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## WINTER MESSAGE OF THE SCIENTIFIC DIRECTOR



Distinguished ERENET Members and Friends,

Quo Vadis European Union? To be or not to be EURO? These are the two main important questions facing the policymakers and civilians today. The ship of the EU is facing major problems and challenges. It is crackling and crunching and we do not know who to steal the thunder in order to save the sail-yard not to break in half. EU still facing enormous economic crises and the economic stability is far

from the normal course.

I remember the international workshop held prior introducing the EURO held at the UN Headquarters in Geneva, when following the presentation by the representative of the European Commission the head of the Economic Analyses department of the UNECE drew attention of the participant that launching the new European currency it is rather an ambitious task as similar to the stunt of jumping from the high shore in the swift current without a crush-helmet not knowing where are the underwater sticking rocks. It is a political decision which does not justify from economic and fiscal points of views. A unique common currency needs unique centrally planned and managed economic and fiscal policy and giving up the national sovereignty and delegation of major political and economic decision-making mechanism to an international selected governing body. However, it will be a danger of losing national independence and this will be similar to the former "socialist brigade movement" *à la arte* of the EU. The EURO was introduces to world financial markets as an accounting currency on 1 January 1999. Since late 2009, it has been immersed in the European sovereign debt crises, which has led to the creation of the European Financial Stability Facility as well as other reforms aiming at stabilizing the economy and the currency. Berlin and Paris are preparing a new EU stability pact which requires the 17 countries in the EURO-zone to limit budget deficits to 3% and debt to 60% Gross Domestic Products. This figures are not news, they are the EURO convergence criteria (Maastricht criteria). The problem is that the majority of the EU countries blew it and far too many exceeded this limits. This situation lead to current catastrophic situation. And most suffered the vulnerable small new EU countries, whose exchange rate is continuously deteriorating, the foreign debt is increasing, and the civil society suffering from the luxury overspending behavior of the reach Western countries. It is not surprising than sometimes street protesters flying into a rage are burning publicly EU flag.

It is even more frustrating the behavior of some policy-makers. The truth of the European democracy is out. Hungary has to learn the bitter lesson from the Western and US media when its Government is trying to behave like a national one. President Sarközy awarded the former Hungarian PM acting earlier as a socialist secret agent, but warn President Orbán to treat leniently the profit hungry French companies. US foreign minister Hillary with Soros support the formation of a new socialist political grouping again the current Government. Just when not a European Government and media did not protested when the Slovakian Government deprives of the citizenship of a 99year old Hungarian teacher who was born in her birthplace but her homeland gone with the wind of history, and last year due to the Hungarian Law on Double Citizenship she applied for her original citizenship. *Quo usque tandem abutere, Europe, patientia nostra? How long, O Europe, will abuse our patientia?* I wonder whether the Danish EU Presidency will deal with such kind of injustices.

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## DEVELOPMENT OF THE SME SECTOR IN THE ERA OF EMERGING FROM THE ECONOMIC CRISES IN ARMENIA <sup>1</sup>

### ABSTRACT

**Significant economic growth was recorded during the period of 2001-2007 in Armenia. The economic crises hit the Armenian economy, however, it become to revitalized since 2010. Small and medium-sized enterprises (SMEs) companies played an important role in the economic revitalization. This paper illustrates how the economic policy promoted economic stability in Armenia, and what kind of measures were taken by the Government to promote small and medium-sized businesses.**

JEL Code: F14, L26, O12, O57

### 1. NATIONAL ECONOMY AND THE SME SECTOR

#### Recent development of the national economy

Recently discussions concerning development of the Armenian national economy have intensified, because Armenia faces new challenges due to its quite complicated geopolitical location, namely by the impacts of the world financial crisis.

Armenia is a small landlocked country situated at the intersection of Europe and Asia. It is bordered by Georgia to the north, Azerbaijan to the east, Iran to the south, and Turkey to the west. Armenia is a mountainous country covering an area of 29,800 square kilometers with a population of just over 3.2 million at the most recent estimate (official figure).

During the last 15 years the Armenian economy has been growing continuously. After the collapse of the Soviet Union and severe economic downturn in 1991-1993, the national economy expanded for more than three times. Average annual growth rate during 1995-2008 was 9%. Significant economic growth was recorded during 2001-2007: on average about 13%. In the same period the per capita GDP also increased from 670 USD in 2001 to 3,689 USD in 2008. During the last quarter of 2008 the world economic crises made the real growth rate slow down significantly: as opposed to the previous years of 2-digit economic growth, in 2008 it made 6.8%. In spite of that fact, the output in 2008 exceeded the level of 2002 for around 2, the level of 1995 - for 3, and the level of 1990 - for 1.7 times, due to the continuous economic growth of the previous years. The effect of the crises continued during 2009, when the national economy experienced downturn of about 14%. However, in 2010 the economy began to revitalize and 2.1% real GDP growth was recorded.

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<sup>1</sup> Study prepared within the framework of the KAS-BSEC-ERENET Project and presented at the Workshop on Entrepreneurship and SME Development in the BSEC Region in the Time of Emerging from the Economic Crises held in July 2011 in Istanbul.

The country's nominal gross domestic product in 2008 was USD11.9 billion or USD3,700 per capita, which was higher than USD9.2 billion of the previous year (USD2,853 per capita). In 2009 nominal GDP decreased to USD 8.7 billion (USD 2,686 per capita) contrary to the government's budget forecasts (over \$13.6 billion was estimated). An finally in 2010 when real growth revitalized, nominal GDP also increased reaching USD 9.7 billion which equals to 3,041 per capita.

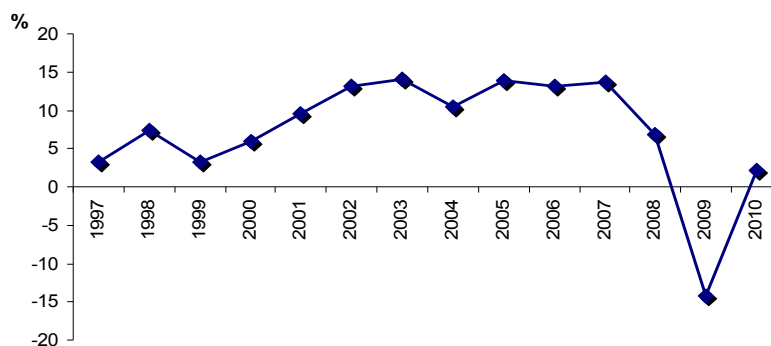


Figure 1 Economic Growth in Armenia in 1997-2010

As concerns the structure of GDP, in 2009 share of industry made up 13.6% (it decreased during the last 5 years), share of agriculture was 16.2% (decreased), share of construction – 18.8% (decreased), trade comprised 20.7% (increased over the last years), and the rest was comprised of other sectors.

As of 2008 average exchange rate for the Armenian national currency dram had been continuously appreciating for several years and was stabilized at AMD 306 for 1 US dollar for the year 2008. However, it depreciated suddenly by about 20-25% during 2009 economic crises, reaching even 384 AMD for 1 USD during the last quarter of 2009. Inflation, which remained fairly low in the early to mid 2000s, increased significantly as a result of higher priced imported goods coming into the country and jumped from 4.4% annual average in 2007 to 9% in 2008. Average exchange rate for the year 2009 stabilized at 363 AMD for 1 USD, however in 2010 it again reached the level of about 380 AMD per 1 USD.

The annual unemployment rate in Armenia was 7% in 2009, up from 6.3% a year earlier. This was due to the world economic crisis. Previously (during the last decade), unemployment in Armenia was much higher (well above 10%). The fall in unemployment has been facilitated by rapid economic growth in the country in early 2000s, especially in labor-intensive sectors.

Average monthly salary increased in 2009 by 11.5% as compared to 2008, and annual average inflation went down to from 9% in 2008 to 3.4% in 2009.

	2007	2008	2009	2010
<b>Population (million)</b>	3.23	3.23	2.24	3.26
<b>Nominal GDP (USD billion)</b>	9.2	11.66	8.71	9.73
<b>GDP Per Capita (USD)</b>	2,853	3,606	2,686	3,041
<b>GDP real growth %</b>	13.7	6.8	-14.2	2.1
<b>AMD/USD exchange rate</b>	342.1	306.0	363.3	373.6
<b>Inflation, %</b>	4.4	9.0	3.4	8.2
<b>Unemployment rate,%</b>	7.0	6.3	7.0	7.2

Figure 2 Main economic indicators, 2007-2010

In general, the growth rate in Armenia was much higher than in developing and especially in developed countries. The economic growth rate in Armenia is higher also in comparison with the neighboring or similar countries, and only lags behind Turkmenistan and Azerbaijan, because of the sharp increase in oil and gas export revenues in those countries. Due to the above-mentioned growth and development trends, Armenia shifted from the group of Low Income countries (according to the World Bank classification) to the group of Low Middle Income countries.

The implemented “first generation” reforms played an essential role in terms of ensuring a decade-long double digit economic growth. Liberalization of economy and establishment of market infrastructures and institutions formed the basis for economic growth and development. Although its first-generation reforms have been largely successful, Armenia must focus on the second generation reforms to sustain growth, especially after the world economic crisis, by smoothing its negative effects. These reforms include sharpening competition through structural and institutional reforms, creating competitive conditions for economic activity and job creation, improving financial intermediation, fostering innovation, and integrating international services and factor markets.

The main source of economic growth in Armenia is the external savings, particularly remittances received from abroad and investments in development programs and infrastructures. The economy highly depends on migrant remittances, and although the share of remittances in GDP decreased recently (from 24% in 2003 to 13% in 2008), the dependence still remains quite high. In 2007, Armenia was among the top 20 countries of the world in terms of the share of remittances in the GDP. Besides, to compare the top five remittance-receiving countries of the world<sup>2</sup> (according to 2007 data of the World Bank) with Armenia, per capita remittances to Armenia exceed the topest value of per capita remittances by about 2.5-3-fold<sup>3</sup>. Besides, remittances accounted for a considerable share of the income of households in Armenia (about 1/3 in 2006-2007). Therefore, it is clear that remittances are an important source of external financial flows for the Armenian economy.

Although starting from the end of 2008 remittances started to decline due to the world economic crisis, in nominal terms level of remittances is still high. Moreover, an increase was recorded in 2010 when the economy started to rebound. According to expert estimations, during the recent years the average amount of private remittances to the households of Armenia have constituted 1.5 bln US dollars annually.

During 2001-2008 economic growth was registered in almost all sectors of economy and the construction and service sectors held the leading positions. Industry and agriculture had almost the same share in economic growth. The growth of the construction sector and its multiplicative effect in other sectors assured the substantial share in GDP growth. In 2001-2008 the average annual growth rate in the construction sector comprised around 19.6%. As a result, during the mentioned period, the share of construction sector in GDP increased from 10% to 27% and assured 1/3 of economic growth (more than industry and agriculture together). However, in 2009 when the country experienced economic downturn, the growing sectors were only services and retail trade, with modest growth rates of 1.3% and 1.0% respectively. The largest decline was recorded in construction and transportation.

The first signs of economic recovery shown at the beginning of 2010 became less prominent in July as the agriculture contracted by some 23% (January-July, year-on-year). As a result, the real GDP growth rate declined from the highest 8.8% (for January-May) to 4.0% (for January-July). The crisis, however, put some adjustment to the growth pattern of the Armenian economy, leading towards more equal contribution of different branches.

Key branches contributing to the economic growth are presented in the figure below.

Share in GDP growth, %				
	2007	2008	2009	2010
<b>Industry</b>	3.6	5.9	-11.7	49
<b>Agriculture</b>	13.8	2.9	-1.2	-85.6
<b>Construction</b>	31.9	26.5	-73	25

<sup>2</sup> India, China, Mexico, the Philippines, and France.

<sup>3</sup> UNDP NHDR 2009.

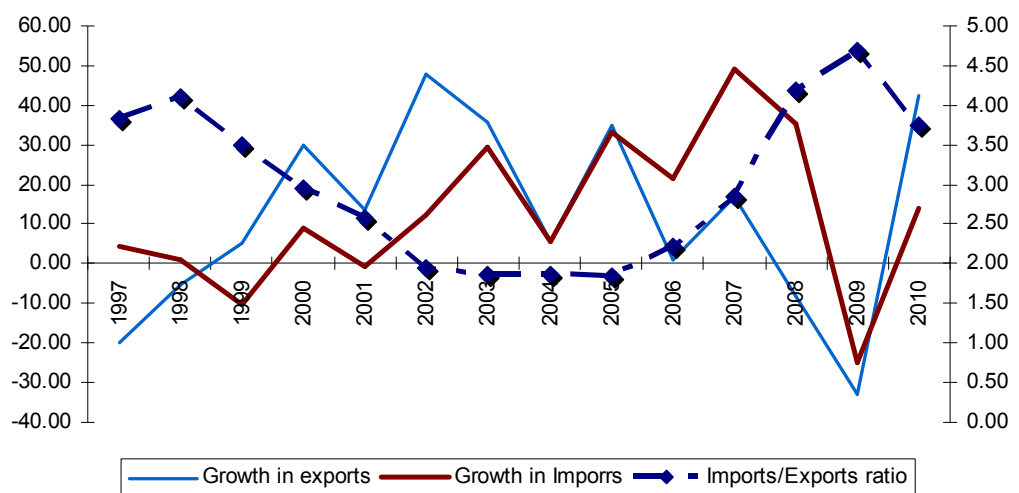
<b>Trade and services</b>	31.9	42.7	4.3	36
<b>Other branches</b>	18.8	22	181.6	75.6
<b>GDP growth</b>	13.7	6.8	-14.2	2.1

Figure 3 Contribution of main economic branches to the GDP growth in 2007-2010

The major driver of growth was mining industry. Mining was the most rapidly developing sector in the economy, recording a significantly higher growth rate compared to other sectors. With only 2.54% share in the total GDP, the mining industry sector contributed 32% of the total GDP growth in 2010.

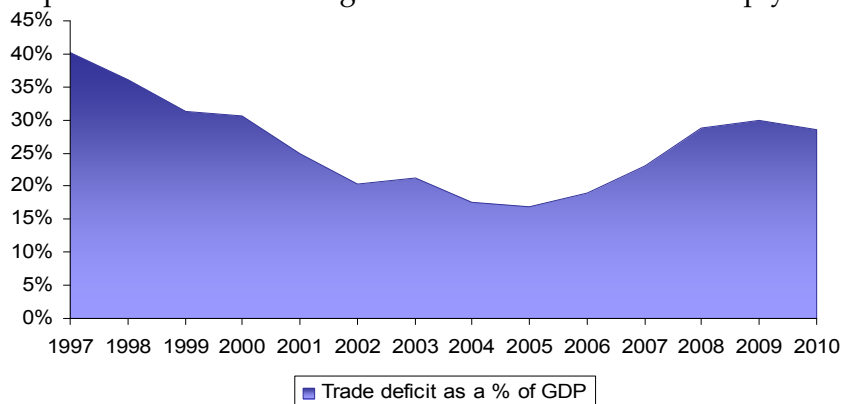
The deficit of the current account has been decreasing since 1998; however during recent years, especially in 2007 and 2008 it increased significantly, due to doubled deficit of trade balance. One should mention the fact that before 2001 imports exceeded exports by almost three times. But during 2002-2007 this ratio decreased almost twice (Figure 4).

Figure 4 External sector of Armenian economy, 1997-2010



In 2008 export volumes decreased significantly, and the share of exports of goods and services in GDP made up around 15% (while the share of imports in GDP was 40%). In 2010 merchandise exports have been growing at much higher rates than imports (43% vs. 23% as of January-July), reflecting positive developments in the external trade sector. As a result, due to large base for imports and exchange rate depreciation, the trade deficit increased from 32 to 37% of GDP. However, the net inflow of non-commercial private transfers (usual proxy for private remittances) increased by 7.5% in January-July 2010 (year-on-year) and may to some extent contribute to the improvement of the current account balance. Remittances from abroad and official transfers are an important source of financing for current account of balance of payments.

Figure 5 Trade deficit as % of GDP, 1997-2010



As can be noted in Figure 5, trade deficit improved during the period of 2002-2006 due to increase in exports, and decreased to 19% of GDP as compared to 40% in 1997. After, it started to increase again and

reached 30% in 2009 due to the world economic crisis.

The relative volume of foreign direct investments in Armenia is rather small. In 2000-2008, FDI inflow constituted around 3 billion US dollars or 6% of the annual GDP on average. These investments were mainly directed towards the development of transport and communication sector, nonferrous-metal industry, mining industry, food industry, and construction and service sectors.

Credits to economy by the internal banking system have not been impressive either. As the main sector of the financial market of Armenia during the last 10-15 years the banking system has extended credits to economy that amounted on average about 9% of GDP. This indicator increased in 2009 and made up around 19% of GDP. In response to the economic growth as well as development trends in the mortgage market the banks have substantially increased the accessibility of consumer and mortgage credits for households: however these indicators remain quite low in comparison to other countries.

Thus, since the deep downturn of 1991-1993 and up to 2008 the economy of Armenia entered the phase of continuous and rapid economic growth. The growth rate was especially high in 2001-2007. The private sector reacted to the liberalization of economy and other constructive reforms; however external savings still were the main source of financing the economic growth. The economic growth to a certain extent was accompanied by economic development: new types and branches of economic activities have come forward and developed. Nevertheless the main carriers of economic growth were the construction and real estate sectors. The years of economic growth were attended by the stability of fiscal and external balances, as well as low and stable prices. The poverty incidence (especially of extreme poverty) has reduced substantially due to growth, employment, as well as public and private external transfers (remittances): the poverty incidence decreased up to 22.7% in 2008 against 50% in 1999. 2009 world economic crisis, however, influenced the growth pattern of the Armenian economy. In 2010 fiscal performance was at positive trend in January-August. The tax collection exceeded the planned indicator by 11% and grew by 20% as compared to the previous year. However, price developments were not satisfactory: due to 1.3 percent inflation in August (driven by 2.5 percent increase of food prices), the 12-months inflation reached 8.2%, which was 2.7% points higher than the upper bound of the inflation target. As concerns contribution to inflation, there is a drift from non-tradables to tradables. If during the first quarter the inflation was formed mainly by prices of non-tradable goods, in the second quarter of 2010 food products prices accounted for more than half of the inflation. Despite some negative signals coming from agriculture contraction and associated with inflation in food prices, the general developments of Armenian economy in 2010 and more favorable global developments formed more positive macroeconomic outlook for the national economy. All major branches of the economy registered some growth, bringing to 2.1% GDP growth in 2010.

### **Recent development of the SME sector**

Armenia's economic transformation since its independence has been profound. Currently the national economy is market-oriented, highly open to trade, capital inflow, and innovation, and is based on services, light industry and metals, construction, and on agriculture. Small and medium-sized enterprises (SMEs) play an important role in economic growth, employment creation and reduction of the poverty. Due to the consistently implemented government policy to support SMEs, indicators characterizing this sector improved during the recent years.

The SMEs in Armenia are classified according to number of their employees in compliance with the Law of the RA "On Small and Medium Entrepreneurship State Support" adopted in 2000. Commercial companies or sole proprietors which employ respective average number of employees are classified as SME units (Figure 6).

Classification	SMEs		
	Micro (number of employees)	Small (number of employees)	Medium (number of employees)
Industry and other sectors of production	5	50	100
Construction and power engineering	5	25	50
Science and education	5	25	50
Transport, trade and services	5	15	30

Figure 6 The Classification Criteria of SME units in Armenia

Organizations engaged in crediting, insurance and investment activities, Lombard, security market professional actors, casinos, and organizations involved in gambling business, as well as subsidiary and dependent units are not considered as SMEs.

The share of SME sector in the country's GDP, employment, taxes, duties and other obligatory payments, as well as in the number of economic entities, the SME development index, etc are the indicators, showing the importance of SME sector in the economy, and are presented in this report. The comparative analysis of the data characterizing the SME sector in Armenia and other countries are also covered.

As indicated in the previous section, GDP, which is the main indicator of economic development of the country, was equal to USD 11.6 billion in 2008 and USD 8.71 billion in 2009. Real growth of GDP was negative in 2009 due to the world economic crisis (-14.2%), however, in 2010 the economy rebounded, showing a modest growth rate of 2.1% as compared to double-digit growth of recent years.

	2007	2008	2009
Total GDP	100.0%	100.0%	100.0%
Industry (including Energy)	15.0%	13.1%	13.6%
Construction	24.5%	26.9%	18.8%
Agriculture	18.2%	15.9%	16.2%
Transport and communication	18.2%	18.2%	20.7%
Financial activity, real estate, renting and business activities	6.3%	7.2%	9.2%
Other type of activities in service providing sector	9.1%	9.4%	13.0%
Financial intermediation	-1.4%	-1.7%	-2.1%
Taxes on product (subtracted subsidies)	10.0%	11.1%	10.5%

Figure 7 Structure of GDP production by branches of economy, 2007-2009

As shown in Figure 7, main branches that accounted for GDP production in 2009 were Transport and communication, Agriculture, Construction and Industry. The picture was almost the same in 2008, except that the share of construction sector in GDP decreased from about 27% in 2008 to about 19% in 2009.

As concerns the contribution of SMEs and large enterprises in total GDP production as well as in main branches of economy, the picture is shown in Figure 8.

Statistics shown on Figure 8 was calculated through statistical method of extrapolation. Despite the estimations in almost all sectors mentioned above, and in total GDP, it was impossible to evaluate the share of SMEs and large enterprises in agriculture and net taxes because of the absence of accurate data. Share of SME sector in GDP in 2009 was 42.5% or AMD 968,722.5 mln AMD and 41.7% or AMD 1,110,304.2 mln AMD in 2008. This means that the share of SMEs in GDP increased by 0.8%. In 2008 this indicator was equal to 41.7%, which was 0.7% higher than the level of 2007 (41%), and exceeded the 1999 level of the indicator twice. Although the growth of this indicator was modest over the period of 2007-2009, the share of SME sector in GDP remained above 40%, indicating the importance of SME sector for the national economy.



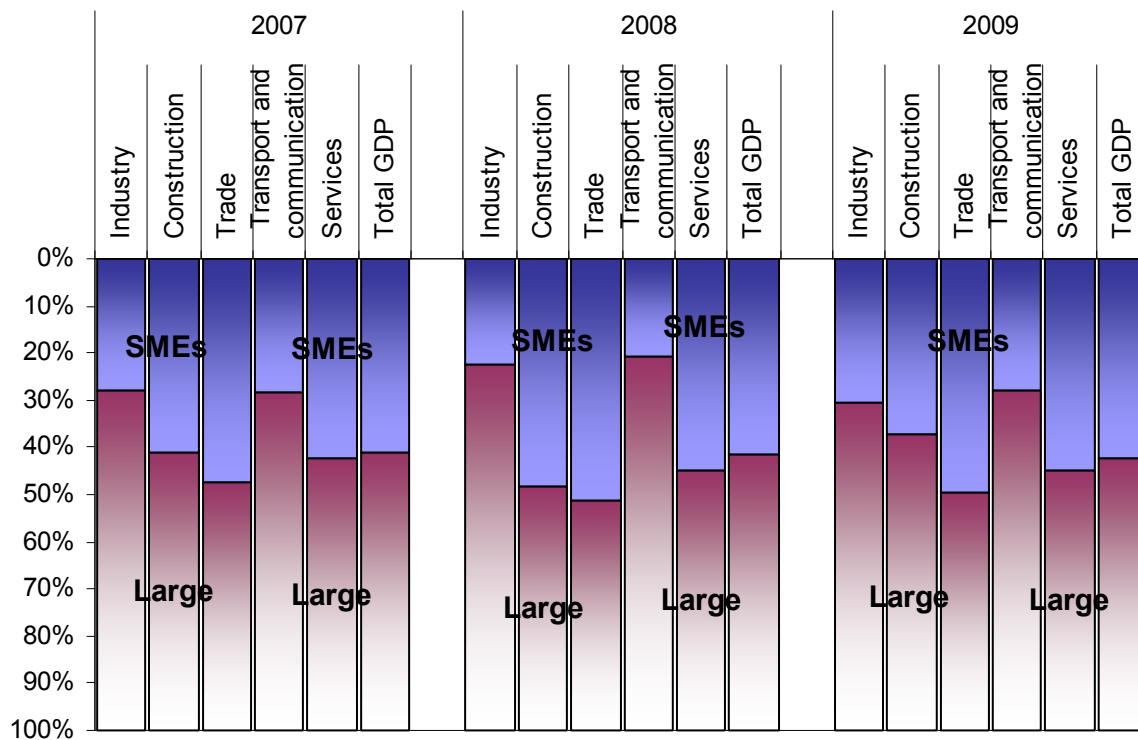
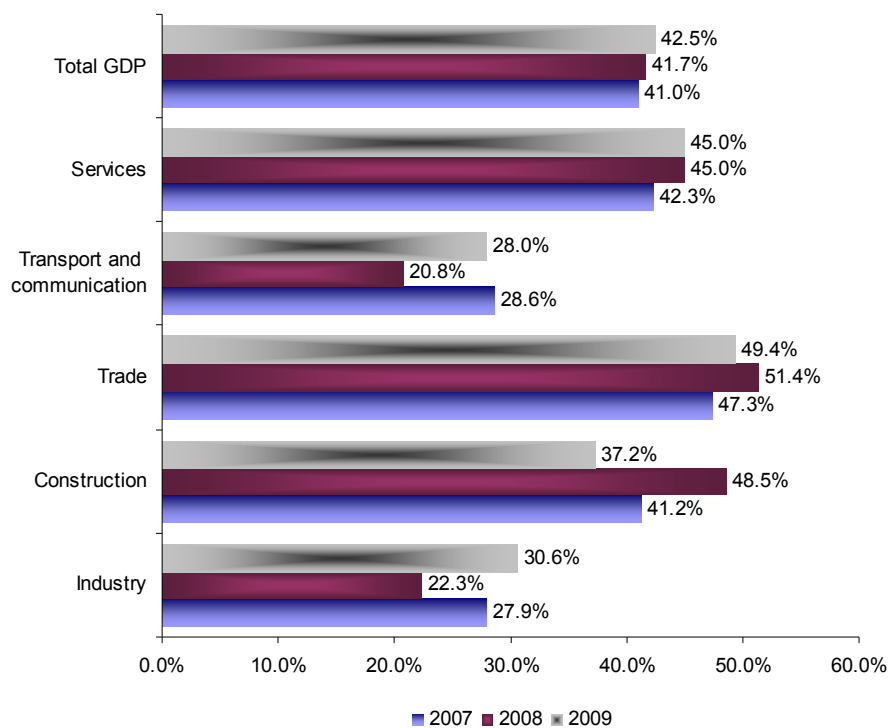


Figure 8 Structure of GDP by SMEs and Large enterprises in branches of economy, 2007-2009

As our data already showed, GDP growth in 2009 was negative due to the world economic crisis. In 2009 modest growth was registered only in services and retail trade sectors. In spite of the significant decline in GDP, the share of SME sector in GDP increased, because the crisis hit mainly large companies, because SME sector is more flexible to economic fluctuations, and because of the anti-crises activities undertaken by the government in order to mitigate effect of the crisis on SME sector. Figure 9 Share of SMEs in various sectors and in total GDP, 2007-2009.



As illustrated in Figures 8 and 9, SME sector has significant contribution to GDP generation and particularly to various sectors of economy, e.g. trade is in the first place by contribution of SMEs, services come on the second place, and construction is the third. Construction is the only sector where the SME contribution to the sector significantly decreased in 2009 as compared to 2008 (37.2% vs. 48.5% of the previous year). In trade sector this decrease made up only about 2% as opposed to 11.3 in construction. Data on other sectors show increasing tendency.

