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Economic Development and Small-Medium-Sized enterprises: A study in the Caucasus region

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DECLARATION OF AUTHORSHIP

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Zásady pro vypracování

The current economic condition of the Caucasus region-Azerbaijan, Armenia, and Georgia is considered transition economies. Considering the fact that SMEs play a crucial role in the region's economic growth since SMEs are the main drivers of employment creation, competition, and innovation. This research will help us to understand the effects of small and medium-sized enterprises (SMEs) in the economic development of Caucasus countries by analyzing existing data sets and reviewing the literature. The expected outcome of this project is to examine the existing effects of SMEs in the economic growth of each country in the Caucasus region.

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Abstract

Along with the importance of micro, small, and medium-sized businesses in developing socio-economic and macroeconomic indicators of a country, the significance of SMEs varies from country to country. This research paper investigates the role of small and medium-sized enterprises in the economic development of various countries, with the main focus on Georgia, Azerbaijan, and Armenia. The economic profile of these three neighbouring countries is different from one another. Azerbaijan is blessed with natural resources. Therefore SME development is not as high as it is in Armenia and Georgia. The main objective of this paper is to identify in which ways SMEs contribute to the economic development of a country. The development of small and medium-sized enterprises and business culture, improving entrepreneurial activities are crucial for future economic development, employment generation, and achieving a higher welfare level of the country's population. In this research, multiple methodologies have been used simultaneously, including description, comparison, and analysis of existing literature and data.

Keywords: economic development, small and medium-sized enterprises, Georgia, Azerbaijan, Armenia

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List of Abbreviations

Abbreviation	Definition
AMD	Armenian Dram
ARMSTAT	Statistical Committee of the Republic of Armenia
AZN	Azerbaijani Manat
CEO	Chief Executive Officer
CIS	Commonwealth of Independent States
COVID-19	Coronavirus Disease 2019
EU	European Union
EUR	Euro
FAO	The Food and Agriculture Organization
FAOSTAT	The Food and Agriculture Organization Corporate Statistical Database
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEL	Georgian Lari
GEOSTAT	National Statistics Office of Georgia
GITA	Georgia's Innovations and Technology Agency
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary and Financial Committee
MSME	Micro, Small and Medium Enterprises
OEC	The Observatory of Economic Complexity
OECD	Organisation for Economic Co-operation and Development
SBA	Small Business Administration
SMB	Small and Midsize Business
SME	Small and Medium Enterprise
SWOT	Strengths, Weaknesses, Opportunities, and Threats
US	United States
USD	United States Dollar
WTO	World Trade Organization

Chapter 1: Introduction

Small and medium-sized enterprises (SMEs) are important actors in a country's economic development. SMEs are the crucial source for employment creation, income generation, and economic development in many countries. SMEs' role in income generation is critical because of the fact that SMEs can be in various sectors and generate income for different layers of society. Moreover, SMEs are an integral part of decreasing income and wealth inequality.

The main focus of this paper is to get answers to the following research questions: What is the role of the SME sector in the economy of Azerbaijan, Georgia, and Armenia? What are the differences in the impact of the SMEs of Azerbaijan, Georgia and Armenia on the country's economy? Finding answers to our research questions will help young entrepreneurs to find a country to pursue entrepreneurial activities. Also, policymakers of a particular country can improve the current situation in their country to achieve a more developed SME sector and advanced economic growth.

Definition of SMEs is crucial to provide support programs and adjust tax rates according to business size. Each country uses different measures to define the category of business. A company can have one employee and still counts as a medium-sized enterprise. In Azerbaijan, the Cabinet of Ministers, in Georgia, the Georgian National Investment Agency and the Ministry of Economy and Sustainable Development, in Armenia, the Ministry of Economy give the definition to micro, small, medium, and large-sized enterprises.

Various development initiatives have been implemented by different countries in order to achieve a healthy level of the SME sector. Researchers such as Bayramov et al. (2017), Szabó and Petrosyan (2007), Toma et al. (2014) provided important insights in their research about the effect of SMEs in economic development. The development of the SME sector could lead to socio-economic and macroeconomic growth in the world. In the developed countries, the role of SMEs can be seen in the country's macroeconomic indicators. In OECD countries, small and medium-sized enterprises are responsible for the creation of more than half of the available jobs.

Sections of this research paper are structured as follows. In the second chapter, the small and medium-sized enterprises and their effect on economic development have been explained. From this part, readers can get an idea of which ways SMEs help countries' economic development in a global context. In the next chapters, the current economic situation of Georgia, Azerbaijan, and Armenia has been analyzed. In the third chapter, readers of the paper will easily get a general idea about Azerbaijan, the economic situation in the country, as well as how SMEs contribute to economic development in Azerbaijan, lastly, the role of government in SME development in Azerbaijan. The following chapter is about the country profile, economic situation, and function of SMEs in the economic development of Georgia. Additionally, readers can find information about the government's role in SME development in this chapter. In the fifth chapter, Armenia's economic situation, the effect of SMEs on economic development will be discussed. In Chapter 6, findings will be cross compared for Azerbaijan, Georgia, and Armenia. In conclusion, in order to increase the impact of SMEs on the economic development of a country, several suggestions have been offered.

Methodology of the research paper

The present Chapter's objective is to explain the steps followed in the present study. The objective of this chapter is to explain to the reader how I proceeded in terms of data collection, literature review, and analysis. The objectives of this research paper led me to follow this method in my research. The study aims to identify the role of SMEs in the economies of targeted countries. As the current research topic is an explanatory research which explores the impact of SMEs and their differences in the target countries, a compilation approach suits better the objectives of this research.

Firstly, the research begins with identifying the role of SMEs in economic development. By reviewing the relevant literature in the global context of the world. The best way to do so, is to review literature and look through the data from various international sources such as the World Bank, IMF, OECD public datasets. While deeply analysing the role of SMEs in the economy of Azerbaijan, Georgia, and Armenia I collect data about microeconomic indicators of the countries. These indicators represent the role of SMEs in the economy. Using the compilation method in this paper would help the author to describe the role of SMEs in employment generation, innovation, GDP, value added.

Literature Review:

The process of reviewing the related literature for this paper would be ongoing throughout the different sections. In order to give a clear picture to the readers of the paper, ongoing literature reviews in each chapter would be beneficial. Therefore, the author decided to use citations from various related articles and papers throughout the research.

Database and descriptors:

The necessary numerical information for this research can be obtained from various sources. However, the author decided to use the public datasets which available on governmental websites, such as for Azerbaijan, State Statistics Committee (stat.gov.az), for Georgia, National Statistics Office of Georgia (geostat.ge), for Armenia, Statistical Committee of Armenia (armstat.am). As well as, the usage of international public databases such as the World Bank datasets, IFM datasets, and OECD datasets, would increase the quality of the research and could help the author to make better comparisons among the countries. Additionally, this part of the research paper will give the concrete answer to the first research question.

Comparison:

Within this research paper the role of SMEs in the economic situation of Azerbaijan, Georgia, and Armenia will be compared. This helps the author and readers of the paper to understand how SMEs contribute to the economy of the country. Additionally, this part of the research paper will give the concrete answer to the second research question.

Context of the study:

The countries in the Caucasus region are Post Soviet countries which have transition economies. It is particularly interesting to learn about their economic conditions as well as understanding their economic diversification through analysing the role of SMEs in Azerbaijan, Georgia, and Armenia. As the mentioned countries have different main sources to generate budget, understanding the SME sector could lead to achieve stronger economic growth. I believe this region is often under researched by other authors in terms of development. Therefore, I decided to concentrate on the Caucasus region.

Chapter 2: The Small and medium-sized enterprises and economic development

The purpose of this chapter of the present research is to give a broader view to the readers about the SMEs in the global context. In this chapter, the different definition of SMEs will be discussed. As well as, the role of SMEs in employment creation and economy will be observed in the global context.

2.1. How do we define small, medium, and large sized enterprises?

Small and medium-sized enterprises are the driving force of the economic activities in many countries in the world. It is hard to put a unique definition on SMEs since their definition varies country to country and sector to sector. For instance, in the European Union business establishments which have less than 250 employees are considered as SMEs (European Commission, 2016). On the other hand in the United States companies with fewer than 500 employees are considered as micro, small or medium-sized enterprises. According to the OECD Glossary of Statistics the definition of the SMEs is “*Small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms which employ fewer than a given number of employees*”. As the definition varies from country to country, therefore, in this paper I am going to use three different definitions in each of the following sections, since the purpose of this paper is to analyze the effect of the small and medium-sized business to the economic development in the Caucasus countries, Azerbaijan, Georgia, and Armenia.

In most cases, while defining SMEs, authorities use two metrics: number of employees and yearly revenue. In the US, the standard threshold limit is set by the U. S. Small Business Administration (SBA) according to the industry to differentiate SMEs from large enterprises. Government and other institutions provide fundings for SMEs. Therefore it is crucial to define them.

According to SBA's *Table of Small Business Size Standards Matched to North American Industry Classification System Codes* (2017), the number of employees and yearly turnover matter while defining the SMEs and providing them with government contracts and funding. For instance, in the agriculture sector establishment, to not be considered an SME, the

establishment's yearly revenue cap must exceed one million dollars. On the other hand, this threshold might increase to 40 million dollars in the construction industry.

In Canada, the definition of SME does not change much by the sectors. Instead, the Government of Canada considers companies that have less than 100 employees as small, between 101-499 employees as medium-sized enterprises.

The definition of SMEs is crucial in a broader perspective, considering the fact that financial institutions, government officials, local authorities, and all other related institutions use various support and assistance mechanisms for small and medium-sized businesses. In many countries tax obligations of the companies change according to their size and yearly turnover. In many cases, in order to encourage entrepreneurship small and medium-sized companies pay less tax. The access to the financial instruments, accessibility of loans are also detrimental by the size of a company.

2.2. Employment and job creation

The contribution of large firms in employment has declined over the years. In the OECD countries, SMEs are responsible for creating 60-70 percent of jobs. However, this domination varies from industry to industry. For instance, in the manufacturing sector, the impact of SMEs is somewhat lower than in the tech sector. It is estimated that SMEs are responsible for 40-80 percent of jobs in the manufacturing sector (OECD, n.d.).

In the last four decades, the role of large enterprises has fallen in job creation especially, in countries like Canada, the US, and the UK. It is considered that small enterprises are the basis of net employment changes. Between the 1980s and 1990s, in all the OECD countries, small companies demonstrated rapid changes in job creation than the larger companies (OECD, n.d.).

Net job creation refers to the measures where a small startup or enterprise is established, and the number of positions, excluding the founders, counts as the net job creation. Researchers Åstebro and Tåg (2017) explain that most startups actually do not create new jobs for others. Rather those startups create employment for the founders of the firm. Therefore, Åstebro and

Tåg (2017) categorize job creation into the following titles: gross (where founders count as employees), net (where founders are excluded as employees).

The main reason behind the argument of why the small businesses account for the more employment than the larger one is the success rates amongst the small businesses is highly volatile. Therefore if the establishment survives from the initial growth stage (from seed enterprises to a big corporation), they tend to expand the business and hire more employees along the way. According to Acharya (2019), startups play a crucial role in job creation in the US. Almost 75 percent of startups fail in their early stages. The critical milestone in startup development is five years' remark since the startups with less than 20 employees in the first five years tend to have an insignificant role in job creation. At the same time, startups with more than 20 employees have positive effects on job creation after five years.

