

REFERENCE BOOK

SMALL &  
MEDIUM  
ENTREPRENEURSHIP  
SPHERE  
IN ARMENIA

2004  
2005



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from OSCE office in Yerevan

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ENTREPRENEURSHIP SPHERE  
IN ARMENIA,  
2004-2005

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*Foreword*

Nowadays the development of Small & Medium Entrepreneurship (SME) is one of the main preconditions for restoration and development of national economies. It is the major guarantee for full establishment of market relations as well as economic development and progress in the country.

SME development is vital for developing countries and/or ones in transition on the path of market economy since it accelerates strong and dynamic private sector formation and hands an opportunity to secure economic growth in a short period at the same time alleviating undesirable developments typical of the transitional period.

SME development facilitates creation of independent and self-sufficient class of entrepreneurs as well as new job places, enlargement of internal market, enhancement of the competitiveness of local goods and services in external market and increasing export potential as well as contributes to cost-effective revitalization and rehabilitation of idle economic potential, ensuring political, social and economic stability of the country.

The reference book contains the classification criteria for SMEs in the RA, analysis of the legal aspects of starting a business, organizational-legal types of companies, licensing and taxation system for SMEs, i.e. all the components characterizing the economic environment in Armenia that allow us to gain a general understanding on the issues of economic activity for local as well as foreign businessmen that want to engage in economic activities in the RA.

It is difficult to evaluate the impact of SME sphere on development of economy without separate and all-embracing statistical analysis on SMEs. The existence of such kind of information will make possible to evaluate the impact of the sphere on country's social and economic development as well as to take into account the data in elaboration and implementation of SME support and development programs.

In order to fill in this gap the development of the Reference Book “Small and Medium

Entrepreneurship Sphere in Armenia, 2004-2005” was initiated by SME DNC of Armenia with Support from OSCE office in Yerevan within the framework of SME State Support Program 2006, which is an important step towards synchronizing the SME statistics in Armenia with the international methodology as well as its systematized presentation.

The analysis and data presented in the reference book are partially based on the existing general macroeconomic data and include both the figures used in international practice for SME sphere statistical records which haven't been assessed in Armenia before and the data that have already been provided. Besides this one of the corner stones of the reference book is the comparative analysis of SME sector in Armenia and number of countries.

The Reference Book “Small and Medium Entrepreneurship Sphere in Armenia, 2004-2005” represents the dynamics and tendency of SME sphere development as well as is an important source of statistical data and valuable analytical material on various spheres of SMEs' activities in Armenia.

This initiative will provide the necessary, full and objective information which can be useful for public-private institutions, international organizations, educational and scientific/research institutions engaged in SME development and support as well as private sector representatives.

## PART 1 Characteristics of Small and Medium Entrepreneurship in Armenia

### The Classification Criteria of SME units

The SME units in Armenia are classified according to the number of their employees – in compliance with the RA law “On Small and Medium Entrepreneurship State Support”. A commercial company or sole proprietor can be classified as a SME unit if the average number of their payroll employees is appropriate to the criteria presented in the Table 1.

SMEs are classified as follows:

Classification Sphere	SMEs		
	Micro [number of employees/man]	Small [number of employees/man]	Medium [number of employees/man]
Industry and other sectors of production	5	50	100
Construction and power engineering sphere	5	25	50
Science and education sphere	5	25	50
Transport, trade and services sphere	5	15	30

If an organization's activities cover more than one sphere simultaneously, its classification as a SME entity should be done according to the main criteria of the sphere in which it operates.

Organizations engaged in crediting, insurance and investment activities, lombards, professional actors of securities market, casinos, and organizations involved in gambling business, as well as subsidiary and dependent units are not considered as SME units.

For the sake of comparison, in EU countries, as of 1 January 2005, an organization is considered a micro enterprise if the average annual number of its employees does not exceed 10 people, net profit or assets – 2 million Euros; a small enterprise is considered to be the one whose average annual number of employees is not more than 50, while annual

net profit or assets are not more than 10 million Euros; an organization is defined as a medium enterprise if its average annual number of employees and annual net profit do not exceed 250 and 50 million Euros respectively, assets being no more than 43 million Euros. The level of independence is an additional criterion for SMEs which means that in practice at the stakeholders' meeting no more than 25% of votes or share of profits belong to a big company.

Criteria operating in the United States are as follows:

Under the category “Small business” included are the enterprises which are run and managed independently, do not occupy a dominant place in the market and employ no more than 500 people.

### **Legislative aspects of starting a business**

In order to launch an entrepreneurial activity in the Republic of Armenia, an entrepreneur should register as a commercial legal entity (LE) or sole proprietor (SP). According to the RA Code of Administrative Violations of the, illegal entrepreneurship is fined at the rate of 15 to 30 times the minimum monthly salary (article 169); besides, according to the “Taxation law” of the RA, it is fined at the rate of the half of the profit generated in the result of illegal entrepreneurship (article 26).

To start the process of ***SP registration***, there is a need to pay 3000 AMD as a state duty to the appropriate account in any bank. This should be followed by the steps of filling in and submitting the registration application; the application form can be received at the State Register Agency of Legal Entities (State Register), Ministry of Justice. After considering the application, the state register can refuse or accept the registration. In the case of refusal, the State register should give a written explanation in the course of one working day after the application; in case of acceptance, ratification should be made in the course of two working days, after which the registration certificate is handed over.

In order to start the

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LE registration process, there is a need to pay 5000 AMD to any bank as a state duty to register the name of the company, as well as to pay 12000 AMD to the appropriate account to register the company with the State Register. Decision on the acceptance or refusal of the company name is made in the course of two working days. Thereafter, the application form, the charter sample, and the sample of the foundation protocol of the founders' meeting can be taken from the State register.

Using the exemplary forms of the documents mentioned above, there is a need to convene a founders' meeting, to adopt a decision about the establishment of a LE, to make the protocol of the meeting, as well as to prepare the foundation document – the charter.

Having obtained all necessary documents, a registration application must be submitted to the State register, after which, in the course of no more than five working days, either the company's registration certificate should be given or the written respond about the registration refusal and the reasons of it.

Independent of the fact whether a company or a sole proprietor was registered, their names should be officially recorded at the State Tax Service (Tax Service) under the RA Government in thirty days after registration. To be recorded at the Tax Service means obtaining a taxpayer's identification number (TIN); thereafter, to be recorded at the Social Security Fund requires submitting the registration copy obtained from the State Register, the charter copy and the TIN.

After accomplishing the steps mentioned above, the LE seal should be obtained which is not necessary for the SPs; however if they wish, they also can obtain it.

If the entrepreneurial activity requires licensing, which is regulated by the article 43 of the RA law “On licensing,” it is necessary to apply to the appropriate licensing body to obtain the license.

Notwithstanding the chosen form of registration, in case of implementing export or import transactions it is necessary to be registered also at the State Customs Committee (Customs Committee) under the RA Government. The customs clearance procedures of exported or

imported goods are carried out at the custom-house of the region where the company was registered.

The legal foundations of the private enterprises of the RA are established by the Civil Code of the RA (adopted on 25 July 1998, effective from 1 January 1999). The legal and procedural norms have been established in more detail in the following pivotal legal acts:

- ☞ The RA law “On sole proprietorship” (effective from 25.04.2001)
- ☞ The RA law “On limited liability companies” (effective from 21.11.2001)
- ☞ The RA law “On joint stock companies” (effective from 27.11.2001)
- ☞ The RA law “On firm names of companies” (effective from 15.12.1999)
- ☞ The RA law “On state registration of legal entities” (adopted on 03.04.2001 and effective since 2002)
- ☞ The RA law “On the implementation of the RA Civil code” (adopted on 17.07.1998, effective from 01.01.1999)