As of the beginning of the year 2010, the total number of registered commercial legal entities (LE) and sole proprietors (SP) was 136,008, of which 75,197 were sole proprietors, the rest were legal entities. According to expert estimations, about 97% of registered LEs and about 98% of SPs are SMEs.

Marzes	SME units	
	Number	Share in each Marz, %
Yerevan	61,857	46.5%
Aragatsotn	4,597	3.5%
Ararat	8,157	6.1%
Armavir	8,784	6.6%
Gegharkunik	6,703	5.0%
Lori	10,153	7.6%
Kotayk	10,745	8.1%
Shirak	6,946	5.2%
Syunik	6,744	5.1%
Vayots Dzor	2,636	2.0%
Tavush	5,603	4.2%
<i>Total in RA</i>	132,923	100.0%

Figure 10 Marz distribution of registered SMEs in 2009

Figure 10 shows regional distribution of SME units. Almost half of the SME units are based in the capital city Yerevan, the rest are almost equally distributed among the other 10 Marzes.

	SP	LE	Total
Number of SME units in RA	73,693	59,230	132,923
Share in Total %	55%	45%	100%

Figure 11 Distribution of SMEs in 2009

Figure 11 above shows distribution of SME units by legal status.

	Share of SME units, %				Share of Large enterprises, %
	Micro	Small	Medium	Total SMEs	
<b>2008</b>	74.0%	18.3%	5.4%	97.7%	2.3%
<b>2009</b>	75.9%	16.8%	5.0%	97.7%	2.3%

Figure 12 Distribution of SMEs in 2009 (by size)

Figure 12 above shows the distribution of SME units by size. Micro enterprises are dominant in total number of SMEs.

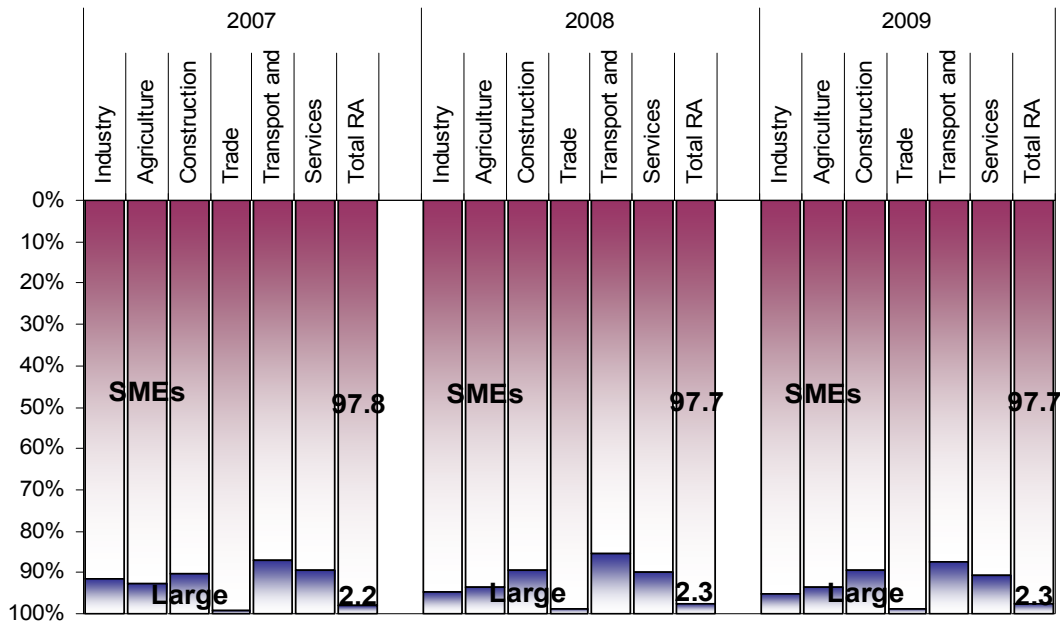


Figure 13 Distribution of SMEs and large enterprises by sectors of economy, 2007-2009

Figure 13 shows that in 2009 SMEs have more actively operated in trade, agricultural food processing, industry and construction sectors. The share of SME units was 98.9, 95.0, 90.4, 90.5 and 89.6%, respectively.

The role of SME sector was significant also in transport and communication sector (87.3%). And the last column for each year shows that SMEs made up vast majority of all registered enterprises in all three years.

Employment generated and maintained by the SME sector is another important indicator characterizing the importance of SME sector for the national economy.

According to estimation, the average number of economically active population in RA in 2009, was 1,185.1 thousand people, 93.1% of which or 1103.7 thousand were employed, and 6.9% or 81.4 thousand were unemployed and registered in the "RA Employment Service" under the Ministry of Employment and Social Issues. However, number of researches, statistics and expert estimation reveal that the unemployment rate is much higher in reality. Figure 14 below shows the share of employment that SME sector ensures.

Figure 14 Share of people employed in SME units in total number of employees, 2007-2009

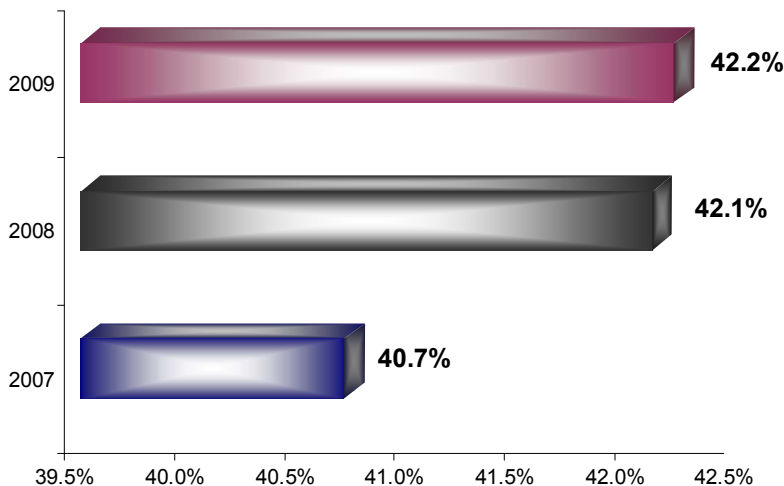


Figure 14 shows that during the period of 2007-2009 over 40% of employment in Armenian economy was provided by the SME sector.

The role of SMEs in new job creation is also noteworthy. For instance in 2008 the number of newly established SMEs was more than 20,000, at which around 27,000 new jobs were created, 51.7% of which in RA Marzes, the rest in Yerevan.

As concerns foreign trade, over the period of 2007-2009, SMEs accounted for up to 18% of exports

and up to 38% of imports. Majority of foreign trade was, logically ensured by large companies.

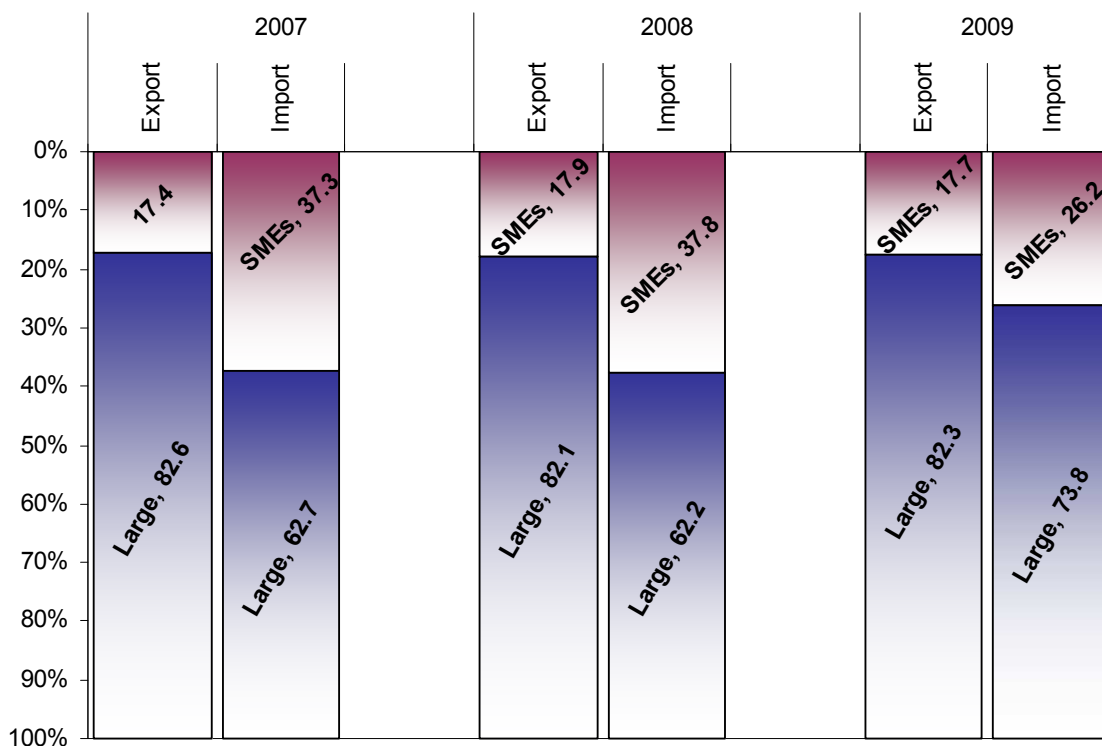


Figure 15 Foreign trade by SMEs and large enterprises, in 2007-2009

Figure 15 above shows that export of SMEs did not exceed 18% of total exports for the period of 2007-2009 and the products imported by SMEs did not exceed 38% of total imports of the country. While share of SME exports remain almost at the same level during these three years, SME imports declined from 37.8% in 2008 to 26.2% in 2009.

By analyzing comparatively small share of SMEs in foreign trade, especially in export, one can conclude that SME sector mostly targets internal market, since the requirements and competition is too high for external markets and SME units, as enterprises with limited funds and opportunities, often cannot overcome obstacles related to foreign trade.

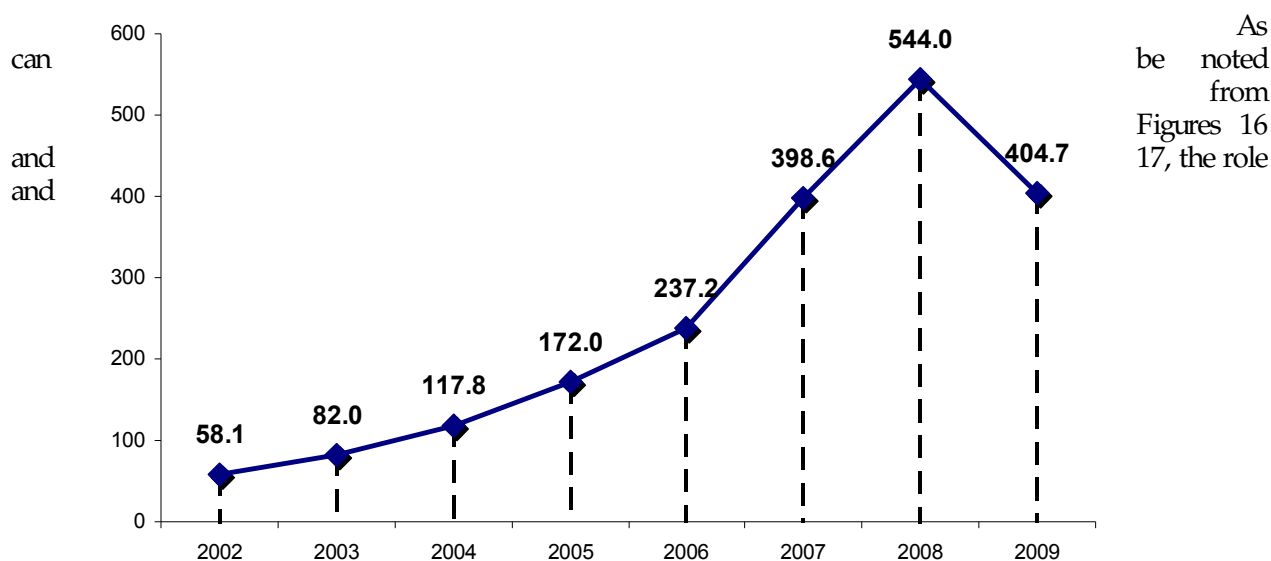
Share of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget made around 25-30% of the last several years. In 2008 this indicator increased by 2.8% points as compared to the previous year. However, in 2009 due to the world economic crisis it decreased by 1.2% points. As concerns the obligatory social security payments, SMEs paid around half of the country's total social security payments over the last 3 years, however this indicator was about 10% higher previously.

In order to get the entire picture of the role and importance or significance of the SME sector for the national economy, an aggregated indicator called "SME Development Index" is calculated in the recent economic researches according to the methodology developed by the United Nations Economic Commission.

	Share of private ownership in economy (%)	Share of SMEs in GDP (%)	Share of the labor force of SMEs in the total labor force of the country (%)	GDP per capita (USD)	SME Development Index (expressed in terms of GDP per capita)
2002	81	34.4	28.2	739.9	58.1
2003	83	36.5	31.0	873.4	82.0
2004	84	38.6	32.9	1104.4	117.8
2005	84	39.8	34.0	1513.0	172.0
2006	84	40.3	35.1	1996.0	237.2
2007	84	41.0	40.7	2844.0	398.6
2008	84	41.7	42.1	3689.0	544.0
2009	84	42.5	42.2	2686.0	404.7

Figure 16 SME Development Index in Armenia, 2002-2009

Figure 17 SME Development Index in Armenia, 2002-2009



significance of the SME sector in the economy of Armenia has been increasing continuously and almost exponentially. In 2008 level of the index exceeded 2002 level by almost 9 times. The only year that the index value dropped down by 25% was 2009, which was the result of the world economic crisis.

A comparative analysis also will be useful, in order to find out what is the situation in SME sector of Armenia as compared to other countries. In developed countries SMEs constitute 97-99% of the economic units. In the USA the share of SMEs in the total number of enterprises is 99.7%, the share in GDP is 52% and in the total number of employees is 53%. According to OECD data, in France and Spain the share of SMEs in the total number of enterprises is 99.8%, in Japan this figure is equal to 99.7% and in Switzerland up to 99%.

The comparative analysis of the basic indicators of SME sector between Armenia and countries located in South Caucasus region as well as number of countries in transition and/or developing countries demonstrates rather interesting results (Figure 18).

	Share of private ownership in economy (%)	Share of SMEs in GDP (%)	Share of the labor force of SMEs in the total labor force of the country (%)	GDP per capita (USD)	SME Development Index (expressed in terms of GDP per capita)
<b>Slovenia</b>	<b>70</b>	<b>56.5</b>	<b>62.6</b>	<b>26,779.0</b>	<b>6,630.0</b>
<b>Estonia</b>	<b>80</b>	<b>73.7</b>	<b>55.6</b>	<b>17,223.0</b>	<b>5,646.0</b>
<b>Lithuania</b>	<b>75</b>	<b>63.0</b>	<b>70.0</b>	<b>14,096.0</b>	<b>4,662.2</b>
<b>Latvia</b>	<b>70</b>	<b>58.2</b>	<b>69.3</b>	<b>14,909.0</b>	<b>4,209.2</b>
<b>Slovakia</b>	<b>80</b>	<b>45.3</b>	<b>66.0</b>	<b>17,565.0</b>	<b>4,201.3</b>
<b>Croatia</b>	<b>70</b>	<b>56.0</b>	<b>65.0</b>	<b>15,636.0</b>	<b>3,984.0</b>
<b>Hungary</b>	<b>80</b>	<b>36.9</b>	<b>56.8</b>	<b>15,409.0</b>	<b>2,583.7</b>
<b>Romania</b>	<b>70</b>	<b>55.0</b>	<b>21.0</b>	<b>9,300.0</b>	<b>751.9</b>
<b>Bulgaria</b>	<b>75</b>	<b>30.0</b>	<b>42.2</b>	<b>6,546.0</b>	<b>621.5</b>
<b>Azerbaijan</b>	<b>75</b>	<b>40.3</b>	<b>34.0</b>	<b>5,330.0</b>	<b>547.7</b>
<b>Armenia</b>	<b>84</b>	<b>41.7</b>	<b>42.2</b>	<b>3,689.0</b>	<b>544.0</b>
<b>Georgia</b>	<b>75</b>	<b>29.4</b>	<b>32.0</b>	<b>2,931.0</b>	<b>206.8</b>

Figure 18 Comparisons of basic indicators of SME sector in Armenia with those of selected developing countries, 2008

Selection of the countries presented in the above figure is preconditioned with geographical position, their relations with Armenia as well as comparable economic development tendency, area, population, and other circumstances in comparison with Armenia.

Due to the fact, that the number of employees in Armenian SMEs is significantly lower than those in EU countries as well as the differences in GDP per capita, the SME Development Index in absolute terms is significantly lower than in advanced and emerging market economies. Azerbaijan and Georgia are in similar situation in comparison with other countries. However, there is continuous improvement in this term, which reflects the positive effect of the targeted and consistent Armenian national SME policy.

During the period of 2002-2009 around 2.6 billion Armenian dram was provided by the state budget for implementation of SME support state programs. Within the scope of these programs, around 20,000 SME units were provided support and over the last 5 years, more than 20,000 applications of start-up and operating SMEs were satisfied. One can state that due to the consistently implemented government policy of providing support to SMEs, indicators characterizing this sector improved during the recent years.

Only in 2009, within the scope of the state support programs 9,370 SMEs were supported. Support (financial and other) was provided to 4,748 start-up SMEs.

In 2009 the following state support programs were implemented:

- Establishment and strengthening of institutions of SME state support,
- Financial and investment support to SMEs,
- Support to start-up SMEs,
- Support to SMEs in applying innovations and advanced technologies,
- Business, information and consulting support to SMEs,
- Training of SMEs,
- Support to SME sales promotion,
- Organizing activities of "European enterprise network" communication center in Armenia (co-financing),
- Development and implementation of joint (co-funded) programs with international and foreign donor organizations in the spheres of state support.

Main developmental tendencies and deficiencies characterizing the economy  
After implementation of "first generation" reforms, the economy of Armenia reached quite a good standing of main economic indicators. Economy has been growing continuously during last 15 years and reached double-digit growth level.

Main branches of the economy were industry, construction, agriculture, transport and

communication. International comparisons show that the agricultural and construction sectors have a substantial share in the structure of Armenian economy.

Main branches contributing GDP growth were industry, agriculture construction, trade and services.

Before the world economic crisis inflation showed relatively low and stable trend, national currency had been continuously appreciating for several years and was stabilized by 2008, however, it sharply depreciated in 2009. The situation has changed for almost all indicators in 2009 due to the world economic crisis, however starting from 2010 things started to get better.

Among one of the steps of anti-crisis policy, the Central Bank announced a return to a floating exchange rate regime in 2009. Exchange rate balanced and stabilized around its market price, leaving behind the risks of financial crisis.

Before the crisis almost all sectors of economy were growing. The growth of construction sector and its multiplicative effect on other sectors accounted for substantial share in GDP. During the economic downturn in 2009 the growing sectors were only services and retail trade (with very modest growth rates). The first signs of economic recovery were shown in 2010. The major driver of growth was mining industry, although it has a small share in GDP.

Trade deficit improved during 2002-2006 due to increase in exports. After, it started to increase again and reached 30% of GDP in 2009 due to the economic crisis. The unemployment decreased during the years of economic growth, however, increased by 0.6% percentage points in 2009. The level of poverty also decreased during the period of economic growth, but poverty rates went up during the crisis. Remittances were growing continuously before crisis, but reduced in 2009. However, in 2010 remittances also started to increase.

The relative volume of foreign direct investments in Armenia has been rather small. Before the crisis almost all economic indicators were improving. The years of economic growth were accompanied by stability in fiscal and external balances, as well as stable prices.

In spite of all these trends moving in positive direction before the crisis, the economy had some deficiencies. Particularly, economic growth highly depended on migrant remittances and investments in development programs. Poverty rate was still rather high. As mentioned above, the economy highly depended on construction sector. It is desirable to have a more stable and secure energy industry. Transport infrastructure also developed significantly since the mid-1990s, although here Armenia relies heavily on support from donor institutions, as governmental funds and private sector interest are still insufficient. Telecommunication is still weak in places. However, it is developing rapidly and several new companies have entered the Armenian market over the past two years. In addition, the government's focus on IT sector, with the goal of developing the Armenian e-economy, has led to internet coverage spreading to such an extent that the development of fiber optic communication lines is today a serious consideration. While social infrastructure has made progress over the last 15 years, it remains a comparative weakness for Armenia, with the healthcare sector in a particularly bad state.

Despite the progress recorded during the first eight months of 2010, key challenges for strong macroeconomic performance still remain. As last year, economic activity of main trading partners, and especially Russia, remains essential for economic recovery.

As mentioned above, the implemented "first generation" reforms played an essential role in terms of ensuring a decade-long double digit economic growth. Liberalization of economy and establishment of market infrastructures and institutions, eradication of controlled wages and prices and the privatization of most land and small companies, formed the basis for economic growth and development and Armenia's GDP and standard of living gradually increased. The country's infrastructure and financial system also made progress. Although the first-generation reforms have been largely successful, Armenia must focus on the second generation reforms to sustain growth, especially after the world economic crisis, by smoothing its negative effects. These reforms include sharpening competition through structural and institutional reforms, creating competitive conditions for economic activity and job creation, improving financial intermediation, fostering innovation, and integrating international services and factor markets.

## 2. LEGISLATION and RANKING OF DOING BUSINESS ACCORDING TO WORLD BANK METHODOLOGY

In order to perform entrepreneurial activity in Armenia, a company should be registered as a commercial legal entity (LE) or sole proprietor (SP). In Armenia the most common types of commercial companies are sole proprietors (SP), limited liability companies (LLC) and joint stock companies (JSC). Other legal forms of entrepreneurship according to Civil Code of RA might be also general partnership, limited partnership and commercial cooperative.

It is mandatory that an enterprise or entrepreneur performs activity based on a registration certificate from the State Registry.

An Individual Entrepreneur or Sole Proprietor is defined as a person who can perform activities independently on his/her behalf and at his own risk, without forming a legal entity, the main purpose of which is to gain profit (income) from using property, selling goods, performing works or delivering services.

Individual entrepreneurs can be the citizens of the Republic of Armenia and foreign citizens with capability, as well as those persons without citizenship, whose right of being engaged in entrepreneur activities is not limited by law.

A Limited Liability Company is a company established by one or more persons with a charter capital divided into shares determined by the company's charter. LLC is a commercial organization with status of a legal individual. It should have a separate property as its ownership and shall bear responsibility for its obligations with this property; it may acquire and utilize property and personal non-property rights, bear duties, be a claimant or respondent in court.

A Joint-Stock Company is a commercial organization, a business entity, the equity of which is divided into a certain number of shares certifying the right of shareholders. JSC is a legal entity, which has property that is separated from that of its shareholders. On its behalf, it can obtain and realize property and personal non-property rights, bear responsibilities, and act as a claimant or respondent at court.

The legal basis for commercial enterprises is established by the Civil Code of the RA (adopted on 28.07.1998, effective from 01.01.1999) and the following legal acts:

- The RA law "On sole proprietorship" (effective from 25.04.2001)
- The RA law "On limited liability companies" (effective from 21.11.2001)
- The RA law "On joint stock companies" (effective from 27.11.2001)
- The RA law "On firm names of companies" (effective from 15.12.1999)
- The RA law "On state registration of legal entities" (adopted on 03.04.2001 and effective since 2002)
- The RA law "On licensing" (adopted on 30.05.2001, effective from 27.06.2001).
- The RA Code of Administrative Violations
- The RA law "on Taxes".

The research implemented by the World Bank, aims at ranking the economies (or 181 countries) on their ease of doing business. The first place is considered the best. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business. Armenia is ranked 44 out of 181 economies. The position of Georgia in the list is 15, while Azerbaijan stands at 33th position. As concerns other countries, Romania is ranked 47, Turkey 59 and the Russian Federation 120 out of 181 countries. A ranking on the ease of doing business is not an absolute term and the indicators used in evaluation of the ranking do not account for all factors important for doing business. However, improvement in an economy's ranking indicates that its government is creating a regulatory environment more conducive to operating a business.



Rank	2009	2008	2010
Ease of doing business	44	41	
Starting a business	66	49	
Dealing with construction permits	42	73	
Employing workers	54	52	
Registering property	5	2	
Getting credit	28	25	
Protecting investors	88	88	
Paying taxes	150	147	
Trading across borders	143	131	
Enforcing contracts	61	63	
Closing a business	47	47	

Figure 19 Armenia ranking in doing business, 2008 and 2009

### 3. SME SUPPORT INFRASTRUCTURE

Small and Medium Entrepreneurship (SME) is considered as one of priority directions for development of Armenian economy. The Government of Armenia consistently performs activities aimed at development of SME sector, through creating state support system for SMEs.

SME development policy is aimed at expansion of SME sector in the context of economic, social and political development of Armenia and enhancement of the role of SME sector in the national economy. One of the main documents underlying this policy is the "Concept for SME Development Policy and Strategy in Armenia" adopted by the Government of RA in 2000. The document contains the economic, social and political objectives of SME development policy as well as the main directions for their realization. The adoption of this document served as a base for adoption of the Law of RA "On State Support of Small and Medium Entrepreneurship". The Law defines the criteria for SME units definition in the Republic of Armenia, as well as the key directions for state support of SME sector.

Since 2001, the Government develops and implements annual programs of SME support, which are aimed at realization of the main directions for state support of SMEs defined by the Law on "State Support of Small and Medium Entrepreneurship".

As concerns the institutions of SME support, the Ministry of Economy of the Republic of Armenia is authorized to elaborate SME development policy and strategy, as well as is responsible for elaboration of programs for development and state support of SME sector in Armenia.

The Fund "Small and Medium Entrepreneurship Development National Center of Armenia" (SME DNC of Armenia) was established in 2002 as another responsible institution in this sphere. It is considered as the main body responsible for implementation of state policy of SME support in Armenia as well as programs of SME development.

Foreign and international organizations (projects) play considerable role in the process for elaboration and implementation of SME development and support programs (projects) in Armenia.

Financial support to SMEs is provided through the Loan Guarantees Provision program allows the solvent entrepreneurs to get loans in terms of insufficient pledge amount and low liquidity, which is particularly specific for the SMEs operating in distant and close to the border regions of Armenia. The program provides up to 70% guarantee of the principal loan amount. The maximum amount guaranteed cannot exceed 10 million drams. The annual interest rates for the loans provided by the SME DNC through this program are and through partner banks are lower than current market interest rates.

Technical support to SMEs consists of Consulting support program, Business training and sales promotion. Within the scope of the consulting support program consulting is provided to SMEs in the following directions: legal advice, analysis of enterprise's business activity, elaboration of investment and development plans, management and marketing, accounting and financing management, tax and customs, innovations, modern technologies and intellectual property rights protection, and other as requested. Preference is given to operating and start-up SMEs in distant and close to the border regions of Armenia.

Training support assumes business education and training to SMEs on the following topics:

clarifications on the Tax legislation of the RA, management, marketing, labor legislation of the RA, business law, sales techniques and skills, human resource management, time management, customer services, financial management, intellectual property protection, business ethics, tourism and other, as requested. Again, preferred beneficiaries are operating and start-up SMEs in distant and close to the border regions of Armenia.

Support in sales promotion is provided to SMEs for adequate presentation of goods and services in the market. When choosing beneficiaries of the support program the preference is given to start-up SMEs, as well as those manufacturing new product, exporting or having export potential in distant and close to the border regions of Armenia.

