus groups. Information on SME training could be provided on the SME agency website, and training offered for SME support institutions on objective setting, service provision to SMEs and resource efficiency. The agency should monitor government-financed training courses, and the CAERC should evaluate the effectiveness of SME training programs and the impact of training on SME performance. Measures to improve coordination of actions and to facilitate communication

with the policy partners, wider public and non-government organisations are needed to ensure co-operation in the provision of high-quality support for SMEs.

Pillar C – Access to finance

Azerbaijan has made good progress in facilitating SME finance. Significant legal and regulatory reforms have been implemented in recent years that will help ease access to finance and improve public confidence in the banking sector. Nevertheless, financial inclusion for SMEs remains limited, as public sector financial programmes are fragmented and un-targeted. The new strategy for financial literacy, if well co-ordinated, could help to increase low levels of financial awareness in the medium-to-long term.

Legal and regulatory framework

Azerbaijan has made significant progress in strengthening the legal and regulatory framework facilitating access to finance for SMEs and several recommendations of the 2016 assessment have been addressed. In 2017, a new secured-transactions law established a functional transactions system in line with the practices of the United Nations Commission on International Trade Law (UNCITRAL). In addition, amendments to the bankruptcy law provide secured creditors with grounds for relief and time limits during an automatic stay, and exempt them from insolvency proceedings (see further dimension on bankruptcy). The rights of minority shareholders have also been strengthened.

Several measures have been adopted to broaden the availability and scope of credit information; this is expected to ease access to finance, particularly for SMEs with typically limited credit histories. A modern, centralised and digital database for property registration, as well as a State Registry for Movable Assets, have both been established. In addition, Azerbaijan's first private credit bureau was created in 2018 upon the initiative of several banks, following legal changes in 2016. Although its services are still limited, the new credit bureau already covers around 44.6% of the adult population (compared to 28.7% covered by the public credit registry in 2014) and includes data from insurance providers, leasing companies and utilities (World Bank, 2019^[5]).

Finally, although capital market finance was somewhat strengthened with the establishment of a centralised trading system (CETA) at the Baku Stock Exchange in 2016, capital-market finance remains underutilised and does not provide a genuine financing alternative for SMEs.

Sources of external finance for SMEs (bank financing, non-bank financing and venture capital)

The economic downturn and currency devaluation hit the financial sector hard. Lending contracted but has since rebounded somewhat. As of the first quarter of 2018, private sector lending was significantly below regional peers, at just above 20% of GDP (World Bank, 2018^[13]). Lending is dominated by conventional bank finance, which mainly services medium-to-large enterprises and those located in Baku. Though somewhat eased since the last assessment, interest rates remain high, and, given the lack of tailored financing options to address their needs, smaller enterprises continue to rely chiefly on internal funding or personal loans. To tackle high levels of dollarization, the regulator has limited foreign currency lending to companies without hard currency income; however, in particular deposit dollarisation remains high at around 60%, posing significant foreign exchange risks.

In 2016 the Financial Market Supervisory Authority (FISMA) was established to strengthen financial sector supervision. Following amendments to the banking law in 2017, the industry was consolidated, with several banks merging or ceasing operations. The adoption of a decree on non-performing loans in early 2019 is expected to further strengthen the performance of the financial sector. While the establishment of FISMA is an encouraging step to ensure sound banking and a level playing field within the industry, further efforts should be made to ensure its independence and enforcement capacity.⁴ Transition to Basel II regulation is currently ongoing, with plans to adopt Basel III regulation in the future.

The Entrepreneurship Development Fund, established in 2018 as a successor to the National Fund for Entrepreneurship Support, offers loans to SMEs, small farmers and agricultural companies at preferential rates. It does not, however, have an exclusive focus on SMEs and its size and outreach remain unclear. Farmers and small agricultural companies additionally benefit from subsidised financing through the newly restructured Agrarian Credit and Development Agency (AKIA). Following the merger of the Azerbaijan Mortgage Fund and Credit Guarantee Fund in 2017, a new credit guarantee fund was established with the primary aim of providing collateral support. It is expected that the newly created SME Agency will facilitate access to public financial support schemes, which may provide more efficiency and an increased focus on SMEs.

Non-bank finance remains underdeveloped, with a legal framework dating back to 2009. Reliable statistical data on non-bank financial activity are unavailable, limiting a full assessment of the industry. Microfinance appears to be the most important source of such finance, but the sector suffered significantly during the economic slowdown and remains largely focused on consumer lending. A sector strategy for the microfinance industry is currently under preparation (with support from the Asian Development Bank), which may help generate more uptake going forward. Leasing and factoring is offered by some banks, but these services are not sufficiently used. A new law on leasing was drafted in 2018 and however, is pending adoption. A review of factoring activity has also been conducted, though conclusions and concrete follow-up actions are yet to be seen.