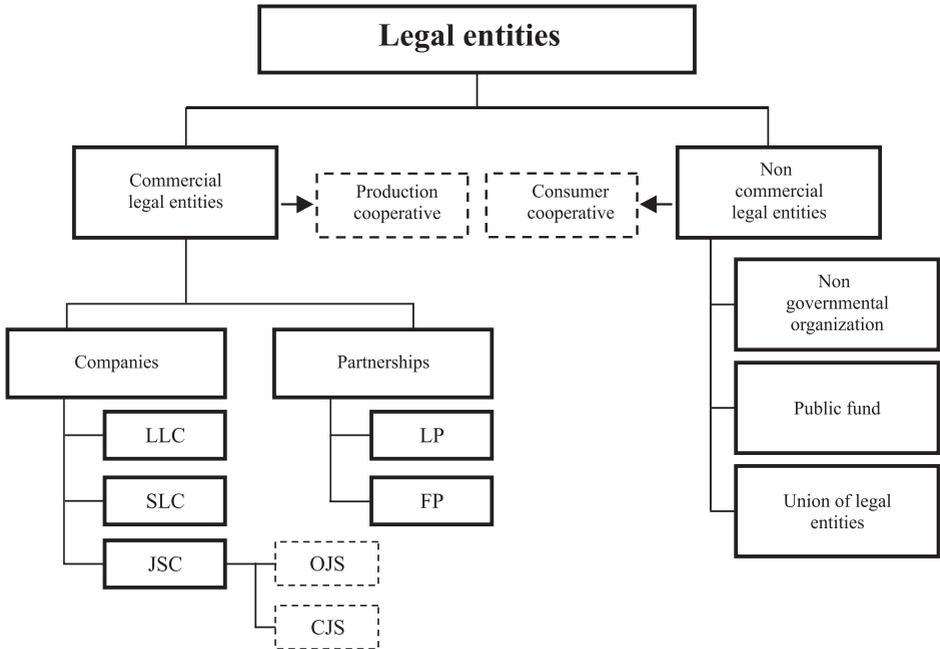
### *The organizational-legal types of company registration*

According to the RA legislation, any citizen wishing to be engaged in an entrepreneurship is entitled to create companies or participate in their activities. The citizen is also entitled to engage in entrepreneurial activity without establishing a LE if he/she has already been registered as a SP.

The SP is a person who has the right to engage in entrepreneurial activities independently, on his/her behalf, at his/her own risk without establishing a LE. The SP has full liabilities, namely, the SP is accountable for his/her liabilities with his/her property.

The LE can be viewed from different standpoints based on certain criteria. The purpose of the LE activities, composition of the founders, and nature of the participants' rights can be considered as such criteria.

The LE-s, according to their purposes, include for-profit or commercial organizations and not for-profit ones that do not distribute the generated profit among the shareholders or non-commercial organizations.



*LE as commercial organizations* can be established in the form of commercial partnerships and companies. To be considered as a commercial partnership or company, a commercial organization should own its authorized share capital consisting of the shares of the founders (participants). The property created due to the deposits of the participants, as well as obtained or produced in the course of the activity of the commercial partnership or company belongs to the latter on principle of ownership. Commercial partnerships can be created in the form of limited or full partnerships. Commercial companies can be established in the form of limited companies or ones with supplementary liabilities, as well as joint stock companies.

Cooperatives, dependent on the nature of their activities, can be for-profit or not for-profit organizations.

### The commercial partnerships are as follows:

- ☞ In the basis of establishment of an ***full partnership*** (FP) lies the wish of several persons and LE-s to unite and run their activities jointly; an important point is that it must be done by uniting the capital and establishing independent commercial companies, namely, the FP participants can be only the SP-s and/or commercial organizations. The latter can only be part of one FP.
- ☞ ***Limited partnership*** (LP) is also a type of unification of several persons and their capital. The participants of this type of partnership consist of two groups – full partners and contributors. The former engage in entrepreneurship on behalf of the partnership and are accountable for the partnership's liabilities with their whole property; it means that the legal regime of the participants of this group completely corresponds to that of the participants of the FP. The second group, the contributors, make their deposits and carry the risks connected with the partnership activities to the extent of their investment.

### Companies

- ☞ ***Limited liability company (LLC)*** is the most widespread type of entrepreneurship at present. The LLC is a company founded by one or several persons the authorized share capital of which is divided into shares according to the rates established by the company statute. The founders of a LLC can be both persons and LEs. The LLC can be established either by one or by several persons. The number of the participants should not exceed 49 people. Otherwise, in the course of one year it should be restructured into a joint stock company; after that period it is subject to dissolution by a court decision. The LLC is characterised by a number of features. For example, the participants are not accountable for the companies responsibilities and carry the risks connected with the company's activities to the extent of their investments; hence the name “limited liability” derives from this nature. As a LE with limited liabilities the

LLC becomes the owner of the assets contributed by the founders in the form of investments. As soon as the participants make their investments in the company's authorised share capital, they lose their ownership rights toward these assets.

☞ ***Supplementary liabilities company (SLC)*** is established by one or several persons, and its authorised share capital is divided into shares according to the proportions stipulated in the company statute. The SLC is different from the LLC due to the nature of liabilities of the participants; if the company assets are not enough to meet the demands of the debtholders, the participants of the SLC can be additionally held solidary. However this type of responsibility has its boundaries. It does not refer to the whole property of the participants but only to a part of it; as specified in the company statute, the level of responsibility is equal for everyone and defined by the same multiplier applied to all investments. The SLC founders can be both persons and LEs. In general, if we push aside the liability characteristics of the SLC, this form of companies can be viewed as a type of LLC, since, by definition, it is the LLC legislation that is applied to SLCs.

☞ ***Joint stock company (JSC)*** is a commercial organization type of company the authorised share capital of which is divided into a certain number of shares assuring the liability commitment towards the company. The participants of the JSCs are not liable for the company's responsibilities and carry the risks connected with the activities of the company to the extent of the value of their shares. A JSC can be established by or consist of one person in case if all shares have been obtained by one of the shareholders. The JSCs can be classified in two types – open joint stock companies (OJSC) and closed joint stock companies (CJSC). The OJSC launches the processes of open subscription for and free sale of their shares. The shares of CJSC are distributed among its shareholders only, the transfer of shares to other individuals being prohibited.

☞ ***Production cooperative*** is a commercial organization engaged in entrepreneurship. It is a voluntary alliance based on the membership of citizens and LEs and created to

licensing (there should be a specification if, according to the law, the activity subject to licensing should be conducted only in an appropriate area), the terms of validity of the license, and the start day of the activity subject to licensing.

***Compound license*** is a permit granted according to the licensing procedures established by the RA government for engaging in a certain type of activity; it defines the binding requirements and conditions to be observed during this activity. The control over the observation of these requirements is implemented by the laws of licensing and ones regulating different spheres of activity, more specifically, “The cases of licence abolishment” (article 36), “On the discontinuing of licence” (article 37).

The essential difference between the simple licence and the compound one is that the procedure of granting the latter requires the discretionary decisions made by the the sphere licensing committee.

The list of bodies in charge of granting Compound licences is defined by the RA law “On licensing,” and the granting of the absolute majority of the licences is subject to this procedure. The Compound licences are given according to the following requirements and conditions defined by the RA law “On licensing”:

- ☞ Within 30 days after submission of all necessary documents (if there are no other statutory requirements),
- ☞ They are granted perpetually (if there are no other statutory requirements),
- ☞ In cases specified by the RA law “On licensing” the compound licence can be given by a competition held in conformance with the existing standards of licensing,
- ☞ The compound licenses are given on the basis of decisions made by the licensing committees of appropriate licensing bodies (established by the RA law “On licensing”),
- ☞ Decisions of the licensing committees should be made and presented according to the quite detailed procedural rules and subsequently in conformance with the maximum

detailed standards worked out by the licensing committees, as defined by the RA law “On licensing.”

Application for a simple licence can be rejected in a written form within three days following the record of the application at the licensing committee. The written rejection of the application for a compound licence can be given within no more than 30 days after the record of the application at the licensing body only if there are no other statutory specifications. The decision to reject the licence application should clearly indicate the legal grounds of the rejection.

According to the RA law “On licensing,” if the licence application is not rejected within the specified time, it should be considered as having been approved, and the applicant can start the activity subject to licensing regardless of the fact whether the licence has been given to him or not.

#### *Taxation system for the SME units*

The taxation system consists of direct taxes, including those that depend upon the results of the taxpayer's activities (income tax and profits tax) and those that do not depend upon the results of the taxpayer's activities (land tax and property tax), indirect taxes (value-added tax, excise tax) as well as of payments substituting taxes (simplified tax which substitutes the value-added tax, income tax or profits tax for the taxpayers; fixed payments which substitute the value-added tax, excise tax and – for some of the taxpayers – the income tax and profits tax).

The system of direct taxes of the RA has undergone some amendments during the recent years. Efforts have been made in the direction of extension of tax base due to decreasing the level of tax exemptions and tax benefits through synchronized lowering of the marginal rate of tax and raising of the income tax threshold, as well as due to the alleviation and redistribution of the tax burden. Introduction of the simplified tax supported the removal of the administrative barriers for those who used to pay “small” taxes; it also helped the

simplified tax payers – the overwhelming majority of them being SME units – to run the accountancy of their own companies without possessing deep professional knowledge.

