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# THE STRATEGIC ROADMAP FOR THE PRODUCTION OF CONSUMER GOODS IN AZERBAIJAN AT THE LEVEL OF SMALL AND MEDIUM ENTREPRENEURSHIP



“The Strategic Roadmap for the production of consumer goods at the level of small and medium entrepreneurship” is developed as a part of a nationwide effort to achieve competitiveness, inclusiveness and sustainability in the economy. The main objective of the aforementioned Strategy is to ensure that small and medium entrepreneurship becomes the key enabler for sustainable economic development in Azerbaijan.

Development of small and medium entrepreneurship (hereinafter referred to as the SME) in Azerbaijan is essential to facilitate economic diversification, increase competitiveness, employment, as well as to meet demand for consumer goods and ensure economic development using local resources. "The Strategic Roadmap for the production of consumer goods at the level of small and medium entrepreneurship" (hereinafter referred to as the Strategic Roadmap) sets the primary policy direction for short, medium and long-term perspectives of economic reforms and development of the SMEs. This document consists of the strategic vision for 2020, long-term vision for 2025 and target vision for post-2025 period for Azerbaijan. In addition to describing the development strategies in the Strategic Roadmap and strategic objectives and targets in the action plan for 2016-2020, they also define a series of priorities to achieve objectives set for these years, as well as actions to be implemented under each objective, key implementers and clear-cut deadlines.

The effective implementation of the selected priorities in the short term will ensure focused and effective execution, which will lay foundation for further efforts in medium to long term.

The following were set as strategic targets for the development of the SME in the country in order to achieve relevant strategic objectives of the Strategic Roadmap and ensure maximum utilization of available potential:

- To further improve business climate and regulatory framework in the country in order to increase SME's contribution to Azerbaijan's GDP in the long run;

- Ensure efficient and cost-effective access to financial resources in order to establish sustainable network of the SMEs;
- Internationalize the SME's activity and increase access to international markets in order to increase currency stocks and bring domestically produced products into line with international standards;
- Increase supply of high-quality products and services in regional markets with special emphasis on training of skilled labor force and improvement of skills of the SMEs;
- Promote innovation to boost competitiveness of the SMEs and strengthen research and development in this field.

Particular attention will be paid to strengthening stimulatory impact of financial and tax policies by introducing improved legislative framework governing the SME-related issues, increasing access to financial resources, strengthening technical and information basis, as well as area-based optimal placement of SMEs in the country, protecting domestic market, developing market infrastructure, introducing "single window" approach for issuance of necessary documents, reinforcing joint work among entities representing this sector, etc.

Realization of these strategic targets will bring AZN 1 260 million added value and 34,240 jobs in the sector.

## **GLOBAL TRENDS**

Small and medium enterprises play a vital role in employment and economic growth in majority of developed countries across the world. According to World Bank data, in high-income countries, the contribution of the SMEs to GDP and employment is over 50 and 60

percent accordingly. Emerging nations across the world take systematic actions to develop the SMEs in order to strengthen economic sustainability, competitiveness and economic activeness. As a result competitive market relations get established, enabling supply and demand balance and stabilization of prices in the market, increase in competitiveness of goods and services offered, effective introduction of economic regulation instruments, economic sustainability and flexible absorption of external impacts. In the light of these reasons, both advanced economies and emerging countries exert multiple efforts to adjust their economies to crisis rapidly via the SMEs.

Other SME specific global trends are the followings:

- International practice suggests that the SMEs tend to have limited access to finance as risk factors associated with them are high. Consequently, both advanced and emerging economies tend to introduce special approaches to the SME funding, such as establishment of guarantee scheme, introduction of collateral-free financing mechanisms, risk insurance, etc.;
- countries across the world launch various support measures facilitating the SMEs' integration into global supply chains to support their increased role as supplier of separate components of products produced by trans-national companies. It is now a widespread practice for the trans-national companies to procure majority of components of their products from small and medium enterprises located in different geographies. It helps the SMEs to become participants of sectors with high added value in global value chain;

- A centralized body serving the SMEs is established in many countries across the world to ensure proper coordination of support of the SMEs and create a favorable business environment;
- The SMEs create horizontal and vertical clusters to keep their positions in markets and reduce production costs. So that, through these clusters the SMEs achieve economies of scale by optimization of costs.

