

*Increasing SMEs' access to  
finance in Azerbaijan through  
the capital market*

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# SMEs as an engine of economic growth



- ❖ Fostering an innovation and technology (long run economic growth)
- ❖ Generating employment
- ❖ Increasing production
- ❖ Increasing standard of living

# Insufficient contribution of SMEs to the Azerbaijan Economy



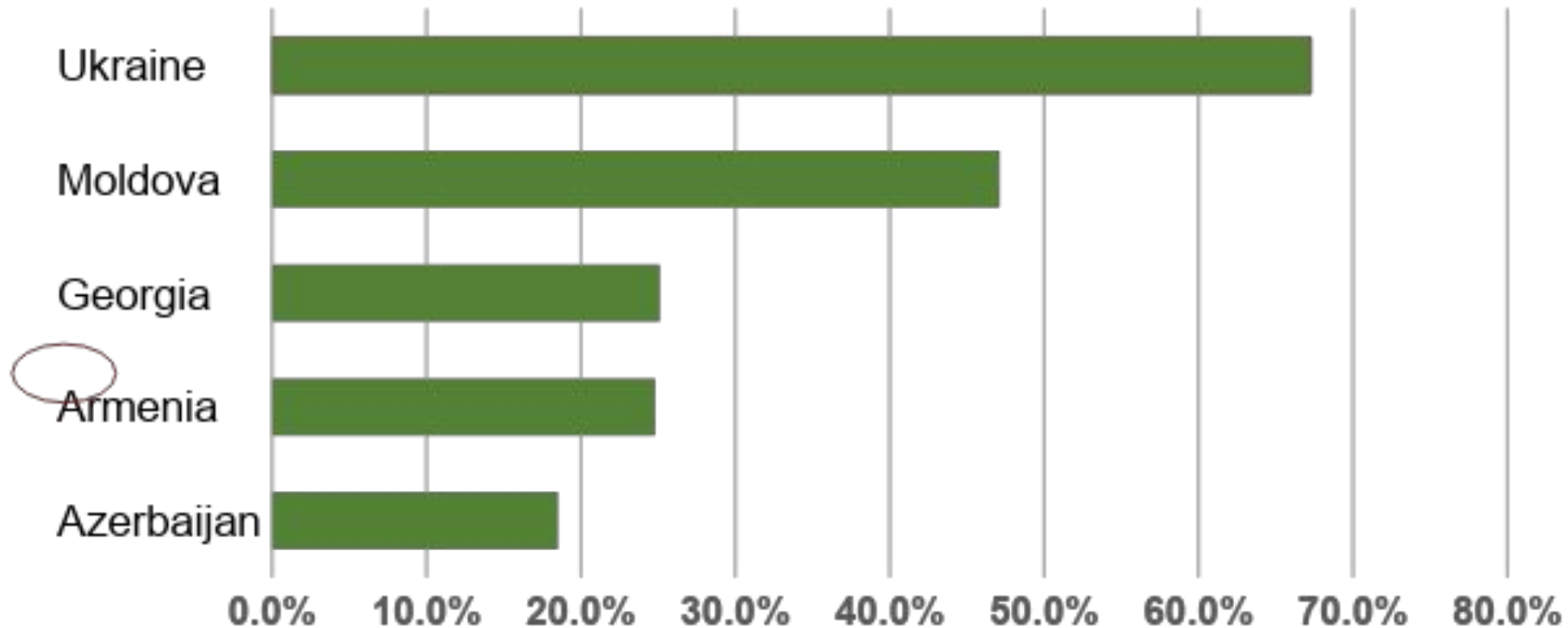
Indicator (%)	2015			2016		
	Total	Small	Medium	Total	Small	Medium
1. Value Added	7.5	5.9	1.6	↓ 6.4	5.2	1.2
<i>non-oil sector</i>	10.9	8.6	2.3	↓ 9.9	8.1	1.8
2. Number of Employees	18.7	5.8	12.9	↓ 18.5	6.6	11.8
<i>non-oil sector</i>	19.1	5.9	13.2	↓ 18.9	6.8	12.1