Amid a missing dedicated legal framework, venture capital (VC) remains nascent, but a working group has been established to review the existing legal framework and identify bottlenecks to VC. Despite some efforts to build a conducive ecosystem (see further Innovation dimension), innovation financing is limited to a number of locally-owned venture funds which provide seed funding. The public “Start-up” project continues to be operative and invested in 12 companies; however, there is no evidence of a successful exit to date.

Financial literacy

Improving financial literacy is a key element of the government’s strategic roadmap. In 2016 the Central Bank launched a National Financial Literacy Strategy (NFLS), and it continues to offer training programmes to the broader population. Under the auspices of the Azerbaijan Banks Association (ABA), the Azerbaijan Bank Education Centre (ABEC) also provides financial training to entrepreneurs. Financial education has also been included in the school curriculum as part of a general initiative to broaden the skill-set of pupils. In early 2019, the ABA called for the creation of a Financial Literacy Council; if established, the Council could help to better co-ordinate public-private sector initiatives and monitor implementation of the NFLS.

Pillar D – Access to Markets

Public procurement

Public procurement in Azerbaijan is regulated by the public procurement law (PPL) adopted on 27 December 2001. There is no overarching strategy for public procurement and the SME Roadmap hardly mentions it. Originally intended to align with the UNCITRAL Model Law of 1994, the PPL largely remained unchanged until 28 December 2018, when general regulations for e-procurement, provisions for improving the level of integrity and measures intended to favour SMEs were added.⁵ The European Union has pushed for alignment of the PPL with international practice, as represented by e.g. the GPA, but negotiations of the public procurement chapter of a new co-operation agreement with the EU have not made any progress.

The PPL applies only to entities financed from the state budget or owned by the state (thus, also to state owned enterprises but not to e.g. local authorities). Below AZN 50 000, contracts may be concluded by requests for quotations from at least three suppliers.

All central public procurement functions, including the review of complaints, fall under the responsibility of the State Procurement Office (SPO), which is part of the State Service for Antimonopoly Policy and Consumer Protection under the Ministry of Economy (MoE). However, the low status and the very modest resources (only ten staff in total) of the SPO limit its ability to promote and enforce good procurement practice, including with respect to SMEs.

The recent amendments to the PPL include a requirement⁶ to reserve up to 20% of the contract value for local SME subcontractors, if it is decided to allow any subcontracting at all, and an obligation⁷ to use e-procurement with participation restricted to SMEs for all contracts below USD 3 000 000, unless fewer than three tenders are received and the procedure must be relaunched.⁸ There is also a new, general obligation for timely payment of contractors. There are no other PPL provisions to encourage or facilitate SME participation.

Reports from the Azerbaijan Chamber of Accounts⁹ indicate that a considerable share of the state budget is spent on goods, works and services procured without the application of the principles and procedures prescribed in the PPL, thus limiting the access of SMEs to these contracts.

The PPL amendments mentioned constitute the main progress since 2016, and their effectiveness remains to be demonstrated. The introduction of e-procurement has the potential to improve SMEs' access to the public procurement market, but development of the new system is still ongoing by 30 June 2019. As of that date, data availability and access regarding public procurement in general and SME participation in particular remained limited, even if the new e-procurement system was starting to generate data.

In this situation, the legal and institutional framework and current practices for public procurement would benefit from the following improvements with respect to the scope for SME participation:

- raise the degree of application of the PPL, and revise its coverage to include regional and local authorities – while excluding SOEs operating independently in competitive markets and subject to bankruptcy;
- create an independent, adequately resourced and recognised review body.

- review the appropriateness and effectiveness of the new PPL provisions intended to support SMEs, and revise them accordingly;
- add explicit requirements and corresponding guidance for other measures, like division into lots and requirements for proportionality, and train contracting authorities accordingly;
- strengthen the SPO as required for the above, and raise its status and independence;
- finalise the development and introduction of the e-procurement system, including proper testing and user training; and
- include measures for facilitating data access and analysis.

Standards and technical regulation

An important foundation for the developments in Azerbaijan's quality infrastructure is the 2017 decree "On additional measures regarding the improvement of management in the fields of standardisation, metrology, accreditation and protection of the patent right objects". Based on this document, various strategic measures were initiated and new institutions were established, improving the country's quality infrastructure significantly. In addition, several European support (TWINNING) projects were implemented to further develop Azerbaijan's quality infrastructure.