## **ANALYSIS OF THE CURRENT SITUATION**

### **Current state of small and medium entrepreneurship**

Over the past period of time, Azerbaijan has taken several actions to support the development of entrepreneurship. Under the Presidential Decree № 610, dated on 24 June 1997, and № 753, dated on 17 August 2002, "State program for the support of small and medium entrepreneurship in the Republic of Azerbaijan (1997 – 2000 years)" and the "State Program on development of Small and Medium Entrepreneurship (2002 - 2005 years)" were adopted and implemented accordingly. In addition, the following programs contain actions for the development of entrepreneurship, further improvement of favorable business environment, improvement of mechanisms for the protection of the entrepreneurs' rights and statutory interests: "State Program on reliable food supply of population in the Republic of Azerbaijan in 2008 – 2015 years" approved by the Presidential Decrees № 3004, dated 25 August 2008 and № 3043, dated 15 September 2008 and "State Program on poverty reduction and socio-economic development in the Republic of Azerbaijan in 2008 - 2015 years", as well as

“State Program on socio-economic development of regions of the Republic of Azerbaijan in 2014 – 2018 years” approved by the Presidential Decree № 118, dated on February 27, 2014 and “State Program on the development of industry in the Republic of Azerbaijan in 2015 – 2020 years” approved by the Presidential Order № 964, dated on December 26, 2014.

In order to increase the contribution of entrepreneurs to strategic issues such as employment, non-oil export and development of favorable business environment and enhance overall support to business in the country, the number of inspections among entrepreneurs have been suspended for two years, number and costs of licenses and permits issued to start business have been reduced, permit issuing procedures have been simplified, as well as works on creation of electronic portal have been continued, Appeal Councils have been established to protect entrepreneurs’ rights, “single window” system has been introduced for transportation of transit cargo through the country, tax and customs incentives have been introduced for a period of 7 years to increase promotion of investments in the country, electronic-customs services have been further expanded to simplify customs procedures during import-export transactions, number of required documents and procedures have been minimized, “Green Corridor” and other customs inspection mechanisms, available in international practice, have been introduced for clearance of goods and vehicles, public procurement have undergone improvements, call centers have been established in governmental bodies to directly respond to requests of businesses and to provide information and consultancy services.

Consequently, the business climate has been further improved in Azerbaijan and the country received high records for some indicators in the World Bank Doing Business 2017 Report (for example, starting a business, registration of property). Public services have been further expanded through the establishment of online government portal in accordance with international practice. Innovation framework for the SME has been improved via infrastructure (for example, industrial parks, technology parks and business incubators) and financial arrangements (establishment of special fund for information and communication technologies (ICT) sector).

## **SWOT analysis for the SME**

### **Strength**

- Existence of legislative framework for the entrepreneurship;
- Achieving significant progress in indicators taken as a basis for global competitiveness;
- Ease of starting business;
- Constant expansion of the scope of the “electronic governance” system
- Progress achieved in recent years in reforms towards more business enabling environment in the country (“one window” principles, “electronic government” etc.)
- Simplification of foreign trade rules ;
- Availability of favorable infrastructure ;
- Public support for the development of SMEs
- Relatively cheaper energy prices compared to neighboring countries .

## **Weaknesses**

- Targeted policy of the government being implemented based on different criteria with respect to the SMEs;
- Public- private partnership and coordination in this specific area not being satisfactory;
- Weak liaison among various sized entrepreneurs;
- Difficulty in access to financial resources;
- Goods and services offered in the financial sector being insufficiently developed;
- Weak monitoring and evaluation system to identify impact of public support for the entrepreneurship;
- Lack of highly qualified specialists;
- Poor business skills, particularly at medium management level;
- Weak cooperation between public and private sector and vocational education facilities;
- Absence of specialized public organization with coordination function;
- Absence of special norms supporting the participation of the SMEs in public procurement;
- Limited number of public authorities and special institutions supporting the SMEs;
- Complicated rules for the termination of business;
- Limited skills in international trade;
- Weak cooperation among the SMEs and enterprises dealing with research and innovation;
- Constrained availability of consultancy services for the SMEs;
- Difficulty in access to international and regional markets.

