Policy-Oriented Reforms and Their Consequences on MSME Performance: Evidence from Azerbaijan

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Abstract

Small and medium companies (SMEs) are one of the most important economic elements supporting modern economies, and the Azerbaijani government has implemented measures to promote the SME sector in recent years, with the goal of reducing reliance on oil. The Republic of Azerbaijan's Small and Medium Business Development Agency, founded in 2017, is an excellent example of this strategy. The goal of this paper is to conduct a descriptive analysis of the influence of SME-friendly economic reforms on SMEs' economic performance. The article analyses the impact of SME reforms on SMEs, particularly after 2016, using data from the State Statistics Committee of the Republic of Azerbaijan to study changes and trends in macroeconomic indicators of SMEs from 2006 to 2019. The results show that the reforms are having a beneficial impact, with rising trends in terms of value addition and job creation by SMEs. Despite these encouraging achievements, Azerbaijan's percentage of SMEs in GDP and employment remains low when compared to developed countries.

I. Introduction

Small and Medium Businesses (hereafter SMEs) are the most dynamic players in every country's economy in the modern world. Governments want to assist SMEs in this setting because of their contribution to both GDP and jobs (Robu, 2013). Small and medium firms are the driving force behind country economies in these two domains, according to the global economy. According to the OECD research, which examines the economic performance of SMEs in various nations, small and medium firms employ over 70% of the workforce in all OECD countries (OECD, 2019). SME output accounts for around 40% of GDP in developing nations, according to the World Bank (Ndiaye, Razak, Nagayev, & Ng, 2018). Given the size of the shadow economy in emerging countries, this ratio is very certainly larger.

With the advancement of technology and the growing trend of internationalization, today's world economy has achieved a high degree of competition. Businesses today must have a more flexible structure in order to respond rapidly to changing technology and adopt the processes required to compete. Because they are more adaptable and have a decision-making body, SMEs have the opportunity to make more effective decisions, even in times of economic crisis. Taking these aspects into account, SMEs can be considered one of the nation's economic cornerstones, according to several research (Mahmudova, 2019). According to a study by Siam and Rahahleh (2010), SMEs have a lot of potential in terms of producing jobs, maximizing economic growth, and having a beneficial impact on the unemployment rate.

Given these characteristics, governments can employ small and medium enterprises as one of the most significant and effective tools for supporting and developing the economy. As a result, numerous economic policies and programs for SMEs are being implemented in industrialized countries. The development of SMEs in Azerbaijan will lead to long-term economic growth by minimizing reliance on imports and maximizing the use of local resources (Bayramov, Hasanov, Aghayarli, Aghahasanli, & Isayev, 2017). The Azerbaijani government, which seeks to revitalize the economy after achieving independence, is attempting to maximize the use of SMEs as a driving force. Specifically, since 2016, many economic measures have been made to help SMEs, as well as significant reforms.

The "Strategic Road Map on Consumer Goods Production at the Small and Medium Enterprise Level in the Republic of Azerbaijan" was authorized by the President of the Republic of Azerbaijan on December 6, 2016. The Strategic Road Map's major purpose is to define short, medium, and long-term priorities for SME-supporting economic changes in order to create a competitive national economy and assure inclusiveness and long-term development. Five strategic goals were defined in this context. A number of initiatives are mentioned in the Strategy Roadmap in order to attain these strategic goals and expand SMEs' contribution to the national economy, and the majority of these activities have already been completed (2016). Figure 3 depicts SME-related activities in Azerbaijan. Information support, customs clearing services, and the issuance of Free Sale Certificates, which are certificates certifying the quality and origin of the products, are among the operations carried out within the framework of AZPROMO to enhance the export volume of SMEs (OECD et al. , 2020). However, there are still a number of problems in terms of encouraging SMEs to export. Effective policies should be

implemented to first identify and then tackle the challenges that SMEs confront when it comes to exports.