Source: EU4 Business Report

# Contribution of SMEs to an employment



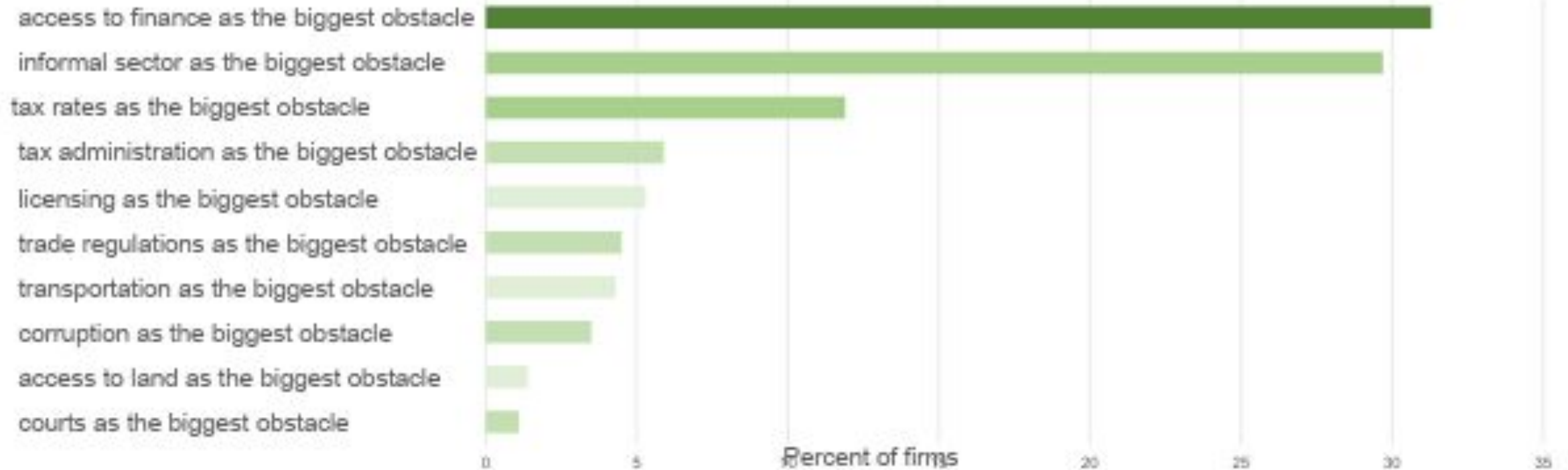
Azerbaijan falls behind in terms of SMEs' contribution to an unemployment



