

Impact of Small and Medium Enterprise-oriented Reforms in Azerbaijan on their Economic Performance

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Abstract

One of the main economic factors supporting the economies of the modern world is small and medium enterprises (SMEs), and in recent years the Azerbaijani government, which aims to minimize dependence on oil, is implementing reforms to support SME sector. The Small and Medium Business Development Agency of the Republic of Azerbaijan, established in 2017, is a clear example of this approach. The purpose of this article is to conduct a descriptive analysis of the impact of SME-supporting economic reforms on the economic performance of SMEs. The article analyzes the changes and trends in the macroeconomic indicators of SMEs in 2006-2019 based on the data of the State Statistics Committee of the Republic of Azerbaijan, and examines the impact of SME reforms on SMEs, especially after 2016. The figures suggest that the reforms have positive effects and there are growing trends in terms of both value added and employment created by SMEs. Despite these positive results, the share of SMEs in the GDP and in employment of Azerbaijan is still low compared to developed countries.

1 Introduction

In the modern world, Small and Medium Businesses (hereinafter SMEs) are important as the most dynamic players in the economy of any country. In this context, governments prefer to support SMEs for their contribution to both GDP and employment (Robu, 2013). When we look at the world economy, we see that small and medium enterprises are the driving force behind the national economies in these two areas. The report by the OECD, which reflects the economic performance of SMEs in different countries, shows that about 70% of employees in all OECD countries work in small and medium enterprises (OECD, 2019). According to the World Bank, SME output accounts for about 40% of GDP in developing countries (Ndiaye, Razak, Nagayev, & Ng, 2018). Given the large scale of the shadow economy in developing countries, it is safe to say that this ratio is higher.

In recent decades, with the development of technology and the growing trend of internationalization, competition in today's world economy has reached a high level. Today's businesses must have a more flexible structure to respond quickly to changing technology and implement the processes needed to compete in a timely manner. In this context, SMEs have the opportunity to make more effective decisions, even in times of economic crisis, because they are more agile and a decision-making body. Taking into account these factors, it can be said that SMEs are one of the cornerstones of the national economy, and various studies support this idea (Mahmudova, 2019). For example, a study by Siam & Rahahleh (2010) found that SMEs have great potential in terms of creating employment opportunities, maximizing economic growth, and creating a positive impact in the context of unemployment.

Given these factors, small and medium enterprises are one of the most important and effective tools that governments can use to support and further develop the economy. For this reason, we see the implementation of various economic policies and programs for SMEs in developed countries. The development of SMEs in Azerbaijan will lead to sustainable economic development by reducing the dependence on imports through the efficient use of local resources (Bayramov, Hasanov, Aghayarli, Aghahasanli, & Isayev, 2017). The Azerbaijani government, which wants to revive the economy after gaining independence, is trying to take advantage of this driving force of SMEs as much as possible. In particular, since 2016, various economic decisions have been made to support SMEs and serious reforms have been implemented.

As follows, on December 6, 2016, the President of the Republic of Azerbaijan approved the "The Strategic Road Map on Consumer Goods Production at Small and Medium Enterprise Level in the Republic of Azerbaijan". The main goal of the Strategic Road Map is to identify short, medium and long-term priorities of SME-supporting economic reforms to create a competitive environment in the national economy and ensure inclusiveness and sustainable development. In this context, 5 strategic goals were identified. In the Strategy Roadmap, a number of activities are listed in order to achieve these strategic goals and increase the contribution of SMEs to the national economy, and most of these activities have already been realized (2016). Figure 3 covers the activities related to SMEs in Azerbaijan. In particular, activities are carried out within the scope of AZPROMO to increase the export volume of SMEs, which include information support, customs clearance services and the issuance of Free Sale Certificates, which are documents confirming the quality and origin of the products (OECD et al., 2020). However, there are still many shortcomings in the context of encouraging the export orientation of SMEs. In order to eliminate these shortcomings, effective policies should be implemented in order to first identify the problems faced by SMEs in exports and then to solve these problems.