#### 4. INDUSTRIES, BRANCHES, REGIONS, CLUSTERS

Among many other countries, the world economic and financial crisis affected the Armenian economy, which was one of the fastest growing economies in the world in recent years. Although Armenia has recently joined the group of middle income countries, it still has a high poverty rate, and over 45% of the labor force is employed in the inefficient agricultural sector. The contraction of real output in 2009 was driven by decline in remittances from abroad and weakness in the critical construction and mining sectors. In the longer term, however, it is expected that Armenia will continue above-average economic growth once the main effects of the crisis have passed.

International comparisons show that the agricultural and construction sectors have a substantial share in the structure of Armenian economy, as compared to other countries, while the shares of services and industry sectors are relatively small in comparison with other countries.

	2002	2003	2004	2005	2006	2007	2008	2009
Industry	22%	22%	22%	22%	18%	16%	13%	14%
Agriculture	23%	22%	22%	19%	18%	18%	16%	16%
Construction	14%	16%	15%	22%	25%	26%	27%	19%
Transport	7%	6%	6%	6%	-	6.9%	6.7%	-
Trade	10%	10%	11%	11%	18%	18%	18%	21%
Other Branches	24%	24%	24%	20%	10%	10%	10%	13%

Figure 20 Structure of GDP by main branches, 2002-2009

During the years of high economic growth (starting from 2001) the structure of the economy underwent through noticeable changes. The shares of construction increased significantly, while shares of agriculture and industry reduced about 1.5 times.

In 2008 Construction and agriculture together accounted for the major share of employment and more than 40% of total GDP. Trade and industry followed these branches, ensuring 18% and 13% of GDP, respectively. In 2009 the structure of GDP changed towards more equal distribution: trade was in the first place with 21%, followed by construction (19%), agriculture (16%) and industry (14%). The sectors of transport and communication, energy and water supply and the real estate, renting and business activities have their special niche. All these seven sectors of economy assure more than 3/4 of GDP.

As concerns the growth of main branches in 2008 the highest growing branches were financial intermediation; fishing; hotels and restaurants; other services; real estate, renting and business activities; construction and trade. In Majority of branches decline was recorded in 2009 due to the economic crisis: construction, agriculture and manufacturing sectors also declined.

In 2010 the major driver of growth was mining industry. With only 2.54% share in the total GDP, the mining industry sector contributed 32% of the total GDP growth in 2010. Sectors of industry, agriculture and construction had negative contribution to GDP growth in 2009 (year when GDP growth was negative). Industry, construction trade and services had positive contribution to GDP growth in 2010, when the economy revitalized and recorded 2.1% growth.

Manufacturing as a part of the industry sector, accounted for around 8.3% of GDP in 2009. The manufacturing sector in Armenia is based on 3 main branches, including food industry, metal industry and production of final metal items (1/4), and non-metal mining industry (9.5%). Other relatively large branches include chemical industry, tobacco industry, publishing and jewellery, which have almost the same volumes

and each account for about 3% of manufacturing.

During 2007-2009 mining industry has expanded by 3.6%, however, in 2009 the mining industry has experienced a decline of 11.4%. This is mostly conditioned by the impact of the world economic crisis and the decline of prices for raw materials, and especially of copper and molybdenum in the world market. The main direction of mining industry is the metallic ore mining, which makes up around 90% of the sector.

The branch of transport and communication has been expanding progressively during the recent years, and in 2009 accounted for 6-7% of GDP. Cumulative growth in this sector over 2001-2007 made up around 13.1%, moreover, in 2007 this indicator was equal to 16.3%. In 2008 it slowed down by making 9.4%. In the first quarter of 2009 the growth slowed even more and made up 3.4%.

In 2008, turnover of telecommunication and communication services increased by 15% as compared to 2007. The 66% goes to the cellular communication, and 26% to the fixed telecommunication. The fixed telecommunication services display a high tendency for decline, whereas the cellular telecommunication services are expanding progressively (though during the first quarter of 2009 the growth rate has slowed down substantially and has made up 2.5%). Significant decline in postal and courier services (by 50%) during the first quarter of 2009 may be explained by general decline in the economic activities, as well as by the increase of accessibility of internet services.

The sector of construction is one of the key branches in Armenia, which accounted for 27% of GDP in 2008, increasing by 7.2% in real terms as compared with the previous year. Starting from the third quarter of 2008 the growth rate in the construction sector tended to reduce, and during the fourth quarter of 2008 and first quarter of 2009 decline in this sector was recorded. In 2009 the share of construction in GDP decreased to 19%, however it still remains one of the major sectors of the economy. More than half of the construction is realized in the sphere of apartment and housing construction.

The agricultural sector in Armenia accounted for 15.8% of GDP in 2008 and 16.2% in 2009 (this was almost 1.5 lower than in 2002). This sector grew by 1.3% during 2008 (as compared to the previous year). The index of production volume in 2009 has decreased by around 5.5% as compared with the same period of previous year and made up 95%. Around one third of the agricultural production in Armenia is comprised of cattle breeding and the rest is crop production.

Tourism is one of the key sectors in Armenia. Since 2001, tourism sector has been growing significantly. One of the key facts to indicate tourism sector development potential is an annual number of incoming tourists. During the last decade the number of incoming tourists in Armenia was increasing by 20% on average. Over the period of 2000-2008, the number of visits to Armenia increased by 12 times. In the first half of 2009, 208 thousand tourists visited Armenia, which is slightly (0.1%) more than the number in the same period of 2008. About 60% of tourists were Diaspora Armenians. In the first half of 2009, internal tourism increase by about 13%. The purpose of 25% of the internal tourism was business, 13% - medical treatment, and 51% - recreation and entertainment.

Armenia is one of the leading information technology nations among the neighbouring CIS and Middle East countries. As of 1998, 35-40 programming companies and internet connection providers were operating, which employed around 1000 specialists. Over the last decade the number of both local start-up enterprises and branches of foreign companies increased significantly. In 2008 the number of IT companies operating in Armenia reached 175.

Since 2000, many foreign companies have established their branches in Armenia since the high professional level of the local specialists and comparatively low levels of expenditures were quite attractive. As a result the number of technical and business specialists in the IT sector reached 5000 in 2008. In 2008 the turnover in the sector of programming and services was equal to 110 mln US dollars, or only about 1% of the annual GDP.

Although, only 11 companies specialized in the sphere of micro scheme design: the revenue of these companies amounted to 16% of the total turnover of the whole IT sector. Other profitable fields are internet services, network systems and communication as well as applied internet programs. The export volume of the sector was 70 million US dollars and was directed to more than 20 countries all over the world. The major part of the export (around 60%) goes to USA and Canada, 18% - Europe and 16% to Russia and CIS countries. Today, Armenian IT industry is one of the most dynamic and promising sectors of the economy.

## 5. THE EFFECT OF THE INTERNATIONAL FINANCIAL AND ECONOMIC CRISES

The recent worldwide crisis originated from the USA markets and reached almost all the countries in the world. Economic growth all over the world has slowed down and a recession was recorded in 2009. In 2010 the world economy started to rebound. Among CIS countries, Ukraine and Georgia especially suffered from the crisis. Eastern Europe and especially Baltic countries recorded profound economic decline. The global financial and economic crisis has been affecting Armenia's economy since October – November, 2008. Risks related to the crisis were:

- Reduced or deferred direct private investments,
- Reduced remittances,
- Temporary fall in mining industry output levels,
- Delays or reductions in some investment projects in the sphere of construction.

The government of Armenia set the following targets in order to address the effects of this crisis:

- Maintenance of macroeconomic stability,
- Financial sector stability,
- Identification and use of extra incentives for economic growth.

Countries that are more and better integrated into international financial and commodity markets were affected by the crisis at first place. Unlike developed economies, Armenia's banking and financial institutions escaped panic, because of relatively low demand for liquidity. However, like many other countries, Armenia did not avoid negative effects of the crisis. Particularly, the following occurred:

- Reduced remittances from abroad,
- Lower raw material and mineral ore prices on the global markets,
- Lower demand for Armenian commodity and service exports due to decreased global demand, decreased exports,
- Decline in revenues from export as a result of reduction in global demand price of copper
- Decline in tourism growth
- Shrinking inflow of investment into Armenia due to the lack of liquidity in the global economy, education of FDI,
- Pessimistic expectations,
- Changed trading conditions, regulation and economic relations.

The first wave of impact was directed towards the financial system and macroeconomic. Armenian authorities managed to avoid the impacts of the financial crisis and to protect country's financial system; however the impact on the real sector was inevitable. Falling real estate prices on the global markets led to diminished interest for domestic real estate immovable assets. Along with reduced investment, this brought to the slowdown and relative inactiveness of the main driving force of Armenia's economy – the construction sector. In 2009 when the country experienced economic downturn, the growing sectors were only services and retail trade, with modest growth rates of 1.3% and 1.0% respectively. The largest decline was recorded in construction and transportation.

Also foreign demand for domestic goods and services was contracted, which resulted in less activity in number of economic branches in Armenia. Trade deficit reached 30% in 2009 due to the world economic crisis (as opposed to previous years of improvement and decline to 19% of GDP). During the last quarter of 2008 the world economic crises made the real growth rate slow down significantly: as opposed to the previous years of 2-digit economic growth, in 2008 it made 6.8% and in 2009 the national economy experienced downturn of about 14%. However, in 2010 the economy began to revitalize and 2.1% real GDP growth was recorded.

The annual unemployment rate in Armenia was 7% in 2009, up from 6.3% a year earlier, as a result of the global crisis.

In spite of the significant decline in GDP (-14.2% in 2009), the share of SME sector in GDP increased. The crisis hit mainly large companies, because SME sector is more flexible to economic fluctuations, and because of the anti-crises activities undertaken by the government in order to mitigate effect of the crisis on SME sector.

In 2009 share of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget decreased by 1.2% points as opposed to the 2.8% points increase in 2008. The level of SME development index which shows the role and significance of the SME sector in the national economy, dropped down by 25% in 2009 due to the global crisis. This was the only year when the index value declined; over the last decade, it has been increasing continuously and almost exponentially.

Since Armenia had the lowest level of inflation among CIS countries, our country managed to maintain its overall economic stability. Low level of inflation was partly conditioned by the GoA's policy aimed at ensuring stable national currency. However, prices of strategic imports, particularly fuel and food, increased due to the crisis. There were also some negative signals coming from agriculture contraction and associated with inflation in food prices. Sharp depreciation of Armenian dram in 2009 (about 20-25%) caused fluctuation in commodity prices in early March, as well as increased utility fees in April 2009. Migration and remittances also started to decline from the end of 2008, however, an increase was recorded in 2010 when the economy started to rebound.

Due to the cautious public debt management foreign debt-GDP ratio was kept at 13.4% as opposed to the average 33.4% across the CIS countries. The low level of public debt during the global crisis provided sufficient room for fiscal maneuvering, particularly, possibility to contract extra debt without putting at risk the public debt sustainability indicators.

## 6. GOVERNMENT MEASURES TO COPE WITH THE IMPACT OF THE ECONOMIC CRISES

### Relevance of economic policies to the features of the country

The Armenian government recognizes that improved infrastructure lies at the heart of its economic growth, and has set up infrastructure development as one of its policy priorities. Improved infrastructure will help Armenia's economy to become modern and competitive. Competitiveness is one of the top priority goals set by the government and they realize that our current infrastructure in the mid-longer term cannot support this ambition. The government has intention to use the power of the private sector in its infrastructure creation and has approved public-private partnership (PPP)-friendly legislation to facilitate this. PPP is considered to be one of the essentials, one of the key pillars of the government's infrastructure policy, and the new legislation will enable us to move ahead with the planned actions.

The following program sections are provided on the government's website:

- Government program,
- Medium term expenditure framework,
- Poverty reduction strategy,
- Anticorruption strategy,
- Millennium challenges,
- Anti-crisis action.

The current government program with main policies is posted under the Government Program section. Policies designed by the RA government are relevant to the needs and features of the country.

The key priorities set by the government are:

#### 1. *Maintenance of macroeconomic stability and high rates of economic growth.*

The Government will have essential, but restricted role in the economy by creating a favourable environment for the development of private sector. Macroeconomic policy will continue to ensure low inflation rates, low budget deficit and floating exchange rates. The final goal will be the significant economic growth, through provision of macroeconomic stability. The government has set an ambitious goal of turning Armenia into a "Centre of Excellence" for regional business development and investments. The geopolitical location of Armenia creates objective limitations for entrepreneurship, making it more costly as compare to neighbouring countries. Therefore, the government has decided that we need to:

- make our air and land transportations less costly,
- make our telecommunication systems all over Armenia more accessible and affordable;
- eliminate red tape in doing business, reduce the number of unjustified requests, high costs and long timelines for issuing licenses, permissions for starting a business;

- simplify the tax system, and provide for the online filing of tax returns;
- reduce the number of check ups by achieving improved quality;
- achieve a qualitatively new standards in the customs system, thereby eliminating obstacles for competitiveness;
- reduce the tax burden.

### 2. *Social integration and consolidation.*

Under this priority the issue of poverty should be addressed. active involvement of the poor in the economic and civil activities is planned. Attention will be focused on the gap inherited from the past years which exists between the average pensions and average wages, which has resulted in a significant gap of living standards of the employed citizens and the retired pensioners (including also the disabled). The government will gradually increase the pensions, and the plan is to make it 1,5 times above the poverty threshold. The work on introduction of multilevel retirement schemes will continue. The government intends to increase the efficiency of budget allocations seeking to mitigate the social tension. The family allowances system will be improved in terms of re-conceptualization and targeting the true needy social groups. To ensure a public consolidation, it is required that the well-off people revise their living habits not showing off their wealth and power.

### 3. *Development of human capital.*

Without human capital development, all the programs may fail. Therefore, the government of Armenia plans to implement reforms in education, strengthening universities, aiming at having a knowledge based society and such an educational system that will provide employees who will form our future. Since education should be ongoing for the entire life, the government presents its Concept on ongoing education. It is planned to establish a link between the educational institutions and research centers, because in case of separating science and educational institutions, they both will become inefficient. Direct link between the educational institutions and business world is planned to establish. The education system will have innovative trends and the government will support it. The educational institutions have to be in a direct continuous contact with the public and provide for the accessibility of their achievements in the fields of research and development. The Government will create exclusive opportunities for the youth to study in the prestigious schools of the world.

Under this priority, a new health care concept will be introduced. The quality and accessibility of the health care services offered by our health care institutions should match the best international standards. Armenia has to become a regional health centre. Also, the government will support provision of health care services to vulnerable families or those with limited possibilities. The government will the development of voluntary insurance systems of life and health. A new electronic system will be introduced, which will include also the patients' medical history along with other information. This will increase the efficiency of the system.

In addition, the basis of our national culture will be strengthened. The government intends to make the cultural resources assessable for the entire population of Armenia. It is about the maintenance and rehabilitation of the historical cultural heritage, development of a library network within the country, being assessable to the best libraries of the world through the information-technological systems, also about the development of mass media, theatres and movies. Also. a special TV channel will be established that will adequately present the Armenian culture.

Environmental education, eco-friendly upbringing, and public awareness are other key issues and will be a good base for creation of a comprehensive and national unified ecology. Leaving in a clean environment is another important component of human capital development.

### 4. *Establishment of effective public, local self-governing and private sector management systems and the introduction of the principles of corporate management.*

All the ambitious programs can remain unrealized if the working methods are not improved. Therefore the government plans to ensure application of new methods with the goal of hitting set targets through set actions. The best international standards in the field of management will be introduced. Transparency and efficiency in the public management system will be increased. Setting clear targets for the desired outcome and the performance assessment leading to that goal will become the main rule of reporting for the government. Procedural audit will be conducted by the Control Chamber of the RoA. The government plans to improve drastically the quality of the services provided by the state and local self-governing bodies and the public will provide feedback on these services. An electronic management system will be introduced enabling the state and local self-governing entities to provide services via Internet/online, thus minimizing the

need of contacting the state official by the citizen. This aims at reducing corruption risks. Corporative management system in the real sector should be introduced. Moreover, the corporative management system will become a mandatory requirement for the companies with state ownership or with its participation. The concept of public private partnerships will be introduced. The wages in the public sector should be competitive with those in the private sector, which also implies that the efficiency and quality of services should also be competitive.

##### 5. *Harmonized regional development.*

Currently the disruptive territorial development has become one of the serious obstacles for the economic and social development of Armenia. The overpopulated Yerevan hinders the regional development, as well as the natural development of Yerevan itself. The Government sets a challenge for itself-it has to turn the town of Dilijan into a financial centre. Cultural, recreational, agricultural and industrial centers will be created outside of the capital Yerevan. This will bring to more equal and harmonized regional development. Since one of our targets is to have a technological society, all distant area in Armenia should have reliable Internet access. The modern information systems, knowledge and services will be made available and assessable to everyone. This will enable us to achieve an improved quality of life all over Armenia.

These are first five priorities of the Government for the upcoming years. The government fights against poverty, corruption, migration, tries to apply practices of good governance, ensuring economic development, competitiveness, higher employment rate, higher incomes, less polarization in society, favorable business and investment climate, efficient budget system, tax and customs systems, secured copyrights and property rights.

Main sectors of the strategic development that the government focuses on are:  
Industry (focus should be on management, productivity, knowledge-based industry, use of technologies and innovation issues, and development of mining industry),

- Agriculture,
- Environmental sector,
- Renewable energy sector,
- Transport and communication,
- R&D and IT, engineering,
- Healthcare,
- Education and science,

Selection of these sectors comply with the country's comparative advantages and "natural endowments". Natural endowments promoted by the country's promotion agency, Armenian Development Agency, are well educated, skilled, easily trainable, cost-efficient, young and growing labor force (with science based skills), mining resources, tourism opportunities, the first country adopting Christianity, capacities in high tech.

Main results that the government expects from the realization of these policies over 2007-2012 are:

- Annual real GDP growth of 8-10%;
- At least a 10% annual increase in investments;
- A significant reduction of regional economic disparities;
- A 10% increase in non-agricultural employment;
- An increase in state revenue collection by 0.3-0.4 percentage points of GDP per annum;
- A significant reduction of poverty: below 11.2% - for poverty and below 1.6% -for extreme poverty;
- Yearly increase in the level of pensions to ensure that average employment (insurance) pension is equal to the minimum welfare budget in 2012.
- Introduction of a multistage pensions system. Higher financing level for social security and insurance systems to reach 6.2% of GDP;
- Higher public expenditure on health care to reach 2.2% of GDP;
- Higher public expenditure on education to reach 3.5% of GDP.

Government policies and actions to smooth the impact of economic crisis  
Anti-crisis policies, adopted by different countries have some similarities. All of them eventually aim at stabilizing demand, promoting production and restoring trust in society. However, each case has its

peculiarities, conditioned by the character of policies. As opposed to many other countries, strengthening of financial institutions and additional insurance of risks were no more priorities for the anti-crisis policy adopted by Armenia.

The first wave of the world economic crisis hit the financial system and macroeconomic stability, which could have led to uncontrollable situation in Armenia. However, this was avoided due to currency temporary regulation policy, as well as excellent baseline indicators of the banking system, high level of financial control and trust towards banks. Though this resulted in some loss of foreign reserves, it allowed managing the expectations in Armenia, in the time of financial panic in main partner countries, and giving time to economic and financial agents to make necessary revisions. In March 2009, the Central Bank announced a return to a flexible exchange rate regime policy. Exchange rate balanced and stabilized around its market price, leaving behind the risks of financial crisis. There were no significant losses carries by financial institutions in Armenia. Anti-crisis policies in Armenia are directed towards regulation of real and social sectors of the national economy.

In order to mitigate negative effects of the global economic crisis, the RA Government drafted an anti-crisis program which was submitted to the National Assembly on 12 November 2008.

The government's anti-crisis program is aimed not only at minimizing the adverse consequences of the global crisis, but creating ground for sustainable development and new type of economic relationship in the country.

The overall goal of anti-crisis policies in Armenia is to prevent the economic crisis and reduction of employment, as well as to create basis for growth in post-crisis stage and long-term effective development. The main steps or components of the anti-crisis policy are the following:

- Implementation of balanced macroeconomic policies;
- Support to investment programs contributing to economic development
- Improvement of business environment and support to entrepreneurship, including simplification of tax regulations and considerable reduction in administrative costs for small businesses;
- Implementation of large-scale projects aimed at infrastructures creation and development;
- Social risks management;
- Providing financial resources for small and medium-size enterprise lending;
- Implementation of sizeable infrastructure-oriented projects and creation of new jobs in these frameworks;
- Priority for welfare programs and State's social commitments.
- Carrying out reforms directed towards growth and development in post-crisis period.

Main principles set under the anti-crisis policy in order to cope with the crisis are:

- To comply with the best traditions of public finance management
- To ensure a high level of accountability and transparency;
- To avoid or limit the application of possible non-traditional measures of government support to the private sector;
- To ensure development and implementation of public-private partnership (PPP), ensuring effective feedback with society and businesses;
- To apply developed Public Investment Assessment Systems (PIAS);
- To remain loyal to liberal economic policy principles and commitments acquired before WTO and other international organizations;
- To ensure sustainability of reforms;
- To ensure effective communication with the public and businesses;
- To maintain macroeconomic stability;
- Achieve macroeconomic stability through financial sustainability and stability;
- Efficient exchange rate policy pursuit;
- To implement expansive monetary and fiscal policies;
- To implement large-scale infrastructure-related programs;



- Business environment improvement and temporary support for entrepreneurship;
- Priority given to socially-targeted programs;
- Identification and use of extra incentives for economic growth.

In order to cope with the crisis effects the government will perform the following actions:

- The RA government will implement pan-Armenian projects in line with the principle of private-public sector cooperation
- RA Government will provide additional amenities for doing business in Armenia
- RA Government shall develop a healthy business environment in Armenia
- RA Government shall take steps to cope with the social and economic problems facing Armenia
- RA Government will take steps to ensure public control over and transparency of the projected actions.

As concerns macroeconomic stabilization policy, government and the Central bank of Armenia are implementing anti-cyclic fiscal and monetary policies based on the assumption that increase in overall demand is counter-cyclical and counteracts economic downturn which, in turn is supposed to revitalize the business environment. Proper coordination is emphasized as priority in this process. Particularly, it has been decided to strengthen financial position of the Armenian banking system and inject extra liquidity into the economy, which can reduce interest rates. The CBA revised refinancing rate by decreasing it. Fiscal policy also has been aimed at expanding gross demand by increasing expenditures.

Another anti-crisis measure was tax and customs reform, under which taxes have been considerably simplified for all types of businesses, including small and medium-size enterprises.

In order to minimize “the contact area” between importers and customs officers and reduce corruption risks, customs broker’s offices and self-declaration desks are now available at customs houses and warehouses as connected to TWM online customs clearance processing software. Customs formalities have been simplified. This will save importers a lot of time and energy. Risk selection criteria have been revised in the TWM customs clearance software in order to enhance control efficiency. The number of documents required for import-export-related border-crossing purposes has been reduced to only 3. This will help save a lot of time during the clearance of imported and exported goods. In addition, the list of products subject to mandatory certification at the time of border-crossing was shortened from 65 to only 16.

The RA government focused attention on improvement of business environment, undertaking an ambitious program of ensuring a sharp rise in our country’s image in terms of entrepreneurship and reaching a top place on the list of most business-friendly countries. Particularly, laws on immovable property tax, tax on means of conveyance and tax on return have been drafted, which envisage a single tax as a substitute for the currently applicable land and real estate taxes, a unified tax on return instead of today’s income and social security taxes. Thereby, only one form will be required to file and submit for each of these new taxes. In addition, The process of creating a legal person has been eased considerably by calling off the requirement of possessing a corporate seal, reporting a minimum statutory capital, as well as by improving the regulatory framework conducive to less lending bank exposure (through the application of an automated system of ownership registration in the management of immovable property cadastre).

The government of the Republic of Armenia has initiated a series of infrastructure-related projects in the spheres of road building, communications, power engineering, industry, social security and so on. These projects of regional importance were chiefly designed prior to the global crisis, though by their anti-cyclic impact, they attracted more interest and can go a long way toward putting a check on unemployment, as well as fostering growth and development in the aftermath of the crisis. These measures are supposed to be carried out in cooperation with international organizations and the private sector based on the principle of public-private sector collaboration (PPSC). Once effectively materialized, these infrastructure-building projects can promote the efficiency of our anti-crisis efforts and help us find quick response to the economic downturn. The major projects are as follows: The North-South Transport Corridor Project; Rural Road Rehabilitation Projects; The Techno-park Project of Gyumri; Establishment of a free economic zone on a site next to Armenia’s Zvartnots international airport; New NPP construction; Activities in the sphere of power engineering; and Construction.

The Operative Staff has been established to provide direct assistance to the real sector. The Staff observes business projects received from the private sector and determines the level of the required assistance.

This implies targeted support for individual enterprises aimed at generating new jobs, ensuring that imports are gradually supplanted by domestic products, enhancing the level of exports, promoting the use of local raw materials, stimulating the application of innovational technologies. For this purpose, the government will provide subsidies and state guarantees (including in agriculture), direct lending and participation in corporate capital. As of 1 September 2009, small and medium-size enterprises had received state guarantees of AMD 233.5 million from the SME DSC under the credit guarantee program for 45 SME facilities covering a loan package of AMD 415 million. An economic stabilization lending program has funds of USD 500 million interstate loan available from the RF government, aimed at boosting the GDP through partial coverage of the needs of economic entities in borrowed funds. The program components will be: address the banks and lending organizations by lending the mortgage market, exports, procuring and processing agricultural produce, implementing air transportations, fostering infrastructure-based tourism, providing loans to consumers, motor-car and housing buyers and, finally, lending small and medium-size enterprises. The second component consists of SME funding and the third component will provide lending to system-building enterprises.

Under the anti-crises policies in agriculture the government provided support to small farms with extra-normative water demand. Besides, the Government has decided to subsidize loan interest due from most vulnerable 60 farms of Shirak marz. Moreover, 35,000 drams per hectare has been allocated in State support for expansion of cereal crop areas in the alpine and border communities of Armenia to a total cost of AMD1.5 billion in 2009. The FRED A venture fund has been established to support agricultural enterprises through lending and capital participation.

As concerns the state-private sector cooperation, the government has approved the construction of a center of agro-tourism and hotel accommodation next to Garni-Geghard highway. The government has similarly endorsed the 2009-2012 Jermuk Town Development Strategy and the conceptual objectives and priority tasks of Tatev Tourism Center's development program. The National Assembly of the RA has passed a law on the Pan-Armenian bank. The latter will serve as a strategic unit mobilizing efforts and resources from Armenians all over the world. The Pan-Armenian Bank started operating in 2010.

Welfare programs have been also developed, for instance, the "Affordable housing for young people" program, meant to extend housing support to vulnerable households; state-backed mortgage lending available to young families for the purchase of housing; and assistance in the following two directions: state support in the form of interest-free credits of 10 to 15 years' maturity covering the amount of 30% advance payment required under mortgage loans, households will get extra 10% coverage for each underage child in the family and partial state subsidy for mortgage loan interest, households will get additional 10% coverage for each underage child in the family until the age of maturity.

As of 1 January 2009, for good compliance with the sustainable development and efficacious governance requirements, Armenia was included in the GSP+ system by the European Commission. Administered by the European Union, this system offers a preferential trade regime to member countries. The GSP+ system enables member countries to pay zero or very low duties on their exports to EU markets for about 6,400 types of products. The signing of the Republic of Armenia-European Union free trade agreement is a key objective behind the cooperation envisaged under the Eastern Partnership Initiative as effective since 2008. The signing of said free trade agreement on the sidelines of European integration processes will provide an exceptional opportunity for the Republic of Armenia to have access to the European common market and sell products of Armenian origin.