The SME units can face the following tax types during their activities:

The ***value-added tax (VAT)*** is an indirect tax which is produced during the delivery of goods and services, gratuitous or partly gratuitous delivery of goods and services, import transactions through free circulation customs regimes.

The rate of VAT is 20% or 16.67% of the general transaction turnover. There are three regimes of VAT assessment: transactions that are taxed in the regime of 20% or 16.67% rate of VAT, transactions exempted from the VAT, transactions that are taxed at the 0% rate of the VAT.

The ***profits tax*** is a direct tax the taxation object of which is the taxed profit of legal entities. The taxed profit is tantamount to gross incomes minus costs, losses and other deductions. In order to deduct costs from the gross profit and to define the taxed profit, it is necessary to possess compelling documents; and, the costs are an indispensable precondition for having income. The rate of the profits tax on the taxed profit is 20%. The accountability period for the profits tax is the calendar year. During the year of account, the LEs are obliged to make profits tax prepayment, a sum equal to the 1/16 of the last year's profits tax to be paid for each month; if the positive difference between 1% of the last month's realization turnover and amortization of fixed assets exceeds the 1/16 of the last year's profits tax (this difference, however, should not be less than 0.5% of the last month's realization turnover), prepayment of profits tax for that month is made at the rate of that 1%.

The ***income tax*** is a direct tax which is levied from the persons who are citizens of the RA as well as the foreign persons whose source of income is in Armenia. For the RA citizens there is a classification of income tax rates according to the types of income. Incomes paid in the form of interest as well as incomes paid as rent are taxed at the 10% rate. For other types of

income, the income tax rate is 10% for the amount below 80.000 AMD; if the income is more than 80.000 AMD, the taxation rate is AMD drams plus 20% of the amount exceeding 80.000 AMD. For non-citizens, the following rates are applied to income taxation: insurance indemnities, incomes in the form of freight payments are taxed at the rate of 5%, while the rest of the income types are taxed at the 10% rate.

When paying incomes to persons, the LEs assume the role of taxation inspectors, namely, according to the law, they have to take on the responsibility of collecting the income taxes at appropriate rates and paying them to the budget.

According to the rules of income tax assessment, the taxed income is equal to the the gross income minus costs and personal deductions. For the RA citizens, the amount of monthly personal deductions is 20.000 AMD. SPs pay income taxes according to the results of their yearly activity at the rate as follows: if the taxed income is bellow 960.000 AMD, the income tax is equal to 10% of the taxed income; if the latter exceeds 960.000 AMD, the tax is tantamount to 96.000 AMD plus 20% of the exceeding sum.

The ***simplified tax*** substitutes VAT, profits tax, and, for SPs, also the income tax, the taxation object of it being the realization turnover. The LEs and SPs can be judged as simplified tax payers if they, before January 25 of a given year, have submitted a statement to the local taxation bodies with a request to be considered simlified tax payers. The newly formed organizations and SPs should submit this statement before the last day of the quarter of registration, but no later than the 30<sup>th</sup> day following the registration. The LEs and SPs can not be considered as simplified tax payers if the amount of realization for last year or the one of account has exceeded 50 million AMD and the remnant stock belonging to them exceeds 15 million AMD. The LEs and SPs can not be considered as simplified tax payers if the remnant stock in their balance exceeds 1 million AMD which at the moment of importation was exempted from the VAT, or if they, during the quarter, imported such goods that were exempted from the VAT at the moment of importation and the customs entry value of which does not exceed 250.000 AMD. The LEs and SPs can not be considered as

simplified tax payers if by January 1 of the year of account they have tax liabilities exceeding 100.000 AMD. The rates of the simplified tax are as follows: for retail – 3.5% of the realization turnover, for notaries – 20% of the realization turnover, for incomes generated in the form of interests and rent – 10% of the realization turnover, for other incomes – 5% of the realization turnover.

### **The concept of the property tax and its taxpayers**

The property tax is a direct tax on assets – belonging to the property tax payers by ownership and subject to taxation – paid to local budgets according to the statutory standards and rates.

The property tax payers include the organizations created in the RA and foreign states, international organizations, the RA and foreign nationals, and individuals without citizenship who own assets on the territory of the RA subject to taxation, except for the RA state institutions.

### **The object of the property tax and the tax base**

The assets subject to the wealth tax are the buildings – including the ones intended for dwelling, public or production functions, garages, buildings under construction – as well as automobile transport, including automobile vehicles, water transport and motorcycles. The base of the wealth tax is the value or the physical size. Besides, the tax base for the buildings is the cadaster value defined by existing standards; assessment (reassessment) of buildings is done once over the period of three years by a body in charge of fixed assets registration. The tax base for the transportation means is the pulling engine power of a transportation means subject to taxation.

The wealth tax assessment is done on the basis of the statutory tax base and rates.

### **The concept of the excise tax**

The excise tax is an indirect tax on the importation of the below-mentioned goods, or on the sale of these goods on the territory of the RA by their producers, collected according to statutory standards and rates and paid to the budget.

The products subject to excise tax are beer, wines made of grape or other wines, wine raw products, spirit, spirit beverages, industrial tobacco substitutes, cigarellas with tobacco or tobacco substitutes, gasoline, raw oil, oil products, diesel fuel, oil gas and gas-like hydrocarbons (except for natural gas). The LEs and persons importing or producing the above-mentioned goods are subject to the excise tax.

### **The object of the excise tax and the tax base**

The objects of the excise tax are importation of goods subject to the excise tax into the RA by the “import for free circulation” customs regime as well as sale of goods subject to the excise tax on the RA territory by the producers. The tax base is the quantity (volume) of the goods subject to the excise tax, this quantity being reflected in the statutory physical units of measurement towards which the excise tax assessment is done according to the statutory standards and rates. The excise tax does not extend to the export of the goods subject to the RA excise tax taxation if there is a copy of the customs entry filled out by the customs statutory standards with the note “the pass is allowed,” to the goods subject to the excise tax exported from and imported into the customs territory of the RA according to the customs regimes specified by the RA customs legislation, different from the “import for free circulation” customs regime, as well as to the goods subject to the excise tax and imported into the RA territory by persons other than SPs the quantity and value of which do not exceed the allowable customs quantity and value defined by the customs legislation.

### **The concept of the fixed payment**

The *fixed payment* is a payment substituting the main taxes, used instead of the VAT and/or profits or income taxes. For persons, the fixed tax substitutes the VAT and/or income tax, for the LEs – the VAT and/or profits tax.

In the general amount of the fixed payment, the extent of the VAT is counted at the rate of 60%.

### **The object and base of the fixed payment**

The following types of activity are subject to fixed payment: shops commercial surface of

which does not exceed 30 square meters, commercial activity carried out through booths, actions towards construction of a commercial place, catering, delivery of automobile transportation, haircut services, photography laboratories, autoservicing stations, gasoline and diesel fuel retail stations, parking services, industrial fishery, as well as currency exchange, dealer currency exchange, casinos management activity, management of gambling machines with money prize, organization of computer games, lottery, billiards, bathes and shower-bathes, automobile gas stations, video recorders and video cassetts rent. The tax base for the fixed payment is the total of initial data and adjustment coefficients as defined for different types of intended activity, in money terms.

The assessment of the amount of the fixed payment is done by the business owners themselves.

### **The concept of social payments and the units subject to it**

The social payments are obligatory payings by the employers for funding the state program of mandatory social security.

On the territory of the RA, the LEs and persons who are in employer-employee relationships with the RA citizens, as well as the hired employees have to make social payments. The social payments are made by employers, hired employees, SPs and notaries. Foreign nationals and individuals without citizenship, as well as employers using their hired labour, who are engaged in entrepreneurship or other activities in the RA, are exempted from the responsibility to make social payments.

### **Calculation objects and rates of social payments as well as standards of their calculation and payment**

Calculation objects of social payments are the money directed by the employers toward the remuneration of labour and the incomes equated to that money, the salary of persons used as hired labour and the incomes equated to the salary, as well as the yearly gross income of the LEs.



The employers make social payments for each of the employees at the following rates:

<b>The monthly rate of the calculation object of social payment</b>	<b>The amount of social payment</b>
Below 20.000 AMD	7.000 AMD
From 20.000 to 100.000 AMD	7.000 AMD plus 15% of the amount exceeding 20.000 AMD
More than 100.000 AMD	19.000 AMD plus 5% of the amount exceeding 100.000 AMD

Besides, every employer calculates the amount of social payments with no regard to the mandatory social security payments made by another employer for the same employee. The hired employees make social payments at the rate of 3% of their salary and the incomes equated to the salary, these deductions being sent to the RA mandatory social security budget by the employers.