2.3. Innovation in SMEs

British researcher Foreman-Peck (2012) mentions in his article that "Innovation is defined as major changes aimed at enhancing your competitive position, your performance, your know-how or your capabilities for future enhancements. These can be new or significantly improved goods, services or processes for making or providing them". SMEs bring Innovation to the world. There are many innovation types that scholars cover in their research. Product innovation is one of them, which describes when the SME introduces a new product and develops the product in the market. To keep up with the competition in the market, companies often work on their product to shine within the industry. Process innovation is another advantage of SMEs. Since the main idea is to be more productive and efficient, companies often put a considerable focus on their process innovation. Implementation speed, accessible information and decreased costs make this category. When it comes to implementing marketing strategies, SMEs use creative approaches, implementation of sophisticated technologies in our daily lives can be observed in companies' marketing. New techniques increase marketing innovation. The study made by Afriyie et al. (2019) states that small and medium-sized businesses are able to compete and thrive in the business environment with their innovative skills.

The meaning of Innovation is different than it was used in the last centuries. Small and medium-sized enterprises are the cornerstones of innovative approaches because of the fact that ability to foresee new opportunities, commercializing new ideas, using modern technologies

to gain a competitive advantage is what makes the SMEs grow OECD (2010). In fact, small businesses are the key players in making radical innovations in various sectors including, software development, clean technology, nanotechnology, biotechnology. In the article of OECD (2018) *Strengthening SMEs and entrepreneurship for productivity and inclusive growth*, it is mentioned that "SMEs are often an essential channel for the diffusion and adaptation of innovations to different contexts".

2.4. The role of Government in SME development

After the collapse of the Soviet Union, it was important to establish a strong SME sector in Central and Eastern Europe. Manufacturing and single sector domination were the main ideas behind the centrally planned economy in the Soviet Union. Therefore, after gaining independence, countries started to implement their policies in order to diversify the economy and play a role in world trade. The development of the SME sector was not only beneficial in terms of economics but also a huge contributor to social transformation. The SME sector is a major source of employment creation. When the centrally planned economy became a transition economy, some of the state-owned companies collapsed. This led to an increase in the unemployment rate in many countries. Implementing the policies in favour of SMEs were facilitators of job creation and social development.

Smallbone and Welter (2001) explain that one of the significant obstacles in SME development is taxation issues. Governments often use various SME-targeted policies to decrease the tax burdens of small businesses. In the initial phase of the startup, zero tax policies help them to thrive. Governments play a crucial role to put a value on entrepreneurship, as ease policies encourage more people to open up their businesses. Also, defining the status of a business helps the government to regulate the legislation accordingly. In order to have a strong SME sector, financial institutions are crucial. Therefore having strong institutions facilitate the development of SME sectors.

Chapter 3: SMEs in the context of Azerbaijan

3.1. Country profile Azerbaijan

The Republic of Azerbaijan is situated in the southern part of the Great Caucasus Mountains in between Europe and Asia. This Transcaucasian country has five neighboring countries on land. To the north, Azerbaijan has a border with Russia for 390 km. Azerbaijan shares a border with Georgia in the northwest for 471 km. The border with Iran from the south of the country is along the Aras river for 765 km. Azerbaijan has the longest land border with Armenia from the west and south-west of the country for 1007 km. Enclaved part of the country, the Nakhchivan Autonomous Republic shares borders with Turkey for 15 km in length. Azerbaijan is on the west side of the Caspian Sea, the largest body of inland water; the Caspian Sea washes the 2647 km coastline of eastern Azerbaijan.

This former Soviet country in the south Caucasus occupies an 86,600 km² area. The current population of the country is ten mln (The World Bank Database, n.d.). Azerbaijan is an ethnically diverse country; according to the national census in 2009, 8.4 percent of the country's population are minorities. The capital city of Azerbaijan Republic is Baku, the largest city of the country with a 2.3 million population and 2140 square km area (Population Stats, 2021). Baku is also the center of economy and politics. The currency of Azerbaijan is Azerbaijani Manat (short AZN). 1 AZN is equal to 0.59 USD as of May 2021. The main spoken language in the Republic of Azerbaijan is Azerbaijani. But as in all other post-soviet countries, the majority of the population speaks Russian as their first or second language.

3.2. Definition of the SMEs in Azerbaijan

Azerbaijan's economic development is crucially affected by SMEs. In order to create jobs, satisfy consumer needs on domestic products and services, decrease the reliability of exported goods, and sustain economic growth, SMEs play an important role. The country is blessed with a huge amount of natural resources such as oil and gas. The authorities try to eliminate the negative effects of the dutch disease since the revenue from the oil and gas sector depends solely on external factors. Therefore, the government puts effort into improving the non-oil sector in the country. The best way to decrease this dependency is to promote entrepreneurship activities. Considering that the oil and gas sector is capital-intensive, therefore the number of

jobs created in the sector is limited. All in all, in Azerbaijan, an improved SME sector would lead to a number of opportunities for the citizens and for the government.

The definition of SMEs varies from country to country in Azerbaijan. The definition of SMEs was approved in December 2018 by the Cabinet of Ministers of the Republic of Azerbaijan. This government agency uses these definitions (Table 1) in order to support SME development, increase their effects on the economy, participate in the protection of small and medium-sized businesses, and apply grant schemes.

In order to pursue effective development strategies toward companies, the definition of micro, small and medium-sized enterprises is crucial. In Azerbaijan, the Cabinet of Ministers (2018) approved the MSME definition by the number of employees and yearly profit rate. Micro companies employ up to 10 people, including founders, where the yearly profit should not exceed 200000 AZN, which is equal to 117 000 USD as of May 2021. Small companies can employ between 11 and 20 employees and can generate yearly profit between 200 000 - 3 million AZN (117 000 USD-1763870 USD as of May 2021). medium-sized enterprises should have 21-150 employees and three million-30 million AZN yearly profit (1763870 USD-17638700 USD as of May 2021). Larger companies create job opportunities for more than 150 people and generate yearly revenue of more than 30 million AZN. In this classification, the agency used the number of employees and the yearly profit of the establishment as a basis of the categorization. If a business establishment exceeds either of these thresholds, they classify it as one higher tier. For instance, company A has 18 employees in the professional year of 2019, and its yearly profit is 3.5 million Azerbaijani Manat; in this case, company A is considered as a medium-sized enterprise despite the fact that the company has less number of employees than in the category of medium-sized companies. That's because of the fact that the yearly profit exceeds 3 million AZN; therefore, company A is a medium-sized enterprise.

Table 1: Definition of SMEs in Azerbaijan

Form of establishment	Number of employees	yearly profit
Micro	up to 10	up to 200 000 AZN
Small	11-20	200 000-3 mln AZN
medium	21-150	3-30 mln AZN

Source: The Small and Medium Business (SMB) Development Agency of the Republic of Azerbaijan

3.3. Economy of Azerbaijan

Azerbaijan's economy has been growing since the collapse of the Soviet Union. During the Soviet period, the Republic of Azerbaijan was one of the main oil and gas providers for the central government. Azerbaijan's economy has been mainly affected by the price of oil throughout its history. The economy of the country was less diverse than the neighboring Georgia and Armenia. Since the beginning of the 2000s, the Government of Azerbaijan started to implement two large privatization projects in various sectors, including agricultural lands and SMEs. The second privatization project contained the larger enterprises to make them privately owned. According to the IMF statistics, the GDP of Azerbaijan in 2019 was 48 billion USD, which is the highest amongst the South Caucasus countries. GDP per capita for the same year is 4813 USD. In the growing economy of Azerbaijan's oil and gas sector, agriculture, tourism and services contributed the most. In 2018, the real GDP increased by 1.4 percent (The World Bank, 2021).

Azerbaijan has the highest agricultural lands in the region; 77 percent (Azerbaijan Geographic Society, n.d.) of the country's area is suitable for growing various types of agricultural products. Azerbaijan is the 5th largest producer of persimmons in the world. The country produces on average 160 thousand tons in a year. European Union carries out an economic diversification program in Azerbaijan. In the southern part of the country, the Lankaran region has one of the lowest rates of economic indicators. Therefore, it is important to diversify the economy in the area. Quality agricultural products, such as tea leaves, citrus fruits, are characteristics of this region. In addition, Azerbaijan exports wheat, barley, potato, watermelon nuts to foreign countries (FAOSTAT, n.d.). The agriculture sector provides 6 percent of GDP (International

Fund for Agricultural Development, n.d). This contribution of the sector creates food security and employment in the country. It is crucial to point out that 47 percent of the total population lives in rural areas. Therefore, 39 percent of the total jobs are within the agricultural sector.

One of the growing sectors in Azerbaijan is manufacturing, especially the production of military equipment. Since the country has a military conflict with Armenia, Azerbaijan tries to increase its military equipment production together with Ukraine, Turkey, and Pakistan (Giragosian, 2007). According to the World Bank on Military Expenditure, Azerbaijan's military expenditure is 4 percent of the total GDP; in Armenia, the percentage of military expenditure is 4.9 percent of total GDP, and in Georgia, it is 2 percent of the total GDP.

Azerbaijan is one of the attractive destinations among tourists within the region. Every year a growing number of tourists visit the country. The State Tourism Agency of Azerbaijan and the Ministry of Culture carry out tourism development projects in the country. By doing so, improving tourism facilities in the country, building high-standard hotels and recreational facilities make Azerbaijan one of the luxury tourism destinations. In recent years, Azerbaijan hosted different international events in sports and culture. In 2012, the Eurovision Song Contest was held in Baku; in 2017, Azerbaijan started to host Formula One motor racing under the name of Azerbaijan Grand Prix (F1 Race Azerbaijan Grand Prix, 2021).

Azerbaijan is making considerable progress in terms of supporting businesses. The World Bank's Doing Business Report (2018) mentions that Azerbaijan improved its Ease of doing business from 57 to 25.

3.3.1 Dutch Disease in Azerbaijan

"Dutch Disease" is an economic term that characterizes the relationship between the economic growth of one sector and decreasing other sectors. Dutch Disease often happens in countries where natural resources are abundant. Government is able to fill the Governmental budget from a certain source and avoid implementing growth strategies. This term brings two pieces of news at the same time; for instance, if an oil reserve has been discovered, and exploitation of oil causes damages to the development of other sectors, this phenomenon is characterized as Dutch Disease. Azerbaijan is abundant with a huge amount of natural gas, oil, and other minerals. The main purpose of this section is to identify whether dutch disease causes any harm to SME development in the country.

Dutch disease infection is typical for Post Soviet countries. Russia is one of the world's most resourceful countries, even a greater economy such as Russia can show signs of dutch disease, researchers Mironov and Petronevich (2015) explains in their paper on *Discovering the Signs of Dutch Disease in Russia* that if we observe even one percent increase in the price of oil. It caused an appreciation in the real exchange rate by 0.2 percent. Also, the same can be observed in other Post Soviet countries such as Kazakhstan, whose economy is mainly dependent on the oil sector.

Azerbaijani Government tries to pursue initiatives to decrease the dependency on the oil sector. Because of the fact that, on average, between 2008 and 2011, oil and gas GDP was 21,139 million AZN (Niftiyev, 2020). Therefore, SME sector development in the non-oil sector is a great way to diversify the Azerbaijani economy.