Various current action items refer to legislation and the introduction of a national strategy to implement (EU) legislation on industrial products. Specific issues include the specification of key sectors for technical regulations, amendments of legislation to reflect EU legislation in priority sectors, as well as updates of standardisation law and legislation on accreditation, conformity assessment and market surveillance in line with the EU *acquis*. The draft of Azerbaijan's State Programme until 2025 makes among other goals the provision for an update of the standardisation law and the adoption of 45 EU regulations.

With regard to standardisation, the timely translation of updated international (conformity assessment) standards is currently an issue. To improve this situation, Azerbaijan's new standards body, AZSTAND (www.azstand.gov.az/en), recently announced the release of translated versions of five key standards by July 2019.

A highlight is that the Azerbaijan Accreditation Centre (AzAK, www.accreditation.gov.az), established in 2017, became a European co-operation for Accreditation (EA) associate member in the same year. As regards the accreditation of conformity assessment providers, Azerbaijan's bodies still use foreign services from the Turkish Accreditation Agency (TÜRKAK), an EA multilateral agreement (MLA) signatory, based on state-of-the-art conformity assessment standards. Strengthening AzAK so that it can fulfil the needs of Azerbaijan's conformity assessment bodies and making it fit for entering into a bilateral agreement (BLA) with EA are important action items.

To address the need for strategies on metrology and market surveillance, analysing good practices from other countries seems to be useful. The relationship with Georgia, which currently serves Azerbaijan with metrology services, could provide helpful framework conditions in this regard. Starting the work of the newly established national metrology organisation (AZSTAND) is another important action item in this context.

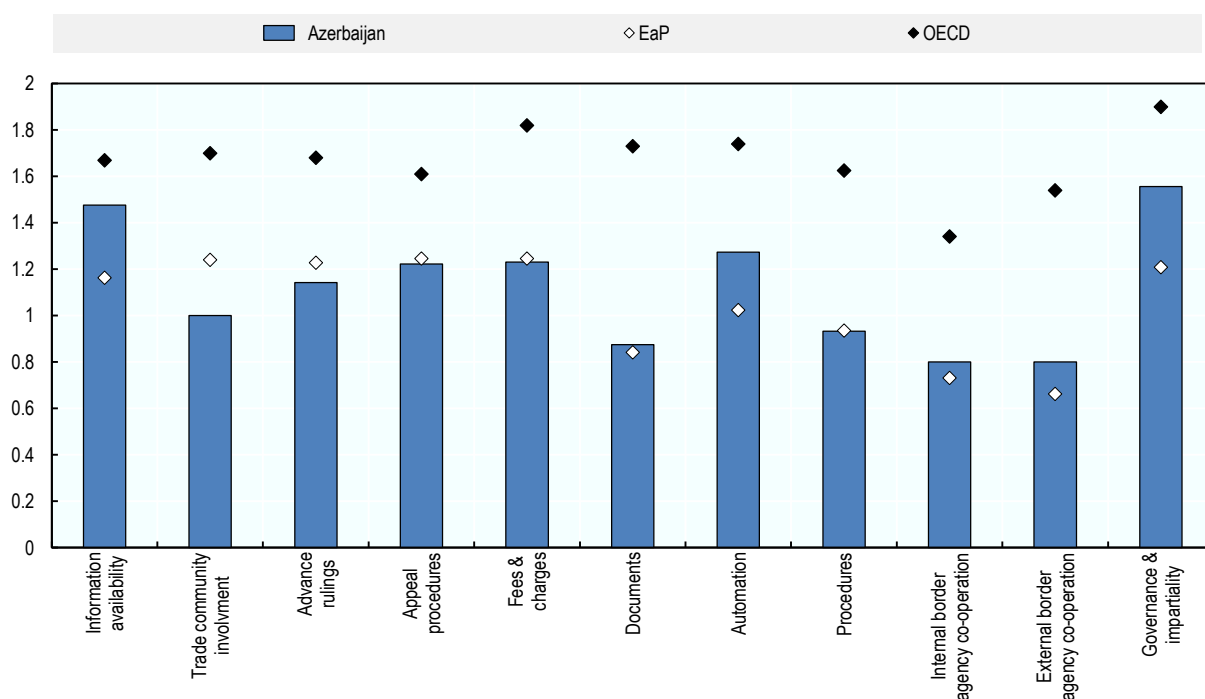
A specific challenge is SMEs' motivation to buy standards and to participate in standardisation. Therefore, it will be important that Azerbaijan implements targeted activities regarding SME education about standardisation and its benefits, and provides

financial support for SMEs' standardisation activities as well as a website in Azeri where SMEs can find information on standards applicable to Azerbaijan's key sectors.