The SPs make social payments at the following rates:

<b>The monthly rate of the calculation object of social payment</b>	<b>The amount of social payment</b>
Below 1.200.000 AMD	15% but no less that 60.000 AMD
More than 1.200.000 AMD	180.000 AMD plus 5% of the amount exceeding 1.200.000 AMD

The SPs has to make minimum social payments each month equal to 5000 AMD till the 15th day of the following month.

The employers transfer the calculated social payments for each month to the mandatory social security budget before the 20th day of the month following that of account.

According to the monthly results, the employers submit a statement of social payments to an authorized body before the 20th day of the following month.

The social payments calculated for the whole year are sent by the SPs to the RA mandatory social security budget no later than March 1 of the following later.

On the basis of the results of each year, the SPs submit a yearly income statement to the authorized body no later than March 1 following the calendar year.

## PART 2

## Figures Characterizing Small &amp; Medium Entrepreneurship Sphere in Armenia

*Gross Domestic Product*

The volume of Gross Domestic Product (GDP), which is the main indicator of economic development of the country, at market prices in 2005 amounted to 2228027.5 mln AMD in comparison with 1893436.2 mln AMD in 2004. GDP growth rate in 2005 was 113.9 % instead of 110.1 % in 2004.

Table 1

*Structure of GDP by SMEs and large enterprises in the spheres of economy, 2004 and 2005*

Sphere	2004		2005	
	SMEs	Large	SMEs	Large
	[ % ]		[ % ]	
Industry	29.7	70.3	25.4	74.6
Construction	43.1	56.9	45.9	54.1
Trade	58.4	41.6	51.2	48.8
Transport & Communications	33.3	66.7	33.8	66.2
Services	34.1	65.9	42.8	57.2
<b>Total GDP<sup>1</sup></b>	38.6	61.4	39.8	60.2

The structure of the GDP by SMEs and large enterprises is presented in the Table 2. The figures presented in the Table are based on the distribution of products (works, services) in each sphere of economy by SMEs and large enterprises, which were calculated through the statistical method of extrapolation. As a result it becomes possible to evaluate the share of SMEs in GDP. But this estimation does not include the distribution by SMEs and large enterprises in agriculture and net taxes because of the absence of correct estimations in above-mentioned spheres. In the case of taxes we can suppose that those are apportioned according to the added value apportionment (where the calculated percents are constant). In the case of agriculture there isn't any criterion for estimation but it is obvious that in the sphere of agriculture it must be mainly directed to SMEs.

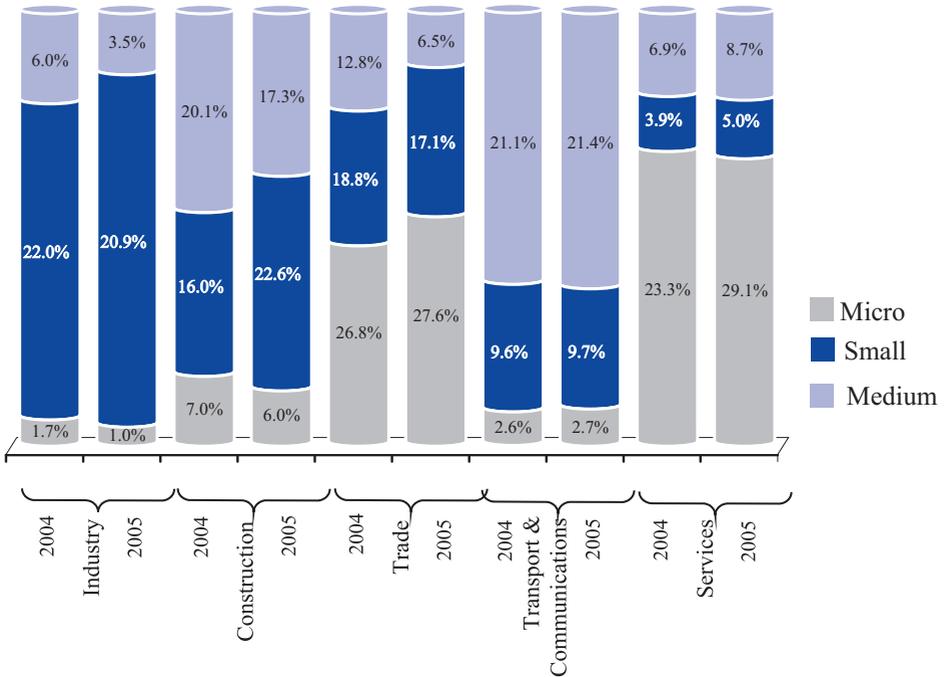
<sup>1</sup> Without agriculture and net taxes.

Share of SME sector in GDP was 39.8% or 644109.4 mln AMD in 2005 and 38.6% or 505530.4 mln AMD in 2004. This means that the share of SMEs in generating GDP increased by 1.2 percentage points or 138579 mln AMD.

The analysis of above-mentioned figures shows that there is a stable tendency of GDP growth in Armenia for the past few years. The GDP growth is mainly constrained with the growth of the basic spheres of economy. By the same time it's important to fix that SMEs have considerable input in those spheres of economy, which is shown in the

Chart 1.

*Chart 1 Share of Micro, Small & Medium enterprises in generating GDP by various spheres of economy, 2004 and 2005*



The Chart shows that SMEs have considerable input in generating GDP particularly in the spheres of trade, construction and services as well as they have significant share in industry. It's interesting that in 2005 the share of SMEs in the sphere of services increased by 8.7 percent and in the sphere of construction increased by 2.8 percent compared to the previous year. In the spheres of industry and construction those figures are accordingly 2.5 and 4.3 percent. By the same time there is a tendency of decrease of SMEs' contribution in generating GDP in the spheres of industry and trade in comparison with previous year equal to 4.3 and 7.2 percent accordingly. In the spheres of transport and communications the share of SMEs increased by 0.5 percent.

**Chart 2** *Dynamics of Micro, Small & Medium enterprises' share in generating GDP, 2004 and 2005*

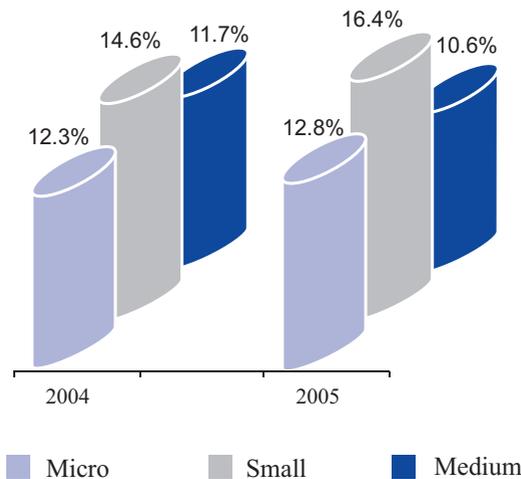
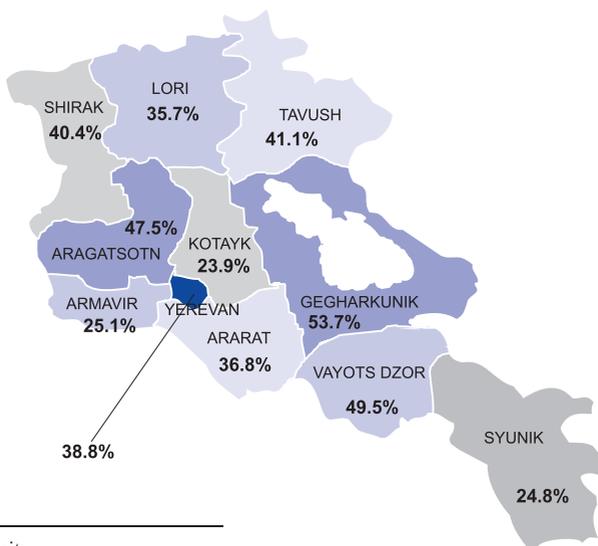


Table 2

*Regional (Marz) distribution of Micro, Small, Medium & Large enterprises by the GDP generation, 2004 and 2005*