Framework	Major reforms implemented in 2016-2020
Responsive government	2016-2020 SME strategy adopted and under implementation SME Development Agency established in 2017 Licensing processes streamlined E-government services improved
Entrepreneurial human capital	Well-functioning formal policy partnership in the area of women's entrepreneurship Policy partnership on entrepreneurial learning established, led by the SME Agency's Lifelong Learning Commission The country's SME agency mandated with coordinating stakeholders involved in skills intelligence collection and analysis
Access to finance	Private credit bureau and movable collateral registry in place Credit guarantee fund established Public-sector Entrepreneurship Development Fund and Credit Guarantee Fund established (will help ease access to finance) National Financial Literacy Strategy launched (under the auspices of the Central Bank of Azerbaijan)
Access to markets	Export Promotion Centre established and information support and e-services for exporting SMEs expanded Law on public procurement amended Standardization and accreditation infrastructure strengthened
Innovation and Business Support	National Innovation Agency established Three technology parks established SME agency tasked with designing and implementing a wide range of business development programs

Source: OECD et al. (2020). Chapter 8. Azerbaijan: Small Business Act country profile. In SME Policy Index: Eastern Partner Countries 2020: Assessing the Implementation of the Small Business Act for Europe, SME Policy Index. Paris/European Union, Brussels: OECD Publishing.

Table 1. Major reforms implemented in 2016-2020

2 Literature Review

Small and medium-sized enterprises play an important role in the economic development of countries, regardless of their level of development. Even if large enterprises gained importance after the industrial revolution, SMEs started to come to the fore in the fields of reproduction, competition and employment with the information age initiated by the information revolution. Entrepreneurial economies provide the source of economic development all over the world, largely through SMEs. SMEs have an important share in both employment and national economy in many countries. Table 1 gives general information about the situation of SMEs in the European Union (Murphy, Smid, Aranda et al, 2021). The data on the European Union reveals once again how important SMEs are, especially in the economies of developed countries. That is, when we look at the business data only, we see that SMEs have a share of 99.8%, and it shows that micro enterprises are of greater importance among SMEs. When we consider the total created value added in 27 European countries, the data shows that SMEs have a 53% share. When we examine the employment figures, the importance of SMEs emerges once again. Namely, 65% of employment is provided by SMEs.

	Enterprises		Value added		Employment	
	Number	%	Value in € million	%	Number	%
Micro SMEs	21,044,884	93.30%	1,179,476	18.70%	36,988,539	29.20%
Small SMEs	1,282,211	5.70%	1,071,196	17.00%	25,313,006	20.00%
Medium sized SMEs	199,362	0.90%	1,087,613	17.30%	20,130,548	15.90%
All SMEs	22,526,457	99.80%	3,338,286	53.00%	82,432,093	65.00%
Large enterprises	40,843	0.20%	2,956,544	47.00%	44,358,284	35.00%
All enterprises	22,567,300	100.00%	6,294,829	100.00%	126,790,377	100.00%

Source: Annual report on European SMEs 2020/2021: digitalisation of SMEs

Table 2. Share of SME's in total number of enterprises, value added and employment in the EU-27 in 2020

To understand the importance of SMEs, it is necessary to consider their contribution to the economy and their strengths. Functions in the economy, such as dynamism, employment, protection of competition, protection of the middle class, are some of the contributions of SMEs to the economy and the social system (Laurențiu, 2016). In addition, the advantages of SMEs are that they are more flexible than large enterprises, have less bureaucracy, and have a simpler organizational structure (Ratko & Ulgen, 2009). It can be seen that the ability of SMEs with flexible production structures to adapt quickly to changes and enter the market in a timely manner has brought significant dynamism to the economy compared to integrated manufacturing enterprises employing thousands of workers

(Chen & Li, 2010). It is recognized that SMEs play a fundamental role in economic development and the country's well-being by creating new businesses (Honjo & Harada, 2006). In addition, as Agus vd. (2015) points out, if opportunities are created for the creation of a competitive environment among SMEs, this will significantly contribute to economic growth. In addition, SMEs are able to adapt quickly to changes in the market due to their flexible structures (Berry, Rodriguez, & Sandee, 2002). Unlike large enterprises, they are more effective in implementing new services and launching new products, especially in times of crisis (Hodorogel, 2009). Robu (2013) also drew attention to this issue in his research and concluded that countries that want to revive the economy need to support the development of SMEs by providing competitive conditions. Another study found that many small-scale enterprises in Indonesia were more resilient than large-scale enterprises during the East Asian Crisis due to their agility (Nichter & Goldmark, 2009).