3.4. Effect of COVID-19 in economy of Azerbaijan

The decrease in the price of oil and gas in the world market, as well as the COVID-19 pandemic, negatively affected Azerbaijan's economy in 2020 and 2021. The Ministry of Economy Mikayil Jabbarov mentioned in one of the videoconferences, in order to decrease the negative results of the pandemic, we have to create *Working Groups*. The main objective of these Working Groups is to identify the damage, and provide the necessary support to business owners, especially micro, small and medium-sized enterprises. On the first stage of the projects of Working Groups, 12 main sectors have been identified, including tourism, entertainment, transportation, trade, etc. sectors.

The COVID-19 brought many strict rules in the country in order to decrease the number of infected cases. The full closure of Baku Metro, which is the main railway transport in the capital city, Baku, limited movement between cities, affected the public transport sector deeply.

Remittances are a crucial part of the economy in the rural areas of Azerbaijan. In 2019, remittances made up 2.6 percent of total GDP, which is equal to 1.2 billion USD (Hasanov, 2021). During the COVID-19 pandemic The World Bank estimates that the income from remittances decreased about 20 percent in 2020. This decrease in the money flow affects the country's economy negatively.

3.5. Role of SMEs in Azerbaijan's economy

For a young country like Azerbaijan, the active presence of micro, small and medium-sized enterprises in the economy are crucial in many aspects. Azerbaijan's dependency on the oil sector must be replaced by investing in SMEs. The Republic of Azerbaijan Ministry of Economy statistics shows that in 2019, in the country, there were 271304 SMEs in various sectors. Out of these business entities, 262622 are categorized as micro, 5956 are categorized as small businesses, 2726 are categorized as medium sized businesses. Azerbaijan is showing a growing number of entrepreneurial activities.

The hub spot of entrepreneurial activities in the country is the capital city, Baku. According to Bayramov et al. (2017), 56 percent of overall registered businesses are operating in Baku. Forty-three percent, on the other hand, are scattered across the country. Baku's role in economic activities is important. Due to the fact that, in terms of population and area, Baku is the biggest city in the country. 13 percent of the active SMEs operate in the Aran region, 7 percent in Absheron economic region, 6 percent Ganja-Gazakh economic region, and 6 percent in the Lankaran economic region (he State Statistics Committee of Azerbaijan Republic, n.d.)

The distribution of SMEs across the sectors varies in the country. According to the Ministry of Economy, the main portion of the SMEs are in the trade sector with 31.2 percent, the construction sector with 10.7 percent, and the other services make up 13.5 percent of SMEs in 2016 Azerbaijan Republic. The role of small and medium sized businesses in the country's value added is smaller than in the OECD countries. According to the National Statistical Committee micro businesses account for 6.6%, small businesses account for 1.9%, and medium sized businesses account for 6.4% of overall value added in 2019. Mostly, large companies operate in the oil sector, and therefore the contribution of the large companies to the value added of Azerbaijan is higher (Bayramov et al., 2017).

Table: 2 Number of economic entities and number of employees in each entity by Classification of Economic Activities and by size of economic entities in Azerbaijan

	Small		Medium	
	Number of Companies	Number of Employees	Number of Companies	Number of Employees
Agriculture, forestry, and fishing	267	3961	131	10363
Mining industry	79	1360	36	2503
Manufacturing	565	10536	334	32937
Electricity, gas, steam and air conditioning supply	32	859	134	12104
Water supply, sewerage, waste management and remediation activities	70	1783	118	12831
Construction	680	11280	420	33734
Wholesale and retail trade; repair of motor vehicles and motorcycles	1922	18297	715	31956
Transportation and storage	288	4758	166	15110
Tourist accommodation and food service activities	216	3958	86	8114
Information and communication	228	3217	120	10055
Real estate activities	201	3491	44	2846
Education	148	2492	44	5136
Provision of health and social services to the population	242	4725	80	8864
Provision of services in other areas	1018	14355	298	20397
Total	5956	85072	2726	206950

Source: The State Statistics Committee of Azerbaijan Republic (2019)

3.5.1. Effect of SMEs on employment in Azerbaijan

The micro, small and medium sized enterprises in Azerbaijan generate employment in the various sectors. This includes water supply, sewerage, waste management and remediation activities industry, wholesale and retail trade, repair of motor vehicles and motorcycles industry. SMEs generated 42.9% of total employment in 2018 (OECD, 2020), in comparison to 60-70% of employment in OECD countries.

In the development of the non-oil sector in the country, the SME sector plays an important role. Due to the fact that the number of enterprises as well as the number of employees in the

various business sectors have a considerable amount of contribution to the country's economy. According to the State Statistics Committee of Azerbaijan in 2019 the total of 332255 people worked in micro, small and medium sized enterprises. Interestingly, as we can observe from Table 2 the number of employees in the micro businesses are 40233, in the small businesses are 85072, and in the medium-sized businesses 206950.

The dynamic changes according to the sector and the size of a business. It can be observed that the role of medium sized enterprises are much higher than the micro and small enterprises in terms of employment. For instance, in the electricity, gas, steam and air conditioning supply industry 83 micro businesses provided jobs for 558 people, 32 small businesses provided jobs for 859 people, whereas 134 medium businesses provided jobs for 12104 people.

3.5.2. Innovation in SME Sector in Azerbaijan

The role of the oil sector in Azerbaijan's economy is considerably high. The development of the SME sector helps the country's economy to be diversified. Azerbaijan's Government put effort into developing innovative companies and startups in various sectors. Therefore the Government implements innovation policies, creates national innovation strategies, as well as creating a special body of the Government which is in charge of the innovation policy, for instance the Innovation Agency. The recent advancements in digitalization include initiatives for improving e-government, accessing and using data, and obtaining Government-to-business services are considerable steps towards increasing the number of innovative businesses. Additionally, the research and development expenditure of Azerbaijan was 0.21% of the total GDP in 2014 (The World Bank Database, n.d.) . Creation and enhancement of the Sciences, Technology, Engineering and Mathematics (STEM) education complement existing support measures to improve education are one of the important ways to support innovation in SMEs. Azerbaijan is the home for various startup companies which are working world wide, for instance Edu-Active, this startup is a platform where various scholarships, job openings, international events, etc. advertised constantly and serve for the Post-Soviet countries mostly.

3.5.3. Effect of SMEs on the GDP of Azerbaijan

The chapter 3.3 gives insights about the economy of Azerbaijan. In the country's economy the role of the oil and gas sector is deterministic. However, in order to achieve sustainable economic growth Azerbaijan diversified their economy by increasing the participation of SMEs in the economy. Table 3 shows the macroeconomic indicators of SMEs. It can be observed from the table that the total value added created by SMEs is 6170.9 million AZN.

Creating employment, value added by SMEs directly impacts the GDP of the country by direct taxes. SMEs contribute to the country's economy by 13.4% (SME Development Report, n.d.) Construction, trade, and tourism sectors are the highest concentrations of SMEs. In order to

increase the participation of the tourism sector in the economy the Government of Azerbaijan provides incentives and easy visa processes to foreigners. This directly increases the role of SMEs in the tourism sector. SMEs contribute more than 50% of GDP in the most OECD countries (ILO, 2019). We can conclude that the role of SMEs in Azerbaijan's economy is relatively low.

Table 3: The main macroeconomic indicators of micro, small and medium enterprises in Azerbaijan

	Micro	Small	Medium	Total
Created value added, million Azerbaijani manat	4900.8	1423.2	4747.7	11071.7
Average monthly nominal salary, Azerbaijani manat	332.5	437	624.6	531
Fixed capital investments, million Azerbaijani manat	515.5	494.2	2412.5	3422.2
Product release, million Azerbaijani manat	7523.8	2553.8	9309.1	19386.7

Source: The State Statistics Committee of Azerbaijan Republic (2019)

3.6. SWOT Analysis of Small and medium-sized enterprises in Azerbaijan.

The main idea of this section of the paper is to understand the actual situation in the country. The findings of this section might help policymakers adjust policies addressed to the development of small and medium-sized enterprises in Azerbaijan. Additionally, strengths and opportunities within the SME sector in Azerbaijan can be an essential piece of information for attracting local and international investors. On the contrary, identifying weaknesses and limitations can be a stimulus for entrepreneurs to increase their research and development and come up with innovative solutions to revolutionize the business environment.

Table 4: SWOT analysis of SMEs in Azerbaijan

List of strengths of Azerbaijani SMEs	List of weaknesses of Azerbaijani SMEs
<ul style="list-style-type: none"> ● Azerbaijan has a regulative measures which dedicated to the protection and improvement of SMEs; ● to start doing business is a quick and easy process in the country. In order to increase productivity and encourage individuals to register their establishment in the government electron portal, the “one window” program was created; (State Tax Service, n.d.) ● in order to increase the participation of SMEs in international trade and international activities, the requirements were simplified for SMEs; ● the infrastructure in the country is growing and has high standards; ● government of the Azerbaijan has support programs to for SMEs; ● the price of energy is relative cheaper than the rest of the Caucasus countries; 	<ul style="list-style-type: none"> ● the relationship with private sector actors and the SMEs are not satisfactory enough; ● the relationship between micro, small, and medium-sized businesses is not strong; ● accessing to financial instrument and credits are hard for SMEs; ● the lack of development in the provided financial instruments; ● the relationship between private sector and public vocational education institutions is weak; ● limited number of experienced individuals to create successful business; ● limited number of experienced organizations to provide support to SMEs; ● lack of managerial and business skills amongst the SME owners; ● lack of support norms to increase government’s demand for SME product and service; ● limited experience of Azerbaijani small and medium-sized businesses in the international trade;

	<ul style="list-style-type: none"> ● lack of productive relationship between SMEs and research and development institutions; ● existing support programs is not fully accessible to SMEs; ● limited access to regional and local market; ● corruption in the business environment;
List of opportunities of Azerbaijani SMEs	List of threats of Azerbaijani SMEs
<ul style="list-style-type: none"> ● increasing the access to the financial instruments and having an appropriate environment to create credit bureau to facilitate the access to credits; ● using the potential increasing trends SMEs in the development of the non-oil sector; ● in the government purchases and the construction of infrastructures using the potential of SMEs; ● increasing the vocational education and business education centers in order to create more educated and experienced individuals for SME sector; ● creating educational institutions which support “lifelong learning” idea ● expanding the production sector and diversification of the Azerbaijan economy; 	<ul style="list-style-type: none"> ● potential international economic indicators such as financial crisis, decrease in demand in the international market, closure of borders etc. ● the limited competitiveness of product and services of the local SMEs in the international market; ● ignoring the influence of the vocational education; ● accessing to the international market is hard due to each country has their own regulations; ● newly established industrial parks offer discounted tax rates to Azerbaijan citizens, this decrease the competitiveness of foreing business owners in Azerbaijan;

<ul style="list-style-type: none"> • having enough labor capital in the country; • adopting roadmaps to plan future of SME sector; 	
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Source: The Decree of the President of the Republic of Azerbaijan, 2016.

Considering this SWOT analysis, Azerbaijan demonstrates a potential to increase its SME sector development. Due to the fact the strength of the SME sector in Azerbaijan is a potential investment opportunity for foreign and local investors. The given government support, which will be analyzed in the following section, easy registration process through a “one window” system, as well as having high standard infrastructures in the country makes Azerbaijan a good place to invest and develop the SME sector. Additionally, Azerbaijan shows possible opportunities in the SME sector growth. As the SMEs in the country have enough labor capital, increasing access to the financial instruments, the development of the SME sector is inevitable.