## **Opportunities**

- Availability of opportunities to increase access to finance, create private credit bureaus and movable collateral register;
- Increase of the use of SME potential in development of non-oil economy;
- Involvement of the SMEs to public procurement and infrastructure projects;
- Additional support provided to SMEs with the expanded use of various international programs
- Creation of centers providing consultancy services and necessary documents for SMEs from a single space;
- Increase of business and vocational education options meeting requirements of the market;
- Creation of training centers based on “lifelong learning” principle for different specializations;
- Diversification of areas of production and economy;
- Availability of potential labor force

## **Threats**

- Impact of possible foreign factors (financial crisis, decrease in demand in international markets, etc.)
- Poor competitiveness of local SMEs in international markets;
- Lack of interest by the SMEs in vocational training;
- Introduction of restrictive measures by various countries to access foreign markets;
- Difficulties in employment;
- Tax benefits offered to residents of the newly established industrial parks

reducing competitiveness of non-resident SMEs;

## **STRATEGIC VISION**

### **Strategic vision for 2020**

The strategic vision of Azerbaijan for the development of the SMEs by 2020 is to achieve further improvement of business environment, simplified access for SMEs to financing opportunities and trade markets and ensure competitiveness, as well as increased contribution of the SMEs to economic development bringing up their business knowledge and skills.

### **Interpretation of the strategic vision**

As a part of the vision for 2020, regulatory framework for the SMEs will be improved, institutional reforms will be continued, competitive environment will be strengthened, the SME Agency and the system for obtaining necessary intellectual and technical resources will be established, and obtaining necessary permits will be further facilitated. As a result of successful implementation of the planned actions, the SME contribution to the GDP and employment will increase by 15 and 20 percent respectively, while the share of non-oil export is targeted to reach 10 percent during this period.

### **Long-term vision for 2025**

Azerbaijan' long-term vision for 2025 is to further improve competitiveness of the SMEs, achieve supply of substantial portion of daily consumer products by the SMEs and give rise to significant SME contribution to the country's GDP and employment.

## **Interpretation of the long term-vision**

Further improvement of favorable business environment, increased access to funding and international markets and introduction of innovative mind-set in all related areas will create favorable conditions for the SMEs in Azerbaijan. This way, Azerbaijani SMEs will make significant contributions to non-oil GDP and generate opportunities for employment in various high profit sectors.

Thanks to strengthened SMEs, Azerbaijan will increase its economic potential by 2025, which will facilitate fully competitive economy in the country, while developing Azerbaijan into one of the most favorable countries across the world for both local and foreign investors.

Simultaneously with strengthening the SMEs by 2025, enterprises will organize themselves into business associations within their respective sectors. Development of business associations will trigger expanded public-private sector dialogue. These associations will help realize priorities by 2025 and beyond within their respective sectors.

In 2025, Azerbaijan will develop into a country with favorable competitive environment, highly skilled workforce and constantly developing non-oil economy, which entered into the new stage of public-private partnership. In this context, the SME will become the driving force of the country's economic development and reduce reliance on import from the perspective of consumer goods due to enterprises producing competitive goods and services.

With the implementation of the long-term vision of Azerbaijan for 2025, the SME contribution to the GDP and employment will increase by 35

and 40 percent respectively, while the share of the SMEs in country's non-oil export is expected to reach 25 percent.

### **Aspirational vision of Azerbaijan post-2025**

As part of its post 2025 aspirational vision, Azerbaijan targets to generate at least 60% of its GDP via SMEs and establish a strong network of local SMEs integrated into global value chains.

### **Interpretation of aspirational vision**

Increased number and quality of Azerbaijan's SMEs will trigger further expansion over the value chain, participating in formation of intellectual values and capturing more of the value domestically. Energy efficiency of SMEs will be enhanced, while use of alternative and renewable energy sources will be stimulated. Development of SME network in all sectors will be kept in mind and SME's contribution to GDP will go beyond 60 percent in the long-term perspective.

In post 2025 vision, upon meeting domestic demand in their particular sectors, powerful local enterprises and the vast SME formation will aspire to expand their trading network into the international markets, mainly to those in the neighboring regions, and to significantly contribute to Azerbaijan's non-oil exports. Azerbaijan specifically targets to increase its share of SMEs in its foreign trade to 30-40%. In addition, in the post-2025 period, it is targeted to increase SME's contribution to GDP and employment by 60% and 70%, respectively.

During the next decade, Azerbaijan will manage to realize these envisioned targets through creation of more favorable business environment,

implementation of various programs and projects addressing the SME's development, and specifically through simplification of necessary procedures and ensuring transparency.

### **TARGET INDICATORS**

The followings are expected to result from the implementation of priorities in the SME sector:

- Increase the SME contribution to GDP by 15 percent;
- Increase the SME contribution to employment by 20 percent;
- Increase the SME contribution to non-oil export by 10 percent;
- Increase GDP by AZN 1 billion 260 million in 2020, in real terms;
- Create additional 34240 employments in 2020.

