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**Assessment of Impact of COVID-19 on SMEs in Azerbaijan:
Consequences and Perspectives**

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Abstract

COVID-19 had a considerable negative impact on the economy of Azerbaijan, with SMEs being one of the major victims from the economic perspective. Economic sectors were affected to a different extent by the pandemic and lockdown measures. As a result of lockdown measures, many SMEs closed their operations with their employers not being paid or left without pay. Although the government provided essential support to small and medium-sized businesses, the share of closed businesses was high. Over two years since the beginning of the pandemic, a measures toward the improvement of the business environment was done. The share of operating and newly created SMEs increased along with legislative incentives adopted for their development.

Introduction

Since 2020 the largest public health crisis in living memory caused large-scale life loss and led to a major economic crisis. All countries across the globe faced collapse in their economies and severe human suffering index.

While estimating the impact on the economy, it becomes clear that due to the restrictions and containment measures adopted by the government of Azerbaijan, not only large industries were affected, but also small and medium-sized businesses (SMEs).

It goes without a doubt that due to COVID-19, SMEs were affected on both supply and demand sides. On the demand side of the economy, demand for SMEs declined due to the suspension of several Global Value Chains (GVCs) along with declining consumer confidence in industries. On the other hand, on the supply side, SMEs faced both material and technical difficulties because of labor shortages and transport disruptions ([Juergensen et al., 2020](#)).

The development of SMEs in Azerbaijan is crucial from the perspective of diversification, economic resilience, competitiveness, and employment. At the same time, following the path of developed countries in terms of SMEs' contribution to the GDP and employment, the development of SMEs should be considered one of the main priorities for the country ([CESD, 2017](#)). Nevertheless, SMEs in Azerbaijan faced a sharp decline in supply chain disruptions,

demand, a shortage of raw materials, delays in the transportation of these materials, and cancellation of export orders.

The closure of businesses led to major losses, while a decline in supply and demand further increased the unemployment rate as approximately 30% of the SMEs have lost their job and sources of income (Akbulaev et al., 2020).

Azerbaijan allocated the largest share of GDP among post-Soviet countries to mitigate the negative outcome of the pandemic (Abasli, 2020). The measures and assistance packages included support for SMEs. However, there is a need for additional incentives to be provided for the stabilization of the operations of SMEs in the country.

SME sector in pre-pandemic environment

Small and medium-sized enterprises play a crucial role in the employment and economic growth of the countries. The economy of Azerbaijan mainly depends on the oil price and trends in global oil markets. However, after the economic shock caused by the slump in oil prices in 2014-2015, Azerbaijan initiated diversification policy (Bayramov and Orujova 2017).

A new definition of small and medium enterprises was introduced in the country in December 2018 to eliminate differences in the methodologies applied by the State Statistical Committee and the Ministry of Taxes. The new definition provided a distinction between micro, small, medium, and large enterprises and is partially aligned with the EU definition. Table 1 illustrates the classification of small and medium-sized businesses in the country.

Table 1. Classification of SMEs in Azerbaijan

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

Large entrepreneurship	251-over	30 000 < AI
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Source: Cabinet of Ministers of the Republic of Azerbaijan

The largest share of SMEs operated in the country is concentrated in Baku. The main reason for the imbalanced distribution might be explained by the fact that the major share of the population lives and operates in Baku. In 2016, SMEs were included in the country's development program. The strategic roadmaps approved in 2016 in different directions aimed to ensure the sustainability of economic reforms in the country, also covered the promotion of small and medium-sized enterprises for identical purposes. Following the first objective of the Roadmap, the establishment of Small and Medium Enterprises Development Agency of Azerbaijan was approved by the rule of the President of the country dated December 28, 2017¹.

Azerbaijan is closely cooperating with the EU in terms of economic development and sustainability. In this regard, the EU is supporting small and medium enterprises in Azerbaijan through its EU4Business initiative².