SME Internationalisation

Despite the modest increase in non-oil exports from 2014 to 2017, international trade in Azerbaijan has continued to be dominated by large enterprises operating mostly in the hydrocarbons sector, with only a small fraction of SMEs being engaged in international trade. Azerbaijan ranks 83rd on *trading across borders* in the 2020 World Bank *Doing Business*, up from 166th in 015 (World Bank, 2019^[5]), with costs to export and import still considerably higher than the OECD average. According to the 2017 OECD Trade Facilitation Indicators, Azerbaijan performs slightly above the EaP regional average; nonetheless, moving forward, it could improve its involvement of the trade community, and reduce the number and diversity of fees and charges collected (OECD, 2017^[14]).

Figure 8.5. OECD Trade Facilitation Indicators for Azerbaijan, 2017



Note: TFIs take values from 0 to 2, where 2 designates the best performance that can be achieved.

Source: OECD, Trade Facilitation Indicators Database, <https://oe.cd/tfi>.

StatLink  <http://dx.doi.org/10.1787/888934087382>

Increasing the internationalisation of SMEs is one of the five strategic targets of Azerbaijan's SME Roadmap. AZPROMO continues to be the main institution responsible for export promotion services. However, its services mostly focus on facilitating companies' participation in international trade fairs and the organisation of trade missions. The "Single Window" Export Promotion Centre, created in 2016 under the CAERC, aims to support SME internationalisation by connecting local companies producing under the brand "Made in Azerbaijan" with international buyers. The services provided by the Export Promotion Centre include information support, customs clearance services and the issuance

of so-called Free Sales Certificates – documents confirming the quality and origin of products. SME Houses that will operate under the SME Development Agency are expected to provide training and consultancy services to increase the export readiness of SMEs, although detailed plans for their development remain to be seen. Moreover, the Ministry of Economy has created 15 export associations with the objective of increasing exports in a number of sectors such as textile, agriculture and tourism; however, the associations lack sufficient capacity and know-how to attract membership and provide effective advocacy and support services. In addition to the government programmes, ITC is currently implementing the EU4Business initiative “Ready to Trade”, which supports the internationalisation of Azerbaijan’s agribusiness sector and light manufacturing. Moving forward, Azerbaijan could ensure a co-ordinated approach to the provision of export support programmes provided by the public institutions and ensure that the SME Development Agency and its regional branches have sufficient capacity to effectively implement their support programmes based on SME demand.

With regard to trade finance, the government has begun to provide export subsidies for certain groups of products of Azerbaijani origin such as agricultural products, leather and textiles. However, there is no financial support mechanism available that systematically supports exporting SMEs across the sectors or provide trade insurance services.

Similarly, no programme is in place to support the integration of non-oil producers into global value chains and better connect local suppliers with large foreign investors operating in Azerbaijan. Initial steps to design such a programme have been taken, however, and, moving forward, Azerbaijan could focus on its operationalisation. In parallel, the Baku E-Commerce Academy, a programme implemented by the CAERC, provides training and consultancy services for SMEs to increase their capacity to access global e-commerce platforms such as Amazon or Alibaba.

Pillar E – Innovation and Business Support

Business Development Services

The recent adoption of the SME Roadmap¹⁰ is a major breakthrough for the provision of business development services to SMEs in Azerbaijan. It went hand in hand with a large-scale institutional redesign and the establishment of the Small and Medium Business Development Agency (SMBDA) in late 2017. The SMBDA, with a founding capital of approximately EUR 2.5 million, consists of several substructures, many of which will be involved in BDS provision to SMEs and start-ups in the future:

- The SME Development Centres will provide an array of BDS support measures to SMEs in the regions. This includes setting up regional hubs for business incubators, supporting the implementation of business ideas, and providing training programmes for entrepreneurs, as well as improving access to finance.
- An SME Friends network of regional centres will carry out business surveys to analyse the demand and supply gaps on the BDS market and serve as a platform for co-operation and dialogue between the local business communities and the government.
- Future regional SME Houses will not only function as one-stop shops providing access to more than 100 governmental services (e.g. business registration and certification), but will also provide business-to-business (B2B) services through banks and consulting companies.

- In addition to attracting external funding for local businesses, the SME Development Fund will also ensure provision of training and consulting to SMEs, as well as support to start-ups, youth, women and disabled persons' entrepreneurship. The Fund can also participate with a 20% share in SME projects.
- The Baku Business Training Centre (BBTC) became part of SMBDA in October 2018. At that time, it had seven representative offices in the regions and operated two incubators. Between 2007 and 2017, it conducted 1 035 trainings and seminars on starting a business, investment planning, logistics, export markets and marketing, with at least 31 000 beneficiaries. The BBTC has used surveys to determine the needs of the entrepreneurs and to plan future training courses. However, this mechanism has not been used ever since. At this stage, it is still unclear whether and how services of the BBTC are going to be sustained.