3 Research Method

The article examines how the reforms implemented for SMEs in Azerbaijan affect the economic situation of SMEs. Qualitative research method is used as research method. In this context, descriptive graphical analysis method is used. The data used in the analysis are compiled from The State Statistics Committee of the Republic of Azerbaijan. These data cover the years 2006-2019. Since the effects of the pandemic were predominantly manifested in 2020, the data of 2020 was not used. In order to determine the economic power of SMEs, it is examined how data such as the added value created by SMEs, the number of employees in SMEs, fixed capital investments and average wages change over the years. One point that should be especially noted here is that the definition of SMEs has changed over time, and in order to reveal this difference, existing deposits have been researched and SME definitions for each period have been given separately. This information will allow us to more clearly understand the change over the years.

4 Results

4.1 Classification of Small and Medium Business Entities in Azerbaijan

If we look at the existing statistics of the State Statistics Committee of the Republic of Azerbaijan on entrepreneurship, it is seen that there are three different forms of classification. For this reason, the macroeconomic indicators of SMEs are reflected below, and in some years, there are significant differences. To understand these differences, it is useful to look at the relevant decisions of the Cabinet of Ministers on the limits of the criteria for determining small and medium enterprises. In this context, the SME classification used until 2015 was determined on the basis of criteria approved by the Resolution of the Cabinet of Ministers of the Republic of Azerbaijan No. 192 of December 18, 2009. Table 2 shows these criteria.

Entrepreneurship category	Average number of employees (people)	Annual turnover (excluding VAT, excise tax)
Industry and construction	< 50	≤ 500 000 manat
Agriculture	< 25	≤ 250 000 manat
Wholesale trade	< 15	≤ 1 000 000 manat
Retail trade, transport, services, and other economic activities	< 10	≤ 250 000 manat

Table 3: Criteria for small business approved by the Resolution of the Cabinet of Ministers of the Republic of Azerbaijan No. 192 dated December 18, 2009

In 2015, the Cabinet of Ministers of the Republic of Azerbaijan adopted new criteria for determining small, medium, and large enterprises, and all statistical indicators obtained later this year were compiled on the basis of these criteria. Table 3 shows the criteria in question.

Category by size of business entities	Average number of employees	Annual income (thousand manat)
Small	Up to 25	Up to 200 manat
Medium	From 25 to 125	From 200 to 1 250 manat
Large	125 and more	1 250 manat and more

Table 4. Criteria for small, medium, and large entrepreneurship approved by the Resolution of the Cabinet of Ministers of the Republic of Azerbaijan No. 215 dated June 5, 2015