On the other hand, certain factors discourage people from engaging with business, for instance corruption in the business environment. The country is prone to the negative effects of potential international economic indicators such as financial crisis, decrease in demand in the international market, and closure of borders.

3.7. Government Support in SME development in Azerbaijan

Starting from 2015, Azerbaijan has shown crucial improvements in SME development by adopting various strategic targets. In order to address the development of SMEs in the country, the *Strategic Roadmap for the Production of Consumer Goods at the Level of Small and Medium Enterprises in the Republic of Azerbaijan (2016)* was adopted by president Ilham Aliyev. The main goal behind SME Roadmap is to create a favorable environment for SME development, attract investments, create a legal framework, and access the financial instruments for SMEs in Azerbaijan by the Ministry of Economic of the Azerbaijan Republic. In order to create and implement this roadmap, Azerbaijan's Ministry of Economy asked for assistance from the OECD.

In recent years, in order to increase the sustainable development of the Azerbaijani economy and have a competitive position in the world market, Azerbaijani Government has approved

support policies and programs towards the development of SMEs. The economic volume of SMEs and their fragilities make the Government pursue support mechanisms; under the *Strategic Roadmap* program.

In conclusion, Azerbaijan shows great potential in the development of the SME sector; meanwhile, the effect of the SME sector in Azerbaijan's economy has been increasing over the years. The creation of the strong SME sector is helpful in the diversification of the Azerbaijani economy and decreasing the dependency on oil prices in the world market. The current contribution of SMEs to the GDP of the country is relatively lower than the neighboring countries. However, the Government of Azerbaijan implements SME-specific support programs in the country. If the results of the set goals reach a desirable level, the role of SMEs in Azerbaijan's economy will be higher. As well as, the *Ease of Doing Business Score* of the country will automatically increase. Considering the fact that, these improvements might lead to a great amount of capital inflow to the country in source of FDI.

Chapter 4: SMEs in the context of Georgia

4.1. Country Profile of Georgia

Georgia, in Georgian Sakartvelo, is an intersection between Europe and Asia. The country is situated in the Southern part of the Caucasus Mountains and the east part of the Black Sea. Georgia has borders with Russia from the north and northeast, with Azerbaijan from the east and southeast, with Armenia from the South, with Turkey from the South. With 3.72 million (World Bank, 2018) population lives on 69,700 square kilometers. The capital city of the country is Tbilisi. Currently, one-third of the country's population resides in the capital city (approximately 1.079 million inhabitants (Population Stats, 2019)).

Georgia is abundant with natural resources, including coal and petroleum. The quality of magnesium in the country is able to compete with global extractors of it, like India and Brazil. Georgian rivers are suitable for receiving hydropower, as some rivers start from the mountains.

The official language in Georgia is Georgian, as the population of the country consists of various ethnic groups; besides the Georgian language in the country, several languages are spoken. Georgian is spoken by 86 percent of the population. Additionally, the Azerbaijani language is spoken by 6.5 percent of the population due to the fact that Azerbaijanis are the largest ethnic minority group in Georgia (General Population Census of Georgia, 2014).

4.2. Definition of SMEs in Georgia

SMEs play a crucial role in Georgia's economy by creating jobs, decreasing demand for imported goods and services. In 2010, in Georgia, 42530 enterprises were under the category of small and medium-sized businesses. These enterprises account for 96 percent of all active companies. Georgian National Investment Agency and the Ministry of Economy and Sustainable Development define SMEs according to their annual turnover and number of employees. If a business has employees less than 20 and yearly turnover is below 500 thousand Georgian Lari (GEL) (125 thousand EUR), this business is considered a

micro-enterprise. The small enterprises have employees between 20 and 50, and yearly turnover between 500 thousand to 12 million Georgian Lari (125 000 EUR to 3 million EUR). Medium-sized enterprises employ between 51-249 employees, and yearly turnover is between 12-60 million Georgian Lari (3-15 million EUR). Large enterprises have more than 250 employees, and their annual turnover exceeds 60 million Georgian Lari (15 million EUR).

Table 5: Definition of SMEs in Georgia

Form of establishment	N of employees	yearly profit
Micro	up to 20	up to 500 000 GEL
Small	20-50	500 000- 12 mln GEL
Medium	51-249	12-60 mln GEL
Large	More than 250	More than 60 mln GEL

Source: Georgian National Investment Agency and the Ministry of Economy and Sustainable Development (n.d.)

According to the National Statistics Office of Georgia, in Georgia, only 4 percent of registered firms are considered large enterprises in 2010. On the other hand, large enterprises consider 79.5 percent of the total yearly turnover of all active businesses. Each category of companies generates a different amount of employment and tax. Therefore, Law on Georgia on Georgian National Investment Agency defined SMEs as mentioned previously to address appropriate support policies and tax collection rates.

4.3. Economy of Georgia

Georgia has a rising economy due to the fact that the country implements successful economic reforms since its independence from the Former Soviet Union in 1991. The economic growth of the country was steady between 2005 and 2019, on average 5 percent growth. Poverty has been declining in the country to 19.5 percent in 2019 (Asian Development Bank, 2021). Despite the government policies and support, the Georgian economy was not able to create enough employment for its citizens. Therefore, the population has been engaging in the less productive agricultural sector.

Georgia's economy is considered as a free market economy; the prices in the market have been arranged by the supply and demand factors of the market. The country's economy was damaged during the early 1990s due to the collapse of the Soviet Union. Georgian economy started its recovery years by the middle of the 2000s. Georgian Government managed to have economic stability in the country after the Rose Revolution in 2003. Currently, the GDP of the country is 15.9 billion USD in 2020 (World Bank, 2021). The GDP and the GDP per capita have been increasing since the early 2000s. However, due to the current COVID-19 pandemic, GDP per capita fell from 4 763 USD in 2019 to 4 274 USD in 2020 (World Bank, 2021).

Georgia is an attractive place for investors from all over the world. Therefore, Foreign Direct Investments (FDI) became the cornerstones of the Georgian economy. The country offers the same rate of taxes for local and international investors. Georgia has steady economic growth, a free market, an investor-oriented tax system, a lower amount of licenses, and the geographical position between Europe and Asia make the country FDI friendly. In Georgia, there are only six types of taxes, income tax which amounted to 20 percent; profit tax or corporate tax, which amounted to 15 percent; value-added tax or VAT, which amounted to 18 percent; property tax can be up to 1 percent, custom tax and excise taxes vary (Legislative Herald of Georgia, 2012).

In trade, Georgia shows considerable improvement since joining European Union's Free Trade Area in 2014 (European Commission, 2021). European Union countries are the major importers of Georgian products; this trade relationship with the EU decreased Georgia's trade with CIS by 22 percent in 2015 (Civil Georgia, 2016). Another important source of income for Georgians is remittances. According to the Central Bank of Georgia's information, a considerable amount of remittances come from Russia. Due to the fact that the Russian Census in 2010 shows that there are over 150 thousand ethnic Georgians living in Russian Federation (Russian Population Census, 2010).

During the Soviet period, Georgia's agriculture sector was damaged; after gaining independence, this sector started to flourish. The agriculture sector provides 55% employment to Georgia citizens. Which only equals 7 percent of the country's total GDP (Invest in Georgia, n.d.). Georgian farmers produce grains, tea, hazelnut, citrus fruits, tomato, wine. The wine sector is a crucial part of agriculture; only in 2011, according to the National Wine Agency of Georgia, Georgian wine exported to more than 40 different countries, which is a total of 54 million USD.

One of the growing parts of the Georgian economy is the tourism sector. Georgian government invests in tourism development by creating recreation facilities, improving the transport sector, and making worldwide advertisements of Georgian hidden gems. For instance, Georgia has the second deepest cave in the world-Krubera Cave. Additionally, in the city of Kutaisi, David the Builder Kutaisi International Airport opened in 2012; the airport mainly operates with low-cost airline companies. This increased the number of incoming tourists from European countries.

4.4. Effect of COVID-19 in economy of Georgia

Georgia is one of the most affected countries in terms of the number of reported cases per million population. Therefore, Georgia's economy has been severely affected by the COVID-19 pandemic. In order to decrease the number of infected people, the country has followed several strict measures. The curfew, border closure, lockdowns, limited transport among regions of the country, limited or restrictive public transport negatively impacted Georgia's economy. As tourism is one of the key contributors to the Georgian economy, in the summer of 2020 and winter of 2021, tourism facilities were closed.

Ever since the start of COVID-19 pandemic measures in Georgia, household consumption has decreased due to the limited usage of transport and recreational facilities, spending on cloth, and electronic shopping. As domestic consumption decreases, the currency value is also decreasing. As a result, investors try to keep their assets safe. Therefore foreign direct investments have been decreasing since the start of the pandemic. In the European Countries, Russia, Azerbaijan, and other countries, several serious COVID measures made trade and employment hard for Georgian citizens. As one of the main sources of the economy is remittances, the decline is inevitable. Also, all these effects create spillover effects in many sectors due to the fact that the demand for goods and services decreased in 2020 and 2021 in the world. Therefore, the Georgian trade balance was negatively affected (The World Bank, n.d.).

4.5. Role of SMEs in Georgia's economy

The role of SMEs in countries like Georgia with little natural resources is important. Therefore, in Georgia the Government supports SME growth. In the previous section of this research paper, we observed the classification and definition of SMEs in Georgia. The definition of SMEs is

different in Europe. This difference in the classification creates various scenarios in terms of access to finances. For instance, if a company borrows credit from a Georgian financial institution, they might be considered corporate clients. As a result, their debts are higher. However, the same category is defined as SME in the EU/IFI (international financial institutions) definitions. All in all, Georgian banks give large amounts of financial instruments to a few larger companies.

Table 6: Number of employees in each entity by Classification of Economic Activities and by size of economic entities in Georgia

	Number of Employees	
	Small	Medium
Agriculture, forestry, and fishing	5701	2845
Mining and Quarrying	3146	1239
Manufacturing	36554	22915
Electricity gas, steam, and air conditioning supply	717	1455
Water supply; Sewerage, Waste Management, and Remediation Activities	767	2372
Construction	37764	20682
Wholesale and retail trade; repair of motor vehicles and motorcycles	110890	27702
Transportation and storage	20737	6652
Accommodation and food service activities	24396	10178
Information and communication	8643	4787
Real estate activities	14341	2583
Professional, scientific, and technical activities	20194	4685
Administrative and support service activities	9488	4692
Education	10674	8908
Human health and social work activities	12068	18890
Arts, entertainment, and recreation	6621	3831
Other service activities	6410	1047
Total	329111	145463

Source: GeoStats, 2018

4.5.1. Effect of SMEs on employment in Georgia

Micro, small and medium-sized enterprises play an important role in Georgia's developing economy. SMEs generate employment, increase productivity in the country. In Georgia, the National Statistics Office (GeoStat) has estimated that micro, small and medium enterprises generate 67 percent of total work in the country. The number of SMEs and the number of employment generated by SMEs vary in various sectors. SMEs hold 98 percent of the tourism industry (hotel and restaurants), 98 percent of agriculture and forestry, 92 percent of communication and transport, 96 percent of construction industries. However, the value-added is 20-40 percent in agriculture, real estate, education sector for the SMEs contribution. In Georgia's economy, the informal economy is crucial. SMEs are an essential part of the informal economy. For the Georgian Government, SME development is one of the top priorities to achieve sustainable economic growth. SMEs in the Georgian economy play a crucial role. GeoStats (2018) shows that out of all the enterprises, 98 percent of them are SMEs. And SMEs generate 62 percent of total employment in the country (GeoStats, 2018).