The government of Armenia undertook steps towards development science and education. Government decrees were adopted related to the establishment of an international research center, for developing fundamental research and applied sciences in Armenia, and to the improvements in the health care system, particularly, oncology and cardiovascular disease treatment. Armenia will turn into a regional center of oncology and will be able to export health care-related services; Armenia will become a regional center of applied physics enabling broader possibilities for education and experimental science. Armenian students and young researchers will be more actively involved in different exchange programs; a research-based chain of innovations will be shaped promoting the development of a broad range of scientific disciplines in the country which can affect positively such important branches of economy as applied natural sciences, agriculture, industry etc.

## ANNEX

## SWOT ANALYSES OF THE SME SECTOR IN ARMENIA

**STRENGTH**

- Elaboration and implementation of SME development state policy and annual support programmes,
- Existence of Small and Medium Entrepreneurship Development National Center of Armenia (SME DNC of Armenia) which provides support for SMEs and development of corresponding infrastructures for SMEs;
- Stable macroeconomic growth and positive trends in SME sector;
- Improvement of situation in labour market and solution of number of serious social problems;
- Significant contribution of SME sector in GDP (42.5% in 2009);
- Flexibility of the SME sector; in spite of the significant decline in GDP, the share of SME sector in GDP increased during the crisis;
- Over 40% of employment in Armenian economy was provided by the SME sector.
- About 1/3 of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget is paid by SMEs
- Increasing role of the SME sector in the economy reflected by the SME Development Index in Armenia (exponential increase during the last decade)
- Under the anti-crisis policies tax and customs reforms were initiated, taxes have been considerably simplified for all types of businesses, including small and medium-size enterprises.

**OPPORTUNITY**

- Operation of SME DNC of Armenia throughout Armenia;
- Good opportunities for tourism;
- Membership of Armenia to World Trade Organization (WTO) enhances the opportunities of SMEs to enter the foreign markets;
- Armenian Diaspora might play a significant role in internationalization of domestic SMEs;
- The continuous and targeted SME development policy, will strengthen SME support system and enlarge geographical and financial opportunities;
- Increasing international cooperation will provide new opportunities for SMEs to implement new projects and enter new markets.

**WEAKNESS**

- SME sector mostly targets internal market, since the requirements and competition is too high for external markets and SME units, as enterprises with limited funds and opportunities, often cannot overcome obstacles related to foreign trade
- Elaboration and implementation of SME state policy started relatively late as compared with other transition economies;
- Low demand in local market;
- Lack of reliable official statistics on SMEs;
- Poor access of SMEs to financial resources;
- Lack of business incubators;
- Low competitiveness of SMEs;
- Lack of quality consciousness of SMEs;
- Lack of managerial skills of SME leaders especially in Marzes;
- Low level of inter-regional cooperation between SMEs;

**THREAT**

- Bureaucracy and corruption are seen as one of major threats hindering the development of SMEs;
- High polarization for income distribution of population;
- Unfair competition;
- Unsettled regional conflicts around Armenia.

Source: Alpha Plus Consulting, Yerevan, 2011

**ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010**

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	LLC	Other economic units considered as SMEs	Total number of economic units
<b>2008</b>	232	72,720	1,172	39,445	52,545	125,265
<b>2009</b>	232	81,762	1,159	41,467	54,246	136,008

**NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		Micro	Small	Medium
<b>2008</b>	125,265	92,696	22,923	6,764
<b>2009</b>	136,008	103,230	22,849	6,800

**EMPLOYMENT**

Year	Total number of employment		Unemployment rate
	in SMEs	in all type of economic units in the country	%
<b>2008</b>	471,394	1,119,700	6.3%
<b>2009</b>	465,761	1,103,700	6.9%

**INDEX OF SME DEVELOPMENT IN ARMENIA**

	Share of private ownership in economy	Share of SMEs in GDP	Share of the labor force of SMEs in the total labor force of the country	GDP per capita	SME Development Index
	[%]	[%]	[%]	[USD]	[USD/SMEs]
2002	81	34.4	28.2	739.9	58.1
2003	83	36.5	31.0	873.4	82.0
2004	84	38.6	32.9	1104.4	117.8
2005	84	39.8	34.0	1513.0	172.0
2006	84	40.3	35.1	1996.0	237.2
2007	84	41.0	40.7	2844.0	398.6
2008	84	41.7	42.1	3689.0	544.0
2009	84	42.5	42.2	2686.0	404.7

*An estimation of the hidden economy according to ADP 2010 report, informal economy reached 11.2% during the year of economic crisis in 2009.*

*According to OECD estimations, in 2008 non-observed economy contributed about 25% of total GDP.*

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## DEVELOPMENT OF THE SME SECTOR IN THE ERA OF EMERGING FROM THE ECONOMIC CRISES IN AZERBAIJAN <sup>4</sup>

### ABSTRACT

**The business environment continuously is improving in Azerbaijan. However, according to the evaluation by the World Bank there are certain field where further improvement is required. The paper describes the SME support infrastructure in the country, and provide a short summary on how the Government tried to ease the effect of the economic crises on the Small and Medium Enterprises (SMEs).**

JEL Code: F14, L26, O12, O57

### 1. NATIONAL ECONOMY AND THE SME SECTOR

Since 2005 there has been carried out a stable policy to provide formation of national economy in the Azerbaijan Republic and its integration in the world economic system. Within that period it was succeeded to achieve macroeconomic stability, diversification of economy, rapid development of non-oil branches and country regions, stability of a national currency, strengthening state support to entrepreneurship and stable improvement of population's social welfare.

#### GDP growth

Within 2004-2009 the GDP has been increased by 2.8 times and accounted 4,874.1 USD per capita in 2009, and 5,797.8 USD in 2010. The highest indicator in the GDP growth has been observed in 2006 by 34.5%. According to the totals of 2010 the GDP has been grown by 5% (see table 1 and table 2)

GDP growth					Table 1		
2003	2004	2005	2006	2007	2008	2009	2010
11.2	10.2	26.4	34.5	25	10	9.3	5

In 2010 the 52.6% of GDP was obtained from industry, 5.4% from agriculture, 7.5% from construction, 6% from transport, 11% from social and other service spheres.

Within 11 months of 2010 the legal and physical entities being registered in Azerbaijan have realized export-import operations with 143 world countries to the amount of 27.9 billion USD, where 6,599.4 million USD fell to the share of import, and 21,324.8 million USD to the share of export (1,299.1 million USD fell to the share of export of non-oil products).

The total amount of investments for fixed capital in 2010 accounted 9,715.2 million Azerbaijani manat (further used as AZN) (with 21.1% growth rate), where 75.2%, i.e. 7,309.3 million AZN (with 15.9% growth rate) fell to the share of domestic investments, and 24.8%, i.e. 2,405.9 million AZN (with 40.9% growth rate) to the share of foreign investments.

<sup>4</sup> Study prepared within the framework of the KAS-BSEC-ERENET Project and presented at the Workshop on Entrepreneurship and SME Development in the BSEC Region in the Time of Emerging from the Economic Crises held in July 2011 in Istanbul.

## Financial system

There are 46 banks operating in the country, out of which 21 bank have some foreign capital participation. In six banks, the foreign capital share ranges from 50 to 100% (in 13 – less than 50%), and two banks act as subsidiaries of a non-resident bank.

The cumulative capital of the commercial banks, their assets and credit investments significantly increased in 2007.

On 1 January 2007, the assets were 3.8 billion Azerbaijani manats (equivalent to \$4.7 billion) and at the beginning of 2008, this indicator reached 6.7 billion Azerbaijani manats (equivalent to \$8.3 billion), 78 percent increase. The cumulative capital of the banks on 1 January 2007, was 603 million Azerbaijani manats (\$744 million), and as of 1 January 2008, it reached 1 billion Azerbaijani manats (\$1.4 billion).

At the beginning of 1996, there were 200 banks with a total capital of \$4.2 million in Azerbaijan. However, by January 2001, the numbers of banks had decreased to 59, with total capital of \$532 million<sup>49</sup>. At the end of 2006, 44 banks were active: two state banks, 20 with foreign capital participation, and 22 commercial and/or joint stock banks. On 1 January 2007, the consolidated capital of these banks was \$693 million.

As of the beginning of 2008, 142 lending agencies operated in Azerbaijan, including 46 mainly undercapitalized commercial banks dominated by the state-owned International Bank of Azerbaijan (45% of total banking assets) and 96 non-bank credit institutions, whose share in total assets and total capital are less than 3%. According to NBA requirements, the minimum amount of a bank's capital must exceed \$12 million as of 1 July 2007. At the end of 2007, the total assets of the banking system were \$7.7 billion. The consolidated credit portfolio amounted to \$5.1 billion, 43% of which was held by state-owned banks.

The banking system remains quite small relative to the size of the economy. Even with high assets and the growth of loans and deposits in Azerbaijani banks over the past few years, total banking assets were only about 26.7% of GDP, with loans accounting for about 19% and deposits only 13% at the end of 2007 – a much lower ratio than the 35-60% of GDP characteristic of the advanced transitional economies of Central and Southeastern Europe.

**Poverty alleviation** Poverty alleviation and improvement of the population's welfare are among the main priorities identified by the Azerbaijan government, when poverty remains to be the major barrier to the stable development of population. The poverty level in Azerbaijan accounted 46.7% in 2002. Due to executing the State Programme concerning poverty alleviation and regional development in the Azerbaijan Republic for 2003-2005 the poverty level from 44.7% in 2003 went down to 13% in 2009. As a result of implementing the State Programme concerning poverty alleviation and stable development in the Azerbaijan Republic for 2008-2015 the poverty level accounted 9% in 2010.

**Advanced branches of economy.** The most advanced branches of the country economy in the non-oil and non-gas sectors are agriculture, construction, engineering industry, tourism and other spheres. The most privileged sphere in the non-oil sector is an agrarian sector. 99.7 per cent of products manufactured in the agrarian sector belong to the private sector, and account 86% of GDP. 12% of population is employed by the agrarian sector. Fuel, motor oils and mineral fertilizers necessary for manufacturing agricultural products are sold to farmers at a discount of 50%, and they became free of other taxes except of land tax up to 2014.

Development of ICT sector also remains to be among priority spheres. Thus, with the purpose of developing this sphere it was adopted and successfully executed "State Programme (Electronic Azerbaijan) concerning ICT development in the Azerbaijan Republic for 2005-2009".

2011 was announced as a Year of Tourism in the Azerbaijan Republic.

## Development of regions

With the purpose of efficient using labour resources, natural and economic potential existing in the regions, intensifying development of non-oil sector of economy, reforming in the agrarian sector and increasing population's employment it has been adopted "State Programme concerning socio-economic development of regions in the Azerbaijan Republic for 2004-2008" and State Programme concerning socio-

economic development of regions in the Azerbaijan Republic for 2009-2013", where carried our regular measures provided in the Programme.

As a result of executing the "State Programme concerning socio-economic development of regions in the Azerbaijan Republic for 2004-2008" within recent five years the real amount of GDP has increased by 2.6 time, the nominal amount of GDP per capita by 5 times, the amount of investments to the non-oil sector by 6.2 times. The growth in the country industry is observed by 2.5 times, with 25.2% in the agriculture. The poverty level was reduced to 13.2% in 2008. In the period of State Programme executing there has been created more 766 ths. new jobs, including 547.6 ths. permanent jobs, where 80% of newly created jobs fell to the share of regions. More 27.5 ths. new enterprises have been established, among which 40% are functioning in the regions.

### Azerbaijan Economy in the first quarter of 2011

#### Macro-economic figures for the first quarter of 2011

Azerbaijan Republic's economy has risen by 1.6%. The non-oil sector has risen by 5.6%; industrial production has risen by 0.3%. In the industrial growth the non-oil sector industry has risen by 9.8%. The level of currency reserves has reached \$34.7 billion in the mentioned period.

#### Main Economic Figures for First Quarter of 2011 in Azerbaijan

GDP Growth	1.6 %
Non-oil GDP Growth	5.6 %
Inflation Rate	9.6 %
Industrial Production Increase	0.3 %
Currency Reserve	\$ 34.7
Monthly Salary	\$ 430
Poverty Line	9.1 %
Budget revenues	\$ 3,503 billion
Budget Expenditure	\$ 2,641 billion
Exports	\$ 3.4 billion
Imports	\$ 1.3 billion
Revenues of citizens Increase	16.0 %
In the first quarter of 2011 inflation has risen by	9.1 %
Population incomes	16 % growth
The average monthly salary	340 AZN or \$430.

#### Revenues to the state budget

In the first quarter of the current year revenues of the state budget have been fulfilled 2.768 billion manats or 118.0%. In comparison with the same period of the previous year it is 3.2% more.

The Ministry of Taxes has guaranteed the entry of 1.161 billion AZN into the state budget which is 151.0 million AZN or 15% more in comparison with the same period of the previous year. 58.7% or 681.0 million AZN of the mentioned fund come from the non-oil sector. In comparison with the same period of the previous year it is 132.0 million AZN or 24.0% more.

In the non-state sector as a real result of increase of economic activity and the activities carried out to expand economy, scale of the revenues of this sector has comparison with the same period of 2010 and 3.5% more in comparison with the previous year.

In accordance with the state law of the Republic of Azerbaijan on the state budget of 2011, 1.12 billion AZN budget duty has been forecasted for the State Customs Committee.

In the first quarter of the current year as a result of import-export operations carried out, 240.6 million manats custom payments have been gathered and directed to the state budget. Forecast has been fulfilled 100.2% which is 17.1% more in comparison with the same period of the previous year.

In the first quarter of the current year 1.33 billion manats allocation has been transferred to the state budget from the State Oil Fund. On additional revenues 36.0 million manats have been directed to the state

budget. In comparison with the same period of the previous year additional revenues have been 32.0 million manats more. In the first quarter of 2011 the expenses of the state budget have been fulfilled 87.3% or 2.87 billion manats more than forecasted and 108.0 million manats or 5.5% more in comparison with the same period of the previous year.

### **Budget expenditures**

In the first quarter, in accordance with the economic classification 47.9% or 1.0 billion AZN of income have been directed to financing social expenses. In comparison with the same period of 2010 it is 14.9% or 129.0 million AZN more.

In comparison with the same period of the previous year in the first quarter of the current year 17.2% or 57.0 million AZN more have been spent on the payment of social pensions and reliefs, 14.2% or 70.0 million manats more have been directed to the payment fund of labor, and 3.8% or 1.6 million AZN more have been spent on food and medicine expenses.

Commitments have been met on paying implied payments to IDPs, pensioner and relief and contribution receivers. In the first quarter of the current year 408 million manats allocation which is 19.2% more in comparison with the same period of 2010 have been directed to social safety and security expenses considering funds allocated for the following quarters.

In accordance with functional classification in the first quarter of 2011 in comparison with the same period of the previous year 21.9% have been directed to military expenses, 21.8% to medical expenses, 18.3% to agriculture, forestry and fishery expenses, 12.4% to education expenses, 11.9% fund has been directed to culture, art, information and physical culture expenses.

In the first quarter of the current year 546.0 million manat fund has been spent on state investment expenses, financing of main investment projects have been provided. Out of the same fund 78.0 million manats have been spent on construction and restoration of educational, medical, cultural, sport and other socio-cultural and domestic places. 94 million manats have been spent on construction and restoration of houses and other such kind of domestic places for disabled-soldiers, martyr families and 5.5 million manats fund has been spent on construction and restoration of sport complexes and other sport places in the regions.

363.0 million manats have been spent on construction and restoration of the main energy, water supply, gas, transportation, communal, land-reclamation infrastructures, as well as 144.0 million manats on construction and restoration of transportation infrastructure, 24.0 million manats on construction and restoration works in Baku metro stations, 17.0 million manats on increase of authorized capital of 'Baku electricity system' stock company, 10.0 million manats have been spent on reconstruction of drinking water and irrigation drainage, 20.0 million manats on the implementation of 'The State Program on formation and development of cosmic industry in the Azerbaijan Republic' and 143.0 million manats have been spent on 'Azerbaijan Airlines' close joint- stock company.

Alongside with expenses allocated from the state budget, 206.0 million manats fund has been directed from abroad to construction and reconstruction of highways, water supply and land reclamation, agriculture, social and other infrastructures by the Azerbaijan government.

In the first quarter of the current year implied 63.0 million manats have been allocated on the budget of the Nakhchivan Autonomous Republic from the state budget and 181.0 million manata subsidy has been thoroughly allocated for local expenses of regions and cities from the centralized expenses implied to regulate local incomes and outcomes .

In the first quarter of 2011 relevant orders have been signed by the president of the Azerbaijan Republic to allocate 31.0 million manats for implementation of several social and infrastructure projects of key importance and for continuation of renovation and construction works from the Reserve Fund of the President of the Azerbaijan Republic.

In the reporting period 14.3 million manats have been allocated to finance events of state importance which were not envisaged in the state budget before from the reserve fund of the state budget and 7.0 million manat fund has already been spent.

Management of the country's internal and external debts, fulfilling debt duties in the international level as well as within country has been kept in the focus of attention and for this purpose 154.0 million manat fund has been directed from the budget.

In the first quarter of 2011 from the state budget 15.0 million manats have been spent to finance the



activities of Azerbaijan Republic's diplomatic representatives abroad and 3.5 million manats have been spent to finance several international and republic events of international and local importance held in our country.

#### **Funds and discounted loans allocated for agriculture product producers.**

According to the State Statistic Committee of Azerbaijan Republic, financial support for agriculture product producers is being continued by Government.

In the reporting period 25.0 million manats have been directed to the implementation of 'The State Program on people's secure supply with agriculture products in the Azerbaijan Republic during 2008-2015'. 27.5 million manat discounted loans have been offered to the entrepreneurs.

10.0 million manats of this has been the fund allocated for the development of entrepreneurship from the state budget.

In comparison with the previous year the number of investment projects has risen by 1.7 times and the amount of lended discounted loans has risen by 1.4 times.

On the basis of discounted loans 25 big and large-scale projects as well as investment projects for construction and reconstruction of five modern fridge storage-complexes with the capacity of 29.5 thousand tons, 5 bakery products companies with the annual productive capacity of 78.1 thousand tons, three poultry industries with the annual productivity of 13 million breeding eggs and 0.6 thousand tons poultry, two meat factories with the annual productivity of 19.8 thousand tons, five cattle complexes with 500 cattle giving milk and other products have been financed.

#### **Entrepreneurship**

Regarding implementation of your order on improvement of the employment of local people in the Baku districts on the basis of the fund of National Fund for Support Entrepreneurship, 2.2 million AZN loans have been offered to 24 entrepreneurs.

On the basis of these discounted loans it is envisaged to build new working places in the Baku districts.

In accordance with 'One Stop Shop' system more than 14,000 entrepreneurs have been registered in the first quarter of the current year. In comparison with the relevant period of the previous year it means 46.1% increase in the number of people registered. In the first quarter of 2011, 61.2% entrepreneurs registered are from the regions.

14.0 million manats have been directed to 'Agroleasing' open stock company to purchase agricultural equipments and chemistry substances and 4.5 million AZN have been directed to State Agency for Agriculture Credits near the Ministry of Agriculture to lend loans to agriculture product producers.

#### **Revenues of the State Social Protection Fund**

In the first quarter of 2011 revenues of the State Social Protection Fund have been 521 million manats, increasing by 19% or 83 million AZN in comparison with the same period of the previous year.

Social insurance revenues have been 270 million AZN, increasing by 15% or 35 million manats in comparison with the first quarter of the previous year.

58.2% of social insurance revenues fall to the non-budget organizations' share, their social insurance payments have increased by 17.3% or 23 million AZN in comparison with the same period of the previous year.

Revenues from physical persons have increased by 24% and the payments of landowners have increased by 40%.

During the quarter 250 million AZN have entered to the treasury account of the Fund as a transfer of the state budget.

The amounts of the revenues of the Fund has enabled to finance expenses on time.

In the first quarter of 2011 the expenditures of State Social Safety Fund have been 466 million AZN. The Fund has spent 457 million AZN to finance pensions and contributions. It is 46 million AZN or 11.2% more in comparison with the first quarter of the previous year. 97% or 444 million AZN of this amount have

been spent on the payment of pensions and 13 million AZN have been spent on the payment of contributions. Currently the amount of monthly payments to people is around \$200 million.

4.2 million AZN have been spent on increasing the insurance part of the pensions of the 620 thousand labor pensioners by 5.7% according to the order of the president of the Azerbaijan Republic dated 15 February 2011.

The average monthly amount of labor pensions has reached 114 manats till the end of the quarter. It has increased by 14% in comparison with the situation on 1 April 2010. The implied monthly average amount has been more than 150 AZN.

### Foreign trade turnover

In January-February 2011 physical and legal individuals of the country have had commercial operations with 102 foreign countries in amount of \$4.7 billion. Exported products from Azerbaijan have covered \$3.4 billion and imported products have covered \$1.3 billion of foreign trade turnover.

In comparison with January-February of the previous year physical volume of the **foreign trade turnover** has increased by 9.9%, as well as import 1.9 times and export has increased by 3.8%. As a result of export prevailing import \$2.1 billion positive saldo has emerged. More than 85% of external commercial operations have been conducted with Italy, United States of America, France, Russia Federation, Malaysia, Ukraine, Turkey, Spain, Bulgaria, China, Germany, India, Israel and Kazakhstan.

### Taxation: the legal framework

The Tax Code is the central instrument for regulating tax issues. It sets forth the powers and duties of the tax authorities, the rights and obligations of the taxpayers, the penalties for violation of tax legislation, rules for appealing against the actions and inactions of tax authorities, tax administration procedures, and regulations for all types of taxes collected in Azerbaijan.

The tax issues that need more detailed regulation are governed by legislative acts of the state authorities at different levels, primarily the Cabinet of Ministers and the Ministry of Taxes (MoT). The Azerbaijani tax system are collected at three levels: (i) state, (ii) the Nakhchivan Autonomous Republic, and (iii) municipal/local:

1. Personal Income Tax (PIT);
2. Corporate Profit Tax (CPT);
3. Value Added Tax (VAT);
4. Excise Tax;
5. Corporate Property Tax;
6. Corporate Land Tax;
7. Road Tax;
8. Mining Tax;
9. Simplified Tax;
10. Individual Property Tax;
11. Individual Land Tax.

The Tax Code differentiates three taxation regimes: standard, simplified, and special.

### Simplified tax regime

Certain businesses that are not required to register for VAT, such as those engaged in transportation of cargo or passengers are simplified tax payers; and businesses with taxable turnover less than 22,500 Azerbaijani manats (\$27,800) within the last three months may opt for the simplified tax regime. Under the simplified tax regime, taxpayers based in Baku pay 4 percent, and those outside Baku pay 2 percent of their gross proceeds as simplified tax.

Businesses engaged in the transportation of cargo or passengers within the territory of Azerbaijan and those carrying out construction of residential buildings are payers of simplified tax regardless of their taxable turnover.

SMEs paying simplified tax are exempt from VAT, CPT, and corporate property tax; individual

entrepreneurs availing themselves of the simplified tax are exempt from PIT and VAT. Both groups of simplified tax payers, however, do pay SST. Moreover, tax payers engaged in the construction of residential buildings are not exempt from VAT under the simplified tax regime.

The simplified tax regime is used by about 80% of individual entrepreneurs and SMEs. However, the difference between the tax burdens of simplified and standard tax regimes is very substantial. An SME moving to the standard tax regime has to pay 18% VAT instead of 2-4% turnover tax, 22% CPT on its corporate profit, property tax.

## 2. SME SECTOR DEVELOPMENT

### Legal basis of SME sector

Activity of SME subjects, mainly, is regulated by the Law of the Azerbaijan Republic "Concerning state support to the small-sized entrepreneurship" and Decree of the Cabinet of Ministers of the Azerbaijan Republic "Concerning approval of criteria for identifying small-sized entrepreneurial subjects by kinds of economic activities".

### Legal definition of SME

Activity of SME subjects in the Azerbaijan Republic (see Annex) is divided into two groups: private entrepreneurs (i.e. subject engaged in the entrepreneurial activity not creating legal entity) and small- and medium-sized enterprises functioning as a legal entity. From legal point of view private entrepreneurs unambiguously are considered to be small enterprises, but those registered as a legal entity are classified according to the two indicators (number of employees and annual turnover).

In accordance with the decree Nr. 57 of the Cabinet of Ministers of the Azerbaijan Republic from 20 April 2004 about classification of entrepreneurial subject by activity sphere the small-sized business is identified according to the sectors as

- construction and industry – if number of employees is less than 40 and annual turnover is less than 200,000 AZN (247,000 USD),
- agriculture – if number of employees is less than 15 and annual turnover is less than 100,000 AZN (123,500 USD),
- wholesale – if number of employees is less than 10 and annual turnover is less than 300,000 AZN (370,500 USD),
- other spheres – if number of employees is less than 5 and annual turnover is less than 100,000 AZN (123,500 USD).

The share of SME in GDP accounts approximately 15%, and 25% in employment (the share of private sector in employment makes 69.3%, i.e. the economically active population in the private sector accounts more 2.8 million people).

In 2010 the number of private entrepreneurs exceeded 290 ths., when 42.6% of them concentrated in trade, 20.2% in transport, 10.8% in service sector and 9.1% in agriculture. 36.1% of private entrepreneurs are functioning in Baku.

The number of legal entities registered within the first half-year of 2010 accounted.

Years	2004	2005	2006	2007	2008	2009	2010 (6 months)
Number of legal entities	65,109	70,287	74,534	79,147	85,618	89,939	91,657

- 11,022 legal entities among 91,657 ones registered within the first half-year of 2010 belong to the state ownership,

- 1,758 ones to the municipality ownership,

- 72,705 ones to the special ownership.  
61.7% of enterprises are functioning in Baku.

*Number of enterprises by kinds of ownership*

Kind of ownership	State	Municipality	Special	Foreign	Joint ventures
Number	11,022	1,758	72,705	4,508	1,664
Percentage	12.1	1.9	79.3	4.9	1.8

**Activity spheres of SME subjects**

In 2010 small-sized enterprises accounted 75,636, i.e. 82.5% from total number of enterprises – legal entities functioning in the Azerbaijan Republic. 38.6% of them concentrated in trade, 13% in agriculture, and 12% in construction.

**3. RANKING OF DOING BUSINESS ACCORDING TO WORLD BANK METHODOLOGY**

Recent five years it was carried out an effective activity towards development of business environment. Especially, improvement of legal basis, application of “one-shop stop” system for registration of commercial enterprises (since 1 January 2008), simplification of estate register, etc. gave an opportunity to the Azerbaijan Republic to win status of a reformer country in the World Bank “Doing Business 2009” report.

In the “Doing Business” reports reflecting estimations on opportunity of business environment prepared by the World Bank and International Finance Corporation the Azerbaijan Republic took the 38<sup>th</sup> rank among 183 countries in 2008 and 2009, the 54<sup>th</sup> rank in 2010.

Moreover, Azerbaijan is among the leading countries on “Starting a business” (15<sup>th</sup> rank), registration of property (10<sup>th</sup> rank), obtaining credits (46<sup>th</sup> rank) and protection of investors (20<sup>th</sup> rank).