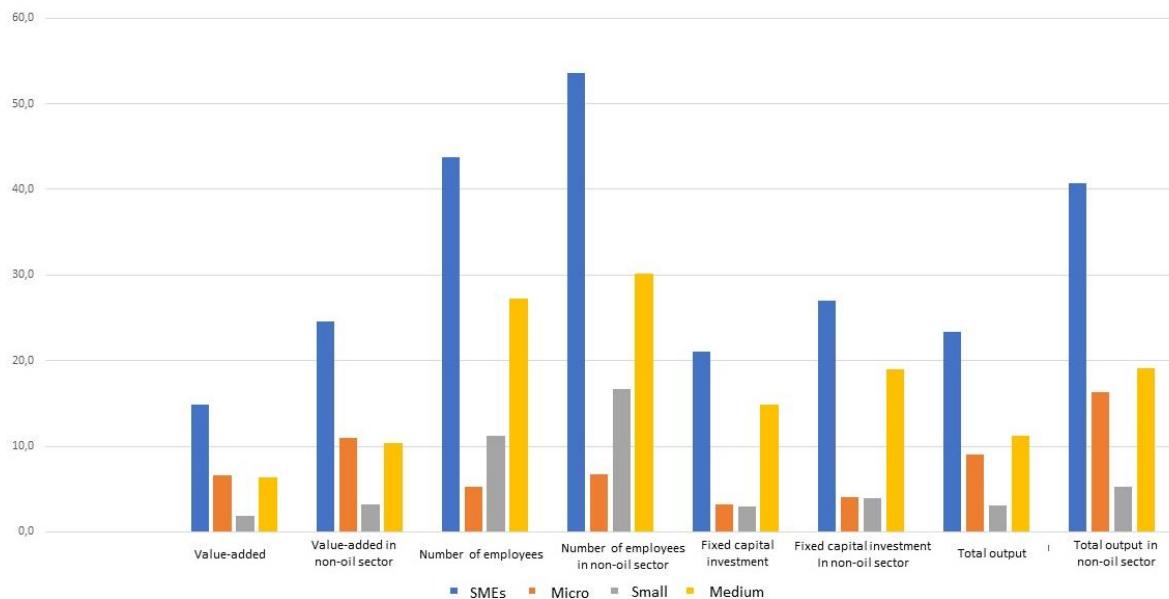
From 2018, entrepreneurs in Azerbaijan are classified into 4 categories. Thus, according to the decision of the Cabinet of Ministers of the Republic of Azerbaijan No. 556 dated December 21, 2018, micro, small, medium and large entrepreneurship criteria were approved. These criteria, which coincide with existing standards for small and medium enterprises in the world, are reflected in Table 4.

Category by size of business entities	Average number of employees	Annual income (ai) (thousand manat)
Micro	1-10	$Ai \leq 200$
Small	11-50	$200 < ai \leq 3\,000$
Medium	51-250	$3\,000 < ai \leq 30\,000$
Large	251 and more	$30\,000 < ai$

Table 5. Criteria for micro, small, medium, and large entrepreneurship approved by the Resolution No. 556 of the Cabinet of Ministers of the Republic of Azerbaijan dated December 21, 2018

4.2 Macroeconomic Indicators of Small and Medium Entrepreneurship in Azerbaijan

If we consider the activities of SMEs in Azerbaijan, it is possible to see that the macroeconomic indicators are below the world average. Graph 1 shows the data of SMEs in 2019 in terms of value added, fixed capital investment and output. Looking at these data, the ratio of SMEs to total employment is 43.7%, and the ratio of value added by SMEs to the economy is 14.9% of the total value added created in the current year. Along with these indicators, the share of SMEs in fixed capital investment and output is 21% and 23.3%, respectively. Given that Azerbaijan's economy is dependent on oil, assessing the performance of SMEs in the non-oil sector may provide a clearer picture. However, the indicators for the non-oil sector are not at the level of the world average. Thus, 53.6% of employees in the non-oil sector operate in SMEs, and only 24.6% of the total value added belongs to SMEs. In the non-oil sector, 27% and 40.7% of fixed capital investments and output, respectively, belong to small and medium enterprises.



Source: The State Statistics Committee of the Republic of Azerbaijan.

Figure 1. Share of micro, small, and medium business entities in Azerbaijan on relevant economic indicators, in percent

Looking at the macroeconomic indicators of SMEs in Azerbaijan, in general, compared to previous years, there is a significant increase in 2019 per capita. Although some of these increases can be attributed to changes in the criteria for the classification of SMEs, especially in recent years, the active support of SMEs has led to an increase in government support for small and medium enterprises, which improves the economic situation of SMEs.