Table 1. Major Reforms Implemented in 2016-2020

Framework	Major reforms implemented in 2016-2020
Responsive government	✓ 2016-2020 SME strategy adopted and under implementation ✓ SME Development Agency established in 2017 ✓ Licencing processes streamlined ✓ E-government services improved
Entrepreneurial human capital	✓ Well-functioning formal policy partnership in the area of women's entrepreneurship ✓ 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
Access to finance	✓ Private credit bureau and movable collateral registry in place ✓ 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)
Access to markets	✓ Export Promotion Centre established and information support and e-services for exporting SMEs expanded ✓ Law on public procurement amended ✓ Standardization and accreditation infrastructure strengthened
Innovation and Business Support	✓ National Innovation Agency established ✓ Three technology parks established ✓ SME agency tasked with designing and implementing a wide range of business development programmes

Source: OECD et al. (2020). Chapter 8. Azerbaijan: Small Business Act country profile. In SME Policy Index: Eastern Partner Countries 2020: Assessing the Implementation of the Small Business Act for Europe, SME Policy Index. Paris/European Union, Brussels: OECD Publishing.

II.   Literature Review

Small and medium-sized businesses, regardless of their growth level, play a significant part in the economic development of countries. Even though major corporations gained

prominence following the industrial revolution, the information age, which was ushered in by the information revolution, brought SMEs to the forefront in terms of reproduction, competition, and employment. Entrepreneurial economies, mostly through SMEs, are the source of economic progress all over the world. In many nations, SMEs account for a significant portion of both employment and the national economy. Table 1 provides an overview of the state of SMEs in the European Union (Murphy, Smid, Aranda et al, 2021). The data on the European Union demonstrates once again the importance of SMEs, particularly in developed economies. That example, when we solely look at company data, we observe that SMEs account for 99.8% of the total, indicating that micro companies are more important within SMEs. SMEs account for 53 percent of the produced value added in 27 European countries, according to the report. The importance of SMEs is highlighted once again when looking at employment statistics. SMEs, in particular, account for 65 percent of all jobs.

Table 2. Share of SME`s in total number of enterprises, value added and employment in the EU-27 in 2020

	Enterprises		Value added		Employment	
	Number	%	Value in € million	%	Number	%
Micro SMEs	21,044,884	93.30%	1,179,476	18.70%	36,988,539	29.20%
Small SMEs	1,282,211	5.70%	1,071,196	17.00%	25,313,006	20.00%
Medium sized SMEs	199,362	0.90%	1,087,613	17.30%	20,130,548	15.90%
All SMEs	22,526,457	99.80%	3,338,286	53.00%	82,432,093	65.00%
Large enterprises	40,843	0.20%	2,956,544	47.00%	44,358,284	35.00%
All enterprises	22,567,300	100.00%	6,294,829	100.00%	126,790,377	100.00%

Source: Annual report on European SMEs 2020/2021: digitalisation of SMEs

It is vital to analyze SMEs' contribution to the economy as well as their strengths in order to comprehend their significance. SMEs contribute to the economy and the social system in a variety of ways, including dynamism, employment, competition protection, and middle-class protection (Laurențiu, 2016). SMEs also offer the advantages of being more flexible, having less bureaucracy, and having a simpler organizational structure than huge corporations (Ratko & Ulgen, 2009, Suseno, 2019). When compared to integrated industrial businesses employing thousands of workers, the ability of SMEs with flexible production structures to quickly adjust to changes and enter the market has contributed tremendous vitality to the economy (Chen & Li, 2010). Small and medium-sized enterprises (SMEs) are widely acknowledged as playing a critical role in economic development and the well-being of a country through establishing new firms (Honjo & Harada, 2006). Furthermore, as Agus vd. (2015) and Suseno & Dwiatmadja (2016) points

out, creating chances for SMEs to create a competitive environment will contribute greatly to economic growth. Furthermore, because of their flexible structures, SMEs are able to respond swiftly to market changes (Berry, Rodriguez, & Sandee, 2002). They are more effective in implementing new services and launching new goods than major corporations, particularly during times of crisis (Hodorogel, 2009). Robu (2013) and Suseno (2015) drew attention to this topic in his research, concluding that countries seeking to revitalize their economies must assist the development of SMEs by creating competitive conditions. Another study indicated that because of their agility, many small businesses in Indonesia were more resilient than large businesses during the East Asian Crisis (Nichter & Goldmark, 2009).

III. Methodology

The article looks at how the changes for SMEs in Azerbaijan have affected their economic status. As a research method, qualitative research is used. The descriptive graphical analysis method is employed in this case. The State Statistics Committee of the Republic of Azerbaijan provided the data for this analysis. These figures span the years 2006 through 2019. The data for 2020 was not included because the pandemic's effects were primarily manifested in that year. It is analyzed how statistics such as the added value provided by SMEs, the number of employees in SMEs, fixed capital investments, and average pay evolve over time in order to estimate the economic power of SMEs. One thing to keep in mind is that the definition of a small business has varied through time, and in order to show this, existing deposits were examined and SME definitions for each period were presented separately. This data will help us better understand how things have changed over time.

