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“AFTER FIFTEEN YEARS OF MARKET REFORMS IN TRANSITION ECONOMIES: NEW CHALLENGES AND PERSPECTIVES FOR THE INDUSTRIAL SECTOR”

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DEVELOPMENT OF ENTREPRENEURSHIP AND SME SECTOR IN THE REPUBLIC OF ARMENIA

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GENERAL INFORMATION ABOUT THE COUNTRY

**Territory** - 29.800 km²
**Population** - 3.1 million, 98% of which are Armenians
**Capital** - Yerevan
**State Form** - Republic
**Head of State** - President of the Republic
**Highest Legislative Body** - National Assembly
**Highest Executive Body** - Prime Minister’s Cabinet
**Administrative Division** - 11 Regions (Marzes) including Yerevan with status of Marz
ECONOMIC POLICY OF THE COUNTRY

For the last several years the Republic of Armenia has turned to a new (qualitative) phase of development for its economy. In this concern it was overcome the majority of difficulties typical for countries with transition economy. As a result of economic reforms being conducted more than 10 years, it was created the basis for stable economic growth (economic progress) in Armenia targeted at improvement of social-economic conditions of Armenian population.

During the last three years the macroeconomic policy of Armenia was targeted at provision of high economic growth as well as at stabilization of prices, development of private sector, creation of convenient competitive and investment environment that provides equal conditions for Armenian economic units.

Current government social economic policies of the country aim at accelerating structural reforms and keeping the economies on a sustainable growth path while improving social security provision. Appropriate development strategies to create employment and eliminate poverty have been adopted as well.

In particular, in transition to market economy the key achievements of the Armenian Government can be considered:

- During the 2000-2004 it was provided real economic growth on average level of 10.5%;
- During the last several years the state budget deficit was decreased to 2.6% of GDP;
- About 80% of GDP is provided by the private sector of the country’s economy;
- It was improved the foreign trade balance. The imported products/services are gradually substituted with similar domestic products/services;
- The capacity of exported products/services was increased. The export promotion of Armenian products/services was supported by the official membership of Armenia to World Trade Organization (WTO) in February 2003;
- The tax and customs administration was improved and tax and customs policies were targeted on stabilization of tax and customs systems in the country;
- During the last several years it was decreased the unemployment rate up to 9.4% (average);
- The Armenian Government carried out systematic measures for poverty alleviation in Armenia and improvement of social welfare of the country’s population.

THE SME SECTOR IN THE COUNTRY

Considering the important role that small and medium entrepreneurship (SME) plays in facilitating the country’s economic growth, creating new jobs, improving living standards, building a middle class within society and in ensuring social and political stability inside the country, the Government of the Republic of Armenia considers it as a priority for development of the country’s economy and undertakes continual steps towards strengthening the sector and improving SME state support as well.

Particularly positive changes in economic policy of the country, which have been recorded for the last several years, could serve an evidence for existence of targeted state policy on creation of enabling environment for SME performance.

Due to the implemented measures SME sector in Armenia became a dynamically developing direction for the last few years.

- The number of SMEs increases year by year thus creating many new jobs: during the last three years about 20.000 SMEs were established, and only in 2004 - about 8.000 new SMEs, providing over 20.000 new work places/
- Besides the sector plays significant role in the formation of the gross domestic product (GDP) of the country: according to the data of 2004 the participation of SME sector in GDP made 39 percent, almost twice exceeding the level of 2000.

At present, the corresponding legal framework is already in effect, which is required for undertaking entrepreneurial activity in any country in transition.

**The Government policy (concept) and strategy for SME support is fixed in policy/strategy materials, which are as follows:**

- “Concept for SME Development Policy and Strategy in Armenia” (adopted by the Armenian Government in August 2000)
- SME State Support Annual Programs (submitted to the Armenian Government according to schedule of submitting policy documents and other strategic materials).

The basis of the above-mentioned policy is considered the “Concept for SME Development Policy and Strategy in Armenia” which has stipulated economic, social and political objectives of SME development policy in Armenia and the main directions for their realization. The adoption of this document was a precondition for drafting the Law of the Republic of Armenia on “State Support of SME”. The adoption of the Law solved two basic problems: it defined: the criteria for SME definition in Armenia and the main directions and the mechanism for SME state support.

According to the Law on "State Support of Small and Medium Entrepreneurship" the SMEs in the Republic of Armenia are classified as follows:

(i) Commercial organizations and individual entrepreneurs with average number of employees not more than 5 persons are considered as micro company.

(ii) Commercial organizations and individual entrepreneurs with average number of employees are considered as small company that meets the following criteria:

- Industry and other productive spheres – not more than 50 employees;
- Construction and power engineering sphere – not more than 25 employees;
- Science and education sphere – not more than 25 employees;
- Transport, trade and services sphere – not more than 15 employees.