# Factors inhibiting SMEs role in Azerbaijan?

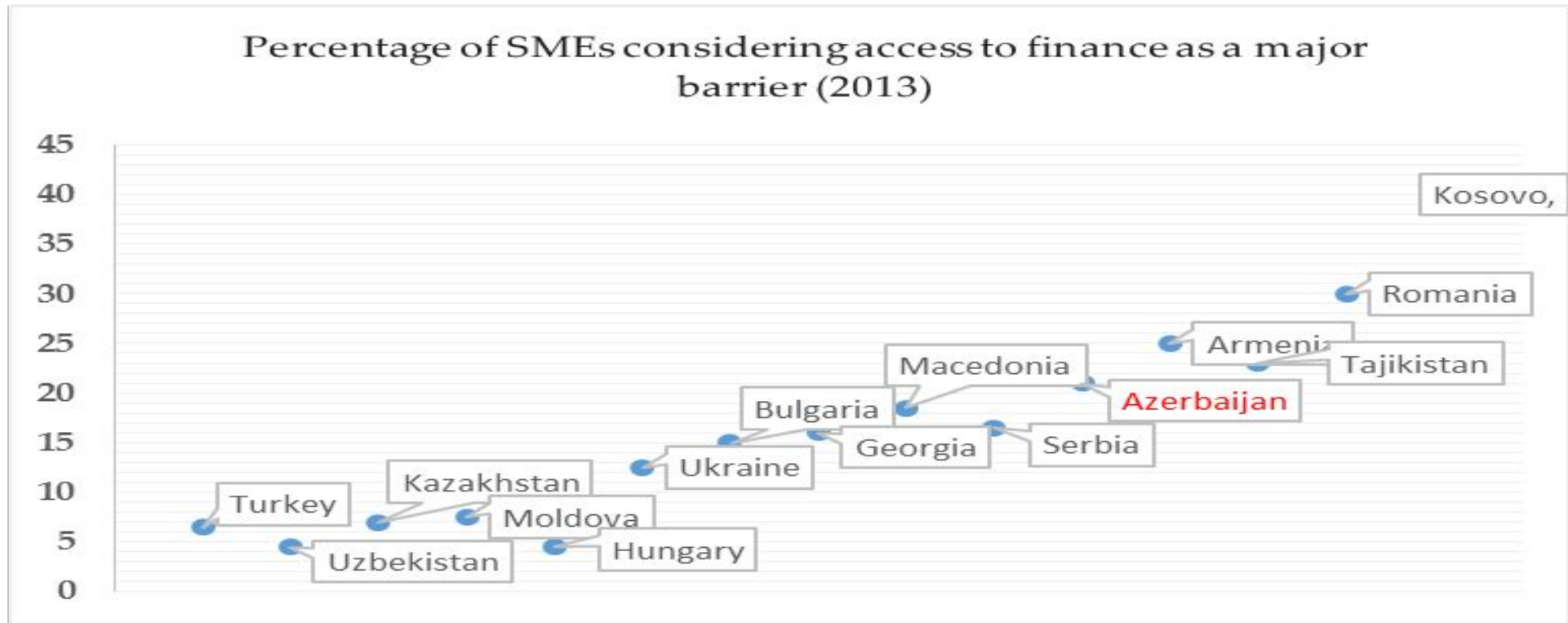
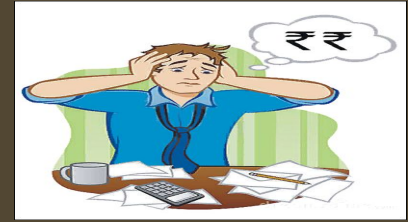


Major obstacles faced by SMEs in Azerbaijan



Source: World Bank, Enterprise Survey

# Access to finance as the biggest obstacle



Source: World Bank

# Access to finance as the biggest obstacle



## Access to Finance Index among Eastern Partnership Countries

	<b>Armenia</b>	<b>Azerbaijan</b>	<b>Belarus</b>	<b>Georgia</b>	<b>Moldova</b>	<b>Ukraine</b>	<b>Average</b>
<b>2016</b>	<b>3.53</b>	<b>2.7</b>	<b>3.08</b>	<b>3.76</b>	<b>3.4</b>	<b>3.22</b>	<b>3.28</b>
<b>2012</b>	<b>3</b>	<b>2.74</b>	<b>2.5</b>	<b>3.52</b>	<b>2.65</b>	<b>2.59</b>	<b>2.83</b>

# Main Sources of Finance



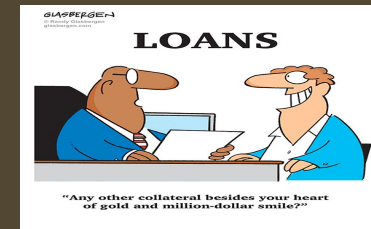
Banks seem as a main source of external finance



Source: World Bank



SMEs' main external source of funds have high collateral requirements and potentially may pose harder requirements (basel regulations)



Percent of enterprises with bank loan / credit line	Small	14,7
	Medium	14,6
Proportion of loans requiring collateral (%)	Small	85,7
	Medium	97,2
Value of collateral needed for a loan (% of the loan amount)	Small	259,1
	Medium	201,2
Percent of firms whose recent loan application was rejected	Small	23,6
	Medium	23,6

Source: BEEPS

# Other Sources of Finance



- International Institutions
  - ❖ EU4 Business
  - ❖ European Bank for Reconstruction and Development (EBRD)
  - ❖ Asian Development Bank
- Governmental institutions
  - ❖ Entrepreneurship Development Fund
  - ❖ **State Agency on the Agricultural Credits**
  - ❖ State Fund for Development of Information Technology
  - ❖ Azerbaijan Mortgage and Credit Guarantee Fund