IV. Results and Discussion

Classification of Small and Medium Business Entities in Azerbaijan

When we look at the existing statistics on entrepreneurship from the State Statistics Committee of the Republic of Azerbaijan, we can see that there are three main classifications. As a result, the macroeconomic indices of SMEs are shown below, with large changes in some years. It's helpful to look at relevant Cabinet of Ministers decisions on the boundaries of the criteria for identifying small and medium firms to comprehend these discrepancies. In this regard, before 2015, the SME classification was based on criteria approved by the Cabinet of Ministers of the Republic of Azerbaijan's Resolution No. 192 of December 18, 2009. These criteria are listed in Table 3.

Table 3: Criteria for small business approved by the Resolution of the Cabinet of Ministers of the Republic of Azerbaijan No. 192 dated December 18, 2009

Entrepreneurship category	Average number of employees (people)	Annual turnover (excluding VAT, excise tax)
Industry and construction	< 50	≤ 500 000 manat
Agriculture	< 25	≤ 250 000 manat
Wholesale trade	< 15	≤ 1 000 000 manat
Retail trade, transport, services and other economic activities	< 10	≤ 250 000 manat

The Republic of Azerbaijan's Cabinet of Ministers adopted new criteria for classifying small, medium, and large firms in 2015, and all statistical data collected following that year were prepared using these criteria. The factors in question are listed in Table 3.

Table 4: Criteria for small, medium and large entrepreneurship approved by the Resolution of the Cabinet of Ministers of the Republic of Azerbaijan No. 215 dated June 5, 2015

Category by size of business entities	Average number of employees	Annual income (thousand manat)
Small	Up to 25	Up to 200 manat
Medium	From 25 to 125	From 200 to 1 250 manat
Large	125 and more	1 250 manat and more

Azerbaijani entrepreneurs are divided into four groups as of 2018. Thus, micro, small, medium, and big entrepreneurship criteria were authorized by the Cabinet of Ministers of the Republic of Azerbaijan No. 556 dated December 21, 2018. Table 4 reflects these criteria, which are consistent with global norms for small and medium businesses.

Table 5. Criteria for micro, small, medium and large entrepreneurship approved by the Resolution No. 556 of the Cabinet of Ministers of the Republic of Azerbaijan dated December 21, 2018

Category by size of business entities	Average number of employees	Annual income (ai) (thousand manat)
Micro	1-10	Ai ≤ 200
Small	11-50	200 < ai ≤ 3 000
Medium	51-250	3 000 < ai ≤ 30 000
Large	251 and more	30 00 < ai

Macroeconomic Indicators of Small and Medium Entrepreneurship in Azerbaijan

When we consider the operations of SMEs in Azerbaijan, we can see that the macroeconomic indicators are lower than the global average. Graph 1 depicts SMEs' data in terms of value added, fixed capital investment, and output in 2019. According to these figures, SMEs account for 43.7 percent of overall employment, and the value added by