(iii) Commercial organizations and individual entrepreneurs with average number of employees are considered as medium company that meets the following criteria:

- Industry and other productive spheres – not more than 100 employees;
- Construction and power engineering sphere – not more than 50 employees;
- Science and education sphere – not more than 50 employees;
- Transport, trade and services sphere – not more than 30 employees.

The concern of companies to SMEs running their activity simultaneously in different spheres is determined by criteria of prevailing sphere of activity. The average number of employees for SMEs is determined under the order stipulated by legislation the country.

Financial/other criteria (like assets/charter capital or turnover) for classifying the SMEs currently is not applicable in the country as it may cause serious difficulties (problems) while estimating the financial-economic indicators for the activity of SMEs.

According to the Law on “State Support of SME” the main directions for SME state support are as follows:

- Formation of favourable legal environment;
- Financial and investment support and provision of loan guarantees;
- Assistance for creation and development of support infrastructures;
- Business information and consultancy support;
- Promotion of foreign economic activities;
- Support for application of innovations and modern technologies;
- Performance of favourable tax policy;
- Vocational education and training;
- Creation of simplified systems for statistic reports and accountancy;
- Support for procedure for performance of state purchasing.

Besides, it were adopted some other laws, governmental decrees and other legal acts in concern to SME sector in Armenia, particularly: the Laws on “Trade and Services, “Electronic Document and Electronic Signature”, “Conformity Assessment”, and amendments were done in the Laws on “Cash-desk Operations”, “Protection of Economic Competition”, “Protection of Domestic Market”, “Simplified Taxation”. In addition, it was elaborated strategic documents in concern to SME sector in Armenia: “Regional Economic Development Strategy of Armenia”, “Concept for Handicraft Development of Armenia”, “Food Security Policy of Armenia”, “Poverty Alleviation Strategic Program of Armenia”.

According to requirements of the Law on "State Support of SME" the Ministry of Trade and Economic Development on behalf of the Armenian Government since 2001 has elaborated SME State Support Annual Programs. These programs contain a number of measures towards financial (provision of loan guarantees to SMEs) and technical (information, advisory, training support, as well as assistance for application of ISO 9000 quality control standards into SMEs, assistance to Start-ups etc.) support.

In the scope of SME State Support Annual Programs the objectives of Armenian Government policy/strategy for support of SMEs are as follows:

- Formation of favourable legal environment
- Financial and investment support and provision of guarantees
- Assistance for creation and development of support infrastructures
- Business information and consultancy support
- Promotion of foreign economic activities
- Support for application of innovations and modern technologies
- Performance of favourable tax policy
- Vocational education and training
- Creation of simplified systems for statistic reports and accountancy
- Support for procedure for performance of state purchasing.

Within the framework of SME state support program for 2002, as a program measure, the Fund “Small and Medium Entrepreneurship Development National Centre of Armenia” (SME DNC of Armenia) was established under the Government Decree (N 282), with the responsibility (authorization) to implement SME state support annual programs in Armenia.

The SME DNC of Armenia is a non-commercial organization with a legal status of a Fund. It is governed by the Executive Director and the Board of Trustees composed from representatives of governmental organizations and business community as well. Aimed at assistance to social-economic and political development of the country the mission of SME DNC of Armenia is to support development of SME sector in Armenia; representing and advocating the interests of SMEs by serving as a liaison between the Armenian Government and business community.

It is funded from state budget within the scope of implementation of SME state support annual programs. Besides, the SME DNC of Armenia is also funded from other domestic and international sources. It implements some projects/measures in scope of cooperation with foreign/international organizations on co-financing basis.
For the several years of its activity the SME DNC of Armenia has already recorded essential achievements. The SME DNC regional subsidiaries have already been established in the 6 regions of the country, the performance of which is targeted at implementation of SME development regional and community programs having into consideration regional development priorities, specific features of single areas and the available capacity. In 2005 it is envisaged to finalize the process of creating a network of regional offices of SME DNC of Armenia.

At present the SME DNC of Armenia in scope of its mission provides technical and financial support to SMEs.

The technical support to SMEs includes the following directions:

- Provision of business information to SMEs;
- Provision of business consultation to SMEs;
- Vocational education and training support for SMEs;
- Support for application of quality control standards/systems (ISO 9,000 series) in SMEs;
- Support for application of innovations and modern technologies in SMEs;
- Support for foreign economic activities (export promotion) of SMEs;
- Other technical support to SMEs (publication of business manuals, booklets, reference books, support for design and creation of Web sites/pages for SMEs, support in organizing meetings, workshops (seminars), conferences (forums) for SMEs, conducting SME sector survey and market research, etc.)