But, recent three years’ Report proves that there is much more to do for improving indexes on construction license (160<sup>th</sup> rank), trading across borders (177<sup>th</sup> rank) and payment of taxes (103<sup>rd</sup> rank)

Ease of ...	Doing Business 2009 rank	Doing Business 2010 rank	Doing Business 2011 rank
Starting a business	38	38	54 (-16)
Dealing with construction permits	155	158	160 (-2)
Employing workers	62	33	-
Registering property	9	9	10 (-1)
Getting credit	12	15	46 (-31)
Protecting investors	19	20	20 (0)
Paying taxes	103	108	103 (+5)
Trading across borders	176	177	177 (0)
Enforcing contracts	25	26	27 (-1)
Closing a business	84	84	88 (0)

The other international institutions also highly appreciated reforms carried out in Azerbaijan towards entrepreneurship development and business environment improvement.

In the “Global Competitiveness Report” prepared for 2009-2010 Azerbaijan has moved by 18 steps

and took the 51<sup>st</sup> rank among 133 countries and the 1<sup>st</sup> rank among CIS countries.

In the report of the “Standard & Poors” Rating Agency situation in the Azerbaijan economy was recognized progressing from “Stable” to “Positive”.

In their turn, state officials have announced completion of transition period in the country economy. Thus,

- it was created a typical legislative basis for market economy,
- it was formulated market institutions,
- the foreign-economic activity became liberalized.

#### **4. SME SUPPORT INFRASTRUCTURE (BUSINESS SUPPORT PROVIDERS, SPECIAL SME FINANCIAL INSTITUTIONS)**

Different government and non-government organizations as well as private consulting companies are operating in the Azerbaijan Republic to render consulting services to entrepreneurs. They are State Service of Antimonopoly Policy and Protection of Consumers’ Rights, National Fund to Support Entrepreneurship, Export Support Fund (AzPromo), Azerbaijan Investment Fund under the Ministry of Economic Development, including branch and regional business associations: Azerbaijan Entrepreneurs’ Confederation (ASK), Azerbaijan Business Women Association, Azerbaijan Farmers’ Union, National Productivity Centre, SMEs Support Centre, Economic and Social Researches Centre and Fund to Support Small Entrepreneurship.

The National Productivity and Competitiveness Centre is rendering information, consulting and training services to SME sector. The Centre pursues its objective to raise productivity and competitiveness of small- and medium-sized entrepreneurial subjects functioning in the Azerbaijan Republic. With the purpose of integrating into Europe the Centre is organizing business tours to EU countries, holding business forums, providing participation of SME subjects in the international fairs and exhibitions. Trainings organized by the Centre are covering marketing, finance, law, management, human resources and other topics.

Azerbaijan Business Women Association (Ganja city) is carrying out regular activity towards development of entrepreneurship among women.

ASK acts as a social partner of government and Trade Unions’ Confederation and protects interests of entrepreneurs before central executive authorities.

Economic and Social Researches Centre is conducting significant surveys on improvement of business environment in the country.

Different international institutions functioning in the Azerbaijan Republic also render technical support to SME sector. Turkish International Cooperation and Development Agency (TIKA), Germany International Cooperation Organization (GIZ), PUM Programme – Senior Experts from Netherlands, etc., render technical support to entrepreneurial subjects, and assist acquiring international experience.

#### **Financial support to entrepreneurship**

Financial support to entrepreneurship is rendered both by local and international financial institutions. The International Finance Corporation (IFC) and European Bank for Reconstruction and Development (EBRD) are carrying out different projects to render financial support to the entrepreneurial subjects.

Government is rendering financial support to the SME sector through the specialized fund, i.e. National Fund to Support Entrepreneurships (NFSE) and granting long-term and privileged credits (annual 6 per cent) for entrepreneurial subjects. Recent period the amount of privileged credits allocated from state budget to NFSE accounted from 50 million AZN (approximately 60 million USD) to 115 million AZN (150 million USD). The privileged credits are granted through agent banks (there are about 30 agent banks) to the advanced economic spheres – production and processing of agricultural products, tourism development and infrastructure projects in the amount of small, medium, large and huge credits (see table)

Information on usage of resources of the National Fund to Support Entrepreneurship of the Azerbaijan Republic within 2010

By economic spheres

X1,000.  
manats

Nr.	Economic spheres	Number of projects	specific weight (%)	Credit sum	specific weight (%)	Number of jobs to be created (persons)
1	Production and processing of different industrial products	94	6.6	23,450.0	20.4	664
2	Processing of agricultural products	16	1.1	10,350.0	9.0	444
3	Production of agricultural products	1,303	91.1	55,651.9	48.4	3,970
4	Tourism development	3	0.2	2815.0	2.4	36
5	Development of service (infrastructure) spheres	14	1.0	22,733.1	19.8	495
<b>Total:</b>		<b>1,430</b>	<b>100,0</b>	<b>115,000,0</b>	<b>100,0</b>	<b>5,609</b>

By types of credits

Nr.	Types of credits	Number of projects	specific weight (%)	Credit sum	specific weight (%)	Number of jobs to be created (persons)
1	Small credits	1,362	95.2	17,580.9	15.3	3,049
2	Medium credits	8	0.6	1,005.0	0.9	106
3	Big credits	26	1.8	14,966.0	13.0	688
4	Large-scale credits	34	2.4	81,448.1	70.8	1,766
<b>Total</b>		<b>1430</b>	<b>100,0</b>	<b>115,000,0</b>	<b>100,0</b>	<b>5,609</b>

About 142 credit organizations are functioning in the Azerbaijan Republic. Among them 47 ones are banks, but 96 ones are credit organizations not being banks with 3 per cent share of capital and assets. Taking into consideration the volume of economy the bank system remains to be significantly small, when, generally, assets make just 26.7 per cent of GDP. The major finance source of SMEs is their own funds. According to the IFC observations, the share of bank credits in the SMEs' own investments makes 4 per cent.

#### Financing SME operations

In market economies, banks and other non-bank financial institutions, such as leasing companies and credit unions, are the main providers of financing.

Based on IFC's research, the penetration of bank credits as a share of SMEs' financing for fixed assets was only 4 percent, with a similar percentage for the financing of working capital. More than 90 percent of entrepreneurs use their own assets for their operating capital and asset acquisition. Thus despite the presence of 46 active commercial and state banks, only approximately 5 percent of entrepreneurs used banking services for their financing needs.

#### Credit terms are unfavorable for SMEs

- High interest rates;
- Securitization of the credit;

- Period of borrowing: Currently, credits for SME financing are given by commercial banks in Azerbaijan mainly for six- to 18-month maturity periods.
- Insufficient amount and payment period
- Inaccessible requirement for the credit security
- The procedures on the applying for the credit are too complicated

**The majority of banks cannot attract long-term low-cost resources for subsequent SME refinancing**  
Banks in Azerbaijan are operating in complex financial market conditions and need to offer high returns in order to attract deposits from individuals and legal entities

**Banks prefer to focus on lending for consumer goods, which in their view is less risky.**

The credit market for consumer goods is rapidly developing in Azerbaijan. Maturities and interest rates in the consumer market are significantly more attractive for the banks, compared to SME crediting. In cases of default, the banks always have the opportunity to repossess the goods that have been bought using the credit. Very often, these are goods, such as cars, which are in demand and can easily be sold on the secondary market.

**Poor mutual understanding between banks and SMEs**

All in-depth interviews with the entrepreneurs demonstrated that they had a poor knowledge and understanding of the services and information that banks offer. This corresponds to the lack of adequate and full information the banks have on their clients. Often businesspeople who have never applied for a credit complain about the terms and conditions offered by banks that they have learned by word of mouth, rather than direct experience with banks.

**SME operations are not transparent, which force banks to incorporate the possible risks into the credit cost.**

**Banks do not actively conduct information campaigns targeting SMEs and entrepreneurs are insufficiently informed about the services banks offer.**

In many respects, the attractiveness of any bank service often stems from advertisements and promotional campaigns aimed at promoting the particular service. Banking services from third parties and not as a result of the banks' communications with the business community.

**Credit bureaus bridge such confidence gaps**

A credit bureau is an institution that collects information on the borrower's credit history from creditors and from general sources. The bureau accumulates information on individual entrepreneurs and SMEs, such as payment history on previous credits (particularly defaulting payments) and information on court decisions and bankruptcies, and then makes a comprehensive credit report, which is sold to creditors. Currently, there is only one credit registry and it does not meet the typical credit bureau standards. A number of limitations prevent the credit registry from expanding into a proper credit bureau:

**a) The registry information is closed for the non-banking financial institutions**

Currently, 96 non-banking credit institutions operate in Azerbaijan. The target market for these non-banking credit institutions includes small farmers, trade and service SMEs, and individual enterprises, which mostly produce consumer goods, *i.e.*, the target group for these microcrediting institutions includes mainly SMEs of various sorts. Not having accurate credit information on borrowers causes the microcrediting organizations to introduce tougher requirements (e.g, higher interest rates, shorter terms) in order to mitigate risk.

**b) Registry information does not offer a detailed analysis of the client**

Unlike the registry, a credit bureau processes the information received: it generalizes, classifies, and sells clients credit reports (histories) to the banks. The registry services include only a small portion of the bureau's possibilities.

## 5. THE EFFECT OF THE INTERNATIONAL FINANCIAL AND ECONOMIC CRISES

The global financial crisis has influenced Azerbaijan also. The first negative influence of crisis has occurred in bank and construction sectors. The commercial banks were forced to pay credits from foreign financial institutions back in advance. Such kind of situation made its negative impact on obtaining of credits, especially for SME, caused increase of credit interests and burdening credit terms.

The construction sector was accompanied by stagnation; the construction boom occurred in 2002-2007 has fallen, and many people have lost their jobs in construction sector.

The labour market faced serious problems, when temporary shutdown of large enterprises caused loss of workplaces.

Slump in oil prices at the end of 2008 caused delay of big projects.

Generally, the share of domestic investments in the main capital accounted 75% and 25% of foreign investments.

The GDP volume in 2007 has decreased from 25% to 5% in 2010.

## 6. GOVERNMENT MEASURES TO COPY WITH THE IMPACT OF THE ECONOMIC CRISIS

Government has carried out special measures to copy with the impact of the financial crisis. The first step was made by the Central Bank, where special preferences were given to commercial banks, and generalized credit interests were decreased.

During the world economic crises in 2008-2009 monetary policy orientation of Central Bank of Azerbaijan has strictly expanded: refinancing rate was cut down from 15% up to 2%, reserve requirement ratio form 12% up to 0.5% . In exchange rate policy CBA maintained financial stability holding a pegged regime against the US dollar.

The last 3 years financial support for agriculture product producers is being continued by government.

This period 25.0 million manats have been directed to the implementation of "The State Program on people's secure supply with agriculture products in the Azerbaijan Republic during 2008-2015". 27.5 million manat discounted loans have been offered to the agro-entrepreneurs. 10.0 million manats of this has been the fund allocated for the development of agro-entrepreneurship from the state budget.

In comparison with the previous year the number of investment projects has risen by 1.7 times and the amount of lended discounted loans has risen by 1.4 times.

On the basis of discounted loans 25 big and large-scale projects as well as investment projects for construction and reconstruction of five modern fridge storage-complexes with the capacity of 29.5 thousand tons, 5 bakery products companies with the annual productive capacity of 78.1 thousand tons, three poultry industries with the annual productivity of 13 million breeding eggs and 0.6 thousand tons poultry, two meat factories with the annual productivity of 19.8 thousand tons, five cattle complexes with 500 cattle giving milk and other products have been financed.

Moreover, government has carried out different measures ,as to finance social expenses, to the payment fund of labor, to support export. The local companies empowered with some benefits from state orders. The ratio of national currency to USD and Euro was preserved.

In the first quarter, in accordance with the economic classification 47.9 percent or 1.0 billion manats of income have been directed to financing social expenses. In comparison with the same period of 2010 it is 14.9% or 129.0 million AZN more.

In comparison with the same period of the previous year in the first quarter of the current year 17.2% or 57.0 million AZN more have been spent on the payment of social pensions and reliefs, 14.2% or 70.0 million AZN more have been directed to the payment fund of labor, and 3.8% or 1.6 million manats more have been spent on food and medicine expenses.

In the first quarter of 2011, 546.0 million AZN fund has been spent on state investment expenses, financing of main investment projects have been provided. Out of the same fund 78.0 million AZN have been spent on construction and restoration of educational, medical, cultural, sport and other socio-cultural and domestic places. 94 million AZN have been spent on construction and restoration of houses and other such



kind of domestic places for disabled-soldiers, martyr families and 5.5 million AZN fund has been spent on construction and restoration of sport complexes and other sport places in the regions.

363.0 million AZN have been spent on construction and restoration of the main energy, water supply, gas, transportation, communal, land-reclamation infrastructures, as well as 144 million AZN on construction and restoration of transportation infrastructure, 24 million AZN on construction and restoration works in Baku metro stations, 17 million AZN on increase of authorized capital of Baku electricity system stock company, 10 million AZN have been spent on reconstruction of drinking water and irrigation drainage, 20 million AZN on the implementation of "The State Program on formation and development of cosmic industry in the Azerbaijan Republic" and 143 million AZN have been spent on Azerbaijan Airlines close joint-stock company.

Alongside with expenses allocated from the state budget, 206 million AZN fund has been directed from abroad to construction and reconstruction of highways, water supply and land reclamation, agriculture, social and other infrastructures by the Azerbaijan government.

In the first quarter of 2011 relevant orders have been signed by the president of the Azerbaijan Republic to allocate 31 million AZN for implementation of several social and infrastructure projects of key importance and for continuation of renovation and construction works from the Reserve Fund of the President of the Azerbaijan Republic.

All of those implemented activities gave a good opportunity to decrease the impact of the Global Financial Crisis.

ANNEX

### SWOT ANALYSES OF THE SME SECTOR

STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> <li>• Political and economic stability;</li> <li>• SME -the major locomotive in the private sector forming and development of regions of Azerbaijan;</li> <li>• The necessary legal basis and state support are available in Azerbaijan for SME development;</li> <li>• Easy enterprise registration procedure, implementation of One stop Shop System;</li> <li>• SME plays an important role in the solving social problems, especially, poverty alleviation and increasing employment,</li> <li>• Development of non-oil sector becomes the main priority area of governmental policy.</li> <li>• A strong legal, finance, technical and information basis as well as human capital for development of SME sector in the Azerbaijan Republic;</li> <li>• Solving social problems, especially, poverty alleviation and increasing employment</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of free market economy knowledge and skills, experience in SME,</li> <li>• Lack of new technology and lack of specialists, who can work with new technology,</li> <li>• Lack of interest on implementation of innovation projects,</li> <li>• Non-usage of International standards on protection of environment, OSH, etc.,</li> <li>• Lack of cooperation between universities and SME,</li> <li>• Unjust competition and monopolism in trade sectors,</li> <li>• Low level of the share of SME sector in export,</li> <li>• Weak cooperation relations of MNC with SME,</li> <li>• Problem with implementation of economical laws, absence of its mechanism,</li> <li>• Azerbaijan is not a member of WTO. Economical integration process into EU passes only through membership of WTO.</li> </ul>

<b>OPPORTUNITIES</b>	<b>THREATS</b>
<ul style="list-style-type: none"> <li>• Application of “one-shop stop” system in the registration of enterprises, import-export operations, registration of real estate will cause increase in the SMEs quantity.</li> <li>• Activities provided in the current State Programmes will give a good opportunity for increasing state support to SME sector. -- The execution of State Programme concerning youth employment strategy means stimulating young entrepreneurs’ growth.</li> <li>• The poverty alleviation Programme will enable to increase employment and to open new jobs, especially, to increase number of new entrepreneurial subjects in the private sector.</li> <li>• State financial support to SME sector getting increased year by year will make its positive impact on strengthening the material and technical basis of SME.</li> <li>• Joining the EU Eastern Partnership Agreement in March, 2009 will support Azerbaijan for its economic integration into EU, and cause application of European development model of SME sector in Azerbaijan.</li> <li>• Possibility of becoming a WTO’s member in new future.</li> </ul>	<ul style="list-style-type: none"> <li>• The quantity of people, especially youth, wanting to deal with the entrepreneurial activity is considerably less than existing opportunities.</li> <li>• Still oil and oil products occupy the main share in the GDP.</li> <li>• The SME’s competitiveness index is too low.</li> <li>• The large companies, especially, transnational companies are not interested in cooperation with SMEs.</li> <li>• It is not applied the 15 per cent preference in the state procurement for SMEs.</li> <li>• “Shadow economy” is still getting increased. - It is not paid due attention to business education, business ethics as well as factors impacting productivity growth in SME.</li> <li>• There are no mechanisms for settlement of economic disputes.</li> <li>• Credit terms are unfavorable for SMEs</li> <li>• The majority of banks cannot attract long-term low-cost resources for subsequent SME refinancing</li> <li>• Poor mutual understanding between banks and SMEs</li> <li>• SME operations are not transparent, which force banks to incorporate the possible risks into the credit cost.</li> <li>• Unsettled regional conflicts with Azerbaijan.</li> </ul>

#### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

<b>Economic unit</b>	<b>Agricultural farmers</b>	<b>Self-employed (individual entrepreneurs/sole proprietors and crafts)</b>	<b>Partnerships, working teams without juridical personality</b>	<b>Incorporate Enterprises With juridical personality with 1-149 employees</b>	<b>Other economic units considered as SMEs</b>	<b>Total number of economic units</b>
<b>2009</b>	2409-as legal entity, 2571 –as individual.	230,000		84,939		314,939
<b>2010</b>	-	290,000		9,157		38,157

#### NUMBER OF SMEs

<b>Year</b>	<b>Total number of Enterprises (economic units) in the country</b>	<b>Micro-, small and medium enterprises with</b>		
		<b>0-9 employees</b>	<b>10-49 employees</b>	<b>50-249 employees</b>
<b>2009</b>	84,939			
<b>2010</b>	91,657	-	75,636	-

## EMPLOYEMENT

Year	Total number of Employment		Unemployment	
	in all type of economic units in the country	in SMEs	number	as % of the total employees
<b>2009</b>	4,118,000 : 1,149,700- in state sector. 2,968,300- in non-state sector	2,159,100- in private sector, 1,160,900-in SME	41,100	0.95
<b>2010</b>	4,329,100 1.142.700-instate sector, 3,186,400- in non-state sector	2,313,300-in private sector, 1,078,900 –in SME	38,966	0.90

## INDEX OF SME SECTOR DEVELOPMENT

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
<b>2005</b>	60	11	17	1,537.90	17.3
<b>2008</b>	62	13	21	5,212.83	88.2
<b>2010</b>	63	15	25	6,008.25	142

Source:

- Share of private sector from EBRD
- Date for GDP from EconomyWatch [http://www.economywatch.com/economic-statistics/Azerbaijan/GDP\\_Per\\_Capita\\_Current\\_Prices\\_US\\_Dollars/](http://www.economywatch.com/economic-statistics/Azerbaijan/GDP_Per_Capita_Current_Prices_US_Dollars/)

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## EMERGING OUT THE ECONOMIC CRISES AND STRATEGIES OF ENTREPRENEURSHIP IMPROVEMENT AND SME SECTOR DEVELOPMENT IN GEORGIA <sup>5</sup>

### ABSTRACT

In addition to developing private enterprise, creating a transparent public sector was one of the main challenges of the Georgian democracy. In summary, the liberalization of Georgia's economy helped to create jobs, attract foreign investments, develop tourism, and improve the country's macro-economic indicators. This paper illustrates how liberal economic reforms promoted economic stability in Georgia, helped and will further assist to develop Small and Medium Enterprises (SMEs).

JEL Code: F14, L26, O12, O57

### INTRODUCTION

After gaining independence in 1991, Georgia implemented extensive reforms. Converting the country's economy from Soviet socialist system to the free market economy required a lot of hard work and energy. Plenty of economic ideas and theories have been discussed. However, the process of altering the economy required to change the entire public governance system as well as people's mentality. Most of the successful reforms came about as a result of the Rose Revolution in 2004. Since then, the government of Georgia cut taxes and reduced business regulation in order to stipulate attractive business environment and enhance foreign direct investment inflow. This ultimately helped to create jobs, stimulate entrepreneurial activity in various fields of the economy, and increase welfare of the population. Promoting the development of private sector is one of the main goals of country's economic policy. Therefore, the need to develop private enterprise in Georgia was at the heart of the reforms implemented after the Rose Revolution.

### 1. NATIONAL ECONOMY AND THE SME SECTOR

Georgia's economy demonstrates positive outlook and **Gross Domestic Product** growth is much higher than it was forecasted. Based on the economic reforms, Georgian economy has been diversified showing an upward tendency. From 2004 to 2010 the real GDP growth of Georgia was 41%. In 2010, nominal GDP of Georgia constituted 11,663.4 million USD, while in 2004 it was only 5,124.7 million USD. At the same period, GDP per capita increased by 37% and reached 2,629.0 USD in 2010.

According to the preliminary data of the National Statistics Office of Georgia, the largest share in sectoral structure of GDP in 2010 was held by industry (16.9%) followed by trade services (16.6%), public administration (13%), transport and communication services (11.6%) and agriculture, forestry and fishing (8.4%). Double-digit real growth was posted in the following sectors: manufacturing (20.3%), financial intermediation (14.7%), trade (14.1%), transportation (13.1%), hotels and restaurants (12.9%), other community, social and personal services (10.4%). Moderate real growth was recorded in real estate, renting

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<sup>5</sup> Study prepared within the framework of the KAS-BSEC-ERENET Project and presented at the Workshop on Entrepreneurship and SME Development in the BSEC Region in the Time of Emerging from the Economic Crises held in July 2011 in Istanbul.

and business activities (8.6%), construction (7.6%), communication (6.5%), mining and quarrying (4.7%), health and social work services (3.1%), education (2.3%), electricity, gas and water supply (2.1%).

Creation of favorable business and stable macroeconomic environment made Georgia attractive for foreign investors. Therefore, during the last years, FDI inflows to Georgia has been charactering by an upward tendency. Namely, in 2006 FDI to Georgia amounted 1,190.4 million USD, which is 164.7% increase compared to the same indicator of 2005. Share of FDI in GDP was 15.3%.

In 2007, FDI amounted 2 014.8 million USD, that is 69.3% increase compared to 2006. It is notable that in 2000-2007 FDI inflow to Georgia increased by 15%.

In 2010, Foreign Direct Investment (FDI) in Georgia amounted to 553 million US dollars, which is 11% increase from 2004, but due to the economic crisis and war it is decreased by 16% compared to the 2009, and 35% decreased compared to 2008. The total share of major foreign direct investor countries reached 86% in 2010. Netherlands was a leader country by FDI in Georgia, which made the investment in amount of 143.2 million USD in 2010. The biggest countries by FDI in Georgia in 2010 are as follows: Netherlands – 25.9% of total FDI; USA – 19.6%; Russia – 9.3%; International Organizations – 9.1%; Azerbaijan – 8.4%; United Arab Emirates – 7.2%; Turkey – 6.8%; Other countries – 13.7%. Breakdown of FDI, by major economic sectors in 2010 was following: Transportation and communication (35.1% of total FDI), Industry (16.4%), Financial sector (16.2%), Real estate (15.3%), Other (17%). Survey on External Economic Activities of Enterprises was the primary area financed by FDI in 2010, constituting 70% of total FDI, which is followed financial services and privatization with 21% and 9% shares of total FDI, respectively.

Starting in 2003, Georgian foreign trade turnover is characterized with upward tendency that is supported by the liberal trade policy provided in the country. Competitive trade regimes in Georgia: Free Trade Regime – with CIS countries and Turkey (since November 1, 2008); Most Favored Nation Regime (MFN) – with World Trade Organization (WTO) member countries; Preferential Regime (GSP) – with USA, Canada, Japan, Switzerland, Norway; Preferential Regime (GSP+) – with EU (7200 items) since 2005.

Due to the implemented liberal reforms of the Government of Georgia, enhanced relations with partner countries and new bilateral treaties, Georgian foreign trade diversified. Georgia has concluded double taxation treaties with 27 countries and has bilateral treaties on investment promotion and protection with 32 countries.

Georgia remains strongly committed to the World Trade Organization (WTO) as the primary basis for its trade policy. Georgia firmly believes that the best way to meet challenges facing an increasingly globalised world economy is trade liberalization.

The basic objectives of the trade policy of Georgia are: integration into the world economy, which implies implementation of obligations undertaken by joining WTO and other international agreements; trade policy liberalization, including simplification of export and import procedures and tariff and non-tariff regulations; diversification of trade relations by concluding free trade agreements with main trading or regional partners. Georgia has a very liberal trade regime with simplified trade procedures; there are no quantitative restrictions on export/import and no tariff quotas. There is also effectively no tariff escalation nor any tariff peaks.

In accordance with the Georgian legislation, no tariff duty is applied to export or re-export from Georgia. Export is exempted from Value Added Tax (VAT) as well. Georgia does not use minimum export prices and export subsidies. There are no non-tariff restrictions (prohibitions, licensing) in international trade included in the Georgian legislation except those cases where health, security, safety and environmental issues are concerned. The share of goods subject to non-tariff restrictions constitutes about 1% of the whole nomenclature.

Due to the reforms carried out by the Government of Georgia in 2003-2008, the barriers to foreign trade decreased tremendously, resulting in increased volumes of export and import flows. Whereas in 2000-2002 the average annual growth of trade turnover was 7.2%, this figure increased substantially in 2003-2008 and constituted 38.8%.

In 2010, Georgian foreign trade turnover amounted to 6,678.5 million USD, which is 21% more than the same data of previous year and 45% more than 2006 year. This data have been almost tripled compared to the 2004.

In 2010, Georgian export amounted to USD 1 583.4 million, which is also almost tripled compared to 2004 and increased by 69% compared to 2006 and by 40% compared to 2009. Traditionally main export products of Georgia have been agricultural products (mineral waters, wine, nuts, and citrus). The structure of

Georgia's export has changed in recent years and besides agricultural products is constituted of ferroalloys, copper ores, fertilizers, gold, medicaments, textile etc. Ferroalloys are the main commodity in Georgian export in 2010. Exported ferroalloys amounted to 263.9 million USD (16.7% of total export). Other important commodities in Georgian export are motor cars (14.4% of total export), ferrous waste and scrap (6.9%), Gold (5.4%), Mineral or chemical fertilizers, nitrogenous (4.6%), copper ores and concentrates (4.5%), nuts (4%), under nated ethyl alcohol, spirits, liqueurs and other spirituous beverages (3.4%), Copper waste and scrap (2.6%), Wine of fresh grapes (2.5%) etc.

In 2010, import reached USD 5,095.1 million (17% more than the same data for 2009, 39% more than 2006 and 176% more than 2004). Main import products are petroleum, oil and gas, motor cars, medicines and different machinery. In 2010, main commodities in Georgian import were Petroleum and petroleum oils (13.6% of total import), Motor cars (6.1%), Medicine (3.7%), Wheat (3.4%), Petroleum gases and other gaseous hydrocarbons (2.6%), Electrical apparatus for line telephony or line telegraphy (2.2%), Cigars (1.6%), Sugar (1.5%) etc. In 2010, share of 10 biggest trade partners (Turkey, Azerbaijan, Ukraine, Germany, China, United States of America, Russia, Armenia, Bulgaria, United Arab Emirates) in Georgian total foreign trade turnover amounted to 67%.

**Well-being of population** increased during the last decade: average monthly incomes of the total Georgian population increased by 66%, average monthly incomes per Household grew by 68% and Average Monthly Incomes per Capita rose by 73% within the period of 2004 -2008 due to growing salaries and jobs creation. According to the integrated studies of households and labor force, the level of income had been characterizing with upward trends.

During the recent years, **wages** have been permanently increasing in both public and private sector. The same trend fixed in case of average monthly nominal wage. Average monthly nominal salary increased by 4 times for the period 2004-2009.