SMEs to the economy accounts for 14.9 percent of total value added in the current year. Along with these figures, SMEs account for 23.3 percent of fixed capital investment and 21 percent of output, respectively. Given Azerbaijan's reliance on oil, evaluating the success of SMEs in non-oil sectors may provide a more accurate picture. The statistics for the non-oil industry, on the other hand, are below the global average. Thus, SMEs employ 53.6 percent of non-oil sector workers, yet they only account for 24.6 percent of total value created. Small and medium firms account for 27 percent of fixed capital investments and 40.7 percent of output in the non-oil economy, respectively.
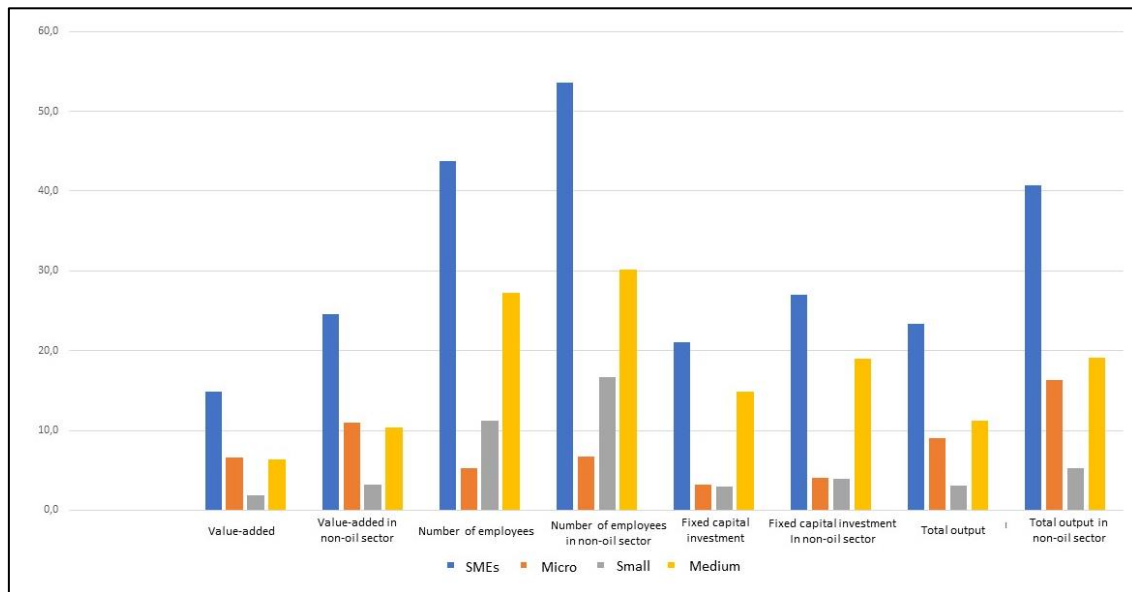
Figure 1. Share of micro, small and medium business entities in Azerbaijan on relevant economic indicators, in percent
Source: The State Statistics Committee of the Republic of Azerbaijan, https://www.stat.gov.az/

In general, when comparing macroeconomic indicators of SMEs in Azerbaijan to prior years, there is a considerable increase in 2019. Although some of these improvements can be ascribed to changes in the criteria for classifying SMEs, particularly in recent years, active support of SMEs has resulted in an increase in government support for small and medium firms, improving SMEs' economic status.

Table 6. Key macroeconomic indicators of SMEs (2006-2019)

Indicators		Created value added, million manat	Number of employees, thousand people	Average monthly nominal salary, manat	Fixed capital investments, million manat
2006	Small	364.7	87.5	130	199.1
2007	Small	449.2	92.1	170.7	289.4
2008	Small	718.7	103.2	182.1	371.2
2009	Small	844.8	105.9	195.2	289.3
2010	Small	1120	93.2	207	276.3
2011	Small	1691.8	90.2	222.2	737.6
2012	Small	2081	95.5	263.3	531.6
2013	Small	2453.3	109	303.5	486.3
2014	Small	2362.8	115	348	746.5
2015	Small and Medium	1987.8	87.6	302.1	807.2
2016	Small	2928	100.9	322.2	1828.6
	Medium	659.2	180.1	349.1	1001.6
	Total	3587.2	281	338.6	2830.2
2017	Small	3051.9	101.9	331.5	2064.8
	Medium	755.7	188.2	365.9	1233.8
	Total	3807.6	290.1	352.8	3298.6
2018	Micro	4467.8	35	294.9	2831.5
	Small	1235.5	76.1	373.5	1046.7
	Medium	4133.3	172.4	517.1	3074.8
	Total	9836.6	283.4	445.3	6953
2019	Micro	4900.8	40.2	332.5	515.5
	Small	1423.2	85.1	437.0	494.2
	Medium	4747.7	206.9	624.6	2412.5
	Total	11071.7	332.2	531.0	3422.2

Source: The State Statistics Committee of the Republic of Azerbaijan

Table 6 shows the main macroeconomic indicators of Azerbaijan's SMEs from 2006 to 2019. Although SMEs added 364.7 million manat to the country's GDP in 2006, this figure has continued to rise in subsequent years. Thus, the number of SMEs increased by roughly 3 times between 2006 and 2010, by about 1.8 times between 2010 and 2015, and by 5.6 times between 2015 and 2019. created value Given that the 2006 SME classification requirements for micro and small enterprises only partially satisfied the 2018 SME classification criteria, a comparison of the 2019 value added achieved by micro and small firms with the 2006 data would be more accurate. In this perspective, microentities' value added in 2019 was 13.4 times higher than in 2006, 4.4 times higher than in 2010, and 2.5 times higher than in 2015.