Table 5 reflects the main macroeconomic indicators of SMEs in Azerbaijan for 2006-2019. Although SMEs created an additional value of 364.7 million manat in the country's economy in 2006, this figure has increased in the following years. Thus, in 2010 the number of SMEs increased by about 3 times compared to 2006, in 2015 by about 1.8 times more than in 2010, and in 2019 by 5.6 times more than in 2015. value created. Given that the 2006 SME classification criteria partially met the 2018 SME classification criteria for micro and small businesses, it would be more accurate to compare the 2019 value added created by micro and small businesses with the 2006 figures. In this context, the value added created by micro-entities in 2019 was 13.4 times higher than in 2006, 4.4 times higher than in 2010, and 2.5 times higher than in 2015.

Looking at the employment indicators, the number of people working in SMEs has increased significantly between 2006 and 2019. Thus, although 87.5 thousand people operated in small businesses in 2006, this figure was 93.2 thousand in 2010 and 87.6 thousand in 2015 (although in 2015 this figure was relatively low, in 2013 and 201 The number of employees in small businesses was 109 and 115 thousand people, respectively), in 2019,

only 125.3 thousand people worked in micro and small businesses, and a total of 332.2 thousand people in micro, small and medium businesses.

Indicators		Created value added, million manat	Number of employees, thousand people	Average monthly nominal salary, manat	Fixed capital investments, million manat
2006	Small	364.7	87.5	130	199.1
2007	Small	449.2	92.1	170.7	289.4
2008	Small	718.7	103.2	182.1	371.2
2009	Small	844.8	105.9	195.2	289.3
2010	Small	1120	93.2	207	276.3
2011	Small	1691.8	90.2	222.2	737.6
2012	Small	2081	95.5	263.3	531.6
2013	Small	2453.3	109	303.5	486.3
2014	Small	2362.8	115	348	746.5
2015	Small and Medium	1987.8	87.6	302.1	807.2
2016	Small	2928	100.9	322.2	1828.6
	Medium	659.2	180.1	349.1	1001.6
	Total	3587.2	281	338.6	2830.2
2017	Small	3051.9	101.9	331.5	2064.8
	Medium	755.7	188.2	365.9	1233.8
	Total	3807.6	290.1	352.8	3298.6
2018	Micro	4467.8	35	294.9	2831.5
	Small	1235.5	76.1	373.5	1046.7
	Medium	4133.3	172.4	517.1	3074.8
	Total	9836.6	283.4	445.3	6953
2019	Micro	4900.8	40.2	332.5	515.5
	Small	1423.2	85.1	437.0	494.2
	Medium	4747.7	206.9	624.6	2412.5
	Total	11071.7	332.2	531.0	3422.2

Source: The State Statistics Committee of the Republic of Azerbaijan

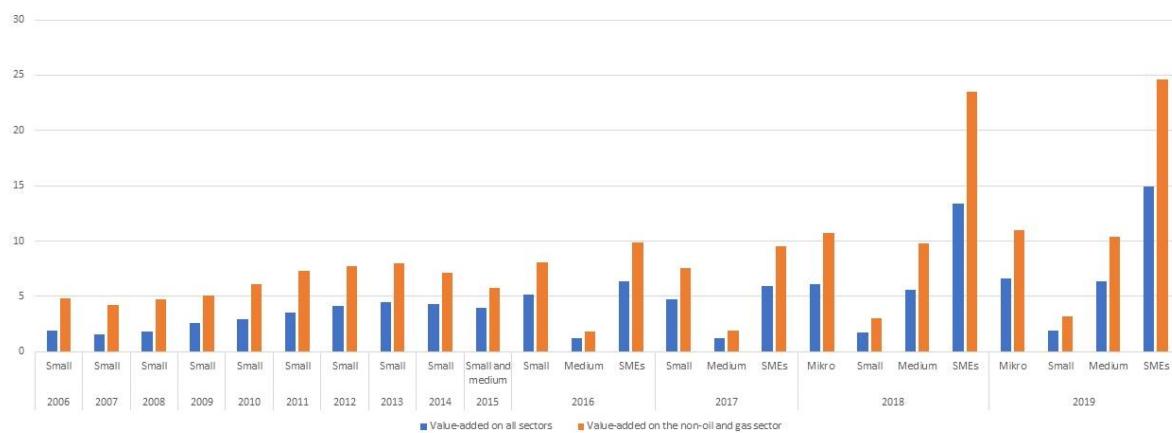
Table 5. Key macroeconomic indicators of SMEs (2006-2019)