The SMBDA website (<http://smb.gov.az/>) provides an overview of the different sub-structures and services. There is also an e-trade business portal (<http://www.enterpriseazerbaijan.com>), which connects businesses with potential buyers through a catalogue of firms. The site of the Ministry of Economy also provides information on support programmes and starting a business among other things.

While not yet fully implemented, the envisioned institutional framework for BDS provision is highly fragmented. Several bodies (SME Development Fund vs. Entrepreneurship Development Fund; SME Houses vs. ABAD 'support to family business' centres) seem to perform overlapping tasks. The sharing of responsibility should be reconsidered in order to avoid duplication of effort. It would also be important to maintain the expertise and range of services previously provided by the BBTC and further build the capacity of the SMBDA staff in advising businesses.

To date, the government support the development of a private BDS market remains limited, and private providers are not involved in SMBDA programme implementation (BDS are rendered by agency staff). In the future, the outsourcing of services to private providers and/or the provision of voucher schemes or matching grants, valid for the purchase of private BDS, could help Azerbaijan develop a private market. A first step would also be enabling the access of private BDS providers to SME houses or the creation of a B2B portal listing private quality-assured consultants.

Innovation policy

A single national innovation strategy is currently being developed, and as of this writing (late-2019), government actions in this area remains scattered across several programmes and policy documents, such as the "National Strategy for the Development of Information Society for 2014-2020" or the "State Programme on Industry Development 2015-2020". Nevertheless, the concept of innovation as an essential feature of developing a competitive economy is taking more prominence in the most recent "Strategic Road Map on National Economy and Key Sectors of the Economy" approved in 2016 and in the "Law on Science", which highlights the integration of science, education and economy to contribute to technological development in the country.

The creation of the National Innovation Agency has been a welcome step in this direction. Established in 2019 under the Ministry of Transport, Communications and High Technologies, the agency will assist local business entities in adopting modern technologies, support innovation-oriented scientific research, and encourage innovative projects. It will do so through grants, concessional loans and equity investments. While

around EUR 430 000 have been allocated to the agency from the state budget for 2019, it is still premature to provide an assessment of its operations and impact. The Azerbaijan National Academy of Sciences (ANAS) should also be mentioned as the main scientific institution in the country, with a leading role in R&D, directing the research of activities of higher education institutions and hosting 360 laboratories.

With regard to the physical infrastructure for innovation, three technology parks are operating in Azerbaijan: the Chemical Industrial Park, the High Tech Park, and the ANAS High Tech Park, the latter in operation since 2017. These sites offer to their residents exemptions from real estate tax, land tax and VAT on all imported technological goods and services for up to seven years. The growing presence of business incubators is another important development since 2016, including some launched by state universities. While such initiatives bring entrepreneurship closer to academia, information about R&D infrastructure remains largely unavailable to the business community, and technology transfer offices (TTOs) are still at a very nascent stage in their ability to allocate IP rights and guide scientists towards commercially relevant research (World Bank, 2018^[15]).

Financial instruments to support innovative entrepreneurship in Azerbaijan have been stable since 2016. The State Fund for the Development of Information Technologies (ICT Fund) aims to support innovative entrepreneurship with a mix of concessional loans, grants and equity investments for the development of software, adoption of new technologies and e-services. While its tools seem well designed for the needs of SMEs and start-ups, the potential beneficiaries of the Fund are limited to the narrow segment of ICT projects. Also, its impact so far remains small in scale: in 2017, there were 21 grant recipients for a total of EUR 125 000, and EUR 1.3 million in loans were issued in partnership with seven banks (ICT Fund, 2018^[16]). The new tax code in force as of 2019 will introduce new tax incentives for investment in R&D. This is a welcome development which could expand the number of SMEs benefitting from fiscal efforts to support innovation in Azerbaijan.

Moving forward, Azerbaijan could focus on 1) completing the organisation of innovation policies under one single national strategy and 2) extending eligibility of grants for innovation beyond the IT sector.