The number of persons working in SMEs has expanded dramatically between 2006 and 2019, according to employment data. Thus, whereas 87.5 thousand people worked in small firms in 2006, the number increased to 93.2 thousand in 2010 and 87.6 thousand in 2015 (despite the fact that the number was relatively low in 2015). In 2019, only 125.3 thousand people worked in micro and small enterprises, and 332.2 thousand people worked in micro, small, and big firms.

Table 4 shows that between 2006 and 2019, the average monthly nominal wage grew. In 2006, the average monthly pay for small enterprises was 130 manat, 207 manat in 2010, 302.1 manat in 2015, and 332.5 manat in 2019 for micro firms, 437 manat for small businesses, 624.6 manat for medium businesses, and 531 manat for all SMEs. Unfortunately, in the absence of indications of average real salaries, it is impossible to say whether or not this element is improving.

Finally, SMEs' fixed capital investment has expanded in recent years. Small businesses invested 199.1 million manat in fixed assets in 2016. Small business owners spent 807.2 million manat in fixed assets in 2015, up from 276.3 million manat in 2010. Micro-entrepreneurs alone invested 515.5 million manat in fixed assets in 2019, while small business owners invested 494.2 million manat. In total, SMEs invested 3422.2 million manat in fixed assets in 2019.

We may identify favorable tendencies in the dynamics of SME development by looking at all of the following macroeconomic variables. With the exception of the relevant statistic on employment, the effect of inflation on the growth of the other three measures cannot be denied (Suseno, et al. 2019). As previously stated, it would be feasible to more correctly portray the pattern of economic dynamics attained by SMEs in 2006-2019 if these indicators had real figures rather than nominal ones. However, our assessment on whether SMEs are more active in the country's economy in the relevant years will be based on their proportion of the economy in terms of important metrics (in particular, value added, number of employees, and fixed capital investments). In this perspective, the analysis is expressed below. Figure 2 shows the ratio of SMEs' value contributed to total value added generated by both sectors and the non-oil sector from 2006 to 2019, or the SMEs' share of GDP. SMEs generated 1.9 percent of total value added in 2006, but these percentages increased to 2.9 percent, 4 percent, and 14.9 percent in 2010, 2015, and 2019. Unfortunately, the available statistics make data for prior years in accordance with the approved SME classification in 2018 impossible to collect. Instead, based on the 2009 classification standards, the percentage of value added created by SMEs in 2006 and 2019 in total value added generated by all industries can be approximated. Thus, although not completely correct, certain micro and small entrepreneurs can be linked to the 2009 small entrepreneur group using the criteria approved in 2018. The highest value that SMEs had on this indicator prior to the introduction of the new SME classification standards in 2015 was 4.5 percent in 2013. In 2019, the percentage of micro and small business operations in GDP was 8.5 percent, and the ratio of value added created by micro-entrepreneurs to value added created in all sectors was 6.6 percent. Figure 2