It can be observed from Table 6 that the various sectors generate different numbers of employment in the country. For instance, the number of employees in the Professional, scientific, and technical activities sector is 20194 for small businesses, whereas the number of employees in the same sector is 4685 for medium sized businesses. This indicates that certain sectors are more likely to operate on a smaller scale. In terms of employment creation, the role of SMEs is growing. In 2006 SMEs provided jobs for 168.7 thousand people in the country. This number increased to 259 thousand jobs in 2014 (the Ministry Of Economy And Sustainable Development Of Georgia, 2015).

4.5.2. Innovation in SME Sector in Georgia

As Georgian economy is mostly affected by the SMEs, the Government puts effort on improving the number of innovative businesses. Therefore, in 2014 Georgia's Innovations and Technology Agency (GITA) was established. This agency operates under the supervision of the Ministry of Economy and Sustainable Development of Georgia. The main aims of the agency are the creation of an innovation ecosystem and coordinating its development, increasing the competitiveness of startups by supporting them, and facilitating cooperation between the representatives of scientists and businesses.

Georgia is a home for successful startups, for instance *Swoop*, *Cnick* — “*smart rings*”, *SpotThatFire*, etc. These startups are operating not only in the local market, but also in the international market as well. The Georgian Government runs several projects in order to support innovative small and medium businesses. The MINI grants project was established in 2019 with 500 thousand GEL. The project aims to support innovative projects. Additionally, the research and development expenditure of Georgia was 0.1% of the total GDP in 2014 (The WorldBank Database, n.d.).

4.5.3. Effect of SMEs on the GDP of Georgia

In Georgia the role of SMEs in the country's economic situation is not only determined by the employment creation, but also their tax payments. In 2018, the limit for being considered as a small business increased from 100 thousand GEL to 500 GEL. Additionally, businesses with yearly turnover less than 100 thousand GEL are exempt from taxation according to the Tax Code of Georgia.

The share of GDP generated by SMEs in the country is 59%. The sectors which have higher concentrations of SMEs are trade, manufacturing, construction, and ICT industries. Additionally, GeoStat report for 2012-2013 shows that the main sectors in which SMEs contribution to value added was 20-40 percent and more were trade (wholesale and retail), education, agriculture, hotel and restaurants, real estate and renting, and transport and communication.

4.6. SWOT Analysis of Small and medium-sized enterprises in Georgia

In this section of the paper, Georgian SMEs' strengths, weaknesses, opportunities, and threats will be observed. The findings will help policymakers to understand the current issues in order to tackle ongoing problems in the SME sector development in Georgia.

Table 7: SWOT analysis of SMEs in Georgia

List of strengths of Georgian SMEs	List of weaknesses of Georgian SMEs
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<ul style="list-style-type: none"> ● Georgia has a beneficial business environment for entrepreneurs; ● starting to a business is a smooth and easy process; ● corruption in the country is low; ● government's support programs to SME development; ● multilingual youth population; ● access to international market is easy; ● highly developed public services 	<ul style="list-style-type: none"> ● limited business knowledge and skills; ● lack of experienced managers; ● lack of access to long-term investment opportunities; ● low productivity; ● lack of qualified labor force; ● lack of capacity to participate in international trade; ● price of technological appliances is high;
List of opportunities of Georgian SMEs:	List of threats of Georgian SMEs:
<ul style="list-style-type: none"> ● increasing access to financial instruments; ● well-developed public institutions to implement international requirements; ● diverse chain of production; ● SME specific support policies; ● existence of modern business culture; ● the country well-positioned geographically; ● being a member of WTO helps to get easy access to world market; 	<ul style="list-style-type: none"> ● dependency on exogenous activities, such as global financial crisis, global pandemic etc.; ● political uncertainty; ● participation of Georgian SMEs in the international market is low, Georgian SMEs struggle to compete against international firms; ● lack of business educational programs; ● having a small sized economy;

Source: Ministry Of Economy And Sustainable Development Of Georgia, 2015

Georgia is one of the ideal places to invest in a business or register a business. Due to the fact that the country offers overall less taxes for businesses, multilingual labor force, government support programs, which will be discussed in the following section. In addition to these factors Georgia's increasing access to financial instruments, developing SME specific support policies, geographical position of the country allows SMEs to grow on a bigger scale.

On the other hand, high price of technological appliances, lower productivity amongst the labor force, having a small sized economy, as well as having a limited number of experienced managerial labor force in the SME sector are the obstacles in front of SME development in Georgia.

4.7. Government Support in SME development in Georgia

Support programs for SME development in Georgia have been implemented for decades. One of the programs, *Small and Medium Enterprise State Support Program for 2002-2004*, was started in 2002 for supporting small and medium-sized businesses.

Under this program, there were two main goals to achieve: increasing access to financial instruments by attracting investments and providing information and advisory services through education and training (Szabó and Petrosyan, 2007).

The Produce in Georgia project was implemented in 2015 in order to receive investments for various projects. Thus, the amount required for the project was 355.6 million GEL. The government's investment is addressed to different sectors; for instance, 26 percent of the total investment is addressed to construction material producer SMEs (Bayramov et al., 2017).

All in all, Georgia has a young and growing economy full of opportunities for entrepreneurial activities. Georgian government tries to create a favorable environment for SME development and attract foreign investors to the country by keeping the low taxes for everyone. Georgian SME sector has a higher potential to contribute to the country's GDP more than it does now.

Chapter 5: SMEs in the context of Armenia

5.1. Country Profile of Armenia

The Republic of Armenia is the smallest country in the South Caucasus region, with a population of 2.9 mln (The World Bank, 2019). The country's population consists mostly of Armenian with 98.1 percent and 1.9 percent minorities: Russians, Yezidis, Kurds, Assyrians, Greeks, Ukrainians, Jews, and others (The Government of the Republic of Armenia, n.d.). Azerbaijan surrounds this landlocked country to the East, Georgia to the North, Turkey to the West, and Iran to the South. The country overall covers a total of 29,743 km² area in Southeastern Asia. After gaining independence from the Soviet Union in 1991, the Armenian government struggled with war with the neighboring country, Azerbaijan. This war negatively affected countries' economic, political and social status for decades. The small and medium-sized enterprises in the country kept their importance after gaining independence from the Soviet Union. SMEs play a crucial role in generating employment, improving living standards, and creating a more middle-class society.

Armenia is a parliamentary Republic, the current President of the country is Armen Sargsyan, who has served the country since 2018. Today, the political power is in the Armenian Parliament, and the current Prime Minister, Nikol Pashinyan, took office in 2018.

The Republic of Armenia is geographically mountainous, with an average elevation of 1800 meters above sea level. The geographical features of the country affect its economic and social life. In the country, lowlands do not exist; most of the country's elevation range between 1000 meters and 2000 meters, the highest point is on Mount Aragats (4095 meters).

The official language of the Republic of Armenia is Armenian. However, a poll in 2012 shows that 94% of the country's population has knowledge of the Russian language (Kempe, 2013). The official currency of the country is the Armenian Dram (AMD).¹

¹ Note: As of May 2021 1 USD is equal to 495 Armenian Dram according to the Central Bank of Armenia's

5.2. Definition of SME in Armenia

Under the current legislation, the definition of SMEs in the Republic of Armenia is made by the Ministry of Economy of the Republic of Armenia in order to correctly address the development projects towards SMEs. In 2018, the ministry started the “*Support to SME Development in Armenia*” program for facilitating SME development in the country. In the definition of SMEs, the officials take into account the number of employees, the yearly revenue of the company, and also the sector of the company. All of these differentiations make the appropriate policies to reach the correct endpoint. Categorizing companies help the Armenian Government to make necessary arrangements in order to strengthen the SME sectors through increasing access to the financial instruments, improving SME development and business culture, creating a market for SMEs, providing legal easiness and favorable institutions for SMEs development. As in recent years, we can observe in the government statistics that there is a considerable increase in SME development. One of the reasons behind this increase is the use of appropriate definitions for SMEs; therefore, officials are able to provide necessary support policies to appropriate audiences.

The Ministry of Economy defines SMEs as follow:

Micro or super small-sized enterprises- the average payroll number of employees is between 0 and 9, with yearly revenue of less than 100 million Armenian Drams.

Small-sized enterprises- the average payroll number of employees is between 10-49, with yearly revenue between 100 million and 500 million Armenian Drams.

Medium-sized enterprises- the average payroll number of employees is between 50-249, with yearly revenue between 500 million and 1.5 billion Armenian Drams.

Table 8: Definition of SMEs in Armenia

Form of establishment	Number of employees	Yearly Revenue
Micro	up to 9	up to 100 mln AMD
Small	10-49	100 mln-500 mln AMD
Medium	50-249	500 mln-1500 mln GEL
Large	more than 250	more than 1500 mln GEL

Source: The Ministry of Economy of the Republic of Armenia, n.d.

The Ministry of Economy of the Republic of Armenia points out that in 2018, the newly established companies per 1000 inhabitants was 9.8 in Armenia. According to the World Bank, in the upper-middle-income countries, this ratio is around 30 businesses. Therefore Armenia is considered as a low, middle-income country in terms of SME development.

The support program for SMEs shows its significance in various aspects of SMEs. For instance, they are creating a favorable tax environment for micro, small, and medium-sized enterprises and providing educational seminars for people with entrepreneurship spirits, and providing consultancy and business development support, and increasing access to the necessary modern technologies. Provide support for the SMEs which operate in overseas countries with their economic activities (Gevorgyan et al., 2005).

5.3. Economy of Armenia

The Republic of Armenia has had a steady developing economy since the country gained independence from the Soviet Union in 1991. In the country, the nominal GDP is 12.6 billion USD according to World Bank (2020) data, which accounts for GDP per capita 4297 USD.

During the times when Armenia was part of the Soviet Union, the country was specialized in the production of chemicals, electronic products, machinery, processed food, synthetic rubber, and textiles, which mainly depended on the import of raw materials from other countries. Currently, Armenia has trade relationships with Iran and Georgia out of neighboring countries. As a result of conflict with Azerbaijan and Turkey, the borders with these countries are closed. The main

ally in the trade of Armenia is Russia. The main sectors of the economy are agriculture, construction, mining, energy, industrial, retail trade, information communication technologies, financial services, and tourism.

The role of the agriculture sector in the country's economy is crucial; agriculture provided 20% of GDP, 35% of employment, and 28% of total export in 2015 (Christensen, 2017). However, the agriculture sector is highly vulnerable to weather conditions; for instance 2010, agricultural productivity decreased by 17 percent due to the bad weather conditions. Armenia is abundant with natural resources such as copper, gold, molybdenum; therefore, the mining sector plays a crucial role in the country's economy. In the year 2017, the output of the mining industry has grown by 14 percent, which accounts for 3.1 percent of total GDP (ARMSTAT, 2017). One of the growing and impactful sectors of the Armenian economy is the information and communication technologies sector. This steady development of the sector positively affects the country's GDP by 7.4 percent (12.4 billion USD) in 2017 (Mkrtumyan, 2019). The recent study by ARMSTAT (2019) shows that the employees of the ICT sector are one of the highest-paid workers in the country.