# Regulation



- According to Article 3.8 of the AR Law on the Securities Market, the issuer's maximum bond issuance requirements are determined by the Financial Market Supervisory Authority (FIMSA)
- Main Segment (a minimum charter capital of 500000 AZN)
- Standard Segment (a minimum charter capital of 500000 AZN)
- Alternative Segment ( more relaxed regulations)

# Why not bond market?



Survey conducted among 30 entrepreneurs, in Baku and Sumgait

*Have you ever been participated in the bond market? If “no” is an answer, what is the major reason for that?*

*Do you know how (what are the requirments) to be listed on the Baku Stock Exchange?*

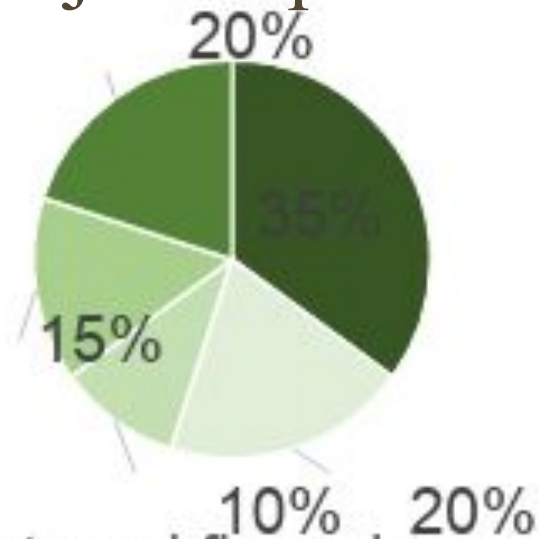
*Are you aware of the fact that bonds are cheaper source of financing than bank loans?*

*Could you please share any thought on the subject not covered by the questions?*

# Survey Results



Financial illiteracy seems a major culprit



- I do not need external financing
- I do not have information about the bond market
- I assume my application would not be accepted
- I do not have information about procedures
- I consider application process complex

# Alternative solutions for tackling with a problem



Facilitating SME's access to the capital market through transparency and increased financial literacy

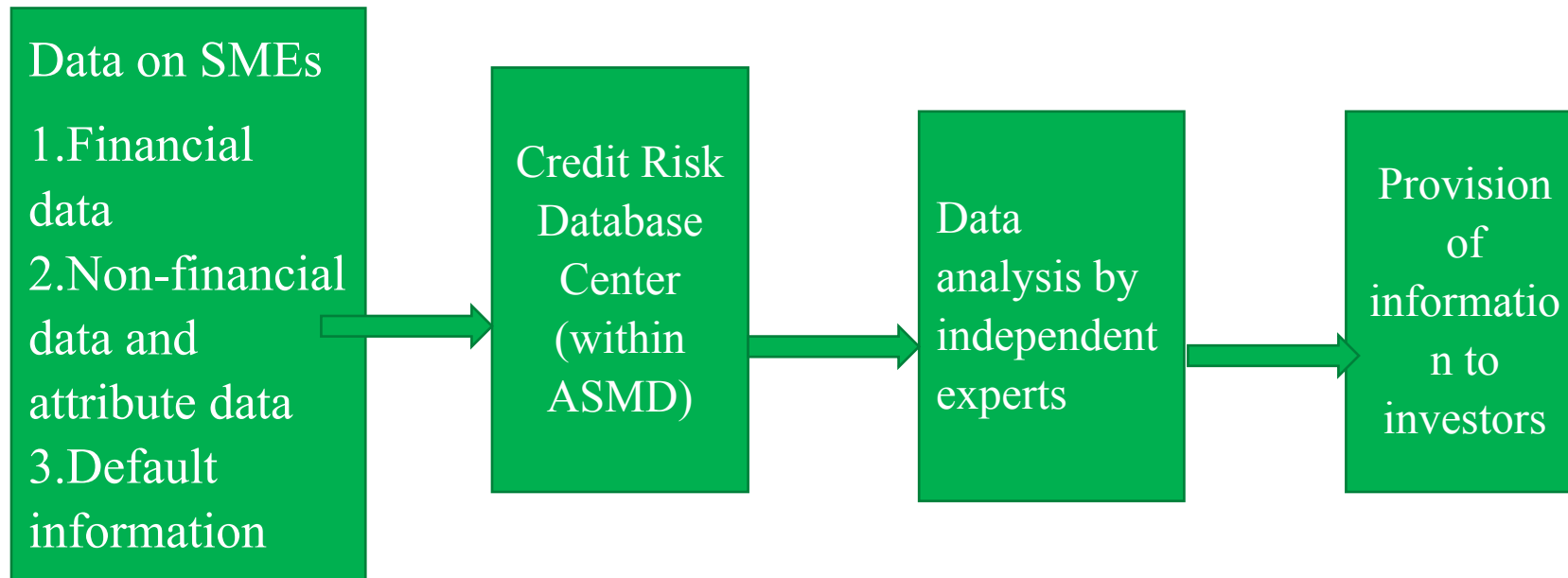
Establishing alternative fixed income platform designed specifically for SMEs