The average monthly nominal wage also increased between 2006 and 2019. The average monthly salary of small businesses in 2006 was 130 manat, in 2010 it was 207 manat, in 2015 it was 302.1 manat, and in 2019 it was 332.5 manat for micro businesses, 437 manat for small businesses and 624.6 manat for medium businesses. and an average of 531 manat for total SMEs. Unfortunately, in the absence of indicators of average real wages, it is impossible to describe more clearly whether there is an increase in this aspect.

Finally, fixed capital investment by SMEs has also increased in these years. In 2016, the investment of small entrepreneurs in fixed assets amounted to 199.1 million manat. In 2010, this figure reached 276.3 million manat, and in 2015, small entrepreneurs invested 807.2 million manat in fixed assets. In 2019, the investment in fixed assets of micro-entrepreneurs alone was 515.5 million manat, and the investment of small entrepreneurs was 494.2 million manat. In general, in 2019, the investment of SMEs in fixed assets amounted to 3422.2 million manat.

Looking at all the above macroeconomic indicators, we see that there are positive trends in the dynamics of SME development. It is true that the effect of inflation on the growth of the other three indicators, with the exception of the relevant indicator on employment, cannot be denied. As mentioned above, if there were real figures for these indicators, rather than nominal ones, it would be possible to more accurately express the trend of economic dynamics achieved by SMEs in 2006-2019. However, the share of SMEs in the country's economy in terms of relevant indicators (in particular, value added, number of employees and fixed capital investments) will provide a basis for our opinion on whether they are more active in the country's economy in the relevant years. The analysis in this context is reflected below. Figure 2. The ratio of value added created by SMEs in 2006-2019 to the total value added generated by both sectors and the non-oil sector, or in other words, the share of SMEs in GDP. In 2006, 1.9% of value added in all sectors was created by SMEs, while in 2010, 2015 and 2019 these figures were 2.9%, 4% and 14.9%, respectively. Unfortunately, the available statistics do not make it possible to obtain data for other years in accordance with the approved SME classification in 2018. Instead, based on the 2009 classification criteria, it is possible to approximate the share of value added created by SMEs in 2006 and 2019 in the value added generated by all sectors. Thus, although not fully accurate, according to the criteria approved in 2018, it is possible to link some micro and small entrepreneurs to the category of small entrepreneurs approved in 2009. Prior to the introduction of the new SME classification criteria in 2015, the highest value that SMEs had on this indicator was 4.5% in 2013. In 2019, the ratio of value added created only by micro-entrepreneurs to value added created in