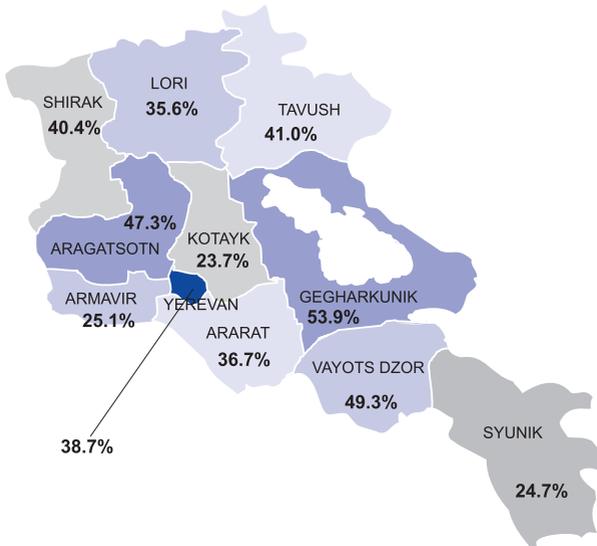
Region/Marz	2004				2005			
	SMEs [%]			Large [%]	SMEs [%]			Large [%]
	Micro	Small	Medium		Micro	Small	Medium	
<i>Yerevan</i>	13.8	13.2	11.7	62.6	13.9	13.3	11.6	61.2
<i>Marzes total</i> <sup>3</sup>	9.1	15.3	10.1	65.6	9.1	15.5	10.0	65.4
Aragatsotn	15.3	23.6	8.4	52.7	15.4	23.8	8.3	52.5
Ararat	6.9	20.9	8.9	63.3	6.9	21.1	8.8	63.2
Armavir	6.9	14.0	4.1	74.9	6.9	14.1	4.1	74.9
Gegharkunik	20.2	9.5	24.1	46.1	20.3	9.6	23.9	46.3
Lori	12.9	15.7	7.0	64.4	13.0	15.9	6.9	64.3
Kotayk	7.2	11.4	5.2	76.3	7.2	11.5	5.1	76.1
Shirak	5.9	13.9	20.6	59.6	5.9	14.0	20.4	59.6
Syunik	3.6	16.5	4.6	75.3	3.6	16.7	4.6	75.2
Vayots Dzor	21.1	20.7	7.5	50.7	21.2	20.9	7.4	50.5
Tavush	12.3	21.8	6.8	59.0	12.3	22.0	6.7	58.9
<b>RA TOTAL</b>	12.3	14.6	11.7	61.4	12.8	16.4	10.6	60.2

Picture 1 *Regional (Marz) distribution of SMEs by GDP generation in 2005*



<sup>3</sup> Without Yerevan city.

Picture 2 Regional (Marz) distribution of SMEs by GDP generation in 2004



### Number of Enterprises

As of 01.01.2006 data the total number<sup>4</sup> of registered legal entities and sole proprietors was 131033. Of this number there were 71562 sole proprietors and 59471 legal entities. 52389 from 59471 registered legal entities were commercial organizations, 30608 of which were the legal entities that were authorized to operate according to the RA legislation.

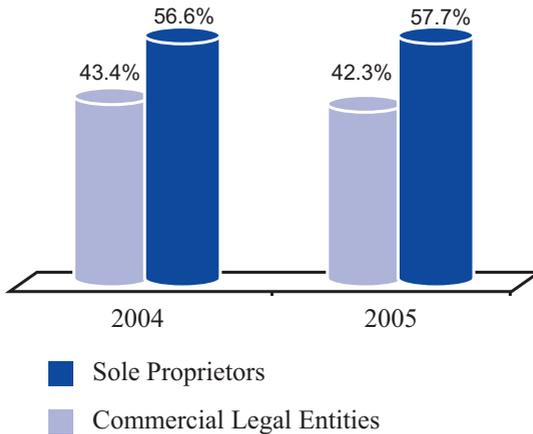
<sup>4</sup> “Social-Economic Situation in RA January-December 2005”, National Statistical Service of RA.

Table 3

*Dynamics of total number of registered economic units  
(commercial legal entities and sole proprietors), 2004 and 2005<sup>5</sup>*

Economic Units	2004	2005	2005 in comparison with 2004 [%]	Registered during the year		
				2004	2005	2005 in comparison with 2004 [%]
Sole Proprietors	67116	71562	106.6	6293	7212	114.6
commercial legal entities total	51480	52389	101.8	2796	2455	87.8
<b>TOTAL</b>	118596	123951	104.5	9089	9667	106.4
of which sole proprietors and commercial legal entities that were authorized to operate according to the RA legislation	95936	102170	106.5	-	-	-

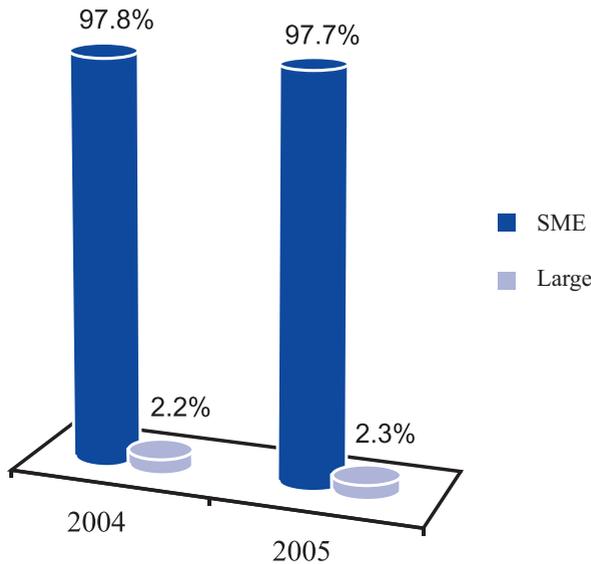
**Chart 3** *Share of sole proprietors and commercial legal entities in total number of registered enterprises in 2004 and 2005*



<sup>5</sup> “Social-Economic Situation in RA 2004 and 2005”, National Statistical Service of RA.

According to the research and expert estimations 96.9%<sup>6</sup> of commercial legal entities that were authorized to operate according to the RA legislation and 98%<sup>7</sup> of sole proprietors were SME units. Summarizing above-mentioned we can underline that there were 99805 SMEs by the end of 2005, which made around 97.7% of commercial legal entities and sole proprietors. The same figures for 2004 were accordingly 93874 and 97.8%.

**Chart 4 Dynamics of SMEs' in total number of registered enterprises<sup>8</sup>, 2004 and 2005**



**Table 4**

**Distribution of SMEs and large enterprises in total number of registered enterprises, 2004 and 2005**

Year	SMEs [ % ]				Large [ % ]
	Micro	Small	Medium	Total	
End of 2004	80.4	13.4	3.9	97.8	2.2
End of 2005	77.3	16.2	4.2	97.7	2.3

<sup>6</sup> This figure was calculated through the statistical method of exception based on the number of large enterprises.

<sup>7</sup> This figure was calculated through the statistical method of random selection.

<sup>8</sup> Sole proprietors and commercial legal entities that were authorized to operate according to the RA legislation.

Table 5

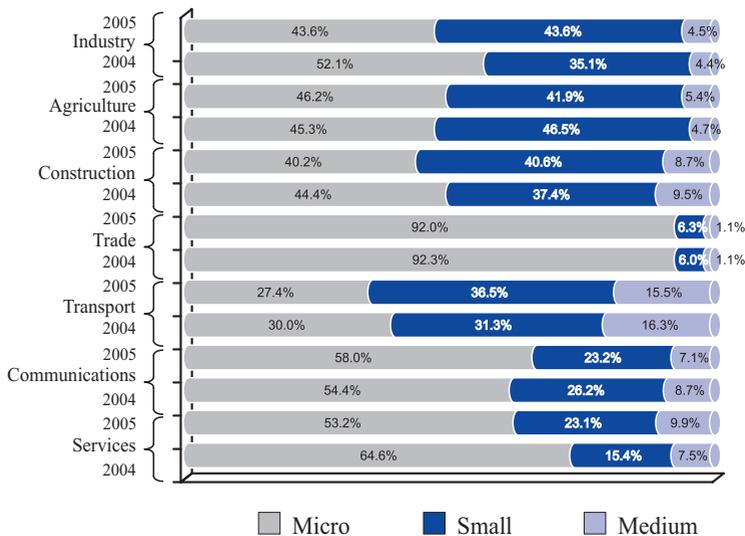
*Distribution of SMEs and large enterprises by the spheres of economy,  
2004 and 2005*

Sphere	2004		2005	
	SMEs	Large	SMEs	Large
	[ % ]		[ % ]	
Industry	<b>91.6</b>	8.4	<b>91.7</b>	8.3
Agriculture <sup>9</sup>	<b>96.5</b>	3.5	<b>93.5</b>	6.5
Construction	<b>91.4</b>	8.6	<b>89.5</b>	10.5
Trade	<b>99.4</b>	0.6	<b>99.4</b>	0.6
Transport	<b>77.5</b>	22.5	<b>79.4</b>	20.6
Communication	<b>89.3</b>	10.7	<b>88.4</b>	11.6
Services	<b>87.5</b>	12.5	<b>86.2</b>	13.8
<b>RA TOTAL</b>	<b>97.8</b>	<b>2.2</b>	<b>97.7</b>	<b>2.3</b>

From the Table 5 it becomes obvious that in 2005 SMEs are operating more actively in the spheres of trade and industry, where the share of SMEs was accordingly 99.4 and 91.7 percent. The share of SMEs is significant in the number of enterprises operating in the sphere of commercial companies for agricultural goods production and construction, which was accordingly amounting for 93.5 and 89.5 percent. The role of SMEs was also considerable in the spheres of communication (88.4%), services (86.2%) and transport (79.4%).