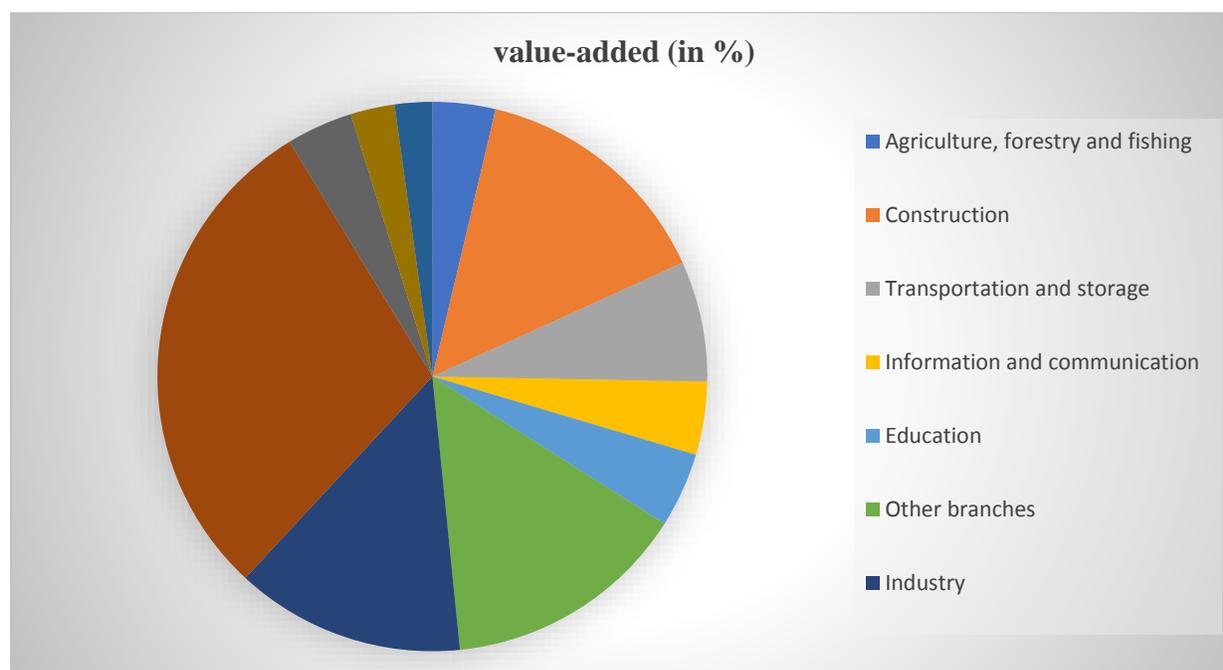
In 2016, the SMEs in Azerbaijan made 6.4% of value-added and 18.5% of employment, while in 2018, small and medium-sized businesses generated 13.4% of value added and 42.9% of total employment (OECD, 2020).

It is hard not to notice that SMEs operated in the country are mostly focused on relatively low value-added activities such as trade and repair of transport means, transportation and storage, accommodation and food service activities and other businesses (Graph 1). Small businesses are more active in trade (29.4%), while medium-sized enterprises are more active in industry (24.5%).

¹ <https://smb.gov.az/en/nav/about-us>

² <https://eu4business.az/en/>

Graph 1. Distribution of valued added created by SME entrepreneurship subjects by types of economic activity (in %)



Source: The State Statistical Committee of the Republic of Azerbaijan

Over the recent years, a significant job was done in Azerbaijan towards strengthening the role of SMEs in the economy of the country, increasing competitiveness, expanding access to financial resources, improving mechanisms for their support, creating favorable conditions for the development of entrepreneurship in the regions and attracting local and foreign investments in this area.

In a meantime, due to considerable investments in its IT infrastructure, Azerbaijan has established an advanced e-government system. Over 450 e-government services are available in a new web portal (www.digital.gov.az), including those closely related to enterprise activity (tax filing, property registration, company registration, etc.). Recently, Azerbaijan has launched a new online sales platform (www.kobmarket.az) to support the development of micro and small businesses and online sales of products and services of SMEs³.