Green economy

Azerbaijan has a variety of different strategic and sectoral planning documents which call for making the economy greener, but most do not target SMEs. The Strategic Roadmap for the Production of Consumer Goods in Azerbaijan at the Level of SMEs, adopted in December 2016, includes a call for policies, a legal framework, and funding initiatives to help SMEs transition to renewable energy and the green economy. However, there have not been policies implemented specifically to support SMEs in this goal. Policies that support the development of renewable energy, such as the State Strategy on the Use of Alternative and Renewable Energy Sources (2012-2020) or the Ministry of Energy's Strategic Road Map (introduced in 2016) do not have provisions for SMEs. A draft law on renewable and alternative energy production will be introduced by the Ministry of Energy in 2019, but as it is based on the Strategic Roadmap, it is not foreseen that it will include specific provisions for SMEs.

Although Azerbaijan has introduced legislation to improve environmental protection and support green economy development, there is a need to implement programmes specifically targeted at SMEs. This includes the tax and customs benefits that are currently available for green businesses operating in designated Special Economic Zones – providing support for SMEs specifically to access those benefits would contribute to SME greening by

improving the business case for it. The same is true for the deployment of renewable energy: the longer payback period for renewable energy installations makes it challenging for SMEs to participate, due to finance constraints. Making finance for SME green projects more accessible would help support uptake.

Sectoral analysis: SME perspectives on the agribusiness sector in Azerbaijan

Although the hydrocarbons industry is a highly strategic sector given its overall contribution to GDP, agriculture is also of strategic importance in terms of employment. In addition, food processing is the biggest manufacturing sector in Azerbaijan, accounting for over 30% of total manufacturing production. Dairy is the largest agribusiness segment, followed by meat production and juices (The State Statistical Committee of the Republic of Azerbaijan, 2019^[3]).

Evidence collected through the 2018 OECD Enterprise Survey of Azerbaijan, private-sector focus group meetings, and interviews with selected food processors and business associations provides some insights into the major constraints faced by companies operating in the agribusiness sector:

- Limited access to finance is the barrier most often cited by SMEs. Banks' reluctance to provide long-term financing, together with high collateral requirements and high interest rates, prevent SMEs from modernising their equipment. Although the government support provided through the Entrepreneurship Development Fund and the Agroleasing is well perceived, the programmes support only a small share of the total business population.
- Outdated farming practices, high land fragmentation (small, parcelled land plots) and inadequate irrigation systems result in a low quality and consistency of agricultural production. In addition, the agribusiness sector in Azerbaijan is dominated by a few large conglomerates (e.g. Azersun, Gilan Holding) that control most of the inputs and food production. Given these constraints, it is very difficult for SMEs to compete with large producers.
- Limited access to markets, both domestic and foreign, continues to be an issue for small food processors. The EU, Turkey and other major trading partners do not recognise local certificates, which prevents local producers from exporting. The existing certification system works relatively well for the domestic market. However, supply chain linkages between small food producers and food retail chains remain limited.

Given the aforementioned challenges, the government could consider the following next steps:

- Besides measures to improve the overall business environment, such as enforcement of competition rules and rule of law, the government could enhance the provision of targeted support programmes. For example, improving food processors' access to alternative sources of finance and increasing their financial literacy might increase their ability to modernise their equipment and upgrade their packaging and marketing practices.
- Increase the government's its co-operation with international certification institutions and increase the capacity of local producers to acquire international quality certificates.

- The implementation of a targeted programme to support the creation of supply chain linkages between small producers and food retail chains could scale up the operations of SMEs and increase their chances of entering foreign markets.

The way forward

Since 2016, Azerbaijan has made significant progress in promoting policies for SME development. The following measures could be considered by the government to further strengthen the system:

- Azerbaijan could prioritise the creation of level-playing-field conditions for all enterprises by ensuring effective enforcement of competition rules. In this context, the government could strengthen the capacity of the SSAPCRP and ensure its political independence and integrity. Regarding contract enforcement, Azerbaijan has made significant efforts to improve its efficiency and transparency, but more could be done to promote alternative dispute resolution and strengthen private-to-public litigation. In the area of business integrity, introducing a risk-based business integrity policy (with active engagement from the private sector) and making disclosure of beneficiary owners mandatory for all companies would be important steps towards preventing corruption in the private sector.
- Azerbaijan has significantly improved its institutional and regulatory framework for SME policy and reformed its operational environment for SMEs. However, further efforts are needed to ensure that the newly created SME Development Agency has appropriate resources and provides demand driven services for SMEs. In addition, the agency could consider leveraging the private sector for the delivery of support programmes which could boost the efficiency of the SME support ecosystem. However, the biggest challenge going forward is the systematic application of regulatory impact analysis (RIA). Finally, the government could consider implementing measures to support financially distressed companies by implementing systematic pre-insolvency tools and warning systems.
- As regards the way forward for the area of entrepreneurial human capital, in *entrepreneurial learning*, Azerbaijan should consider emphasizing the entrepreneurship key competence at all education levels, and ensuring the availability of practical entrepreneurship experience at system level as part of education-business cooperation, e.g. by extending the Career Guidance action plan and introducing incentives for businesses. In teacher training, the use of active teaching and learning methods is recommended both in pre- and in-service teachers' and school managers' training, and teacher qualification standards could be adapted to introduce a key competence approach. Annual work plans for the Lifelong Learning Commission should be developed with an agreed understanding of what *entrepreneurship key competence* means for Azerbaijan.
- For *women's entrepreneurship*, a dedicated communication plan should be integrated in action plans of roadmaps and the annual work plans for the Social Commission, to facilitate information sharing, especially with non-government organisations. Women entrepreneurs from the regions should be identified as role models and promoted with the support of a multi-stakeholder approach, and good-practice sharing should be based on predefined selection criteria. It is important to strengthen the capacity of NGOs and business associations so they can better support women's entrepreneurship, and to engage their participation in monitoring