<sup>9</sup> Commercial companies for agricultural goods production.

**Chart 5 Share of Micro, Small, Medium & Large enterprises by the spheres of economy, 2004 and 2005**



**Table 6**

**Number of SMEs and large enterprises established during 2004 and 2005**

During the year	Total number of registered enterprises	SMEs		Large	
		Quantity	[%]	Quantity	[%]
2004	9089	8889	97.8	200	2.2
2005	9667	9445	97.7	222	2.3

**Table 7**

**Distribution of SMEs in Yerevan city and RA other marzes, 2004 and 2005**

Marz	2004		2005	
	SMEs		SMEs	
	Quantity	[%]	Quantity	[%]
Yerevan city	45529	48.5	48206	48.3
RA other marzes	48345	51.5	51599	51.7

Confronting the figures characterizing the distribution of SMEs in Yerevan city and RA other marzes and the last population census results handed an opportunity to calculate figures practiced internationally, which are presented in Table 7.

According to the result of the last population census in RA the number of existing population is 3002.6 thousand<sup>10</sup>, of which 1091.2 thousand or 36.3% in Yerevan city and 1911.4 thousand or 63.7% in RA other marzes.

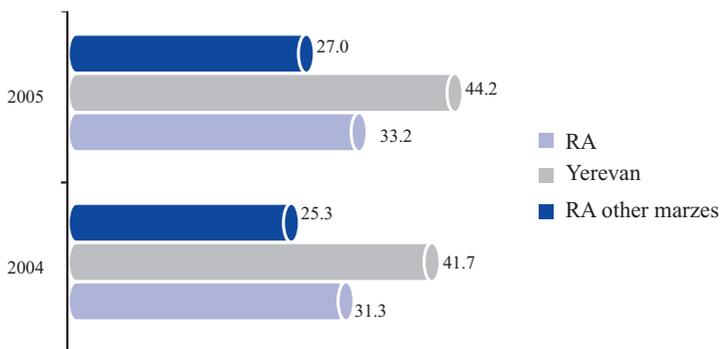
**Table 8**

*Number of SMEs per 1000 inhabitants in RA, 2004 and 2005*

	2004	2005
Number of SMEs per 1000 inhabitants in RA	31.3	33.2
Number of SMEs per 1000 inhabitants in Yerevan city	41.7	44.2
Number of SMEs per 1000 inhabitants in RA other marzes	25.3	27.0

Coming to a conclusion from the figures presented in Table 8 we can state that there are considerable differences of business activity in Yerevan city and RA other marzes, which brings to the huge disproportions in social-economic conditions particularly in far regions and border areas.

**Chart 6** *Number of SMEs per 1000 inhabitants in RA, 2004 and 2005*



<sup>10</sup> Social-economic situation in RA 2003” National Statistical Service of RA.

*Employment*

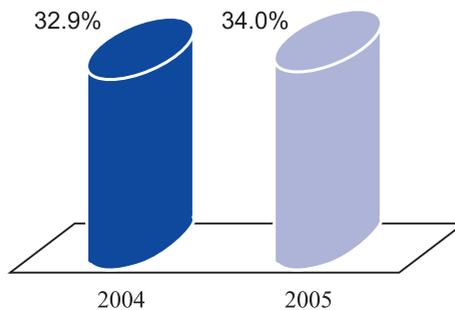
According to estimations the average number of economically active population in RA in 2005 was 1203.3 thousand of which the 91.9% or 1105.3 thousand were employed in economy and 8.1 % or 98.0 thousand were unemployed and were registered in the “Employment Service of RA” under the RA Ministry of Employment and Social Issues. Though the official statistics, number of researches and expert estimations show that the unemployment rate in RA is much higher than 8.1%.

**Table 9**

*Share of SMEs in employment in RA, 2004 and 2005*

Year	Total number of employment		Unemployment
	Share of SMEs	Number of economically active population employed in economy  (thousand man)	Percentage in total number of employed
	Percentage in total number of employees <sup>1</sup>		
2004	32.9	1110.9	9.4
2005	34.0	1105.3	8.1

**Chart 7** *Share of SMEs in employment in total number of economically active population, 2004 and 2005*



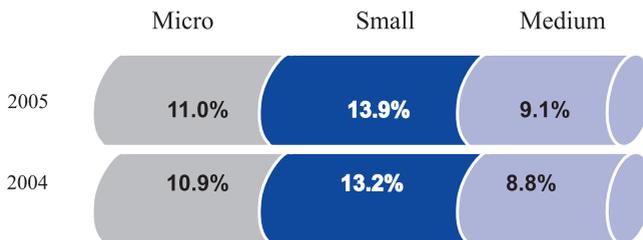
<sup>11</sup> Without state employees and people working in agriculture.

Table 10

*Distribution of employment in SMEs and large enterprises by the spheres of economy, 2004 and 2005*

Sphere	2004		2005	
	SMEs	Large	SMEs	Large
	[ % ]		[ % ]	
Industry	29.3	70.7	32.3	67.7
Agriculture <sup>1</sup>	62.6	37.4	44.2	55.8
Construction	43.8	56.2	42.0	58.0
Trade	78.3	21.7	81.1	18.9
Transport & Communication	9.5	90.5	13.2	86.8
Services	17.9	82.1	21.7	78.3
<b>RA<sup>2</sup> TOTAL</b>	<b>32.9</b>	<b>67.1</b>	<b>34.0</b>	<b>66.0</b>

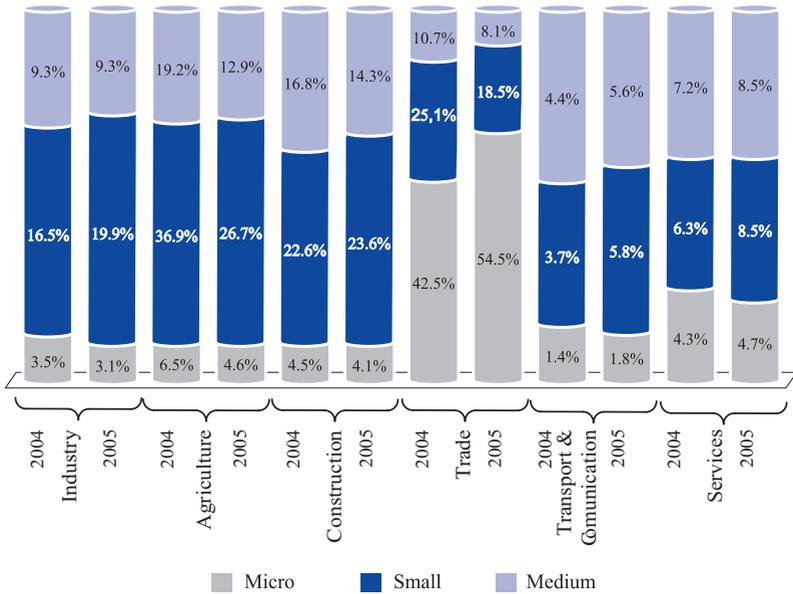
*Chart 8 Distribution of employment in Micro, Small & Medium enterprises, 2004 and 2005*



<sup>12</sup> Enterprises engaged in production of agricultural goods.

<sup>13</sup> Without state employees and people working in agriculture.

**Chart 9** *Distribution of employment in Micro, Small & Medium enterprises by the spheres of economy in percents, 2004 and 2005*



**Foreign trade**

Foreign trade turnover of the RA at market prices in 2005 was 1240536.8 mln AMD or 2718.3 mln USD, including export 433395.1 mln AMD (950 mln USD) and import 807141.7 mln AMD (1767.9 mln USD). For the same period the deficit of trade balance was 373746.62 mln AMD (817.6 mln USD).