³ <https://smb.gov.az/en/all-news/an-online-sales-portal-for-micro-and-small-businesses-wwwkobmarketaz-has-been-launched>

Pandemic and its consequences on SMEs in Azerbaijan

It is an undeniable fact that COVID-19 caused a considerable negative impact on small and medium-sized businesses operating in Azerbaijan. Due to restriction and quarantine measures applied by the government, businesses faced considerable challenges reflected in a decline in income, supply chain destruction, and a decrease in demand.

On the basis of a survey conducted among SME representatives in Baku and other regions of Azerbaijan, the majority of respondents stated that the pandemic has extremely negatively impacted business operations. SMEs operating in the fields of tourism, restaurants, and catering, along with those operating in the field of education, were among the most negatively affected.

A comparative analysis conducted in the EaP countries indicated that in Azerbaijan, 41 businesses were closed by mid-2020⁴. During the same period, only 17.5% of SMEs could operate normally, while 30% of small and medium-sized businesses had to partially shut down their operations. Around 52.5% of SMEs had to completely shut down their operations.

As was stated above, as a result of the imposed restrictions, a lot of companies faced severe losses, which in turn, led to economic stagnation.

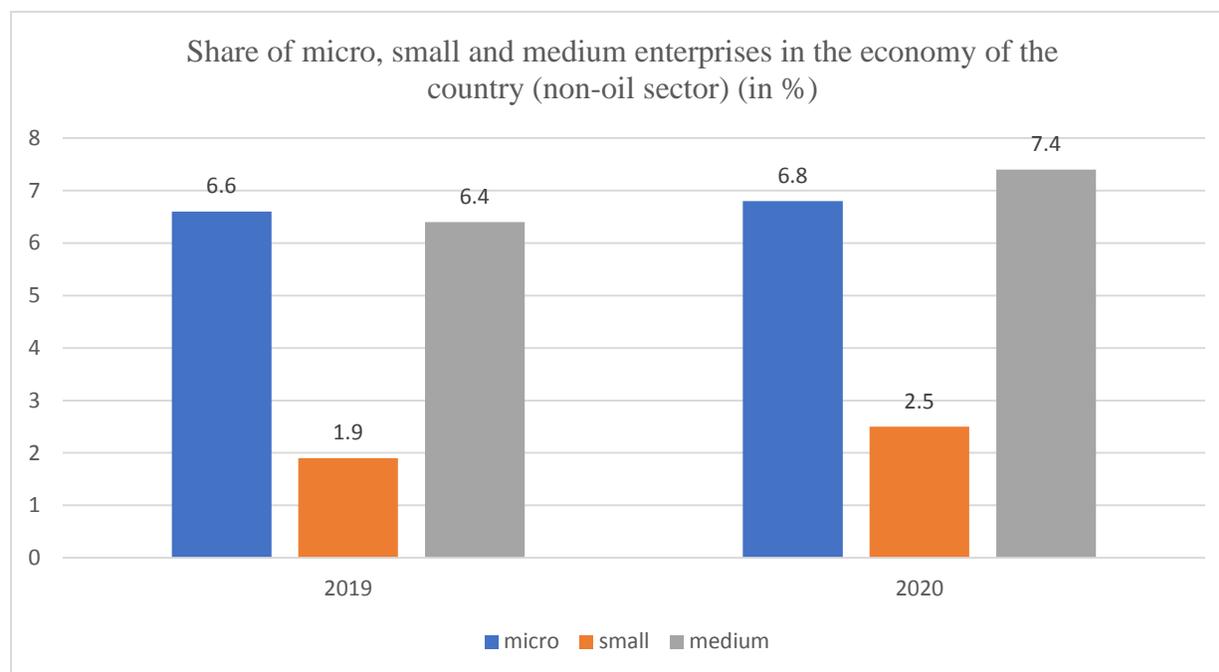
The authorities allocated support to the affected businesses and individuals in the amount of 3.3 billion manat (\$ 1.94 billion). Implemented measures included partial coverage of salaries (215 million manat/ \$ 126 million), support to micro-entrepreneurs (80 million manat/ \$ 47 million), temporary public jobs (54 million manat/ \$ 31 million), subsistence and unemployment payments (230 million manat/ \$ 135 million) and funds allocated to the Entrepreneurship Development Fund (50 million manat/ \$ 29 million). The amount allocated to the partial payment of salaries to 300,000 employees in the affected sectors was composed of \$ 127 million (CESD Press, 2020).