and evaluation exercises of the Centre of Analysis of Economic Reforms and Communication.

- In the area of *SME skills*, there is a need to build on the skills intelligence approach used in previous years, which included training needs assessment and stakeholder coordination, e.g. by Baku Business Training Centre (BBTC) and its regional offices. Data collection instruments should target specific groups' needs, like women entrepreneurs or specific sectors. Monitoring and evaluation requires special attention, e.g. the SME agency should monitor government-financed training programmes, and the Centre for Analysis of Economic Reforms and Communication should evaluate the effectiveness of SME training programmes and the impact of training on SME performance.
- Additional efforts will be needed in the coming years to improve SME access to finance and ensure reform efforts are fully implemented and progress is monitored. The limited level of financial intermediation remains a key challenge. More effort is needed to extend financial services to smaller enterprises and those located outside of the capital. A co-ordinated and targeted focus of public financial support programmes would help alleviate the current lack of SME finance, while deepened credit information will ease SME access to finance in the long term. A focus on developing non-bank financial services would further broaden access to credit. The law on leasing should be adopted swiftly, and concrete actions to develop a legal framework should be taken. Effective implementation of the National Financial Literacy Strategy (NFLS), including a concrete action plan and co-ordination body, will help raise awareness of these products and support uptake. Lastly, the scope and granularity of statistical data for the financial sector could be improved, which would allow for a comprehensive assessment of market size and better segregation of borrowers. This would help financial service providers develop products that are better tailored to the various market segments.
- Building on a number of well-established institutions, Azerbaijan could consider further improving SME access to domestic and international markets by expanding the services provided by AZPROMO, the SME Development Agency and the Azerbaijan Export Promotion Centre to better connect local suppliers with foreign investors. Tailored services, such as training and mentorship programmes, could be provided to enhance the export readiness of local SMEs. The government could also consider establishing mechanism to provide export finance for SMEs. Regarding SME access to public procurement, the government should prioritise the finalisation of the e-procurement system, collect data on SME participation in public procurement and raise the level of its application. With regard to standardisation, the government could enhance the capacity of AzAK and implement programmes to raise SME awareness of the role and benefits of standardisation.
- To support the performance in Innovation and Business Support, the government could adopt an innovation strategy, which would set the overall targets and ambitions of the government in this area. The strategy and policy actions stemming from the strategy should go beyond the IT sector to support a broad range of private sector innovation. While the business support ecosystem has improved rapidly in Azerbaijan, it is important to ensure that newly established institutions, in particular the SME development agency, provide services that are mostly needed by the SMEs and support the uptake of private providers of business support services. A first step

in this direction could be the creation of a B2B portal listing private quality-assured consultants. With regard to SME greening, Azerbaijan should implement SME-targeted programmes to support the uptake of renewable energy use and introduce financial and regulatory incentives.