The government for the facilitation of **tourism sector** developed tourism infrastructure, restored different tourist centers, and improved transportation. The number of non-resident visitors at national borders of Georgia increased by 6 times for the period 2004-2010. In 2010, number of arrivals of non-resident visitors at national borders of Georgia equaled to 2,032,586 (in 2004 it was only 368,312), which is 36% increase from the prior year. Development of tourism positively influenced different sectors of the country's economy, such as transportation, production of primary agricultural products, service – including hotels and restaurants, trade etc., generating income for local enterprises, especially for SME's and spreading economic benefits of tourism throughout the country. In 2010, new airport was constructed in the mountainous region of Georgia (Svaneti, Mestia), which aspires to become as one of the most attractive touristic destination in Georgia.

Economic recovery and positive trends are reflected in the business sector in 2010. All indicators of business related figures are increasing. Deposits increased by 33% and loans increased by 2%. Compared to 2004, deposits and loans increased in 2010 by 5 and 7 times, respectively.

In 2010, total turnover of business sector increased by 14% compared to 2009 and by 3 times compared to the 2004. Furthermore, employment increased by 3% compared to the 2009.

As mentioned above, during the last couple of years, Georgian government implemented broad and comprehensive reforms that touched every aspect of the country's life. Reforms included simplification of **licensing procedures**. The number of licenses and permits required in Georgia are at minimum, and rules for obtaining them are simple. (From 2003 to 2010, number of licenses and permits in Georgia decreased almost by 88%. There are only 103 licenses and permits (49 licenses and 54 permits) required in the country in 2010). Currently, licenses and permits are only used in the production of highly risky goods and services; also usage of natural resources and specific activities. The procedures of issuing licenses and permits were significantly simplified, the "one-stop shop" and "silence is consent" principles were introduced which implies that if person is not notified with rejection about issuance of license in limited framework, the license is considered as issued from the relevant body.

In the direction of promoting the development of private sector and enhancing sustainable economic growth, important step by Government of Georgia was **Liberalization Tax Code** – number of taxes and rates as well were significantly reduced. In 2004, there were 22 different taxes in Georgia. Numbers of taxes and tax rates have been gradually decreased. Since 2004, only 6 taxes left out of the original 22: **Value Added Tax** (0% and 18%), **Personal income tax** (20% flat), **Corporate Income Tax** (15%), **Import tax** ((0%, 5% and 12%) (only on agricultural products and construction materials), **Excise** (depends on the type of good)

and **Property tax** (up to 1%).

Out of six taxes in Georgia, five (Personal Income Tax, Corporate Income Tax, Value Added Tax, Excise Tax, and Import Tax) are state-wide, and one (Property Tax) is a local tax. There are no capital gains, inheritance, wealth, property transfer, social, branch remittance, or other taxes imposed in Georgia.

In 2008, corporate income tax reduced from 20% to 15%; Payroll taxes (PIT and social tax) merged into one and W.A. tax rate reduced from 27% to 25%. In 2009 reforms carried out towards reduction of tax burden: Income Tax rate reduced from 25% to 20% and Tax rates for dividends and interest payments reduced from 10% to 7.5%. The fact that the government reduced taxes in Georgia resulted in the increase of tax revenues by 2.6 times from 2003 to 2006.

In 2007, unified Revenue Service of Georgia was established in Georgia. Revenue Service merged into one tax, customs and financial police agencies. Since then, taxpayers have only one single governmental agency to deal with regarding tax issues.

Effectively functioning public institutions and rule of law led to dramatic reduction of informal activities. At the same time, better administration and simplified business regulations provoked rapid growth of tax revenues. Customs and tax revenues increase by 11% from 2009 to 2010 and by 100% from 2005 to 2010.

**New Tax Code** was elaborated in Georgia which is in force from January 2011. New "Tax Code" provides more simplified procedures for of doing business and special treatment (incentives) for micro and small businesses that will serve as an additional incentive for business development and overall economic growth. The new Tax Code aims to increase confidence towards the Georgian tax system and enhance trust in the Georgian tax authorities, by improving communication between taxpayers and tax authorities, by protecting taxpayers' rights, by making administration more efficient, and by harmonizing the Georgian laws with the best international tax practices. The new Tax Code offers low tax rates on existing taxes, or increased exemptions. Withholding taxes on interest and dividends will be eliminated by 2014. Individuals will also benefit by 2014 from the gradually reduced personal income tax rate of 15%. Micro and Small Business status shall reduce overall administrative and tax burden on individual taxpayers. The simplified rules for obtaining a residency status of Georgia is an opportunity for "high net worth" individuals, as they can become Georgian residents without their actual presence in Georgia.

Extended filing periods, automatic refunds, and simplified taxation on imports comprise the constantly expanding list of benefits offered to taxpayers. Income and gain received from listed securities and Government bonds have been exempted from taxation for both corporate and individual taxpayers. Noteworthy, that Georgia already started convergence to European tax standards, in that it has recognized the technical regulations of the Organization for Economic Cooperation and Development (OECD), and has introduced the generally accepted transfer pricing rules within the new Tax Code. This fact will consequently promote the development of the business environment and cross-border trading. Georgian tax legislation offers another unique opportunity to serve offshore companies in the most efficient and least costly way. International Financial Company, a financial institution established in accordance with Georgian tax legislation, carries out most of its services with parties outside of Georgia.

New Georgian Customs Code was established to simplify customs procedures. Customs Tariffs Reform significantly simplified and sharply reduced costs connected to the foreign trade. Number of import tariffs was abolished on approximately 90% of products and only 3 tariff rates (0%, 5%, 12%) exist instead of previous 16. Georgia sets custom taxes on only several kinds of agricultural goods and constructing materials. In addition, there are no quantitative restrictions (quotas) on imports and exports, as mentioned previously in this paper.

A law on "Free Industrial Zones" (FIZs) was adopted. According to government's decision or on a basis of an initiative of physical person/legal entity, such zone can be created on more than 10 000 square meters. Companies, acting within the zone, are free from profit, property and value added taxes. Besides, the import of goods, produced in the free industrial zone to the other territory of Georgia (outside the free industrial zone), as well as the export of foreign goods to the free industrial zone is free from customs tax.

Therefore, the Law of Georgia on Free Industrial Zones and the Tax Code of Georgia give manufacturers a unique opportunity to process, produce and export goods with a minimum tax burden. With Georgian Free Trade Agreements, one can export goods free of trade barriers to global markets consisting of over 300 million consumers. Thousands of goods can be exported from Georgia to the European Union (the

EU) market, free of trade barriers under the GSP+ arrangements.

In 2010, among several new governmental initiatives was the creation of “Free Tourist Zones” was directed to the tourism development which has high growth potential. Investors, invested in construction of hotel facilities will enjoy from tax incentives (exemptions from Profit and Property Taxes for 15 years). Two FIZs are already established in the western part of Georgia - Poti and Kutaisi.

**Free Warehouse Company**, from a taxation perspective, is designed as an integral logistical unit for international transit companies. The benefits include: exemption from corporate income tax applied to income received from re-exporting goods from free warehouses via the Free Warehouse Company and exemption from VAT on the supply of goods by a Free Warehouse Company to a VAT payer in a free warehouse. The Free Warehouse Company categorization can be effectively used by international cargo companies, large regional network distributors, and any stakeholder desiring to transport goods from Central Asia to global economic markets, or vice versa, in the fastest and least costly way.

The removal of technical barriers for Georgian goods and services on international market is inevitable precondition for further economic development of Georgia. In order to reach this goal, the reform of technical regulation system was implemented in Georgia, which ensured the removal of technical barriers in international trade, the improvement of investment environment, consumer rights protection, the increase of access of Georgian goods to the foreign markets, the implementation of obligations under the requirements of WTO, which basically includes the transformation of national mandatory standards into the voluntary standards, the eradication of corruption, and service transparency in the field of technical regulation.

As a result of the reform, national mandatory standards system was replaced by the voluntary standards and the state regulating role in this system was declined. This process is supposed to significantly facilitate the expansion of entrepreneurial activity. The introduction of voluntary standardization in Georgia gives entrepreneurs the possibility to select the standard for his activities registered in the country, to use the standard of any country or any regional or international standard, to register standards in Georgian National Agency for Standards, Technical Regulations and Metrology and to use them for entrepreneurial activities, to elaborate own standard for new goods, register it in the national agency and use it in entrepreneurial activity and obtain consultations for standards' selection and elaboration.

Starting from 2004, provision of aggressive and transparent **privatization** policy was one of the important reforms of Georgian Government that was addressed to denationalization of the remained state property in order to attract foreign investments, develop the private sector and effectively use the country's resources.

In 2010, law on **Information Technology Zones** was passed. According to this law incentives are provided to entrepreneurs in terms of exemptions from property tax and VAT in case of services export.

Georgia's Geographical location creates an extra benefit for country strategically. Georgia is situated at the crossroads of Europe and Asia. This creates opportunity to transit goods from Asia to Europe, and vice versa. Country is spread between the Black and Caspian seas. Georgia is bordered by Turkey and Armenia in the south, by Azerbaijan in the east, and Russia in the north.

Georgia is pleased to emerge and serve as a physical and political bridge connecting European and Western markets to the vast Caspian/Central Asian potential, through an ongoing implementation of several major energy and transportation projects.

## 2. SME SECTOR DEVELOPMENT

No one doubts about the importance of SME sector to the economy. SME sector is considered to be a significant contribution in achieving various socio-economic objectives, such as - employment generation, contribution to national output and exports, fostering new entrepreneurship and to provide depth to the industrial base of the economy.

According to the Law on “The National Investments Agency of Georgia,” Small and Medium Enterprise are classified as an enterprise with average number of annually employed not more than 20 persons and annual turnover not more than Georgian lari (GEL) 500,000 (small), and an enterprise with average number of annually employed – not more than 100 persons and annual turnover not more than GEL 1,500,000 (medium).

As was previously mentioned, the new **□Tax Code□**, which came in force from January 2011, provides simplified procedures for Micro and Small businesses. According to the New “Tax Code” Micro and



Small businesses are covered by special tax regimes.

The status of **Micro Business** is given to a physical person who is not using hired persons work and is conducting economic activity independently from which annual total income doesn't exceed 30,000 Georgian Lari (GEL).

The Ministry of Finance of Georgia is responsible for giving and abolishing the status of Micro Business. The tax organ is responsible for giving a certificate for the Status. Since the New "Tax Code" came into force 4,575 new micro businesses were registered with ministry of finance of Georgia from January till June 2011.

**A physical person who has a Micro Business Status is free from income tax and current taxes.**

The status of **Small businesses** is given to a physical person/an individual/sole entrepreneur whose annual total income from economic activity doesn't exceeds GEL 100,000.

Small Business is taxed with one single tax. Tax rate for Small Business is 3% or 5% of income. Removing requirements of book keeping is in conformity with international standards. In case of 5% tax rate Small business is obliged to run only simple "purchases and sales journal" and cash registers. In case of 3% tax rate 60% of their income falls on expenditures/consumptions, proved by documentations. In 2010, 39,003 enterprises were operating in the country, among them small enterprises ratio to total number was 81.5% (31,772) and medium size enterprise ratio to total number – 10% (3,733). In essence, most businesses in Georgia are small and medium enterprises. The number of enterprises in 2010 increased by 2% compared to the previous year and by 43% compared to the 2004. The number of small and medium size enterprises increased by 15% in 2010 compared to 2009 in Georgia and by 35% compared to the same data for year 2004.

In 2010, 42% of total employees in enterprises are working in the small and medium enterprises, in medium size enterprises – 20% and in small size enterprises – 22%. The number of employees in small and medium size enterprises decreased in 2010 by 8% compared to 2009 and by 1,5% compared to 2004, but previous years were characterized by incensement of employment in SME (In 2009 number of employees increased by 18% compared to 2008).

Employment distribution in business sector in 2010 by kind of economic activity is following: Industry – 24%, Trade – 17%, Health and social work – 16%, Transport and communications – 14%, Construction – 8%, Real Estate – 8%, other – 13%.

60% of employees in business sector in 2010 are employed in the capital of country, in Tbilisi, then follows Kvemo Kartli Municipality – 8%. Average monthly remuneration of employed persons in 2010 in small enterprises increased by 5% and in medium size enterprises by 25% compared to 2009 and the same data in small enterprises increased by 5 times and by 4 times compared to 2004.

Turnover of small size enterprises in 2010 constituted 1,006.0 million USD which is 22.5% more than the same data for the year 2009 and the same trend increased by 100% from 2004. Turnover of medium size enterprises in 2010 constituted 1,023.4 million USD which is 7% more than the same data for the year 2009 and this trend increased by 33% since 2004. In 2010, small enterprises ratio in total turnover is 8% and medium size enterprises ratio equals to 9%.

Output of small size enterprises in 2010 constituted 594.7 million USD, which is 20% more than the same data for the year 2009 and this trend was tripled since 2004. Turnover of medium size enterprises in 2010 constituted 617.3 million USD which is 4% less than the same data for the year 2009 and this trend increased by 100% since 2004. In 2010, Small enterprises ratio in total output is 9% and medium size enterprises ratio equals to 9%.

### **3. LEGISLATION AND RANKING OF DOING BUSINESS ACCORDING TO WORLD BANK METHODOLOGY**

Georgia is the most active worldwide in reforming business regulation, according to **Doing Business 2011**. Among the world's 174 (total 183) economies, Georgia improved its business environment the most in the last five years, according to „Doing Business 2011“: Making a Difference for Entrepreneurs, the eighth in a series of annual reports published by International Finance Corporation (IFC) and the World Bank. By this measure, Georgia has been the most active worldwide in reforming business regulation and is number one in the list. Georgia has also been recognized as top 10 Doing Business reformers in previous years.

The „Doing Business“ 5 year measure (from 2006 till 2011) of cumulative change illustrates that doing business became the easiest in Georgia. Georgia takes the first position in this ranking. This figure shows the distribution of cumulative change across the 9 indicators and time between „Doing Business 2006“ and „Doing Business 2011“.

Georgia improved access to credit by implementing a central collateral registry with an electronic database accessible online. Georgia strengthened investor protections by allowing greater access to corporate information during the trial.

Incidentally, Georgia made the enforcement of contracts easier by streamlining the procedures for public auctions, introducing private enforcement officers and modernizing its dispute resolution system and improved insolvency proceedings by streamlining the regulation of auction sales.

In „Doing Business 2011“ „Ease of Doing Business“ ranking Georgia takes 12 position. Georgia's ranking was increased by 1 position compared to the previous year. In „Ease of Doing Business Ranking“ Georgia took 15<sup>th</sup> place in 2009, 18<sup>th</sup> place in 2008 and 37<sup>th</sup> place in 2007.

According to „Doing Business 2011,“ compared to the previous year's same report, Georgia improved its condition in Ranking in following measure of regulations: Getting Credits (by 15 positions), Paying Taxes (by 3 positions) and Protecting Investors (by 21 positions). Georgia's position was deteriorated in following measure of regulations: Starting a business (by 3 positions), Trading across borders (by 5 positions), Closing a business (by 10 positions). No change was indicated in following measure of regulations: Dealing with construction permits, registering property and enforcing contracts.

Georgia is listed among the countries, where starting a business is easiest. It requires only 3 days starting business in Georgia and in this indicator Georgia takes 3<sup>th</sup> position among the countries in fastest group. Georgia is places among the countries with easiest dealing with construction permits and easiest registering property.

In „Doing Business 2011,“ Georgia is ranked 8 overall for Starting a Business and is ranked 7 overall for Dealing with Construction Permits among the countries with good practice. Georgia is ranked 2 overall for Registering Property among the countries with good practices.

In „Doing Business 2011,“ Georgia is ranked 15 overall for Getting Credit, 20 overall - for Protecting Investors, 61 overall - for Paying Taxes, 35 overall - for Trading Across Borders, 41 overall - for Enforcing Contracts and 105 overall - for Closing a Business.

One-stop shops are starting to expand beyond business registration formalities. In Tbilisi, Georgia, a public service center assists entrepreneurs not only with business licenses and permits but also with investment, privatization procedures, tourism-related issues and state-owned property management. According to a firm survey in 2008, senior managers in Georgia spend only 2% of their time dealing with regulatory requirements—and 92% of firms report spending less than 10% of their time on such requirements. By saving time, Georgian entrepreneurs save money too. Another survey, in 2009, found that the service center's simplified procedures helped businesses save an average of 3.25% of profits that year. For all businesses served, this amounted to direct and indirect savings of \$7.2 million.

Georgia, after 6 years of steady improvements, has the most efficient permitting system. To comply with formalities in Tbilisi it takes 98 days, far fewer than the regional average of 250 days.

Georgia now allows property transfers to be completed through 500 authorized users, notably banks. This saves time for entrepreneurs. A third of people transferring property in 2009 chose authorized users, up from 7% in 2007. Georgia's new electronic registry managed 68,000 sales in 2007, twice as many as in 2003.

In Georgia improvements in customs clearance procedures, coupled with greater trade, contributed to a 92% increase in value added tax revenue (60–65% of which is collected at the border) between 2005 and 2009.

Made enforcement of judgment more efficient - in Georgia private enforcement officers were introduced alongside state enforcement agents, increasing enforcement capacity. And debtors can now pay creditors the outstanding debt before the closing of an auction to avoid the sale of their assets.

Georgia combined the state and private models, introducing private bailiffs in 2008 alongside the state bailiffs to increase enforcement capacity. Since 2009 the Georgian Ministry of Justice has issued 38 licenses to private enforcement agents.

According to the World Bank report **Investing Across Borders 2010** (IAB) Georgia is one of the most open countries to foreign equity ownership among 87 countries as measured by the Investing Across Sectors indicators. Georgia for all of the 33 sectors covered by the indicators is fully open

to foreign investment. There are neither sectors with monopolistic or oligopolistic market structures nor any perceived difficulties in obtaining any required operating licenses. With only 4 procedures and 4 days, Georgia is among the fastest countries in the world in terms of establishing a foreign-owned limited liability company (LLC). A foreign company requires no additional procedure other than the authentication of the parent company's documents abroad. According to the new order on the Approval of Instruction on State and/or Tax Registration Procedure of Taxpayers and Branches, a company must be registered on the same day of filing or the following day. The application is available online. Registering with the Entrepreneurial Register and obtaining an identification number and a certificate of state and tax registration are required in order to commence the company's activities. Companies in Georgia are free to open and maintain bank accounts in foreign currency. There is no minimum capital requirement for foreign or domestic companies. Since 2008, evidence of contribution to the company's capital is no longer required.

Foreign company can start a business in Georgia less than a week. It's remarkable, that companies can't start business in shorter period than Georgia none of investigated countries. In Tbilisi, Georgia's capital, registration of land-related rights has become a simpler and quicker process due to a law that was adopted in 2008. Both privately and publicly held land may be leased or bought. Lease contracts can be of unlimited duration. There are no restrictions on the amount of land that may be leased. The time required to lease land from a private holder ranges from about 1 week in Georgia.

**In □Forbes□ □Best Countries for Business 2010□ rating Georgia improved its position by 3 stages and now ranks 61 among 128 countries.** In "Forbes" rating "Best Countries for Business 2009" Georgia ranked 64. According to the "Forbes", in 2010, Georgia improved its condition in following indicators: Trade Freedom (ranks 5) and Tax Burden (ranks 44). Areas of recent improvements in Georgia include growth in the construction, banking services, and mining sectors. Georgia has overcome the chronic energy shortages and gas supply interruptions of the past by renovation hydropower plants and by increasingly relying on natural gas imports from Azerbaijan instead of from Russia. The construction on the Baku-Tbilisi-Ceyhan oil pipeline, the Baku-Tbilisi-Erzurum gas pipeline, and the Kars-Akhalkalaki Railroad are part of a strategy to capitalize on Georgia's strategic location between Europe and Asia and develop its role as a transit point for gas, oil and other goods. Georgia has historically suffered from a chronic failure to collect tax revenues; however, the government, since coming to power in 2004, has simplified the Tax Code, improved tax administration, increased tax enforcement, and cracked down on petty corruption.

"Forbes" "Best Countries for Business 2010" rating involves following indicators: GDP Growth, GDP per Capita, Trade balance as % of GDP, Population, Budget balance as % of GDP. Sources for mentioned ranking are: Heritage Foundation (Economic Freedom Index); World Economic Forum (Global Competitiveness Report); Transparency International (Corruption Perceptions Index) etc.

**In □The Global Competitiveness Index ranking 2010□2011□ Georgia takes 93 position among 139 countries (with 3.9 score).** In 2009-2010 Georgia ranked 90 among 133 countries.

Moody's Investors Service has assigned first-time Ba3/Not-Prime foreign and local currency issuer ratings to the government of Georgia in 2010. The outlook is stable. The decision to assign a rating of Ba3 reflects: The country's progress in building social, political and economic institutions and providing a healthy operating environment for business that is unique in the region; The government's proactive response to the global crisis and the 2008 conflict with Russia, which has addressed the curtailment in foreign direct investment (FDI) and other capital inflows and maintained affordable debt service; Geopolitical risks due to the unresolved conflict with Russia.

Georgia's rating reflects marked progress in recent years in building institutional capacity that attracted substantial capital inflows and boosted growth while keeping government debt at affordable levels. Early in the decade, Georgia was stricken by widespread corruption and highly ineffective political leadership. However, this landscape was transformed following the "Rose Revolution" of 2003, which ushered in extensive economic and political reforms. In particular, the government introduced a liberal economic platform, with emphasis on improving the business operating environment. The authorities undertook a major effort to combat corruption, which led to a rapid improvement in government effectiveness. These reforms delivered strong growth, which was interrupted first by the conflict with Russia and then by the global downturn, but economic activity has recovered briskly so far this year. Over the medium to long term, the economic model is dependent on private capital inflows to deliver strong growth, but that FDI inflows have yet to reach their pre-crisis levels. However, generous aid solicited from the international community following the conflict with Russia and proceeds from the IMF stand-by program are more than covering any

shortfall at present. Remittances, which correspond to roughly 10% of GDP, have largely recovered.

In Moody's opinion, the Georgian government has a credible programme to reduce the budget deficit from over 9% of GDP last year to 2%-3% within the next few years.

According to the Transparency International's Global Corruption Barometer 2010, Georgia ranks the first among world countries in the term of decrease corruption level. According to "Global Corruption Barometer 2010", 78% of surveyed people in Georgia claimed corruption level was decreased. Georgia is among the list of top world countries where corruption level is the least. 77% of surveyed people in Georgia considered effective government's actions in the fight against corruption. About seven out of 10 respondents in Georgia consider their government's actions as being effective or extremely effective.

In the Paying Taxes 2011 – the Global Picture's Ease of Paying Taxes Ranking Georgia, compared to the previous year, improved its condition by 3 position and ranks 61 among the world's 183 country. In the "Paying Taxes 2010" "Ease of paying taxes ranking" Georgia took 64 position. In the "Paying Taxes 2011", compared to the "Paying Taxes 2010", Georgia improved its position in the „Time to comply ranking“ too. (Ranking was improved by 2 positions). Georgia is among the list of 10 countries, where the Total Tax Rate is the lowest.

Standard & Poor's Ratings Services revised Georgia's outlook to positive from stable and at the same time affirmed country's B+ long-term and B short-term sovereign credit ratings on the sovereign in March, 2011. Standard & Poor's also affirmed Georgia's recovery rating "4". The "BB" transfer and convertibility (T&C) assessment on Georgia remained unchanged. Standard & Poor's Ratings Services outlook revision reflects their view of the likelihood of an upgrade if external performance continues to improve, allowing the country to build reserves and reduce its reliance on external funding, while also abating inflationary pressures. The company expects Georgia's external performance to improve, reducing external financing needs and inflationary pressures. The ratings on Georgia are constrained by diminishing, but still considerable, external, monetary, and political risks, and supported by good economic growth prospects and ongoing fiscal consolidation.

Following GDP growth of an estimated 6.4% in 2010, driven by a recovery in export growth and a rebound in credit growth to the private sector. Standard & Poor's Ratings Services expects that the Georgian economy will recover more rapidly than was anticipated. The company expects growth in the near term to benefit from an extension of public sector investment in infrastructure, energy, agriculture, and tourism. In the medium term, Georgia will be less reliant on donor grants and concessional funding.

According to the Global Economic Forum's "The Global Enabling Trade Report" Georgia takes 37<sup>th</sup> place among 125 countries in "The Enabling Trade Index 2010". In "The New York Times" ranking "Best Places to Go in 2011" Georgia takes 6<sup>th</sup> place. The magazine focuses on Georgia's high mountain resorts: Georgia - A rustic ski wonderland on the verge of discovery. Tucked between the Black and Caspian seas and smattered with mountains, Georgia has the kind of terrain adventurous.

Fitch Ratings has revised the Outlook on Georgia's Long-term foreign and local currency Issuer Default Ratings (IDR) to Positive from Stable and affirmed them at B+ in 2011. The agency has also affirmed Georgia's Short-term IDR at B and Country Ceiling at „BB-“. "Fitch Ratings" has assigned Georgia's USD 500m Eurobond, due 12 April 2021, a rating of "B+". The Positive Outlook reflects Georgia's strong economic recovery, a reduction in both the budget and current account deficits, an improvement in the financial sector's health and some easing of political risk. The Georgian economy is recovering strongly, benefitting from the global economic recovery, large-scale international donor financing and an apparent improvement in trade performance. "Fitch" estimates real GDP growth of 6.5% in 2010, after a contraction of 3.9% in 2009. The agency projects relatively strong GDP growth will continue, with 5.0% and 6.0% forecast for 2011 and 2012, respectively. Georgia's ratings are underpinned by its level of human development, which is well above the "B" range median, a favourable business climate (underscored by Georgia's 12<sup>th</sup> spot in the World Bank's Ease of Doing Business rankings) low corruption and generally sound governance, strong GDP growth prospects, a track record of relatively low inflation and strong support from the international community.

#### 4. SME SUPPORT INFRASTRUCTURE

Strategy for support and foster entrepreneurship development in Georgia is - to create appropriate climate for improving access to finance for SMEs and conduct policy and legislative reform; Also improve quality standard within the business community; increase private sector participation in economic activities; Professional and entrepreneurial education connection enhancement; Start-ups assistance; Entrepreneurial Education availability system development; Maintaining program diversification; Education System harmonization to the European and international educational systems; Train competitive staff for inter and international labor market satisfaction; Support social partnership between the Government, Employer, professional unions, education providers and etc.

In order to identify Entrepreneurial Education Demand there are conducted surveys by the different organizations and institutes. Surveys include market tendencies general evaluation, labor market survey, market demand investigation, new market and product testing, Entrepreneurial management evaluation and etc. There were identified Entrepreneurial Education some Demand Areas, included - Agriculture; Tourism; Handicraft; Construction; Information technologies and other fields. Training courses, programs and consultations involves: Management; Marketing; Finance and Accounting; Licenses and Permits; Procedures for Incorporation; Business Planning; Starting Business; Human Resource Management; Service providing; Advertising, Communication; Design and Structure of Organization; ISO standards, GSP, GSP+ and others.

The scope of **Governmental Employment Program for Small and Medium Business Development (2007)** was to increase employment in Georgia, support regional economic development infrastructure and help small and medium enterprises activity through credit recourse access improvement. The aim of this program was also to provide vocational education for unemployed people in professional education centers. Beneficiary of this program were small and medium enterprises operating in tourism business included start ups, which could provide jobs. Beneficiary was selected by bank through government credit. Government gave financial resource to bank (which was selected by competition) for operating program. Credit was given by small interest rate for 5 year period. Maximum volume of credit was 50 000 GEL. 5.5 million Georgian Lari was allocated from budget for this program. Donor organizations were also involved in the program for conduct trainings, consultations, marketing and consultations. As a result of this program more that 2 000 persons were trained. It appeared that volunteers were more that program could cover.