illustrates that the share of SMEs in GDP has improved over time, particularly in the non-oil sector. Thus, whereas the non-oil sector's proportion of GDP was 4.8 percent in 2006 and 5.8 percent in 2015, only the non-oil sector's share of micro-entrepreneurs was 4.8 percent in 2019. The percentage was 11%.
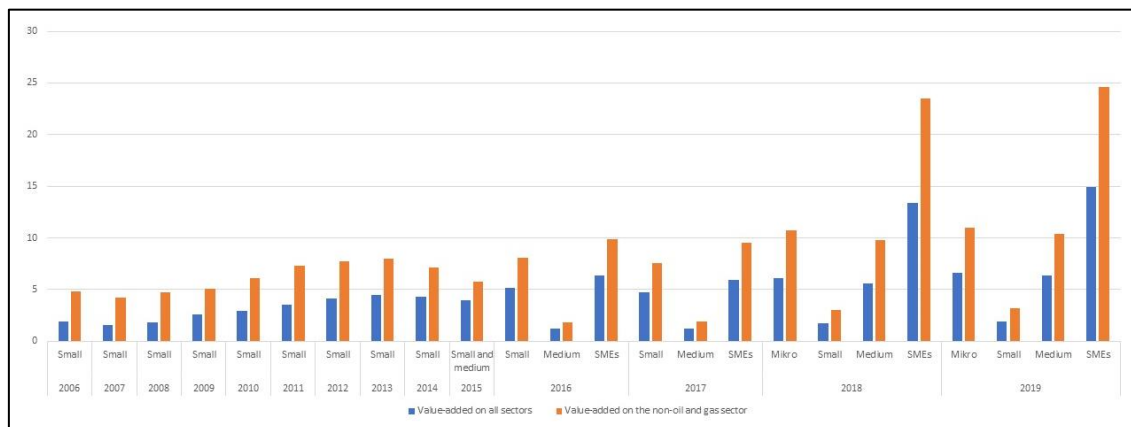
Figure 2. Share of SMEs in GDP (%)
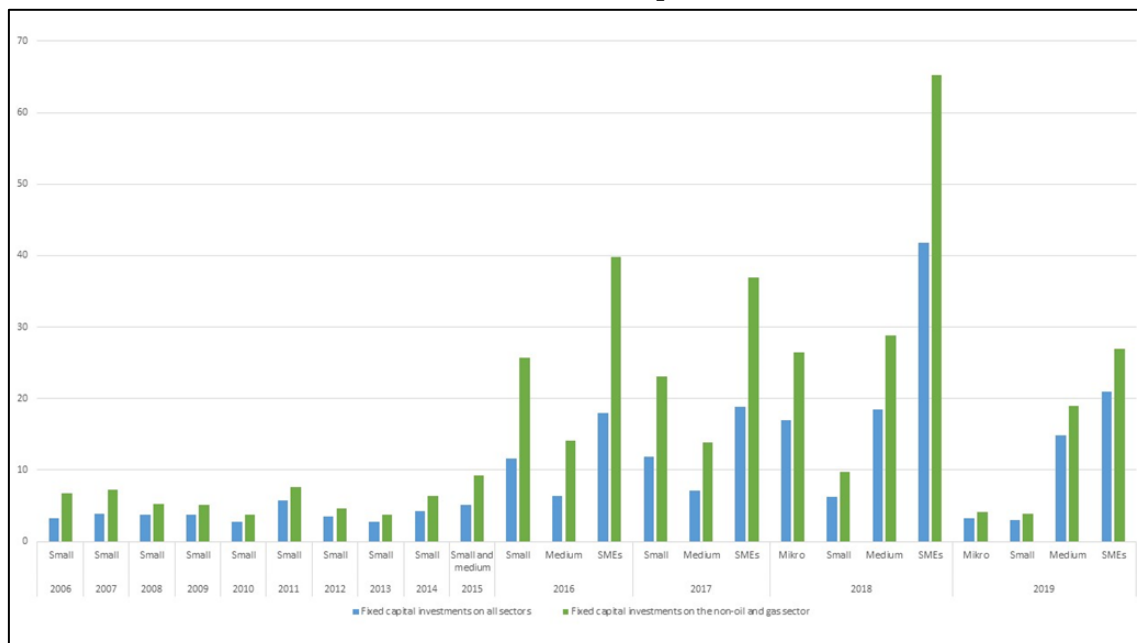**Source:** The State Statistics Committee of the Republic of Azerbaijan