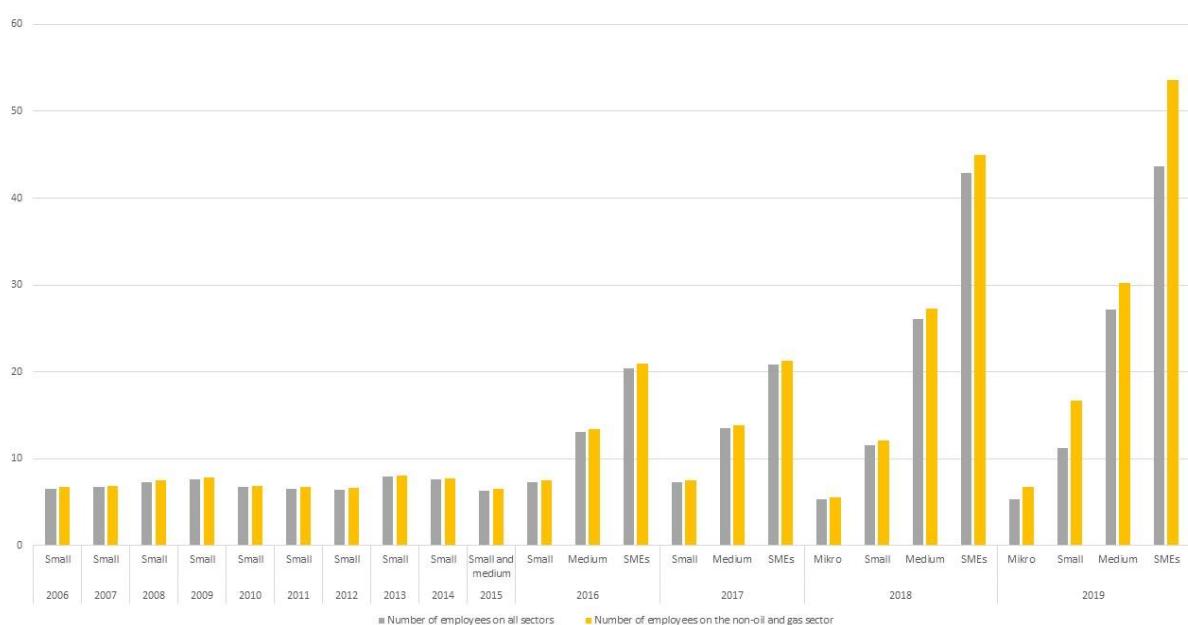
all sectors was 6.6%, and the share of micro and small business activities in GDP was 8.5%. Figure 2. shows that the share of SMEs in GDP, especially in the non-oil sector, has improved over the years. Thus, although the share of SMEs in GDP in the non-oil sector was 4.8% in 2006 and 5.8% in 2015, in 2019 only the share of micro-entrepreneurs in GDP in the non-oil sector It was 11%.



Source: The State Statistics Committee of the Republic of Azerbaijan

Figure 2. Share of SMEs in GDP (%)

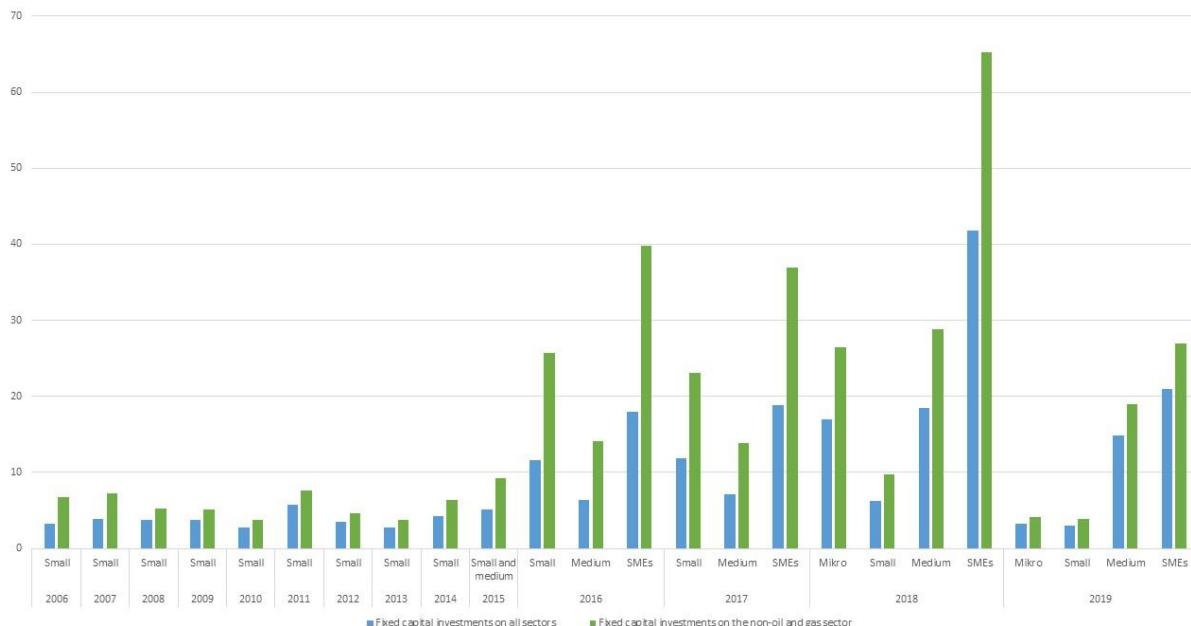
A number of economic theorists and researchers agree that SMEs play a significant role in providing employment in the country's economy. In some countries, small and medium enterprises account for 70-80% of the employed population. The goal is to increase the share of SMEs in employment to 70%. Figure 3 shows the share of small and medium enterprises in the employed population during 2006-2019. As can be seen from the graph, in 2006 and 2015 the share of SMEs in employment in all sectors was 6.5 and 6.3%, respectively, but in 2019 this figure was 43.7%. The impact of the above SME classification criteria is also reflected in the fact that in 2019, the ratio of employees in micro-enterprises to total employment was 5.3%, and the corresponding ratio of micro and small businesses was 16.2%. This indicator also shows the positive effects of SMEs in the context of employment over the years. Looking at the non-oil sector, the share of SMEs in employment, which was 6.8% in 2006, increased significantly in 2019. Thus, the share of micro-entrepreneurship in employment in the non-oil sector was 6.7%, and the share of micro and small entrepreneurship in general was 23.4%. The share of SMEs in the total non-oil sector employment in 2019, determined according to the 2018 classification criteria, was 53.6%. This figure is 19.1% higher than the corresponding figure recorded in 2018.