The financial support to SMEs includes the following direction:

- Provision of loan guarantees to SMEs for enhancing their access to financial resources in a way of conducting Loan Guarantee Provision Project for SMEs.

In the framework of SME state support program for 2004 a techno-park was established in the city of Yerevan based on "Andron" scientific-research institute of complex electro-devices. It is worth to mention over 70 percent of SME state support program for 2004 was directed to the raise of economic activity in the regions of the Republic of Armenia.

SME state support program for 2005 is directed to state support and development of SME sector, improvement of business and investment environment, as well as to surmounting the existing problems, which is a significant precondition in the economic growth of the country, in the provision of employment and in the improvement of social state of the society and generally in overcoming poverty.

At present NGOs, professional unions representing the interests of businessmen, as well as entrepreneurs are actively involved in elaboration process of state support programs. In this regard:
- 7 respective public organizations of private sector interests are involved in the SME DNC Board of Trustees;
- The Council for Entrepreneurship Support was established by the Premier-Minister of the Republic of Armenia, where a number of organizations of private sector interest and entrepreneurs are involved;
- The President of the Union for Manufacturers and Businessmen in Armenia is invited to the Government sessions etc.

Along with this the foreign and international organizations are running intensive activity for implementation of programs for financial and technical support in SME sector in Armenia.

For elaboration of SME development policy and programs/projects for development of SME sector in Armenia and enhancement of efficiency for its implementation the Coordination Council for Support of SME in Armenia was formed under the initiative of the Ministry of Trade and Economic Development. The Coordination Council is composed from representatives of governmental organizations in charge of elaboration of SME development policy and programs as well as SME support companies and foreign and international organizations that in scope of their activity conduct
projects/measure towards the development of SME sector in the country (UNDP, UNECE, World Bank, OSCE, German Project “ProSME”, USAID and others). In its turn the Coordination Council created several working groups on different SME related matters, which currently successfully conduct their activities.

Having into consideration the above-mentioned the SME support structure of the country can be conditionally divided into policy and institutional levels.

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<td>Governmental Body</td>
<td>SME Support Main institution</td>
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Despite several positive changes targeted at development and state support of SME sector, there are still obstacles, which refer to SME sector in the country: The main ones are considered as follows:

- Unavailability of financial and credit means for SMEs (lack of mid and long-term loans/financial resources and difficulty in providing collateral, high interest rates for loans, absence of financial/credit opportunities for start-ups);
- Discrepant export opportunities for SMEs conditioned by political situation of the Region, non-correspondence of good/services produced/provided by SMEs to international standards;
- Inadequate competitive conditions;
- Existing inconvenient tax and custom procedures.

The SWOT analysis of SME sector provides a comprehensive overview of the strengths and weaknesses, as well as the main opportunities and threats covering SME sector in Armenia.
STRENGTHS

- Elaboration and implementation of SME development and state policy;
- Elaboration and implementation of SME state support annual programs;
- Establishment of Small and Medium Entrepreneurship Development National Center of Armenia (SME DNC of Armenia) on March 2002 with a mission aimed at provision of state support for SMEs and development of corresponding infrastructures for SMEs;
- Stable macroeconomic growth and positive trends in SME sector;
- Improvement of situation in labor market and solution of number of serious social problems.

WEEKNESSES

- Elaboration and implementation of SME state policy came into force relatively late;
- Low demand in local market;
- Uncertain and unfriendly tax administration;
- Poor access of SMEs to financial resources;
- Lack of alternative financial sources for SMEs;
- Lack of managerial skills of SME leaders.

OPPORTUNITIES

- SMEs provide an opportunity for implementation of modern technologies and innovations with more rapidness and less expenses;
- High potential for business service providers’ (BSPs) market development;
- Operation of SME DNC of Armenia throughout Armenia via its regional subsidiaries;
- Membership of Armenia to World Trade Organization (WTO) enhance the opportunities of SMEs to enter the foreign markets;

THREATS

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


Taking into consideration the above mentioned the Ministry of Trade and Economic Development of the Republic of Armenia presumes on further cooperation with UN Economic Commission for Europe via applying UNECE regional advisory services targeted at elaboration and implementation of new projects for entrepreneurship development, as well as overcoming the mentioned obstacles.

Armenia is in transformation process towards market economy. In this context the assistance of such a honourable organization as UNECE could be a valuable asset in further development of country’s economy and entrepreneurship as well.

It is evident that SME development targeted policy and broader international cooperation will ensure prosperity of the sphere and country’s economy with integration into the world economy.