The scope of the program **Governmental Program for professional skills training (2007-2008)** was labor professional skills training and qualification development in labor market through governmental financing. The actors of this program were persons willing professional skills training and professional training centers involved private companies willing qualified labor. Person's age limitation was 25-65 years. During 3 month period Government was financing labor salaries, while they were improving their working skills in enterprises. As a result about 114,000 persons were trained with this program, in the field of service, construction, manufacturing, industry and etc. For about 10% of beneficiary began working in the chosen training centers.

The aim of the **Governmental program for professional education infrastructure development □ Vocational Education for employment (2008)** was to raise private sector role in vocational education, support satisfaction of labor demand with qualified trained human resources. To ensure this, governmental property was given to physical and private entities for establishment of professional schools. Program's objective is to establish 50 professional training centers, to attract investments in this direction. Established professional training centers must provide profile of training centers for 7 years.

The aim of the program **Governmental Program Cheap Credit (2008-2009)** was to provide cheap credit for private enterprises, to establish new enterprises, develop existing and create new jobs. Volume of credit: minimum 20,000 GEL, Term of credit use: maximum 10 years, Interest rate: maximum 9 percentage, Grace period: maximum 3 years. Beneficial's of this program were small and medium start ups in the field of agriculture, handicraft and other sectors. Governmental financing involved following businesses: reproduction of fruits and vegetables, Receipt and reproduction of tea, tourism, handicraft, delivery of grapes and production of drink, recipient points of milk and meat, Reproduction of nuts and cereals (wheat, sunflower seeds), Reproduction of timber, production of briquette and wood-shaving tiles, factors of poultry raising, production of shoes and textile and others. Legal entity of public law "fund of municipal development of Georgia" implements documental monitoring and provides information Ministry of Economy and Sustainable

Development of Georgia monthly and quarterly. Ministry of Economy and Sustainable Development of Georgia, for its part, implements the evaluation of ongoing projects, plans work meetings in entrepreneurs. 130 projects were financed within the framework of "Cheap Credit" program with total value of projects 65 million GEL (approximately 43 million USD).

**Presidential Program for Professional education centres' Rehabilitation** aimed rehabilitation of existing professional education centers. In the frame of this program 10 professional education centers and 3 vocational education institutes were rehabilitated. Rehabilitation involved full renovation and equipping center with modern equipment.

**Computer and English Free Courses, Study to Be Employed** - Tbilisi city hall offers free computer and English courses. The basic knowledge of computers and English will assist population to get employed. Tbilisi city hall gives a chance to each citizen from the age of 23. People who wish to study English and computer should apply to the local administrative bodies. Tbilisi city hall will assist the successful ones to get employed at private companies and at governmental bodies.

In the frame of "**Local Business Support Program**" (since 2006) **Start the Business with the City Hall** projects are financed which are supporting: tourism development; entrepreneurship development; supply of ecological products made in different regions of Georgia's; Development of territory of Tbilisi. More programs are financed in the trade field. Terms of Credit: Minimum amount – 5,000 GEL, Grace period – 2-3 month, Term of credit validity – maximum 60 month, Interest Rate – 4% each year. Beneficiaries are chosen by the commercial banks. Banks are chosen by the credit volunteers.

International support for SME includes following organizations: United States Agency for International Development (USAID), United Nations Development Programme (UNDP), United States Department of Agriculture (USDA), Millennium Challenge Georgia (MCG), International Labor Organization (ILO), Eurasia Partnership Foundation (EPF), International Organization for Migration (IOM), German Technical Cooperation (GTZ) and others.

Improving access to finance for SMEs is essential for SME development in Georgia. However, the creation of an enabling environment and support of business development service providers are further conditions for a successful promotion of SMEs.

**United States Agency for International Development (USAID)**, in line with this objective and to promote the growth and development of SME in Georgia executed the Private Sector Support to Small and Medium Sized Enterprises Project - "SME Support Project" from 2005 till 2009. The SME Support Project was designed to directly contribute to the achievement of USAID/Georgia's Strategic Objective for Economic Growth – "Accelerated Development and Growth of Private Enterprises to Create Jobs". SME Support Project was designed to address the needs of small and medium sized enterprises by providing assistance to: increase access to medium- and long-term financing through Development Credit Authority mechanisms; encourage increased participation of Georgian businesses in international markets, through the adoption of internationally recognized self-certification standards; develop advocacy skills in selected Georgian business associations in order to more effectively engage government at all levels on a variety of business issues; and improve business skills, including training for youth and minorities. The SME Support Project contributed directly to the improved business environment for SME's in Georgia including: assistance provided to increase SME finance by supporting SMEs and the agriculture sector, supporting microfinance institutions and microenterprises, and technical assistance and training for financial institutions; assistance to associations, educational organizations, and other institutions by supporting business associations to develop self-certification, providing support to business associations to develop advocacy skills, and supporting business associations, educational organizations, and other institutions to support expanded skills and entrepreneurship. To complete project goals and objectives, the SME Support Project used a combination of direct assistance and a grants program with six rounds of disbursements grant awards. Notable achievements include the creation of business support organizations that provided consulting services and training and advocacy support to SMEs; advancing the development of the local credit bureau; setting up a Georgian Banking Training Center for financial institutions; support provided to institutions with USAID DCA guarantee loans which resulted in the increased access to finance to SMEs; developing business incubators throughout Georgia; providing assistance and training to internally displaced persons; developing the tourism industry and developing basic tourism infrastructure; and engaging the public private dialogue which resulted in the Government of Georgia actively meeting with business associations to get feedback on laws affecting the business community. Overall, the SME Support Project provided the Georgian business community with

the needed foundation to develop and strengthen private enterprises and create new jobs.

The SME Support Project created 1,196 jobs; supported the creation of 162 enterprises; trained 4,562 people to develop entrepreneurship skills and improve their businesses; fostered direct assistance to 4,544 MSMEs; trained 1,237 potential borrowers in accessing finance; and trained 602 loan officers on providing commercial financing to MSMEs etc. USAID Projects supporting SME sector in Georgia also included: Pilot Business Development and Employment Program; Regional Student Consulting Program in Adjara; Agribusiness Lending Training Program; Regional Student Consulting Program in Samtskhe-Javakheti; Innovative Economic Development Education Program in Shida Kartli etc.

**IFC (International Finance Corporation)**, a member of the World Bank Group, is also supporting Small and Medium Enterprises in Georgia. Given the particular importance of SMEs for the Georgian economy, IFC's priority is to reach a broad number of these enterprises through continued support to banking sector to ensure access to finance for them. Following the August 2008 conflict, IFC responded quickly to support its banking clients enabling them to continue lending to retail clients and SMEs, two key client bases that drive economic growth in Georgia, at the same time promoting stability in the sector and signaling IFC's continuous engagement in the country. IFC also helped bankers in Georgia via conducting training to develop their ability to provide financial services to small and medium-sized enterprises, thus helping create new jobs and sustain economic recovery. IFC also provided advisory services aimed at improving the investment climate by reducing administrative barriers to starting and operating businesses. In 2010 IFC launched IFC Georgia Tax Simplification Project to lower tax compliance costs for micro, small, and medium enterprises and expand their tax base. IFC Georgia Tax Simplification Project supported Georgian Government in adopting the new legislation (New Tax Code, as well as the secondary legislation) enforced from January 2011 to reform taxation system for micro and small companies.

IFC's cumulative investments in Georgia since 1995 (Georgia became a member of IFC in 1995) total nearly 500 million USD in 36 projects across a variety of sectors. IFC is also helping raise food safety standards in the country.

**The United Nations Development Programme (UNDP)** implemented project named – Increasing Access to Finance for Micro Businesses in Conflict Affected Regions (microfinance), which was funded by the European Union. Within the programme Inclusive Financial Systems in Georgia (IFSG) UNDP conducted Business development services and provided micro loans for businesses. The Inclusive Financial Systems in Georgia (IFSG) project's three Business Development Service Providers (BDS Providers) administered a total of 94 Information Sessions (1,727 beneficiaries), 223 Business Skills Trainings (2,132 beneficiaries) and 899 Consultations (775 beneficiaries). The BDS Providers also assisted the target beneficiaries in preparing 491 business plans, which were used to access 146 loans and grants from the IFSG's seven partner financial institutions, ProCredit Bank, Liberty Bank, Action Against Hunger, People in Need and International Organization for Migration. A total of 2,555 target beneficiaries directly benefited from the BDS Providers' business skills trainings and one-on-one consultations. The IFSG's seven financial institutions disbursed a total of 3,144 loans valued at GEL 4,581,593 (USD 2,573,929) to the project's target beneficiaries operating in 356 towns and villages, including; 1,776 loans to women entrepreneurs, 214 loans to internally displaced persons (IDPs), 220 loans to start-up enterprises and 2,218 loans to support primary agricultural production. A total of 184 target beneficiaries received two or three loans with IFSG funds as of September 2010. The UNDP disbursed the GEL equivalent of USD 1,781,000 to seven partner financial institutions for on-lending to the IFSG target beneficiaries during the life of the project. A total of 2,960 target beneficiaries accessed loans from the IFSG's partner financial institutions as of September 2010.

UNDP's Entrepreneurial Education Centre conducts business trainings, consultations, helps start ups, self employment, enhances business and professionals cooperation. UNDP supports also Modernization of Vocational Education and Training System in Georgia. UNDP Vocational Education Project is to contribute to improving the quality of vocational education and training, increasing incomes and employment opportunities among the rural poor.

There is functioning Business Incubator in the region of Georgia, in Adjara. The main aim of incubator is to stimulate business development in Adjara with supporting start-ups. Incubator aims to support start ups for future sustainable development and profit, so that they could develop new technologies, create new jobs and force local and national economy. UNDP contracted with Georgian Business Development Service Providers (BDS Providers). The BDS Providers offer business skills trainings and one-on-one consultations on topics, such as; business planning, business plan development, marketing, financial

accounting, agricultural production, access to credit, etc. There are also many organizations which are supporting SME's in Georgia, including banks providing preferential financial recourses and different institutes offering entrepreneurial education etc.

## 5. THE EFFECT OF THE INTERNATIONAL FINANCIAL AND ECONOMIC CRISIS

While reforming the country's economy, Georgia was faced by two significant challenges: the Russian invasion in 2008 and, subsequently, the world economic crisis. Although the war with Russia and the financial crisis hit Georgian economy at around the same time in 2008, the country demonstrated exceptional resilience and was able to contain both crises, largely due to the substantial aid provided by Georgia's international partners in the amount of 4.5 billion USD.

In October 2008, on the Donor Conference, which was held in Brussels, donors promised assistance for Georgia in the amount of 4.5 billion USD. From this financial resource 40% was grant and 60% long term credit with high level preference. As of March 2011, consent of donors has reached to 90% of promised resource. There are registered agreements between the Government and private sector for this amount. It's expected that for all promised amount will be contracted for 2011.

Donor's assistance for the Government was used to maintain living conditions for refugees from the war 2008 and also for financing following sectors: Road Infrastructure, Energy, Municipality, Agriculture and other.

While most nations of the world, including the industrialized countries of Western Europe, suffered from economic downturn in 2008, Georgia's economy was able to grow by 2.3% in 2008. However, the country's economy declined by 3.8 in 2009. The primary cause of this decline was the contraction of the construction industry in Georgia and decline in foreign investment inflow (-57.9%). It is also noteworthy that the banking industry of Georgia was resilient in the midst of the global financial crisis.

Although real estate and construction industries were negatively affected by the financial crisis, they show some signs of recovery - in January-November real estate transactions are increased by more than 20%, the growth of construction sector (in GDP) during 2010 amounted to 7.6%.

Due to the growth of economic activity and creation of new jobs, unemployment rate decreased to 13.3% in 2007 (13.6% in 2006). However, in 2008, employment lessened, resulted by global economic crisis and August events with Russia and unemployment rate reached 16.5%.

## 6. GOVERNMENT MEASURES TO COPE WITH THE IMPACT OF THE ECONOMIC CRISES

In order to cope with the global financial crisis and the aftermaths of the conflict with Russia, the government of Georgia launched a stimulus package which included investments in infrastructure in the amount of 2.2 million GEL and social aid package in the amount of 1.6 billion GEL. The social aid package was designed to help the most vulnerable part of the Georgia's population. On the other hand, investment in infrastructure was aimed at attracting foreign investment.

Main purposes of the government's strategy were to stimulate economy – jobs maintaining, attraction donor's financial recourses maximally short period and investing infrastructure; social assistance – assistance of people which were under poverty level, insurance expansion; Attracting International Investments; Activate Foreign Relations – double taxation avoidance and free trade agreements; Tax liberalization; Energy Sector.

Government of Georgia decreased taxation rate which allowed Economic stimulation. From 2009 thanks to the decrease extra 250 million GEL is staying in the Economy.

In addition to the economic stimulus package discussed above, the government of Georgia drafted a new stimulus package in 2009 with the primary purpose of strengthening the construction and banking sectors of the economy. More specifically, the stimulus package entailed granting loans to construction companies.

Georgian Government, already in September 2008 had to elaborate anti economical recession plan. Georgian economy recovery was supported by the IMF (750 million USD), Brussels' Donor Conference (4.5 billion USD). International financial crisis was also affected government's decisions: already planned activities were accelerated and was elaborated additional.

One of the primary reasons why Georgia was able to overcome the financial crisis and aftermaths of



its conflict with Russia was its international financial support, as mentioned in the previous paragraphs.

Georgia's sound fiscal and economic policy is evidenced by the real GDP growth of 6.4% in 2010, beating analysts' expectations. Furthermore, growth is demonstrated by other economic indicators evaluated by the international financial institutions such as the World Bank and the International Monetary Fund.

External shocks didn't effect on Government's commitment for further reforms too. As was mentioned before, during last 2 years Georgia's position in international ratings was promoted.

One must also mention that the National Bank of Georgia (NBG) guaranteed financial stability by providing prudent monetary policy for insurance price stability. More specifically, inflationary pressures that were created growing prices in international markets were eliminated by NBG by lightning and monetary and fiscal policies and promoted economic growth based on private sector financing.

## **7. TASKS FOR IMPROVEMENT AND FURTHER DEVELOPMENT OF THE NATIONAL SME SECTOR**

Georgia has a growing SME sector, which is essential in ensuring employment and promoting sustainable economic development of Georgia. As the share of SMEs in the total number of enterprises is so high and their contribution to the overall economy – significant, it is very important to further develop micro, small and medium businesses in the country. Towards this goal, it is imperative to provide SMEs with financial and technical assistance. Thanks to the Georgian government's efforts in the direction of tax liberalization and special incentives for Micro and Small businesses, there is a solid foundation for SME sector growth. Most important change in this direction was before mentioned "New Tax Code" which came into force from January, 2011. Incentives, stimulus and opportunities which are created for SMEs with the "New Tax Code" will certainly give raise their activities and will help SMEs further development in the country in near future.

In terms of providing international business opportunities for SME, Georgia will need assistance from its international partners. Incidentally, educating Georgians about entrepreneurial opportunities offered by SME is important to ensure the growth of this sector. For further SME development in Georgia, it is also necessary to raise business skills in the country among small and medium business operators. This will increase Georgian products' competitiveness in the global market, which will ultimately result in increased exports and international trade. Furthermore, it is crucial to develop quality infrastructure that meets European standards. Therefore, Georgian national quality institutes need to adopt international best practices of quality control in order to support SMEs.

This paper is based on the premise that liberalization of Georgia's economy yields economic growth and attracted foreign investments. It is very important to raise employment in Small and Medium Enterprises. Therefore, providing opportunities for SMEs in terms of access to finances and education is one of the main goals of Georgia. Among the various issues discussed in this paper were GDP growth, liberalization of Georgian Tax Code, the role of SME in the Georgian economy, international organizations' evaluation of Georgia's economic performance, and Georgia's strategies to deal with the aftermath of its conflict with Russia and the global financial crisis.

In conclusion, we believe that the role of SME will increase in Georgia's economic development as the country continues to liberalize its economy.

## ANNEX

## SWOT ANALYSES of SME

<p><b>STRENGTHS</b></p> <ul style="list-style-type: none"> <li>• Growing SME sector (The number of SME increased by 15% in 2010 compared to 2009 in Georgia and by 35% compared to 2004)</li> <li>• High SME ratio into total number of enterprises (91.5%);</li> <li>• Government liberality and support of SME (benevolence)</li> <li>• High level of population involvement in SME</li> <li>• Liberal Tax Administration</li> <li>• Simplified procedures provided by New “Tax Code“ (in 2011) for of doing business and special incentives for Micro and Small businesses</li> <li>• Ease to start business (In „Doing Business 2011“, Georgia is ranked 8 overall for Starting a Business and is ranked 7 overall for Dealing with Construction Permits among the countries with good practices)</li> </ul>	<p><b>WEAKNESSES</b></p> <ul style="list-style-type: none"> <li>• Small SME ration into total number of employment</li> <li>• Small number of business incubators</li> <li>• Lack of human capital in the terms of business skills (Professionals)</li> <li>• Incentivizing SME might hinder their growth opportunities</li> <li>• Incompliance of local products with international quality standards</li> </ul>
<p><b>OPPORTUNITIES</b></p> <ul style="list-style-type: none"> <li>• Countries economy further development</li> <li>• Attractive tourism destination</li> <li>• Country’s investment favorable environment</li> <li>• Georgia’s promotion and going advance into international ratings</li> <li>• Georgia’s liberal trade regime with simplified trade procedures, no quantitative restrictions on export/import, no tariff quotas, double taxation avoidance agreement with the 22 countries, country’s membership in World Trade Organization (WTO), Ratified Commonwealth of Independent States (CIS) Free Trade Agreement and signed EU-Georgia European Neighborhood Policy Action Plan, Free Trade Agreement with Turkey etc. creates opportunities for SME sector for foreign trade and especially for export</li> </ul>	<p><b>THREATS</b></p> <ul style="list-style-type: none"> <li>• Possibility of finance accessibility reduction for SME <ul style="list-style-type: none"> <li>✓ Non satisfactory competitiveness</li> <li>✓ Lack of technology and innovation</li> <li>✓ Lack of Human resource development and strengthening the professional education sector</li> </ul> </li> <li>• Investments decrease probability</li> <li>• Regional conflicts emergent</li> <li>• Ecological catastrophes existence (which can harm agricultural products)</li> </ul>

ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
<b>2009</b>	451.3 <sup>1</sup>	105,9.0 <sup>2</sup>	NA	35,324*	NA	38,187**
<b>2010</b>	448.1 <sup>1</sup>	100,7.1 <sup>2</sup>	NA	34,565*	NA	39,017**

## NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 Employees	50-249 employees
2009	38,187**	32,193	4,667	1,156
2010	39,017**	33,102	4,606	1,140

## EMPLOYMENT

Year	Total number of employment		Unemployment	
	in SMEs	in all type of economic units in the country	Number	as % of the total employees
2009	615,584***	1,656.1 <sup>3</sup>	335.6 <sup>4</sup>	16.9 <sup>5</sup>
2010	598,772***	1,628.1 <sup>3</sup>	316.9 <sup>4</sup>	16.3 <sup>5</sup>

## Remarks:

- \*) Currently operated enterprises with employed from 1 to 149 persons;
- \*\*\*) Currently operated enterprises totally;
- \*\*\*) Annual average number of employees in SME (included agriculture)

1. Number of households (thousand) with at last 1 person employed in sector of agriculture
2. Number of self-employed (thousand);
3. Employment totally (thousand);
4. Unemployment (thousand)
5. Level of unemployment (%).

## INDEX OF SME DECTOR DEVELOPMENT

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	78	10	36	1483.5	47.47
2008	89	12	37	2921.1	105.16
2010	91	15	37	2629.0	189.29

## Remarks:

- An estimation of the hidden economy according to N/A is N/A % of the GDP.
- An estimation of the unobserved economy according to the National Statistics Office of Georgia is approximately 18% of the GDP.

## CONFERENCE PAPERS

### GLOBAL MICROCREDIT SUMMIT 2011 CONCLUDED IN SPAIN

The Global Microcredit Summit 2011 concluded on 17 November last year in Valladolid, Spain with the aim to alleviate poverty and reach the MDG goals through microcredit which has already proven to bear positive results around the world. The four-day summit began on Monday 14 November, 2011. **Her Majesty Queen Sofia of Spain**, and **the founder of Grameen Bank, Nobel Peace Prize winner Professor Muhammad Yunus**, opened the "Global Microcredit Summit" at a ceremony that also featured the participation of **Soraya Rodríguez**, Spanish Secretary of State for Development Cooperation; **Trinidad Jiménez**, Spanish Minister of Foreign Affairs; **Sam Daley-Harris**, Director of the World Microcredit Campaign; **Juan Vicente Herrera**, President of the Autonomous Government of Castilla y León, and **Francisco Javier León de la Riva**, Mayor of Valladolid.



**Professor Yunus** said that "microcredit is a way of helping future generations, because they are the future." Yunus expressed regret that the crisis had forced decisions to be made that affected microcredit. Against this backdrop of dark clouds, he argued that "microcredit is a shining hope, creating light at the *end of the tunnel*."

**Queen of Spain, Sofia**, who is also the honorary co-chair of the Microcredit Summit Campaign, stated at the inauguration that "the world of microfinance and this Summit are absolutely necessary" to achieve the United Nations' Millennium Development Goals and reduce by half the number of people living on less than one dollar a day. The Queen highlighted that "Spain has become the second largest donor [to the microfinance sector] in the world."

**Queen of Spain, Sofia**, who is also the honorary co-chair of the Microcredit Summit Campaign, stated at the inauguration that "the world of

In her speech, the Spanish Minister for Foreign Affairs said that Spain contributes more than any other OECD country to development cooperation, the seventh highest amount in the world. "The crisis has forced us to make decisions, but that will not affect our convictions. We must continue making effective progress toward the eradication of poverty."



Photo by Yunus Centre ©

The Spanish Secretary of State for Development Cooperation highlighted that 1.4 billion people live on less than one euro a day and that among the poorest people; eight out of every ten are women. **Soraya Rodríguez** stressed the "courage, bravery and tenacity" of **Professor Muhammad Yunus** and emphasized that microfinance "opens up a window of opportunity," adding that "we need ideas and this Global Summit is a unique opportunity."

Microcredit summit authority has received a letter from **Turkish Minister Fatma Sahin** inviting to host

the Global Microcredit Summit to be held in 2016, on behalf of the Prime minister. She mentions that "Prime Minister *Erdogan* is a long time friend of *Professor Muhammad Yunus* and a great supporter of microfinance." She reminded in the letter that the Prime minister inaugurated the Turkish Grameen microcredit program with Professor Yunus in 2003.

During the Summit, a photo exhibition by *Daniel Mordzinski*, titled "Yunus. The Banker of Dignity" was opened by *Her Majesty, Sophia*, Queen of Spain and *Ramiro Ruiz Medrano*, President of the Province of Valladolid. The streets of Valladolid are displaying pictures of Professor Yunus on it.

More than two thousand delegates from more than 90 countries attended the 2011 Global Microcredit Summit, including heads of state and government and other dignitaries. This summit provided the opportunity for microfinance practitioners, advocates, investors, donors, and others committed to the Campaign's goals to assess progress, discuss challenges to achieving the goals set for 2015 Microcredit Summit, share best practices, and accelerate innovations.

The 2011 Global Microcredit Summit included:

- six cutting edge topics discussed in plenary,
- over 50 workshop sessions,
- a number of intensive day-long courses on a variety of subjects, and
- some 30 additional associated sessions organized by delegates.

Sessions at the Summit demonstrated that microfinance institutions can provide access to financial services and, in some cases, offer non-financial services that can contribute to improvements in the health, education and overall well-being of clients and their families. Professor Yunus urged everyone at the Summit to start social businesses, no matter how small. He stated "Once you have your goals set, then gradually, continuously, you can start solving social problems. The Wright Brothers did not create a jet airplane right away," he said. "You must create a solution then continuously improve it."

During the concluding ceremony, Professor Yunus hoped that the Global Summit in 2011 will have a positive impact in improving the microfinance field, and help achieve the Millennium Development Goals. He hoped that the Global Summit would become a landmark in the economic and social development of the poor.

The first Global Summit was held in Washington in 1997, which had set a goal to ensure that 100 million of the world's poorest families, especially women, would receive microcredit and other financial and business services by 2005. This target was nearly reached. Therefore, a new campaign was launched in November of 2006, with two new goals: to work to ensure that 175 million of the poorest families receive credit for self-employment and other services, as well as working to raise the income of 100 million families above the dollar a day threshold.

**Source:** Yunus Centre,

<http://www.muhammadyunus.org/Yunus-Centre-Highlights/global-microcredit-summit-2011-concluded-in-spain/>



## DYNAMO - FIRST NATIONAL DAY ON BUSINESS CONTINUITY

"Dynamo", the very successful event held on 10 of November as part of **European SME Week 2011**, involved the main transnational stakeholders on **Business Transfer** topic.

The contributions and the presentations of the seminar are available to be downloaded at

[http://dl.dropbox.com/u/7315468/Dynamo-Contributi\\_e\\_presentazioni.zip](http://dl.dropbox.com/u/7315468/Dynamo-Contributi_e_presentazioni.zip).

Dynamo has been an opportunity to discuss the state of the art on *Business Transfer Process* thanks to the "voices" came from Sweden, from the Netherlands and directly from the European Union, together with the one of the Italian "Mr. SMEs", Giuseppe Tripoli (represented in this occasion by Mr. Giuseppe Capuano).



The event has been characterized by its vivacity and dynamism, not only thanks to the lively participation of prestigious guests, but also thanks to the coordination and moderation of **Toni Brunello**, **European expert** in Transfer of Business and Generational Changeover, as well as founder of StudioCentroVeneto.

The program of Dynamo has been really rich. The presentations given by speakers took turns on the one hand by *videoconferences* with other colleagues and experts in Transfer of Business unable to be physically present (including Mr. Francesco D'Aprile - ICMCI President) and on the other hand by the direct personal testimonies offered by some guests (entrepreneurs, researchers, officials of institutions).

The newspaper "Il Sole 24 Ore" writes: *"The companies support offered by StudioCentroVeneto is a model for Europe. (Il supporto alle imprese di StudioCentroVeneto è un modello per l'Europa.)"* Toni Brunello adds: *"Our experience in assisting more than 1200 companies in the last 30 years allows us to have a good knowledge of the problem. From this field experience we have created an innovative tool, the Kit.Brunello.System - appreciated by EU and recognized as EU Good Practice - which is available for companies, Business Associations and Institutions and, in particular, for Chambers of Commerce."*

Source: [http://www.studiocentroveneto.com/news- dett\\_eng.php/id\\_cat=99/firm\\_pagina=1?utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=transfbiz](http://www.studiocentroveneto.com/news- dett_eng.php/id_cat=99/firm_pagina=1?utm_source=newsletter&utm_medium=email&utm_campaign=transfbiz)

## RECOGNIZING INNOVATIVE SMEs IN MALAYSIA

17 November 2011 | Kuala Lumpur, Malaysia

The Government of Malaysia, recently named the 21st-most competitive nation in the world, announced at a ceremony several programs to support innovation and technological growth in SMEs.



*Note: This article was originally published by Business Times14 November 2011*

*(see [http://www.btimes.com.my/Current\\_News/BTIMES/articles/sme2012/Article/](http://www.btimes.com.my/Current_News/BTIMES/articles/sme2012/Article/)) and by <http://www.idisc.net/en/Article.39204.html>*

For a country that has jumped three spots to the 21st most competitive nation in the world this year, there is a lot of catching up to do by Malaysia in innovation area.