Conclusion

Table 8.5. Roadmap for policy reforms – Azerbaijan

Promoting a level playing field for all enterprises
<ul style="list-style-type: none"> • Grant institutional and budgetary independence to the State Service for Antimonopoly Policy and Consumer Rights Protection (SSAPCRP) • Enable effective enforcement of competition rules, in particular against hard-core cartels • Develop and put in place a risk-based business integrity policy with active engagement from the private sector • Introduce the disclosure of final shareholders for all companies, including an efficient system of verification of provided information and enforcement of sanctions in case of violations • Ensure the efficient functioning of the e-court system and monitoring mechanism to address its deficiencies • Consider establishing a dedicated IP chamber within the general court system, with judges possessing both training in IP law and the experience necessary to provide for high-quality IP dispute resolution • Ensure adequate enforcement of the mediation mechanism introduced in April 2019 and promote ADR use by SMEs
Strengthening the institutional and operation framework environment
<ul style="list-style-type: none"> • Upgrade and expand the “Roadmap for the Promotion of the Production of Consumer Goods by SMEs in Azerbaijan” in order to include the service sector and guide the development of the entire SME sector, in the absence of a specific SME development strategy • Establish effective channels of consultations with organisations representing the entire SME sector and build partnerships for project development; make sure that the newly established SMBDA plays an active advocacy role in the representation of small business with the government structure • Make a plan for the systemic application of RIA and take steps to define the RIA guidelines and methodology, identify a central body in charge of the RIA introduction (and the monitoring of its application), and train the public officials in charge of conducting RIA applications • Introduce measures to upgrade the IT skills of small entrepreneurs, in parallel with the extension of the range and sophistication of e-government services, in order to ensure an optimal utilisation of the e-government service platforms • Promote the use of restructuring and out-of-court-mediation procedures; introduce simplified or pre-packaged in-court proceedings specifically targeting SMEs • Adopt a comprehensive and proactive second-chance strategy for bankrupt entrepreneurs
Promoting skills and entrepreneurship development
<ul style="list-style-type: none"> • Introduce the entrepreneurship key competence at system level across all education levels as part of the lifelong learning strategy. • Make independent evaluation of women's entrepreneurship support programmes an important feature of policy design, building in engagement and feedback by non-government policy partners • Focus on the availability and quality of data for policy making and ensuring highly relevant and effective provision of SME training services for different target groups
Facilitating SME access to finance
<ul style="list-style-type: none"> • Enhance financial inclusion by supporting the development of non-bank financial services and deepening credit information; adoption of the new law on leasing would be an important first step • Improve the availability of statistical data on the financial sector. A more granular market assessment would allow financial service providers to develop adequate products tailored to the needs of borrowers
Supporting SME access to markets
<ul style="list-style-type: none"> • Ensure a co-ordinated approach to the provision of export support services and built capacity in the SMBDA and its regional branches to support SME internationalisation • Enhance SME access to trade financing and implement the support programme to create supply chain linkages between SMEs and large investors • Strengthen AzAK and make it fit for entering into a bilateral agreement (BLA) with EA

- Implement targeted SME training in standardisation and its benefits; provide financial support for SMEs to obtain and implement technical standards
- Ensure that e-procurement can be used in a wider range of award procedures, without limitation to any particular categories of tenderers or contract amounts
- Raise the status, authority, independence and capacity of the central public procurement institutions

Enhancing SME competitiveness

- Complete the organisation of innovation policies under a single national strategy
- Extend eligibility of grants for innovation beyond the IT sector
- Establish proper co-ordination mechanisms among all bodies involved in BDS provision, particularly between SMBDA and the Baku Business Training Centre; build the capacity of SMBDA and sub-structures' staff in advising businesses
- Start outsourcing support services to private BDS providers and/or offer a simple co-financing mechanism to SMEs for first-time BDS use, enabling firms to choose their preferred providers
- Target specific green-economy policies, including renewable energy uptake as well as financial and regulatory incentives, towards the capacities and needs of SMEs

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Notes

¹ By a presidential decree of 23 October 2019, the Ministry of Taxes, the State Property Committee, the Antimonopoly Agency for Supervision of Consumer Markets are transferred to the Ministry of Economy.

² <https://www.azernews.az/business/150120.html>

³ A study of corruption risks for the integrity of businesses, carried out by the government in co-operation with the business associations and civil society, is the basis for the risk-based integrity policy.

⁴ In accordance with the Presidential Decree dated 28 November 2019, the Financial Markets Supervisory Authority (FIMSA) was abolished. However, this recent development did not influence the assessment as implemented after the cut-off date for the analysis.

⁵ Consolidated text of the amended PPL: see www.e-qanun.az/framework/1029

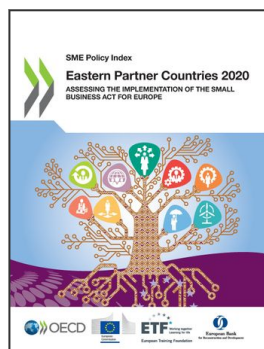
⁶ PPL, Art. 40.7.

⁷ PPL, Art. 50-1

⁸ The threshold is surprisingly high, compared with the stated focus on SMEs, and its application might be found cumbersome and a cause of delays, to the point of inciting contracting authorities to get around it.

⁹ Available at <http://sai.gov.az/2/hesabatlar>.

¹⁰ Strategic Roadmap for the Production of Consumer Goods in Azerbaijan at the Level of Small and Medium Entrepreneurship.



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