SMEs, according to a number of economists and analysts, play an important role in creating jobs in the country's economy. Small and medium businesses employ 70 to 80 percent of the workforce in various nations. The goal is to increase the percentage of SMEs employed to 70%. Figure 3 depicts the percentage of people employed by small and medium businesses from 2006 to 2019. As shown in the graph, the share of SMEs in employment in all industries was 6.5 percent in 2006 and 6.3 percent in 2015, respectively, but it was 43.7 percent in 2019. The impact of the foregoing SME classification standards may also be seen in the fact that the ratio of employees in micro-enterprises to total employment was 5.3 percent in 2019, while the comparable ratio of micro and small firms was 16.2 percent. This metric also demonstrates the favorable benefits of SMEs on employment over time. In the non-oil industry, the percentage of SMEs in employment climbed dramatically in 2019, from 6.8% in 2006. Thus, the non-oil sector's proportion of micro-entrepreneurship in employment was 6.7 percent, while the overall share of micro and small entrepreneurship was 23.4 percent. According to the 2018 classification standards, SMEs accounted for 53.6 percent of total non-oil sector employment in 2019. This figure is 19.1% greater than the previous year's figure.
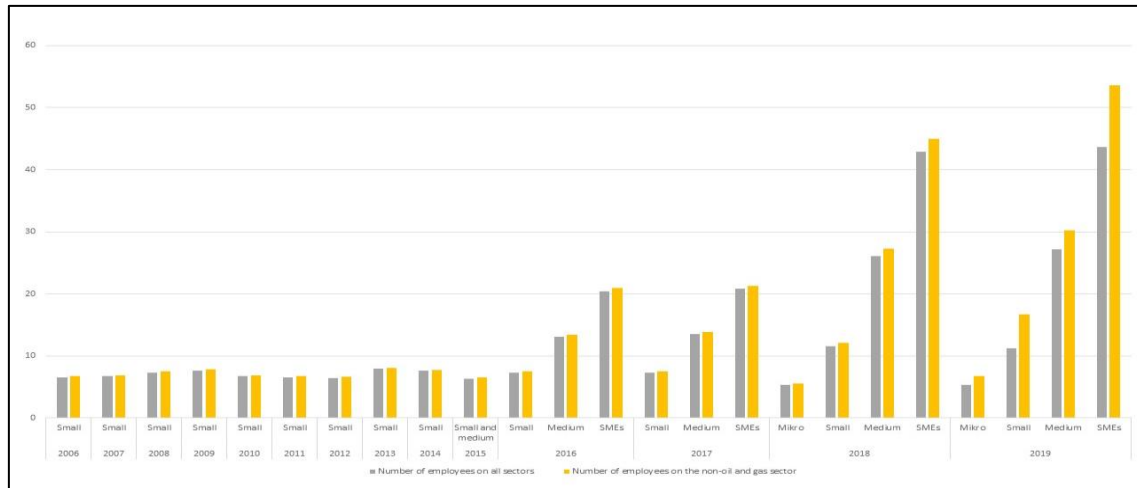
Figure 3. The share of SMEs in employment
Source: The State Statistics Committee of the Republic of Azerbaijan

As illustrated in Figure 4, the proportion of SMEs in total fixed capital investment in the country's economy rose from 2006 to 2019. Despite the fact that SMEs had a 3.3 percent share of the relevant indicator in 2006, micro and small entrepreneurs had a total share of 6.2 percent in 2019, and micro, small, and medium entrepreneurs had a combined share of 21 percent in 2019. In this regard, the average entrepreneur, especially according to the 2018 SME classification criteria, covers the significant values. Another important element to note in Chart 4 is that the proportion of SMEs in fixed assets in the country's economy peaked in 2018. As a result, SMEs made 41.8 percent of fixed capital investments across all industries in 2018, and 65.2 percent in the non-oil sector.

Figure 4. Relevant share of SMEs in fixed capital investment
Source: The State Statistics Committee of the Republic of Azerbaijan

V. Conclusion

The article's main goal is to provide a broad overview of how economic reforms affecting SMEs in Azerbaijan have impacted their macroeconomic status. In this case, the State Statistics Committee of the Republic of Azerbaijan's data from 2006 to 2019 were used. The article views the Strategic Roadmap, which was created in 2016 with the goal of revitalizing the SME sector, as the start of significant economic reforms in this area. We can compare the time before (including 2016) and after 2016 to assess the impact of reforms on the economic performance of SMEs.

The value added, average number of employees, average nominal wage, and fixed capital investment are all evaluated in this article. A comparison of the nominal values of these measures (excluding the relevant employment indicator) through time was done to construct an initial picture. The analysis takes into consideration the fact that SMEs are categorised differently in different years. When we look at the indicators of micro and small enterprises in 2018 and 2019, we can observe that four of them have increased over prior years. This finding demonstrates that the reforms have had a favorable impact. While the fact that SMEs accounted for 65.2 percent of fixed asset investments in the non-oil sector in 2018, demonstrating the beneficial effects of reforms, it also underscores the importance of SMEs for the development of the national economy and the reduction of reliance on oil.

Despite the fact that the study depicts the macroeconomic status of SMEs in Azerbaijan following the reforms, it has significant limitations. As a result, the lack of appropriate monthly, quarterly, or annual data, as well as the various classifications of SMEs throughout time, make it impossible to develop an econometric model to determine the factors affecting SMEs' economic performance.

For more research on this topic, it is suggested that SMEs be contacted directly using a questionnaire survey, which is one of the quantitative research methodologies, and that their perspectives and degree of awareness of current policies be investigated.

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