Selling bonds issued by SMEs through traditional banks

# Facilitating SME's access to the capital market through **trans** and increased financial literacy



- **Centralized Rating System** for SMEs within the The Agency for Small and Medium Business Development of Azerbaijan (ASMD)



# Facilitating SME's access to the capital market through transparency and increased **financial literacy**



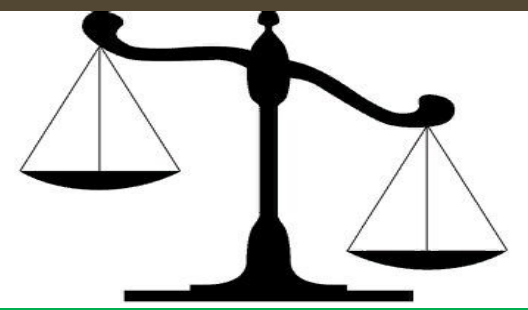
- Increasing Effectiveness of existing institutions which provides training and consultancy services for SMEs
  - ❖ Doing promotion through several channels
  - ❖ Tailoring programs to the needs of SMEs
  - ❖ Creating coordination among those institutions
- Increasing an awareness about bond market, its advantages and application procedures through assigning a group of workers of relevant institutions to SMEs



## 2<sup>nd</sup> Alternative: Establishing alternative fixed income platform designed specifically for SMEs

- A separate platform for trading bonds only issued by SMEs
- Requirements are designed in accordance with SMEs (e.g. instead of equity requirement, operational indicators are set, such as current ratio, or net profit margin)
- Success stories from several European countries such as Spain, or Germany

# Alternative Fixed Income Platform



- More flexible market for SMEs
  - Greater speed in processing the issues
  - Simplified Procedures
  - Better concentration on SMEs
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- ❖ Difficulty associated with raising awareness about the market
  - ❖ Difficulty associated with attracting investors to the market

## 3<sup>rd</sup> Alternative: Selling bonds issued by SMEs through traditional Banks



- In the first stage, only big and financially healthy banks are allowed to sell these securities
- Minimum criteria should be set
- Close monitoring and supervision
- Success stories from China (currently 12 commercial banks are being granted right to sell corporate bonds)

## 3<sup>rd</sup> Alternative: Selling bonds issued by SMEs through traditional Banks



- Already SMEs are aware of existence of banks and know how to work with them
- Increasing credibility on the bonds issued by SMEs
- Revenue diversification for the banks

❖ Riskiness

# Criteria for selecting the most optimum alternative



- Politically suitable
- Not requiring dramatic institutional changes
- Not requiring significant regulatory changes
- More flexible environment (requirements) for SMEs
- Lower cost of finance (e.g. lower compared with loan given by banks)

# Recommendations and Final Results



- In the first stage: Facilitating SME's access to the capital market through transparency and increased financial literacy
- ✓ ***Centralized Rating System*** for SMEs within the The Agency for Small and Medium Business Development of Azerbaijan (ASMD)
- ✓ ***Increasing Effectiveness of existing insitutions*** which provides training and consultancy services for SMEs
- ✓ **Increasing an awareness about bond market**, its advantages and application procedures through assigning a group of workers of relevant institutions to SMEs

# References

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