Estimates show that there are twice as many Armenian living abroad than Armenia itself. Therefore, it is understandable that the role of remittances in the country's economy is undeniable. According to the World Bank data, in 2019, personal remittances consisted of 11.2 percent of GDP.

According to the statistics of OEC, Armenia was 129 for their exports in 225 counties in 2019. The main bulk of exports in the country come from mineral materials, natural resources, tobacco, and liquor production. The total amount of exports in the country adds \$3.34 billion to the country's budget. However, the government spends more on imports, around \$5.04 billion, which creates a trade deficit. The main importers of Armenian products are Russia (\$734 million), Switzerland (\$681 million), China (\$220 million), Bulgaria (\$208 million), and Iraq (\$177 million). Armenia lacks natural gas and petroleum; therefore, the main imports of the country are in these sectors. The major exporters to Armenia are Russia (\$1.44 billion), China (\$525 million), Georgia (\$398 million), Iran (\$300 million).

5.4. Effect of COVID-19 in economy of Armenia

As it is shown in the above-mentioned section of the paper, over the years, Armenia shows a gradual, steady economic development. However, the current health crisis affected Armenia's economic growth negatively. Due to the COVID-19 pandemic, the country was ranked 33rd globally in terms of the COVID-19 patients per million population (The World Bank, 2021). This pandemic, together with the war with Azerbaijan, negatively affected the country's macroeconomic stability, increased poverty, and fiscal decline. The pandemic hit the country in several ways. Effect of countrys' entry barriers, the trade has been negatively affected, Armenian SMEs struggled to continue their activities. The economic vulnerability has increased; as a result, the production capacity of SMEs decreased. Despite the fact that companies increased their domestic sales, it's not enough to cover all the losses from international trade. Armenia has several e-commerce startups and dropshipping businesses. These kinds of businesses require fast delivery and return of the product. However, the pandemic made it impossible to ship the products outside of the country, and it was difficult to make timely returns. Therefore, SME business owners lost their customers and profit. As SMEs are mostly unable to perform their economic activities, they become unable to pay their debts. Moreover, there was a sharp increase in the SMEs' debt burden. According to the survey, 79 percent of SME owners mentioned that their business's survival is solely dependent on government support(United Nations, 2021).

5.5. Role of SMEs in Armenia's economy

SMEs play a crucial role in Armenia's economy; in the "non-financial business economy," 99.8% of all firms are SMEs. The role of small and medium-sized enterprises in employment is considerably high in the non-financial business economy; SMEs provide jobs for 68% of total employed people (OECD, 2020).

Table 9: Number of economic entities and number of employees in each entity by Classification of Economic Activities and by size of economic entities

	Small		Medium	
	Number of Employees	Number of Companies	Number of Employees	Number of Companies
Mining and quarrying	532	25	917	8
Manufacturing	11830	596	12000	128
Electricity, gas, steam and air conditioning supply	1470	92	535	4
Water supply, sewerage, waste management and remediation activities	298	14		
Construction	5848	295	7252	68
Wholesale and retail trade; repair of motor vehicles and motorcycles	13935	787	11331	112
Transportation and storage	4060	203	2204	28
Accommodation and food service activities	6602	357	4890	53
Information and communication	4360	233	3935	42
Real estate activities	1833	94	842	9
Professional, scientific, and technical activities	3465	191	2164	26
Administrative and support service activities	2766	130	3700	36
Repair of computers and personal and household goods	262	14	156	1
Total	57261	3031	49926	515

Source: Statistical Committee Of The Republic Of Armenia (ARMSTAT), 2018

5.5.1. Effect of SMEs on employment in Armenia

Small and medium-sized enterprises are the cornerstones of the Armenian economy. In 2018, companies categorized as SMEs comprised 99.8% of all business establishments in the country. SMEs provide employment for the workforce of Armenia in various sectors, including manufacturing, accommodation, and food service activities, and information communication technologies. All in all small and medium-sized enterprises account for 68 percent of total employment (OECD, 2020).

The growing Armenian economy supports the SME sector since the country's labor force takes advantage of the improved SME sector. Within the SME sector, companies in different categories generate different amounts of employment. For instance, on average micro establishments generate two employment per company. Statistics show that MSMEs created jobs for approximately 245 thousand people in 2017, which is one-third of the total employment of the same year. The number of establishments in the country change according to the sector in which they operate and the type of the business. In 2017, 76 615 micro-enterprises generated almost half of the employment in the MSME sector, around 122 thousand jobs. On the other hand, statistics show that 4570 small enterprises generated 63 thousand jobs for Armenia's labor force. And 1024 medium-sized enterprises generated 61 thousand jobs in the country in 2017 (Business Support Office, 2018).

SMEs operate in many sectors, including mining, transportation, construction, etc. Each of the sectors generates various numbers of jobs. Each SME category led a certain sector. For instance, as it is clear in **Table 9**, in 2017, in the mining and quarrying sector, there are 234 operating businesses; out of these, 25 of them are small, 8 of them are medium enterprises. However, when it comes to employment generation in the mining and quarrying sector, large-sized enterprises generate more jobs than the rest combined. In this sector, small, and medium-sized enterprises generated 532, and 917 jobs consecutively. 357 small-sized enterprises generated 6602 jobs, and 53 medium-sized businesses generated 4890 jobs.

5.5.2. Innovation in SME Sector in Armenia

The Caucasus countries engage in various activities to boost their transition economies. Azerbaijan and Georgia work together on the Baku Tbilisi Ceyhan pipeline project to bring Caspian oil to the Mediterranean sea. On the other hand, Armenia is a landlocked nation

without having trade relations with neighboring countries like Turkey and Azerbaijan. Therefore, in recent years, the Armenian economy has flourished with high-tech startups. Writer Wade Shepard entitled Armenia as “the world’s next tech hub” in his article on Forbes in 2020. Armenia has a growing number of successful startups which not only operate in the local market but revolutionize the international market. As SMEs a crucial part of the Armenian economy, the government has deep support for creating and developing tech startups in the country. In the last decade, startups like “PicsArt” have gained great fame in the international media. This photo and video editing company started as a seed startup in 2011, and it is growing over time; currently, the company employs more than 600 employees (Kunthara, 2020). Armenian startups operate in a wide range of sectors, including entertainment, education, personal growth, etc. One of the groundbreaking online education platforms-” SoloLearn” is a free application for learning coding and programming. The company has more than a million active users monthly. Additionally, the company employs over 240 employees in 2021 (Craft.co, 2020). Having successful startups increases innovation idea generation in the Republic of Armenia. Therefore, high-tech startups would be the cornerstones of the economic development of Armenia. Additionally, the research and development expenditure of Armenia was 0.24% of the total GDP in 2014 (The WorldBank Dataset, n.d.).

5.5.3. Effect of SMEs on the GDP of Armenia

Economic effects of the SME sector in Armenia have been growing, as small and medium-sized businesses facilitate employment generation, innovation, and a competitive business environment. The country's budget also takes a great advantage. Due to the increase in the number of businesses, the number of taxpayers also increases. Micro, small and medium-sized businesses contribute differently to the GDP of the country. Armenian Government facilitates the support mechanisms to help startups to achieve higher development, therefore certain groups of business are exempt from taxation. Despite this fact, 66 percent of total SMEs are taxpayers. The number of businesses which pay tax in the country is above 50 thousand. In the year 2016, SMEs paid 209 billion AMD tax to the government budget. Micro, small, and medium-sized businesses play a crucial role in export of Armenian products to the world. The main importers of Armenian products are Commonwealth of Independent States (CIS).

In 2017, small and medium sized enterprises contributed to the country’s GDP by 35 percent. This share varies according to the sector they operate. SMEs in the “trade” sector contribute to the country’s GDP by 7.4 percent, and services provide 7.5 percent, the industry sector provides

5.4 percent, the construction sector among SME businesses contributes to the country's economy by 3.3 percent. SMEs operate in the regions of Armenia other than the capital Yerevan; important destinations for SME growth include Kotayk, Armavir, Ararat, Shirak, etc.

5.6. SWOT Analysis of Small and medium-sized enterprises in Armenia

Small and medium-sized businesses in Armenia are crucial in many ways including employment creation, innovation etc. In order to fully understand the current status of SMEs in Armenian economy, this section provides SWOT analysis of SMEs in Armenia.

Table 10: SWOT analysis of SMEs in Armenia

Strengths of the Armenian SMEs:	Weaknesses of the Armenian SMEs:
<ul style="list-style-type: none"> ● stable growth in SME sector and recent macroeconomic growth; ● creation of government support programs; ● creation of institutions in order to support SMEs; ● labor market effectiveness; 	<ul style="list-style-type: none"> ● demand side issue in the local market for products and services provided by SMEs; ● lack of access to financial instruments; ● lack of business skills among SME owners, especially in the managerial level; ● high number of people in poverty
Opportunities of the Armenian SMEs:	Threats of the Armenian SMEs:
<ul style="list-style-type: none"> ● access to modern technologies to facilitate development of SMEs; ● being a member of WTO increase chances of Armenian SMEs to participate in the world market; ● potential to increase cultural tourism; 	<ul style="list-style-type: none"> ● level of corruption in the country; ● ongoing regional conflicts with Azerbaijan; ● high income inequality amongst the population

Source: Gevorgyan et al. (2005)

As it was observed in the previous sections, the SME sector plays an important role in Armenia's economy. This is due to the stable growth in the SME sector and recent macroeconomic growth, creation of government support programs, which will be analyzed in the following section, creation of institutions in order to support SMEs, labor market effectiveness, as well as having access to modern technologies to facilitate development of SMEs. These factors make Armenia one of the desired places to develop a business. Therefore, the number of SMEs in the country is increasing every year. On the other hand, the level of corruption, current conflict with Azerbaijan, lack of access to financial instruments are the main obstacles in front of the SME development.

5.7. Government Support in SME development in Armenia

The Ministry of Economy and the Government of Armenia in 2020 approved *the Small and Medium-sized Entrepreneurship Development Strategy* for 2020-2024 to facilitate the development of SMEs in the country. The main objective of this strategy is to establish an SME-friendly business environment and increase entrepreneurial activities. The target of the program is to eliminate weaknesses in the SME sector. Improving access to financial resources, creating local institutions for SME support, encouraging people to pursue their business ideas are the primary targets to achieve from these action plans. It is projected to achieve 3 percent higher productivity between 2020 and 2023. By 2024, the targeted goal is to achieve 7.5 percent SME productivity and growth (The Ministry of Economy of the Republic of Armenia, n.d.). The current COVID-19 health crisis has caused an immense amount of damage in the SME sector in Armenia, and these action plans will help business establishments to cope with the bankruptcy.

Armenian Government has been implementing macroeconomic policies in order to facilitate its economic growth. The development of the country gained a newer speed in the last two decades, mainly due to the visible effects of the economic reforms. These reforms mainly targeted improving the economic and social conditions of the country's growing population.