**Table 11**

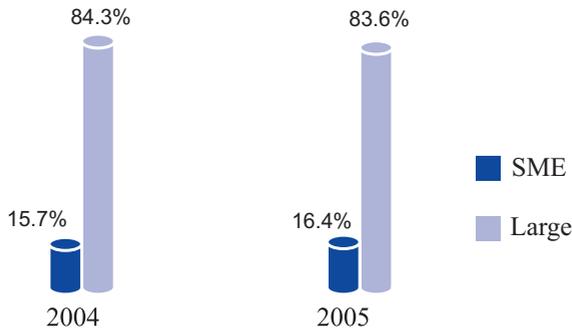
**Dynamics of Foreign Trade Turnover in 2004 and 2005 by SMEs and Large Enterprises**

	2004			2005		
	Total [mln AMD]	SME	Large	Total [mln AMD]	SME	Large
		[%]			[%]	
Export	381380.1	15.7	84.3	433395.1	16.4	83.6
Import	717773.0	34.8	65.2	807141.7	36.3	63.7

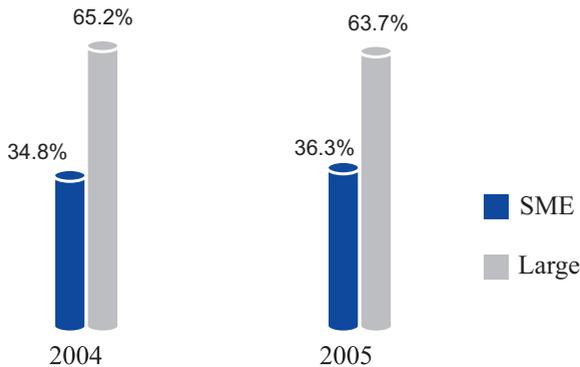
The figures illustrated in the Table 11 indicate that the share of SME sphere in the foreign trade turnover is low: the share of SMEs in export and import was accordingly 15.7% and 34.8% in 2004, 16.4% and 36.3% in 2005.

The analysis of the reasons of the small share of SMEs in foreign trade turnover particularly in export allows concluding that now the internal market is the target market for SMEs, because they can't satisfy the external market requirements and during exporting deals facing some formidable obstacles either within the country or in selling their products overseas.

**Chart 10** *Share of SMEs and Large Enterprises in Export, 2004 and 2005*



**Chart 11** *Share of SMEs and Large Enterprises in import, 2004 and 2005*



<sup>14</sup> According to OECD and UNECE SME share in export in Czech Republic is 36.2%, in France 30.0% and in Georgia 10.7%.

*Foreign Investments*

In recent years the dynamics of foreign investments growth is encouraging. According to the official statistics, in the period from 2003 to 2005 the total foreign investments in Armenia amounted to 935.6 mln USD, of which 624.7 mln USD were foreign direct investments (FDI). As of 01.01.2006, 3102 companies with participation of foreign capital were founded the majority of which were established in recent years.

In the period from 2003 to 2005 essential structural changes were noticed in the volume of foreign investments. In this period when the process of privatization could be considered as mainly accomplished and foreign investments had no considerable share in the privatization process, the annual volume of foreign investments was formed due to investments made in newly established enterprises including small and medium ones as well as reinvestments in operating enterprises.

This analysis is the first attempt to estimate the share of foreign investments made in SME units in total volume of foreign investments. The analysis has been carried out for the years 2003-2005 and the total volume of foreign investments and number of enterprises with foreign capital participation in Armenia during this period were used as reference indicators.

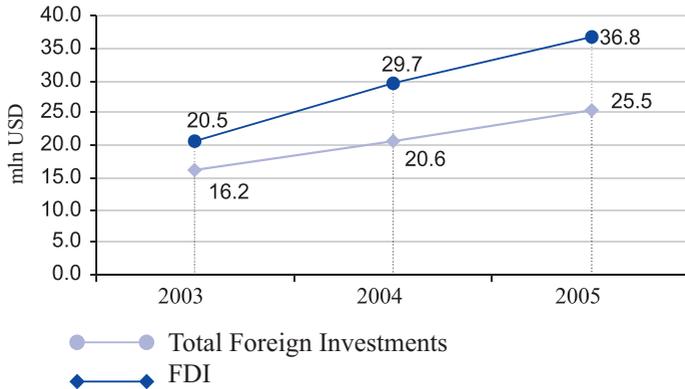
**Table 12**

*The dynamics of share of foreign investments in SMEs<sup>15</sup> and Large enterprises in mln USD, 2004-2005*

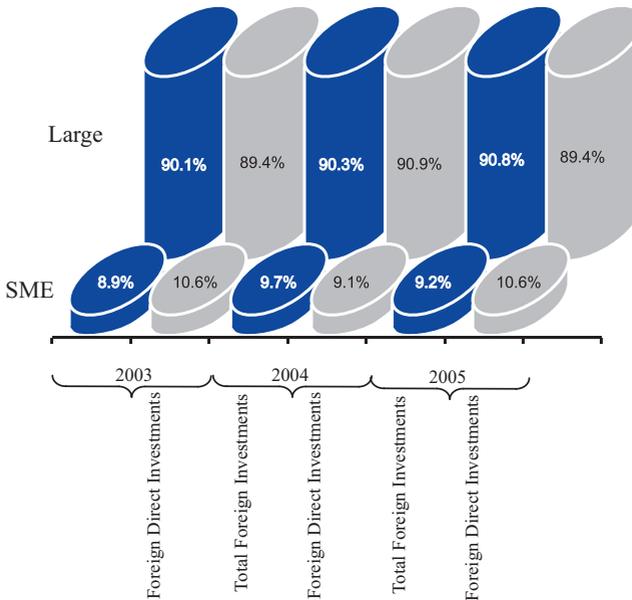
Year  Classification	2004		2005	
	SME	Large	SME	Large
	[mln USD]		[mln USD]	
Total Foreign Investments	29.7	275.9	36.8	363.6
Direct Foreign Investments	20.6	206.1	25.5	218.9

<sup>15</sup> The share and quantity of foreign investments in SMEs were assessed according to the foreign investments made in large enterprises with the application of the statistical method of exception.

**Chart 12** *The dynamics of share of foreign investments in SMEs and Large enterprises in mln USD, 2003-2005*



**Chart 13** *The dynamics of share of foreign investments in SMEs and large enterprises in percents, 2003-2005*



In the period from 2003 to 2005 in the SMEs operating in the real sector of economy the volume of foreign investments in absolute numbers have been growing year by year. In the same period their share in percents in the total volume of foreign investments made in Armenia has not changed considerably. By the expert estimations from 2003 to 2005, 865 enterprises with foreign capital participation were founded the overwhelming majority of which (90%) were SMEs.

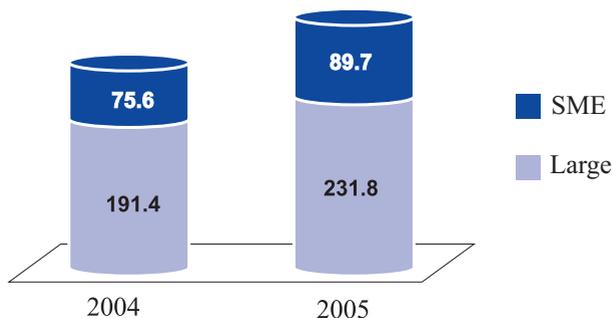
*Taxes*

As can be seen from the table, in the last two years the share of taxes, state duties and other obligatory payments in absolute numbers contributed by SMEs in 2005 to the RA state budget in the total of the budget incomes increased around 14.1 bln AMD in comparison with 2004 but at the same time their share in percents has not undergone considerable changes and decreased by 0.4 percentage points.

**Table 13**  
*The share of taxes paid by SMEs and Large Enterprises in the total amount of tax incomes of the RA state budget, 2004-2005.*

Classification	Year	2004		2005	
		Total [bln AMD]	[%]	Total [bln AMD]	[%]
<b>Large</b>		191.4	71.7	231.8	72.1
<b>SME</b>		75.6	28.3	89.7	27.9
<b>Total</b> <i>RA budget tax incomes, state duties and non tax incomes</i>		267	100	321.5	100

**Chart 14** The share of taxes paid by SMEs and Large Enterprises in the total of the RA state budget tax incomes, 2004-2005



SMEs are mainly operating in the spheres under the fixed tax regime, where from the fiscal perspective the economic growth<sup>18</sup> is intangible. However, in 2005 5 percent decrease was recorded compared with 2004, in the same period the simplified tax budget entries reduced around 6 percent; at the same time the indirect taxes paid by SMEs increased and an essential growth with regard to income tax and profits tax was recorded.