Source: The State Statistics Committee of the Republic of Azerbaijan

Figure 3. The share of SMEs in employment

The share of SMEs in fixed capital investment in total fixed capital investment in the country's economy, as shown in Figure 4, increased during 2006-2019. Thus, despite the fact that in 2006 the share of SMEs on the relevant indicator was 3.3%, in 2019, micro and small entrepreneurs had a total share of 6.2% on this indicator, and micro, small and medium entrepreneurs together had a share of 21%. In this context, it is possible to say that especially according to the 2018 SME classification criteria, the average entrepreneur covers the notable values. Another crucial point in Chart 4 is that the share of SMEs in fixed assets in the country's economy reached its maximum in 2018. Thus, in 2018, 41.8% of fixed capital investments in all sectors in the country, and 65.2% in the non-oil sector were made by SMEs.



Source: The State Statistics Committee of the Republic of Azerbaijan

Figure 4. Relevant share of SMEs in fixed capital investment

5 Conclusion and Discussion

The main purpose of the article is to provide a general analysis of how the economic reforms applied to SMEs in Azerbaijan have affected their macroeconomic situation. In this context, the existing data of the State Statistics Committee of the Republic of Azerbaijan for 2006-2019 were used. The article considers the Strategic Roadmap adopted in 2016, aimed at reviving the SME sector, as the beginning of decisive economic reforms in this area. To study the impact of reforms on the economic performance of SMEs, we can compare the period before (including 2016 as well) and after 2016.

The article assesses four different indicators: value added, average number of employees, average nominal wage, and fixed capital investment. To create an initial picture, a comparative analysis of the nominal values of these indicators (excluding the relevant employment indicator) was conducted over the years. The analysis takes into account that SMEs are also classified according to different criteria in different years. Approaching from this framework, if we take into account the indicators of micro and small businesses in 2018 and 2019, we can see that there is an increase in four indicators compared to previous years. This fact shows that the reforms have yielded positive results. In particular, while the fact that in 2018, 65.2% of investments in fixed assets in the non-oil sector in the country were made by SMEs, once again shows the positive effects of reforms, it also emphasizes the importance of SMEs for the development of the national economy and the reduction of dependence on oil.

Although the study reflects the macroeconomic situation of SMEs in Azerbaijan after the reforms, there are some limitations of the research. As follows, both the different classification of SMEs over the years, as well as the lack of sufficient monthly, quarterly or annual data do not allow to establish an econometric model to determine the factors affecting the economic performance of SMEs.

For further research on this topic, it is recommended to communicate directly with SMEs through a questionnaire survey, which is one of the quantitative research methods, and to study their opinions and level of awareness on applied policies.

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