The assessment of public opinion regarding governmental policies adopted to eliminate the impact of COVID-19 on SMEs indicated that the majority of SME representatives were fully satisfied (37.69%)/ satisfied (35.68%) with the adopted measures.

⁴ <https://eu4business.az/en/news/weekly-digest-on-impact-on-smes-in-eap-10-july/>

Following the data provided by the State Statistical Committee, the value-added created by SMEs decreased by 1.2% in nominal terms in 2020 compared to the previous year. In the non-oil and gas sector, the value-added was composed of 23.7% of the value-added created in the non-oil and gas sector of the country (Graph 2).

Graph 2. Share of micro, small and medium enterprises in the economy of the country (non-oil sector) (in %)



Source: The State Statistical Committee of the Republic of Azerbaijan

One of the main factors directly affecting the development of entrepreneurship in the country is their access to financial resources. In this regard, both internal and external resources are of great importance.

In 2020, more than 80% of investments in fixed assets were made at the expense of internal resources, while the rest from external sources. Compared to 2019, a 21,9% decrease was observed in the total volume of investments directed by SME subjects to fixed assets.

Conclusion and Recommendations

Even though the vital role of SMEs in employment and economic growth is obvious, several factors create challenges for their development, such as access to finance, regulatory framework, availability of skilled employees, and innovation.

The report on the implementation of the Strategic Roadmap for SMEs states that the government has already implemented (78%) targeted strategic goals to increase the efficiency of SMEs' access to finance. However, in practice, access to finance is still a significant concern for SMEs.

On the other hand, the availability of ASAN services considerably improved the regulatory conditions such as registration and licensing. Nevertheless, limited access to finance and the availability of skilled employees remain the main challenges affecting the performance of SMEs in Azerbaijan.

Following experts' opinion, the most sustainable model for Azerbaijan is the EU model. In this regard, Azerbaijan's cooperation with the EU in the field of business development practices through the Eastern Partnership program can bring positive achievement further.

Over recent years, several reforms were carried out in the area of SME operations. These reforms include the launch of effective mechanisms for promoting export and investment, reducing the tax burden through expanding the taxation base, different measures aimed at supporting domestic production, receiving soft credits, and simplifying procedures related to the use of other financial mechanisms.

Countries applied different measures to assist SMEs during the outbreak of coronavirus. The policies came in a variety of shapes and sizes. Some countries focused on more broad-based initiatives and Azerbaijan, in its turn, also adopted numerous measures to assist small and medium-sized enterprises towards crisis mitigation.

However, in order to ensure the sustainable development of SMEs in Azerbaijan, there is a need for further reforms adopted in the sphere of a business environment.

- Ensuring the provision of extended financial assistance loans along with subsidies and grants seems crucial from the perspective of resilience and development.
- Additional support is required to help SMEs improve their productivity, boost their competitiveness, and expand their access to new markets.
- Increase the investment in entrepreneurial human capital through a focus of formal education on key competence development, along with the provision of practical entrepreneurship experience for students as part of education-business cooperation.
- Banks and other chambers of commerce should offer different stimulus packages to address liquidity challenges and avoid the closure of enterprises, respectively.
- Strengthening monitoring and evaluation of SME support programs is recommended to ensure the sustainable development of policies oriented toward the improvement of SMEs' operations.

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