These economic reforms impact the private sector, the creation of a favorable business environment. As well, the increasing role of Armenia in foreign trade created a stable environment for the stable inflation rate and currency exchange. As a member of the WTO, Armenia has escalated its exports. Researcher Winter (1995) mentions that the Development of the Private Sector and Privatization is another crucial factor for facilitating SME development in

the country. Armenian Government implies privatization projects in the country. As the country was ruled under a centrally planned economy, this is the fastest way to facilitate growth in the private sector. As one of the major interests is to attract foreign investors to the country, privatization is the key. After the collapse of the Soviet Union, Armenia needed to apply structural changes in its economy. During the centrally planned economic time frame, most of the activities were limited by the Government; therefore, these restrictions mainly were one of the obstacles in front of the growing SME sector. Therefore, in the last three decades in the country, some business restrictions were lifted. This has resulted in the creation of a competitive business environment.

In conclusion, Armenian SMEs play a crucial role in the country's economic development. SMEs provide employment for the Armenian labor force and contribute to the country's GDP. Therefore, in Armenia in recent years, SME sector growth has been accelerated. Government support programs, creation of institutions to increase the know-how of business development help Armenian SMEs to thrive and prosper. Armenia has a relatively successful SME sector because of the fact that Armenian startups can compete in the international market and contribute to the country's GDP immensely.

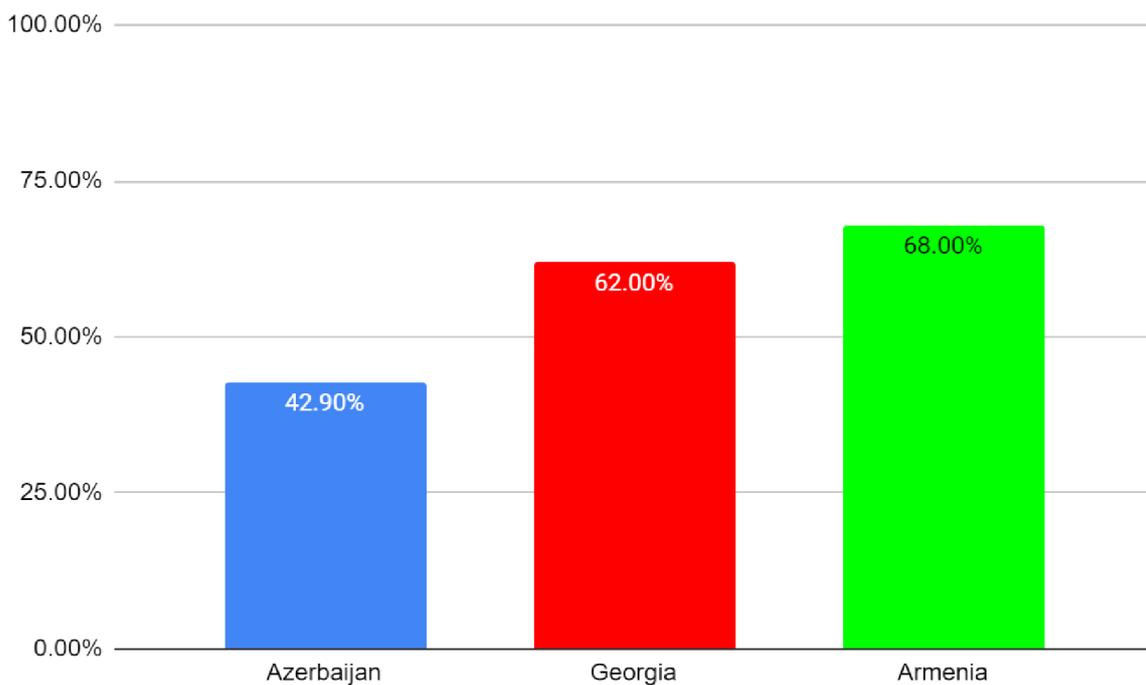
Chapter 6: Comparison of SMEs and their effect on Azerbaijan, Georgia, and Armenia

In each of the target countries the development level of SMEs and their effects on the national economy vary. In this section of the research work the author makes comparisons based on the definition of SMEs, the effect of SMEs on employment, innovation in the SME sector, effects of the SMEs on the GDP of Georgia, Azerbaijan, and Armenia.

The definition of the SMEs changes country to country, this is one of the limitations of this comparison. Since, each country uses the different measurements for defining the businesses, this comparison may not be 100 percent accurate for instance, in Azerbaijan, small enterprises are considered the ones with 11 to 20 employees, in Armenia small enterprises are considered the ones with 10-49 employees, in Georgia small enterprises are considered the ones with 21-50 employees. Therefore, the comparison is based on the defined type of business rather than the number of employees or yearly turnover.

In order to make a fair comparison in terms of employment generation by SMEs in the target countries, we have to look through the number of employees by each of the business types in each country. In Georgia 474574, in Azerbaijan SMEs provided jobs for a total of 292022 people, in Armenia SMEs provided jobs for a total of 107187 people. Converting these numbers in percentage terms makes understanding the comparison better. It is clear from Figure 1 that in Georgia SMEs generate 62 percent of total employment in the country, in Azerbaijan SMEs generated 42.9% of total employment in the country, in Armenia SMEs generated 68% of total employment in the country. However, the base year for each information is slightly different, therefore a slight inaccuracy in the comparison may be observed.

Figure 1: The share of SMEs in the employment creation

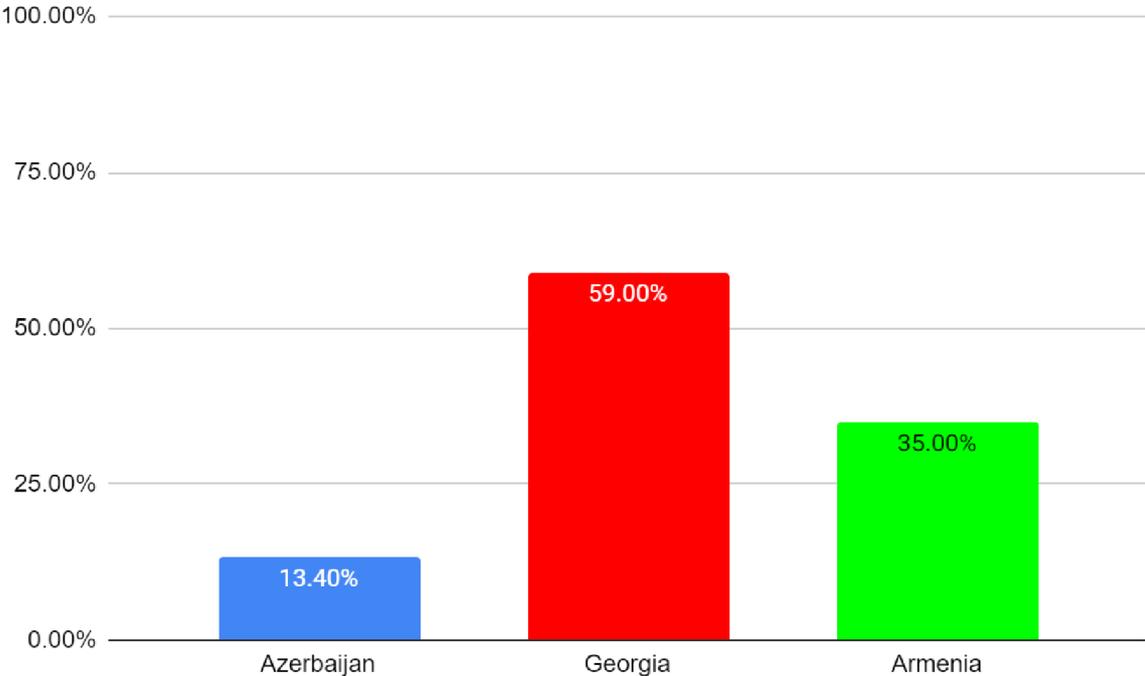


Source: The author used data from OECD (2020), GeoStats (2018), to create this Figure

Comparison of SMEs in terms of business could be possible to see how many percent of the GDP is spent for research and development in each country. For instance, research and development expenditure of Azerbaijan, Georgia, and Armenia was 0.21%, 0.1%, and 0.24% of the total GDP of the country respectively. In terms of innovation in the SME sector Armenia has more successful startups in the local and international market. On the other hand, Georgian and Azerbaijani Government put effort into increasing the number of innovative businesses. Improving the quality and quantity of innovative businesses could generate higher revenues and become vast enterprises in a short amount of time. However, Government's expenditure on research and development could be addressed in other sectors for instance health, military etc. Therefore, while comparing countries by their research and development expenditure we have to keep in mind that not all spending goes to SME sector development.

Comparing the effect of SMEs on the country's GDP could be possible by analysing how much SMEs contribute to the GDP of the country. Figure 2 shows the percentage of GDP which was provided by SMEs. Azerbaijan's economy is mainly based on natural resource revenues, therefore, the role of SMEs in the country's GDP (13.4%) is relatively less. Georgia, on the other hand, demonstrates the importance of SMEs in the economy, since SMEs consist of 59% of GDP. Despite having successful SMEs in Armenia, the role of SMEs in the GDP is 35%.

Figure 2: The share of SMEs in the GDP



Source: This figure is a combination of available data on SME Development Report, n.d. and Business Support Office, 2018.

Azerbaijan's economy is growing; however, the role of SMEs in this growth is considerably less. Because of the fact that the main production and export of Azerbaijan are oil and gas and petroleum related products. Azerbaijan needs diversification in its economy. The price of oil and gas is fluctuating, and Azerbaijan does not have a strong position to determine or affect the prices in the world market. Therefore, the development of small and medium-sized enterprises in the country can help Azerbaijan to improve other sectors and become less dependent on natural resources.

As it is clear from this research work, small and medium-sized enterprises play a crucial role in a country's economic development. SMEs contribute to economic development differently. This is due to several factors. For instance, Georgia is interested in SME development because of the fact that the country's natural resources are limited. In Georgia, government incentives play an important role in attracting different investors to the country. Therefore, starting a business in Georgia is relatively easy for entrepreneurs. Georgian Government keeps the level of taxes at the same rate for local and international investment. The geographical location of Georgia makes it an attractive destination for FDIs because entrepreneurs in the European Union countries and other developed countries struggle with the taxation of their countries. Therefore, they choose Georgia to invest and start a business; Georgia's proximity to Europe and to the Middle East makes it an ideal country to grow a business.