The above-mentioned was mainly preconditioned by growth of the import volume by SMEs as well as legislation changes, particularly from January 1, 2005, a number of spheres were transferred from the simplified tax regime to the general taxation field.

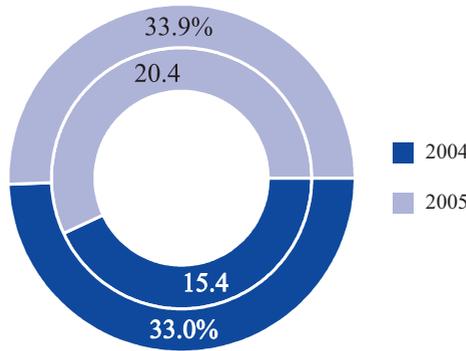
**Table 14**  
*The share of obligatory social security payments made by SMEs and Large Enterprises in the total of the obligatory social security payments, 2004-2005*

Classification	Year	2004		2005	
		Total [bln AMD]	[%]	Total [bln AMD]	[%]
SME		15.4	33.0	20.4	33.9
Large		31.3	67.0	39.7	66.1
Total Obligatory social security payments		46.7	100	60.1	100

<sup>18</sup>The supplementary added value produced by SMEs.

As can be seen from the table, compared with 2004, in 2005 the amount of obligatory social security payments increased around 28.6% or 13.4 bln AMD. In the same period, the share of SMEs increased by 0.9 percentage points in the total amount of obligatory social security payments, amounting to 20.4 bln AMD or 33.9% in 2005 compared with 15.4 bln AMD or 33.0% in 2004.

**Chart 15** *The share of obligatory social security payments made by SMEs in the total of the obligatory social security payments, 2004-2005*



*SME Development Index*

In order to get the overall picture of SME sphere role and significance for countries economic system in the recent economic researches implemented in the SME sphere by United Nations Economic Commission was practiced calculation of an aggregated figure called “SME Development Index”.

The SME Development Index is a complex economic indicator that incorporates the share of the whole SME sector in the overall performance of the national economy based on three economic parameters such as:

- the share of private ownership
- the share of SMEs in GDP
- the share of the labor force of SMEs in the total labor force of a country.

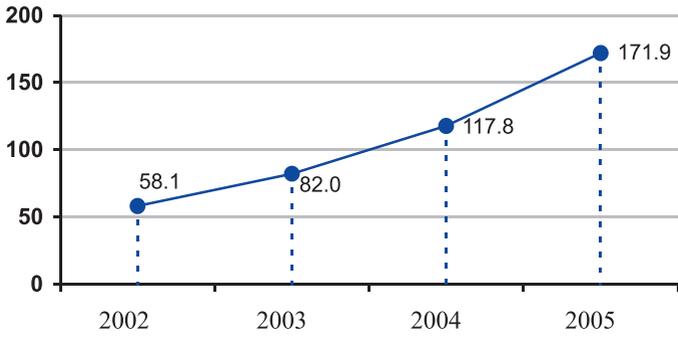
SME Development Index can be expressed in terms of percentage and/or GDP per capita.

*Table 15*

*SME Development Index in Armenia, 2002-2005*

Տարի	Մասնավոր հատվածի տեսակարար կշիռը տնտեսությունում [ % ]	ՓՄՉ ոլորտի տեսակարար կշիռը ՀՆԱ-ի մեջ [ % ]	ՓՄՉ սուբյեկտներում զբաղվածների տեսակարար կշիռը զբաղվածների ընդհանուր թվաքանակում [ % ]	Մեկ շնչին ընկնող ՀՆԱ [ԱՄՆ դոլար]	ՓՄՉ զարգացման ինդեքս  [ՀՆԱ-ի նկատմամբ մեկ շնչին ընկնող եկամուտների հաշվով]
2002	81	34.4	28.2	739.9	58.1
2003	83	36.5	31.0	873.4	82.0
2004	84	38.6	32.9	1104.4	117.8
2005	84	39.8	34.0	1513.0	171.9

Chart 16 Dynamics of SME Development Index in Armenia, 2002-2005



### Part 3 Comparative Analysis of Small & Medium Entrepreneurship Sphere

Based on the results of analysis and calculated indicators presented became possible to delineate the complete picture of SME sector in Armenia. However, in prospect of having a complete and accurate picture of SME sector in Armenia, a comparative analysis of the main indicators of SME sector between Armenia and number of developed and developing countries was conducted and included.

The results of analysis gave the complete picture of SME sector in Armenia, however by our deep belief, the comparison of transformation processes occurring in the economies of the countries in the South Caucasus and number of other countries and drawing parallels between them make the material complete.

The role of SME sphere in developed and developing countries is increasingly recognized and is demonstrated by the results of comparative analysis given below.

In developed countries SMEs constitute 97-99% of the economic units. In the USA the share of SMEs in the total number of enterprises is 99.7%, in GDP - 52% and in the total number of employees - 53%.

According to OECD in France and Spain the share of SMEs in the total number of enterprises is 99.8% and in Japan this figure amounts for 99.7%. In these countries SMEs also have significant role in increasing employment rate. SME sphere has significant contribution in those countries in employment, i.e. balancing supply and demand in labor market.

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

Based on the observations the following countries were chosen for comparative analysis: Azerbaijan, Georgia, Slovakia, Slovenia, Latvia, Lithuania, Estonia, Bulgaria, Croatia,

<sup>19</sup> Small Business in Japan “White paper on small and medium enterprises in Japan” MITI, 2002, 219 p., p. 109.

<sup>20</sup> South Caucasus region.

Serbia, Czech Republic and Hungary.

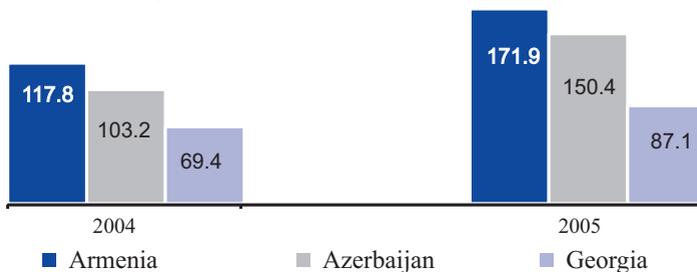
The choice of these countries for comparative analysis is reasoned by the geographical position and tendencies of their economic development, sizes of territories and number of population, which are this or another way comparable to Armenia.

**Table 16**

*Basic indicators of SME sphere in Armenia and in number of developing countries and/or countries in transition, 2005*

Country	Share of private ownership in economy <sup>1</sup> [ % ]	Share of SMEs in GDP <sup>21</sup> [ % ]	Share of the labor force of SMEs in the total labor force of the country <sup>23</sup> [ % ]	GDP per capita <sup>22</sup> [USD]	SME Development Index [Expressed in terms of GDP per capita]
Slovenia	65	56.5	62.6	16950	3896.8
Estonia	80	73.7	55.6	10076	3303.1
Lithuania	75	63.0	70.0	7235	2393.0
Slovakia	80	45.3	66.0	8592	2055.1
Latvia	70	58.2	69.3	6695	1890.2
Hungary	80	36.9	56.8	10920	1831.0
Croatia	60	56.0	65.0	8369	1827.8
Czech Republic	80	32.7	56.7	11990	1778.4
Romania	70	55.0	21.0	4305	348.1
Serbia	55	46.6	32.4	2466	204.8
Bulgaria	75	30.0	42.2	2005	190.4
Armenia	84	39.8	34.0	1513	171.9
Azerbaijan	60	41.3	40.0	1517	150.4
Georgia	65	29.4	32	1424	87.1

**Chart 17** *Dynamics of SME Development Index in Armenia, Azerbaijan and Georgia, 2004-2005*



<sup>21</sup> Azerbaijan, Georgia.

<sup>22</sup> EBRD “Transition Report 2005” Businesses in Transition.

<sup>23</sup> SME sphere database 2004, UN ECE.

The Reference Book “SME Sphere in Armenia 2004-2005” was developed within the framework of SME DNC of Armenia's initiative by “Logicon Development” LLC with support from OSCE office in Yerevan. The statistical indicators presented in the Reference Book were assessed based on the data of the National Statistical Service of the RA, Tax State Service under the Government of the RA, Customs State Committee under the Government of the RA as well as non official sources connected with the information used in the Reference Book.

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Հայաստանի  
փոքր և միջին ձեռնարկատիրության  
զարգացման ազգային կենտրոն



Small & medium entrepreneurship development  
national center of Armenia