According to the analysis of 162 cities and countries by Australia-based innovation agency 2thinknow, Kuala Lumpur is ranked 13th in terms of innovation among other Asian cities. Countrywise, Malaysia ranks 67th.

This reflects the innovation and technological adoption among local small and medium enterprises.

That is why SME Corp Malaysia, the government agency entrusted with the development of SMEs in the country, has implemented various initiatives to promote innovation among the SMEs.

These include SME Innovation Award and 1-Innovation Certification for Enterprise Rating & Transformation (1-InnoCERT) programme.

For this year's SME Innovation Award, SME Corp will offer a total cash prize of RM2 million to SMEs that has the best innovation.

Winners in each of the six categories that will receive RM200,000 each, while the Top Most Innovative SME will be awarded a RM1 million cash prize.

The categories include the Best Innovation Award in Manufacturing, Services, ICT & Software Development, Engineering & Industrial Design, Biotechnology & Agro Technology, and Green Technology.

SMEs certified with 1-InnoCERT are encouraged to participate.

SME Corp Chairman *Datuk Dr Mohamed Al Amin Abdul Majid* said the award would enable the transformation of the economy and private sector-led growth, including encouraging the development of high-growth SMEs. The award, he said, will not only boost the visibility of innovative companies, but also encourage other SMEs to emulate these innovators and look beyond short-term challenges in charting their high growth strategies.

SME Corp will organise awareness workshops to guide interested SMEs on the application process. The workshops will be held from 10 November 2011 to 15 January 2012.

The annual award will be presented during the SME Innovation Showcase 2012, which will be launched in June 2012. The event is organised by SME Corp in collaboration with SIRIM Bhd and the Association of Banks in Malaysia (ABM).

## INSTITUTIONAL PROFILE



### INTERNATIONAL COUNCIL FOR SMALL BUSINESS - ICSB

Founded in 1955, the International Council for Small Business (ICSB) is the first international membership organization to promote the growth and development of small businesses worldwide. The organization brings together educators, researchers, policy makers and practitioners from around the world.

Global Knowledge.

ICSB promotes the development of knowledge in all areas of business theory and practice and is particularly focused on strategies and policies proven to be effective in sustaining small businesses and entrepreneurship.

Global Knowledge is communicated through a variety of mediums including conferences, journals, books, bulletins, and an interactive website. ICSB's annual international conference allows members to share their expertise on the latest business developments and to receive constructive feedback from those researching similar topics. The Journal of Small Business Management is a highly respected forum for the exchange of ideas and practices within the small business and entrepreneurship communities. The ICSB web site provides access to searchable databases that cover a wide range of information related to the international business community.

Global Networks.

ICSB currently has 11 country-based or regional affiliates with members from over 70 countries. Membership consists of professionals from four primary groups: educators, business practitioners, government policy makers, and researchers and consultants. The ability to interact and connect with one another through ICSB provides member groups an opportunity to enrich and expand their contributions to the global business community. Combining the theoretical and conceptual skills of the research and university communities with the practical knowledge and real world expertise of business managers and policy makers allows for a higher level of understanding among all participants.

Source: <http://www.linkedin.com/groups?about=&gid=2223491&trk=eml-groups-join-0-GYML&ut=3TukgXx9os8R41>



## CALLS □ EVENTS □ NEWS



Istanbul/Turkey  
23-24 February 2012

### infoDev Global Business Incubator Management Training

#### In short

- Two days in-depth training for incubation professionals as well as incubation program planners and managers;
- Delivered by a group of incubation experts / trainers from all continents;
- First-hand incubation practice drawing from the experience, examples, and lessons learnt from the *infoDev* global incubator network (more than 400 business incubators in more than 100 countries worldwide);
- Interactive participant-centred training method (PCT) for maximized exchange of experience and practice;
- *Participants receive an infoDev training certificate;*
- Istanbul/Turkey, 23-24 February 2012;
- Based on financial support from *infoDev* the fee is only USD 550;
- Number of participants is limited to secure intensive training – early registration is recommended!

#### Objective and participants

High quality leadership is a key factor determining the probability of success for a business incubator. World Bank's *infoDev* has developed an in-depth business incubation training program, drawing from the lessons, good practice, and different business models from around 400 business incubators coming from more than 100 countries worldwide. The training program consists of 12 modules (one day each) covering all areas from planning and managing an incubator to specialized topics like virtual incubation and technology commercialization.

Participants of the training include business incubation and business start-up support professionals, business incubation program planners and managers as well as individuals and organizations that currently prepare for starting business incubation programs. Participants will gain high quality incubation management skills in key areas of successful incubation leadership. The training will offer a minimum of four of the 12 *infoDev* training modules. The selection of topics will reflect the wishes of the participants.

#### Methodology

Led by a group of international incubation professionals and trainers, participants will be engaged into active participation and exchange. Introductions to global good practices and examples of business incubation will be delivered through a state-of-the-art participant-centred training (PCT) method. Working in small groups of participants will optimize the learning effect.

## Participation fees and registration

- Participation fee for the two days training (two training modules) including training materials, welcome dinner and catering during the training (not including travel and hotel in Istanbul) is **USD 550,00 (USD 275,00 per module and day)** incl. taxes per participant. For registration details, please see below Registration.
- The number of participants is limited. Please, now indicate your interest to participate! With confirmation of participation we will inform about the modules offered.

## Agenda

Wednesday, 22 February	Arrival Registration and networking dinner (7pm)
Thursday, 23 February	Full day training <i>Please find more details on the training modules in the attached document infoDev training program overview 12.2011.pdf</i>
Friday, 24 February	Full day training Celebratory dinner with certificates of participation
Saturday, 25 February	Departure

## Registration

We kindly request you to register for your participation in the training by completing and returning to us the questionnaire below as soon as possible. Following your registration, you will receive confirmation and further information on the training logistics as well as the official invitation, payment details and further information for your preparation.

Name:

Organization:

Position:

Contact details:

Our organization is interested to participate with            participant(s).

We require further information. Please get in touch with us.

We book participation for the following modules (Please find more details on the training modules in the document *infoDev training program overview 12.2011.pdf*).

For participation please contact [todor.yalamov@online.bg](mailto:todor.yalamov@online.bg)

*(Mr. Todor Yalamov, coordinator of infoDev's ECABit Eastern European and Central Asian Incubators Network – Registration and Contact Point for **all** participants)*

For further information please visit the following site: <http://www.infodev.org/en/Article.780>.

## DOCTORAL COURSE IN ENTREPRENEURSHIP EDUCATION



In collaboration with NordForsk and European Council for Small Business and Entrepreneurship, Aarhus University is pleased to invite you to a Doctoral Course in Entrepreneurship Education on April 16-21 2012 at **Aarhus University**.



This course focuses on introducing participants to state-of-the-art research in entrepreneurship education with particular focus on developing their own research agendas.

The six-day course targets both PhD students and junior faculty who are undertaking research in entrepreneurship education. For most of these participants the area of entrepreneurship education contains a multidisciplinary element, either because they have their background in entrepreneurship and have to extend their knowledge in the area of learning and pedagogy, or because they come from education and pedagogy, and have to improve their competencies in entrepreneurship research in order to deliver entrepreneurship courses.

The six days will include the following themes:

- (i) A historical overview of the development of entrepreneurship education research;
- (ii) The central phenomenon of entrepreneurship and genesis of opportunities
- (iii) Entrepreneurial didactics research;
- (iv) Transformation processes, entrepreneurial pedagogy and learning research;
- (v) Constructing an entrepreneurial context;
- (vi) The research-to-teaching-to-research cycle.

The course will contain both pre-course work in the form of reading selected articles; the post-course work will be the production of a paper on own research in collaboration with a senior faculty.

With participating research faculty representing both USA and Europe, the students will be introduced to state-of-art research in entrepreneurship education.

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### Fee

For students from the Nordic countries the course is free of charge (including room and board).

For students from the rest of Europe and the Baltics the course costs DKK 7,500 (including room and board).

For more information please contact: Professor Helle Neergaard at [hen@asb.dk](mailto:hen@asb.dk)  
For application please contact: Ms. Julia Rolsted Stacey at [stacey@asb.dk](mailto:stacey@asb.dk)

file: <http://badm.au.dk/uddannelse/doctoral-course-in-entrepreneurship-education/>



## **SPIRITUALITY AND SUSTAINABILITY**

Annual Conference of the European SPES Forum

September 21-23, 2012, Visegrad, Hungary

The *Business Ethics Center of the Corvinus University of Budapest* (<http://ethics.uni-corvinus.hu>) and the *ERENET - Entrepreneurship Research and Education Network of Central European Universities* (<http://www.erenet.org>) organizes the 2012 Annual Conference of the *European SPES Forum* (<http://www.eurospes.be>) in September 21-23, 2012 in Visegrad, Hungary. The collaborative partner is the *Business Ethics Society*, Budapest.

The aims of the conference are (1) Disclosing the spiritual dimension in business ethics and sustainability management, and (2) Introducing/strengthening the European SPES Forum in Central and Eastern Europe.

### **The European SPES Forum**

The mission of the European SPES Forum is to open up spirituality as a vital source in social and economic life. The keyword of SPES is an acronym for ‘SPirituality in Economics and Society’, but it is also the Latin word for Hope, the virtue that sustains our belief in a better future. The European SPES Forum has a focus on experience-based spirituality that succeeds in making a connection between day-to-day activities and the inner, pluriform quest for meaning.

### **Issues to be Addressed**

- What are the spiritual orientations to nature in different cultural traditions (Christianity, Buddhism, Judaism, Hinduism etc.)?
- How can spirituality and ecology contribute to transforming contemporary management theory and praxis?
- How art can influence the commitment of people and organizations to sustainability and nature?
- Which are the promising sustainability business models in Europe and other parts of the world?
- Which new leadership roles emerge for sustainability in business?
- How entrepreneurship can be inspired by nature and spirituality in a meaningful way?

### **Place and Date**

The “Spirituality and Sustainability” Conference will be held at the venue of the *Visegrad Conference Hotel*, in the historical town of Visegrad, 40 km from Budapest, Hungary. The conference will start on September 21, 2012 and will end on September 23, 2012 (from Friday afternoon to Sunday noon).

**Keynote speakers**

*Paul Shrivastava*, David O'Brien Distinguished Professor of Sustainable Enterprise, and Director, David O'Brien Center for Sustainable Enterprise, John Molson School of Business, Concordia University, Montreal, Canada

*János Vargha*, Alternative Nobel Prize winner environmentalist, Founder of the Danube Circle, Budapest, Hungary

**Scientific Committee**

Members of the Scientific Committee of the Conference include:

*Luk Bouckaert*, Professor Emeritus, Catholic University of Leuven, and President of the European SPEES Forum

*Zsolt Boda*, Deputy Director, Institute of Political Science, Hungarian Academy of Sciences

*Paul Shrivastava*, Professor and Director, David O'Brien Center for Sustainable Enterprise, John Molson School of Business, Concordia University, Montreal, Canada

*Antal Szabó*, Scientific Director of ERENET - Entrepreneurship Research and Education Network of Central European Universities

*Laszlo Zsolnai*, Professor and Director, Business Ethics Center, Corvinus University of Budapest

**Publication**

Selected papers presented in the conference will be published in a volume edited for the “*Ethical Prospects*” book series of Springer.

**Participation Fee of the SPES Annual Conference**

200 Euros for regular participants

150 Euros for participants from Central and Eastern Europe

100 Euros for students and accompanying persons

**Submissions**

Interested participants should send a *detailed abstract* of their planned presentation (about 500 words) accompanied by a *short biographical note* (100 words) electronically by *February 28, 2012* to:

Laszlo Zsolnai, Professor and Director  
Business Ethics Center  
Corvinus University of Budapest  
H- 1824 Budapest, P.O. Box 489, Hungary  
Phone/Fax: 36-1 482 5844  
E-mail: [laszlo\\_zsolnai@interware.hu](mailto:laszlo_zsolnai@interware.hu)

Conference organizers are interested in receiving proposals for *academic papers* as well as *practice oriented* submissions.

*Full papers* should be submitted by *July 31, 2012*.

### About the history of Visegrád

Hungarian King Bela IV built the current fortress system in the 1250s. King Charles Robert located his royal court in Visegrád in 1323. The famous *Royal Summit of Kings* took place here in the autumn of 1335 (the location of the summit for the four Central-European kings). His descendant, Louis the Great was welcoming the delegation of the Polish Orders, who offered him the Polish crown. The current plan of the palace was established in the reign of King Sigismund. The next days of glory for Visegrád came under the reign of King Matthias, who erected magnificent buildings in the fortress and renovated the palace of King Sigismund and was residing in Visegrád until 1408.

Visegrád and its sister town, Nagymaros - located on the other side of the Danube - became symbol of the environmental fight in the late 20th century in Hungary. The so-called *Bős-Nagymaros Dam project* aimed at constructing a huge, artificial system consisting of a canal and two dams for electricity production in the region. It was not only highly destructive in environmental and cultural sense but also economically irrational because it required about USD 3 billion for the completion, but this investment would never recovered through the benefit of electricity production. The Danube Circle led by Alternative Nobel-Prize winner and environmentalist *Janos Varga* was able to stop the project in 1998. Today there is no damaging, artificial construction exists on the site of Visegrád and Nagymaros.



Further information on Visegrad can be gained by visiting the website of the city:  
**<http://www.visegrad.hu/en>**

## PUBLICATIONS - NEWS - BOOKS

### Main conclusions European Commission study « BUSINESS DYNAMICS: START-UPS, BUSINESS TRANSFERS AND BANKRUPTCY » from file: <http://www.transeo-association.eu/index.php?page=newsletter-members-edition02#2>

The European Commission conducted this study to analyze the economic impact of legal and administrative procedures for licensing, business transfers and bankruptcy on entrepreneurship in Europe. The study encompasses the 27 EU member states plus Croatia, Turkey, Iceland, Norway, Serbia and Montenegro. For the business transfer focus area, the study analyses to what extent the recommendations included in the 1994 Commission Recommendation to improve transfers of business have been implemented and which are the main obstacles still remaining to successful business transfers.

1. Approximately 450.000 firms with 2 million employees are being transferred each year across Europe. The study estimated that every year, there is a risk of losing approximately 150.000 firms and 600.000 jobs due to inefficiencies in the business transfers system.

2. The smallest businesses are the most vulnerable to failed transfers. Other factors of vulnerability are the legal status of a company (sole proprietorships are the most vulnerable) as well as its age (companies less than three years old are very vulnerable).

Following the Transeo « deal-breakers » study, we thought it might be interesting to underline the factors that make SMEs more vulnerable to transfer failures, identified in the Business Dynamics study :

- **Firm size** : micro firms highly exposed to transfer failure – medium-sized firms not vulnerable in case of transfer

- **Industrial sector** : not a great impact - Construction, Hotel & Restaurants and Trade are the most vulnerable sectors to transfer failures

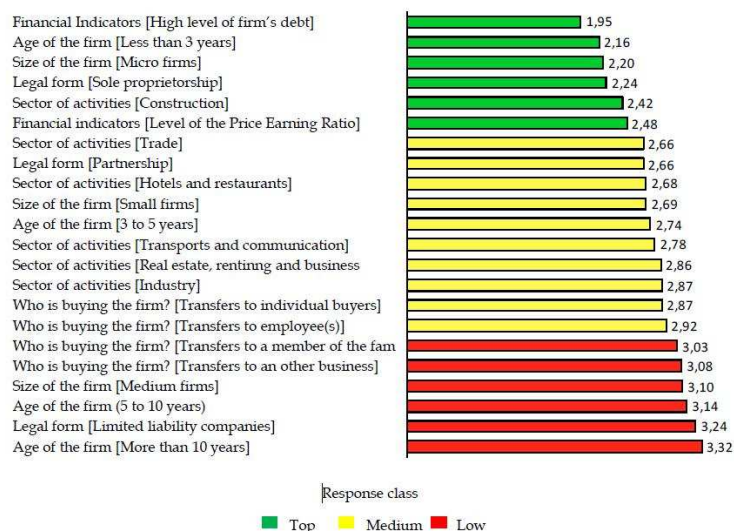
- **Financial indicators** : profitability vs. price is not a problem – debt vs. equity has a significant role – transfer price considered as high if more than 10 times average annual profitability – debt considered as high if more than two times the equity

- **Legal status** : legal status has an important impact – sole proprietorship firms are more vulnerable

- **Age of firm** : companies less than three years old are very vulnerable in case of transfer to third parties/ family members

- **Type of buyers** : no real impact on vulnerability - Transfers to another business or to members of the family rather than to employees or individual buyers are slightly more favourable.

Figure 4-48: Factors that make SMEs more vulnerable to transfer failure



Source: Business Dynamics Survey 2010

As you can see in the graph, the top factors making SMEs more vulnerable to transfer failure are the financial indicators (high level of firm's debt), the age of the firm (less than 3 years), the size of the firm (micro-firms) and the legal form (sole proprietorship).

*To draw a parallel with the Transeo « deal-breakers study » (analyzing the main obstacles in business transfers in the countries members of the association), the **main deal-breakers** that were identified by were the following:*

*- **Disagreement on price** between the acquirer and the seller is undeniably the ultimate deal breaking factor. However, price rather than the cause of divergent perceptions, reflecting risk, surroundings and*

*All the deal breakers identified beforehand have been considered significant by the interviewed experts. of the deal breakers observed are common to the scrutinised markets, only their intensity may vary in case.*

*- However their average intensity varies. Across the twelve countries under study, the **role of the banks**(restricting loans provided to the acquirers), the **complex regulations** (diminishing the market attractiveness) and the **culture of secrecy** spread amongst most of the small enterprise owners perceived as being the most important obstacles to deal making.*

*The full deal-breakers study is exclusively available to Transeo Members but you have access to the **Executive Summary** at*

*<http://www.transeo-association.eu/uploads/Newsletter/Transeo%202011%20Deal-breakers%20study%20-%20EXECUTIVE%20SUMMARY.pdf>*

Other conclusions of the Business Dynamics study include :

3. A transfer-friendly regulatory framework is under development in some European countries, yet awareness of the entrepreneurial community and stakeholders (professional associations, legal firms and consultants to entrepreneurs) is still low.
4. Systematic monitoring of business transfers activity is lacking.
5. The lack of reliable descriptive (what has already happened) and predictive (what is anticipated to happen) data on business transfers results in a lack of support for governments to produce and implement specific policies to facilitate business transfers.
6. Support is needed for business transfers and creation of awareness.



## SMALL COMPANIES CREATE 85% OF NEW JOBS IN EU

*Source:*

[http://ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item\\_id=5708&lang=en&tpa\\_id=0& displayType=news&nl\\_id=1014](http://ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item_id=5708&lang=en&tpa_id=0&displayType=news&nl_id=1014)

**Date: 16/01/2012**

**85% of net new jobs (1) in the EU between 2002 and 2010 were created by small and medium sized enterprises (SMEs). This figure is considerably higher than the 67%-share of SMEs in total employment.**

**During this period, net employment in the EU's business economy rose substantially, by an average of 1.1 million new jobs each year.**

These are the main results of a study on the essential contribution of SMEs on job creation presented by the European Commission today.

With 1% annually, the employment growth for SMEs was higher than for large enterprises with 0.5%. A clear exception is the trade sector, in which employment in SMEs increased by 0.7% annually, compared to 2.2% in large enterprises. This is due to the strong increase of large trade enterprises, in particular in sales, maintenance and repair of motor vehicles.

Within the SME size-class, micro firms (less than 10 employees) are responsible with 58% for the highest proportion of total net employment growth in the business economy. Secondly new firms (younger than five years) are responsible for an overwhelming majority of the new jobs. New enterprises operating in business services create more than a quarter (27%) of the new jobs, while the new firms in transport and communication contribute least (6%).

Commission Vice-President *Antonio Tajani*, responsible for Entrepreneurship and Industry said: *"In this critical time for European economy, we see small enterprises delivering and confirming their role as main generators of new jobs. Their significant share in job creation highlights the greater than ever economic relevance of SMEs and the need to support them at all levels. The small and new enterprises are clearly the key for restoring economic growth"*.

More information can be found on the webpage of the SME Performance Review at the site:

[http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/index_en.htm)

### **Main effects of the crisis: smaller enterprises report negative impacts more often**

According to the results of the survey, the economic crisis has left its mark on enterprises from all size-classes, with micro firms being particularly vulnerable. As a result of the 2009/2010 economic crisis the number of jobs in the SME-sector has on average decreased by 2.4% annually, as against 0.95% annually in the large enterprises sector. Employment developments are still negative in 2010, but expectations for 2011 were improving at the time the survey was held. The share of firms that expected to lay off employees in 2011 was smaller than the share of firms that actually laid off employees in 2010.

Besides the employment effects, by far the most important negative effect of the crisis on firms is the overall decline of total demand for their products and services (mentioned by 62% of companies), followed by the increase in customer payment terms (mentioned by 48% of firms) and finally the shortage of working capital, which affected 31% of the respondents.

### **Innovativeness is a weapon against the crisis**

Innovation seems to have a positive effect: innovative enterprises, as well as enterprises from more innovative countries, more often report employment growth and have higher employment growth rates.

The survey underlines that innovative SMEs or companies operating in more innovative

economies suffered less from the economic crisis. For example, while the decline in overall demand is mentioned by 70% of enterprises in countries that are considered modest innovators (2), the corresponding figure is 45% for countries which are innovation leaders.

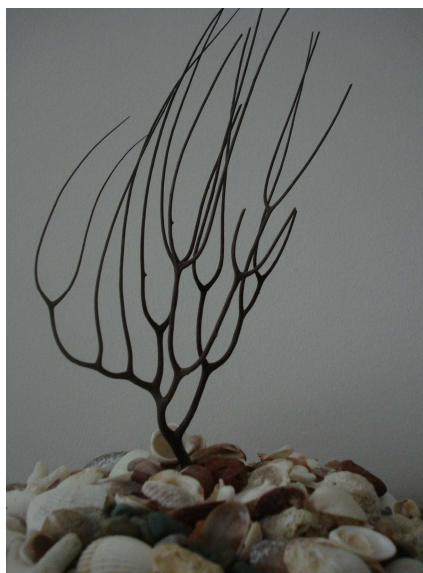
### **Job quality in SMEs**

The study distinguishes two broad dimensions of the job quality: employment quality and work quality. On average it is true that jobs in small enterprises are less productive, less remunerated, and less unionised than jobs in large enterprises. However, microenterprises report that they have a competitive advantage over their competitors as far as 'soft' aspects of the human resource aspects of an enterprise are concerned: working climate, work-life balance, working-time arrangements.

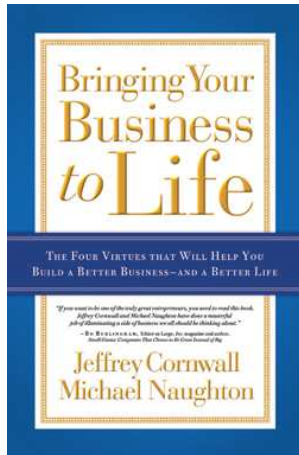
### **Background**

The study is part of the SME Performance Review project and based on a survey of enterprises conducted at the end of 2010 and covering the 27 EU member states and 10 other countries participating in the Entrepreneurship and Innovation Programme, namely Albania, Croatia, the Former Yugoslav Republic of Macedonia, Iceland, Israel, Liechtenstein, Montenegro, Norway, Serbia, and Turkey.

**See MEMO 12/11 as of 16 January 2012 on "Do SMEs create more jobs?" at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/11&format=HTML&aged=0&language=EN&guiLanguage=en>**



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## BRINGING YOUR BUSINESS TO LIFE

The Four Virtues that Will Help You Build a Better Business—and a Better Life  
by

**Jeffrey Cornwall and Michael Naughton**

Published by REGAL from Gospel Right, Ventura, California, US, 2008

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**Summary:** *Bringing Your Business to Life* examines the four cardinal virtues necessary for doing well and being good within the complexities of business. The authors draw from their vast combined experiences and from the rich and profound virtue tradition of doing business. The authors demonstrate how the four main virtues could connect entrepreneurs with their faith and relationship with their business:

1. **PRUDENCE:** using effective means to good ends, in the right circumstances;
2. **JUSTICE:** creating right relationships though distribution of the resources of the enterprise,
3. **COURAGE:** knowing when to take risks and endure adversity to achieve good ends; and
4. **TEMPERANCE:** understanding when enough is enough - when love for work has become and addition that disorders other important aspects of life.

Practical and inspiring, this unique blend of real cases and practical insights provides a vision of business that is both faithful and doable.

**About the Authors:** **Jeffrey Cornwall and Michael Naughton** are national award-winning teachers of a popular course on faith and entrepreneurship, authors of a number of books and articles and consultants to educators and businesses worldwide.

Prof. Dr. Jeffry Cornwall

**Dr. Jeffry Cornwall** is the inaugural recipient of the Jack C. Massey Chair in Entrepreneurship at Belmont University in Nashville, Tennessee. He has held several faculty positions and was co-founder and President/CEO of a fast-growing corporation before returning to academics. Dr. Cornwall consults with a variety of businesses, is the author of four books and has a top-rated blog, *The Entrepreneurial Mind*. Jeff is Member of the ERENET. For further information please contact his web-site at

[http://www.belmont.edu/business/faculty/cornwall\\_dr\\_jeff.html](http://www.belmont.edu/business/faculty/cornwall_dr_jeff.html)



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**Michael Naughton** holds the Moss Endowed Chair in Catholic Social Thought at the University of St. Thomas, Minnesota. He is the director of the John A. Ryan Institute for Catholic Social Thought and he is the author and editor of several books and dozens of articles. For further information please visit at

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The book "Bringing your business to life" was translated in Hungarian by *Péter Osvay* and was presented on 30 November 2011 at the Sapientia College of Theology of Religious Orders. The Press release in Hungarian published at the web-site of the Magyar Kurír Katolikus Hírportál (Hungarian Courier Catholic Newsportal). See the site <http://www.magyarurir.hu/node/37509>.

**Opening address was delivered by *Tamás Szabó***, President of the Hungarian Radio Maria. The Radio Maria is a special media. It is not profit oriented. Its aim is to prepare broadcasting assisting in life style of the people. The radio is run by 700 volunteers under the guidance of only 7 professionals. The Radio Maria deals with the social teaching of the church including economic questions as well. Four years ago it has been launched a programme management as if faith mattered. At the end of 2009 a Conference on "What worth is the catholic social teaching in area of crises?" was held at the Sapientia College with participation of *Sr. Helen Alford OP* and *Professor Stefano Zamagni*.



Mr. Tamás Szabó

**The Hungarian Radio Maria** wish to disseminate models which it finds as valuable. The model presented in the book "Bringing your business to life" belongs to this. In the world we need new paradigm. The current situation seems to be very vulnerable. We have to change the current economic thinking of the society and we believe that your book will facilitate the necessity changes.



**Mr. Roland Szilas**, Teacher at the Sapientia College of Theology of Religious Orders presented his appreciations of the book. Roland teaches at the special course on "Christian social principles in economy" which is a special postgraduate course for four semesters. This course provides an integrated economic teaching with christian approach for those graduates who already obtained economic background. Entrance criteria for this course is a graduate with BA and BSc degree. Roland introduces both of you and your activities. He added that both of you already visited Hungary and the Sapientia College highly appreciate your works.

Roland Szilas

*Sources:*

<http://www.iajbs.org/resources/264.pdf>

<http://www.amazon.com/Bringing-Your-Business-Life-Virtues/dp/0830745939>

*Photos:*

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