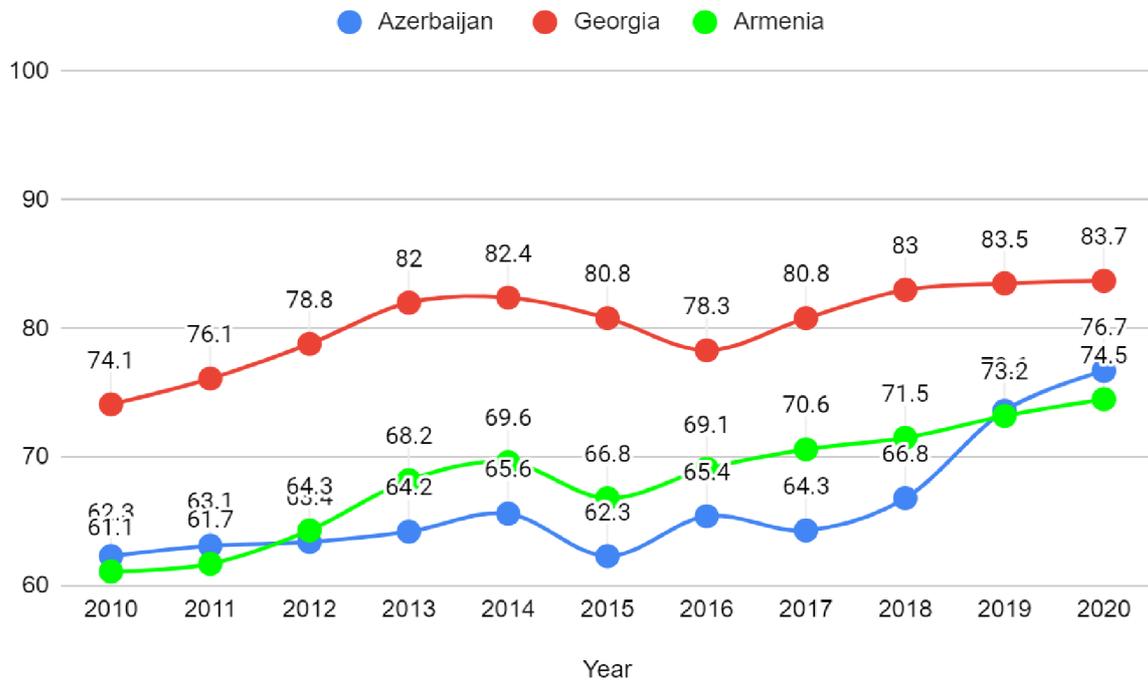
However, currently, the role of SMEs in the economic development of Georgia is limited. Due to several factors, the large population of the country engages in low productive sectors such as agriculture. On the other hand, limited access to financial institutions, lack of experienced labor force in the startup environment, low productivity of existing companies, and the small size economy of Georgia make the country's SME development slow. As the development of SMEs is slow, the effect of small and medium-sized enterprises on the country's economic development is low.

The development of the small and medium enterprises in Armenia is crucial for gaining economic stability in the country. Limited amount of natural resources, closed borders with two out of four neighboring countries, landlocked position, military conflict with Azerbaijan are the main reasons front of Armenia's economic development. Therefore, having a strong SME sector is important; not only are SMEs the main source of employment in the country but also SMEs make the country recognizable amongst foreign investors. As SMEs contribute to the economy of Armenia more than they do in Azerbaijan and Georgia, the Government of Armenia pays strong attention to the development of this sector. Moreover, the number of successful tech companies emerging from Armenia is growing.

One of the ways to compare the SMEs is to look through the Ease of Doing Business Score. This score is calculated by using various methods by the World Bank. Several *Doing Business*

topics have been used to create a single scoring system. The given quantitative indicators cover 10 different topics and create *Ease of Doing Business Score*. These topics are as follows: Starting a Business, Dealing with Construction Permits, Getting Electricity, Registering Property, Getting Credit, Protecting Minority Investors, Paying Taxes, Trading across Borders, Enforcing Contracts, Resolving Insolvency.

Figure 3: Ease of Doing Business Score



Source: The World Bank, Ease of Doing Business

It can be observed from Figure 3 that Georgia has a steady increase on Ease of Doing Business. Findings in this thesis also support the idea that Georgia has a favorable environment to start a business and create successful small and medium sized enterprises. Azerbaijan and Armenia also show steady growth. Amongst these countries Azerbaijan has the lowest Ease of Doing Business Score. It can be explained by the effect of Dutch Disease as well as the corruption level in the country. According to the Doing Business Report 2020, Georgia is ranked 7th, Azerbaijan is ranked 34th, and Armenia is ranked 47th in the world out of 190 countries, based on their Ease of Doing Business Scores.

Scoring higher in the Ease of Doing Business report can reveal various aspects of the country. Doshi et al. (2019) point out in their paper that not only the World Bank and respective countries are aware of the situation of businesses, but also domestic and international investors have a broader overview on the business environment of the country. Therefore, we can conclude that comparing the SMEs and their effects on target countries according to Ease of Doing Business Score is applicable.

Discussion

This chapter is divided into three sections, highlighting the role of SMEs in Azerbaijan, Georgia, and Armenia's economy respectively.

Azerbaijan:

Considering the findings of the paper the role of SMEs in Azerbaijan's economy is relatively lower than the other target countries of this research. As initially mentioned, Azerbaijan's economy suffers from the *Dutch Disease*, namely the main source of the economy is the oil and gas sector. It is understandable why the SME sector development and the contribution of SMEs in the local economy is lower. This is mainly the matter of incentive by the Government and people. The necessity of developing sectors other than oil and gas is a lower priority for the newly independent country full of natural resources. However, in order to diversify the economy of the country, the non-oil sector must be carefully invested.

Azerbaijani Government creates support programs for SMEs, and improves registration processes. However, the certain negative aspects of the country discourage the entrepreneurs to invest and build their companies in Azerbaijan. Therefore, most of the SMEs are in the wholesale and retail trade sector which cannot be imported to the country. Creating a successful startup in the country is a hard process, due to the corruption, limited improvement in the business environment, etc. That could be the one of the main reasons that the role of SMEs in the GDP falls far behind the OECD countries. On the other hand, for future development the country has a major advantage to improve the role of SMEs in the economy. If the Government support programs become successful in the future, SMEs' participation in the economy will also increase.

While conducting the SWOT analysis of SMEs in Azerbaijan I realized that there are more threats and weaknesses than the opportunities and strengths. The main reason could be the country is a transition country which gained the dependence only three decades ago. Therefore, it is not enough time to create a sustainable business environment. All in all, the role of SMEs in Azerbaijan's economy is proportionally small, but growing over time. Based on the literature reviews and findings of this paper, I predict that in Azerbaijan the role of SMEs in the economy won't exceed the oil and gas sector in the near future.

Georgia:

My initial predictions about the role of SMEs in Georgia's economy was met after completing the research. The main reason behind Georgia's success in the SME sector development is investing and creating better incentives to promote SMEs. Georgia has natural resources however the share of natural resources in the country's economy is lower. Georgia after gaining independence from the Soviet Union suffered economically. One way to attract money into the country was to attract FDIs. Therefore, in the country there is an attractive ground for investing in a new business. As we observed in Chapter 4 that in Georgia's GDP SMEs contribute 59%.

This share of SMEs in GDP is observed normally in the developed economies. Here we have to keep in mind that Georgia's economy is relatively smaller than Azerbaijan.

Georgia is not only a solid ground for foreign investors, but also an attractive place for locals. The offered tax incentives as well as reduced or no tax for starting businesses make the process easier and attractive. Considering the fact that Georgia's main economic, entrepreneurial, and business hub is the capital city. The majority of the regions are rural areas where the main economic activity is agriculture.

On the other hand, SWOT analysis of the SME sector in Georgia shows that the current development level of SMEs is reasonable and there is room for improvement in the future as well. One of the main reasons is that the newly established businesses pay an inconsiderable amount of taxes. However, this factor alone is not compatible in the world. Countries like Belize, Panama provide the same tax rates. Georgia's main advantage is its geographical location, the country is in between Europe and Asia.

Armenia:

Out of these three target countries, Armenia is influenced by the role of SMEs the most in terms of employment. The relation of the SMEs and economy follows the logic. In order to increase the GDP the country must produce and participate in international trade. The major disadvantages of Armenia are being a landlocked country and having an ongoing conflict with neighboring countries. Therefore, the potential to increase the economy is to create more businesses in the country. Some businesses become successful enough to change their status from micro business to small, small to medium, medium to large.

Considering the SWOT analysis of the SMEs in Armenia the potential for further growth is inevitable. However, dependency on the volatilities in the international market could be a major setback. For instance, the current pandemic, and the war with Azerbaijan decreased the economy of the country. This negative aspect directly impacts the SME development and their impact on the country's economic development. All in all, Armenia's potential for SME growth will eventually lead to a higher share of SME incomes in the country's GDP.

Analysing the role of SMEs in the target country in terms of employment generation, innovation, and impact on GDP give the readers a solid understanding of how and why the role of SMEs are different from country to country. Finding answers to the research questions could potentially help investors, policymakers to understand the importance of the SME sector in the country's economic situation. Therefore, I find that this research topic has potential to do further and deeper analysis in various countries. As the author of this paper, I truly hope that the present paper will guide the future researchers of the topic.

Conclusion

SMEs are the main economic development mechanism in many countries. Due to the role of SMEs in economic development, their positive effects on job creation, reduction of income inequality, and poverty alleviation are widely known in recent years. Comprehensive research shows that SMEs have considerable effects on countries' economic growth. However, each country's GDP gets a different share from small and medium-sized enterprises. In Armenia, SMEs are the main source of income and employment generation; however, in Azerbaijan, larger companies provide more employment. The development level of SMEs, as well as government support to SME development, vary from countries' view on SMEs.

There are several factors negatively affecting SME development in Georgia, Azerbaijan, and Armenia. The common issue in all three countries is the lack of access to finance, and banks are reluctant to provide loans for startups or individuals due to the fact that lending money to entrepreneurs seems risky for banks. Engaging in military conflicts: all three countries have had military conflicts in the last two decades. Most recently, Azerbaijan and Armenia declared war against each other on the Nagorno-Karabakh territory. Having military conflicts causes various issues, including discouraging foreign investors from investing in the country. Additionally, once there is a military conflict in the country, the government's military expenditure is growing. Another common issue in terms of SME development in the South Caucasus countries is the lack of an experienced labor force to manage and develop a business. It is understandable that all three countries gained their independence in the early 1990s.

SMEs, which follow the markets closely, understand customer needs better, and are in close contact with their employees, are more flexible than large companies in production, marketing, and service. Because this flexibility allows it to adapt to changes in time and space, SMEs can easily overcome many problems with minimal damage. Although SMEs have some weaknesses, they are subject to changing conditions. They also absorb the effects of the economic crisis and play a squeezing role. In this context, SMEs are of vital importance, especially for developing countries.

Given the above, it can be concluded that the effects of SMEs on the economic development of a country are obvious. Countries try to implement various support mechanisms to achieve strong SME sector development. However, in Azerbaijan, for instance, the level of contribution

of SMEs to GDP is not high enough. Therefore, the future plans of the Government of Azerbaijan are to put emphasis on SME development. This research paper helps readers to understand the role of SMEs in economic development. Below recommendations have been added to consider potential ways to improve the SME sector in the South Caucasus countries, Georgia, Azerbaijan, and Armenia. This paper provides information about the effects of the SME sector on the economic development of Azerbaijan, Georgia, and Armenia. As well as, the current status of the SME sector in Azerbaijan, Georgia, and Armenia.

Limitations and recommendations to improve the quality of future researches

Currently, in all three countries, there is a lack of reliable and detailed information about the effect of small and medium-sized businesses on the economic development of a nation. This limitation causes various issues in the research; first of all, limited access to the up-to-date data makes it hard to demonstrate the current situation in the country. Therefore, I suggest the following recommendation to the statistical committees of each country.

Improving statistics about SMEs by creating a single database to store available information is crucial for having extensive future research. In order to make the database more detailed, contributions of each sector can be added, the size of a business can be mentioned, as well as the number of employees in each of the companies should be noted.

Considering the fact that each country uses a different definition to SMEs, therefore comparison of SMEs might be slightly inaccurate. Additionally, used data in this research paper is from various years, therefore slight inaccuracies might be observed.

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