The following key performance indicators have been identified for measures towards the development of SME:

- Increase the SME contribution to products produced within industrial clusters by 40%;
- Improve by 2 times the rate of dispute settlements among SMEs before court procedures;
- Increase recovery rate of the SMEs (from insolvency) by 4 percent;
- Increase by 2 times the indicators of admission of immovable property as collateral by banks;
- Increase share of leasing transactions in GDP by 2 percent;
- Achieve 5 percent increase in non-oil exports;
- Establish 3-5 model entities;
- Establish 5 new business incubators;

- Launch at least 25 start-up projects throughout a year;
- Organize special trainings for at least 1000 small and medium entrepreneurs throughout a year;
- Establish 3 innovation- oriented regional clusters.

## STRATEGIC OBJECTIVES

Strategic objectives in SME sector are the followings:

- Shape more favorable business environment for SME;
- Increase competitiveness and role of the SMEs in the economy;
- Ensure that all major parts, particularly intellectual part of works and services are provided through the development of SMEs and consequently, the innovations;
- Increase the SME contribution to employment;
- Ensure that key consumer goods are produced by small and medium enterprises;
- Increase share of the SME export in the overall export of the country.

## STRATEGIC TARGETS

The Strategic Roadmap for small and medium entrepreneurship identifies 5 strategic targets, with relevant priorities for each strategic target. These can be classified as below:

### Strategic target 1

- Improve favorable business environment and regulatory framework for the operation of the SMEs
- Establish centralized SME Agency

- Improve SME-specific legislative framework and introduce legislative impact analysis
- Enhance public-private partnership
- Improve competitive environment
- Improve inspection and licensing mechanisms for the operation of the SMEs and continue tax reforms
- Establish SME-specific special industrial zones and clusters
- Expand public-private partnership and strengthen institutions representing the SMEs
- Improve alternative dispute settlement options among the SMEs
- Introduce criteria for the identification of the SMEs in all support measures and introduce systemized mechanism for statistical data

### Strategic target 2

- Ensure cost-effective and efficient access to financial sources for the SMEs
- Conduct reforms to solve winding-up and insolvency issues
- Create SME Loan Guarantee Fund
- Improve activities related to property issues and increase access to finance
- Develop leasing and alternative financial instruments (forward, futures, option, swap, factoring, etc.) market to ease access to finance.

### Strategic target 3

- Internationalization of the SMEs and improvement of their access to foreign markets
- Expand financial services for international trade deals of the SMEs and promote foreign direct investments
- Establish sector-based export associations

#### **Strategic target 4**

- Increase knowledge and skills of the SMEs and accelerate the introduction of best practices
  - Develop business incubators and start-up projects, create model entities
  - Increase training and education options for the SMEs and accelerate introduction of best practices
  - Promote entrepreneurial mind-set
  - Develop female entrepreneurship

#### **Strategic target 5**

- Expand promotion of investments, research and development activities for the SMEs
  - Improve national innovation system
  - Form innovation infrastructure stimulating small and medium entrepreneurs

#### **FINANCING MECHANISMS**

It is forecasted that achieving these strategic targets will require AZN 700 million investment by 2020. Implementation of actions in the Strategic Roadmap will be provided at the expense of the state budget, non-budgetary funds, funds of National Entrepreneurship Support Fund, local budgets, enterprises and organizations regardless of the type of ownership, foreign direct investments, credits and grants by country banks, technical and financial assistance by international organizations and foreign countries, other sources not prohibited statutorily.

In order to ensure effective spending of funds for priority targets, budgets will be prepared within the result-oriented budget drafting process. A great deal of the required funds will be provided

through the restructuring of existing budgets, joint financing initiatives of private sector and different investors.

#### **MONITORING AND EVALUATION**

The Strategic Roadmap will be monitored and evaluated through the required tools, processes etc. to ensure successful implementation. During monitoring and evaluation, attention will be paid to the implementation of actions based on merits, predefined results and indicators expected from relevant priority, compliance with deadlines. Monitoring and evaluation will be conducted based on the rules designed in accordance with international methodologies.

Annual work programs of the working group will be consulted with the delivery unit and approved by the key implementer. Quarterly meetings of the working groups will be held with attendance of representatives of delivery unit.

The key implementer will submit a quarterly report on activities to the delivery unit not later than 10 days before a quarterly meeting of working group. The delivery unit will, considering detailed analysis of report and discussions of working group at the quarterly meeting, submit the results of the quarterly meetings and recommendations to the key implementer within 10 days upon such meeting. The delivery unit and the key implementer will take actions to ensure that the monitoring results and recommendations are considered by the working group in its daily undertakings.



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