

ANNEX 1

of the Commission Implementing Decision on
the Annual Action Programme 2014 in favour of Armenia to be financed from the
general budget of the European Union

Action Document for Support to SME Development in Armenia

1. IDENTIFICATION

Title/Number	Support to SME Development in Armenia CRIS number: ENI/2014/030-964		
Total cost	Total estimated cost: EUR 8 200 000 Total amount of EU budget contribution: EUR 7 000 000 This action is co-financed in parallel co financing by the Government of Armenia for an amount of EUR 1 000 000 Estimated co-financing by grant beneficiaries: EUR 200 000		
Aid method / Management mode and type of financing	Sector Approach <ul style="list-style-type: none">• Direct management – grants (direct award) and procurement of services• Indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)		
DAC-code	32130 25010	Sector	Small and medium-sized enterprises (SME) development Business support services and institutions

2. RATIONALE AND CONTEXT

2.1. Summary of the action and its objectives

Support to small and medium-sized enterprises (SME) development is in line with the EU Single Support Framework (SSF) 2014-2017 for Armenia. Under the private sector development sector, it corresponds to the specific objective (1.1) to improve the national business and investment climate for SMEs. In terms of Armenian strategic framework, the Armenia Development Strategy and the SME State Support Strategy are the main documents. The SSF and this programme address some of the key issues identified in them.

The action aims to create employment opportunities by enhancing private sector development in Armenia. The specific objective is to improve the national business and investment climate and support the creation and development of SMEs by strengthening the government and the organised private sector in implementing the national policy for SME development, and by facilitating incubation of innovative small businesses through grant schemes. Implementation partnership with the German Agency for International Development (GIZ) will promote alignment with the EU best practices, including the Small Business Act for Europe.

Out of the total allocation available for private sector development under the SSF in 2014 (EUR 22 million), an amount of EUR 15 million is channelled to the Neighbourhood Investment Facility (NIF) for a project aiming to diversify the sources of financing for start-up businesses and SMEs. This project is complementary to the present action.

2.2. Context

2.2.1. Country context

Economic and social situation and poverty analysis

Before the 2009 global financial crisis, the Armenian economy grew by about 12 percent per year. This high growth performance resulted in improvement of the per capita income from USD 680 in 2001 to USD 3 340 in 2008. However, this was generated through an unsustainable economic model narrowly based on expansion of residential construction, domestic services, and foreign exchange inflows (including remittances). During the same period, the share of manufacturing declined from 17 to 9 percent of Gross Domestic Product (GDP), whereas large remittance inflows and appreciation of the national currency rendered domestic tradables uncompetitive and left the economy highly vulnerable to external shocks. As the global economy went into recession and external financing of the domestic construction sector was interrupted, the sector collapsed by 48 percent, and GDP per capita declined to USD 3 170 in 2009. The Armenian economy started recovering again in 2010, and according to World Bank data, the GDP per capita had increased to USD 3 850 in 2013. Growth decelerated to 3.2% in 2013 from 7.3% in 2012 and according to IMF projections is expected to rise to 4.5% in the medium term. These figures show that Armenia continues to recover economically after its GDP shrank by 14 per cent in 2009 in consequence of the global financial crisis. However, the labour market situation is difficult with an unemployment rate in Armenia of 16.2% in 2013 according to the International Labour Organisation.

According to the latest National Statistical Service "Social Snapshot and Poverty in Armenia"⁶, the poverty level in 2011 reduced as compared to the previous year. Poverty in Armenia in 2012 was estimated at 32.4%, nearly one in every three persons. Poverty is higher for women-headed households (about +10 percentage points) and for families with children up to 6 years of age. Poverty for men and women is, however, relatively homogeneous, as is the case for both rural and urban residents. In terms of age, children below 19 are the most likely to be poor (36%) whereas older Armenians have the lowest probability (25%). The lowest incidence of extreme poverty was observed in Yerevan. However, in the country as a whole, the majority of the extremely poor (80%) are urban residents.

National development policy

The Armenia Development Strategy (ADS), which was adopted in April 2014, is the overall policy framework for sustainable socio-economic development in Armenia. It identifies cross-cutting governance issues that adversely affect economic growth, competitiveness and labour market outcomes, underlying the need to fight corruption and improve the business climate. The ADS takes into account existing direct policies to achieve its goals. In particular, it refers to the SME State Support Strategy and the Industrial Policy. It recognizes SMEs as a driving force for economic and employment growth, noting that during 2008-2011 SMEs have created 100 000 job opportunities.

The current SME State Support Strategy (2012-15), implemented through annual programmes by the SME Development National Centre of Armenia (SMEDNC), aims at ensuring a dialogue between SMEs and the State, increasing efficiency and competitiveness of SMEs, ensuring availability of business development services for SMEs, expanding the financial opportunities for SMEs, promoting innovations and research and development (R&D) activities of SMEs, assisting the establishment of new SMEs, and supporting internationalization of SMEs' activities. The annual budget allocated by the Government under the Medium-Term Expenditure Framework (MTEF) 2014-2016 to support private sector development (industrial development, competitiveness, quality infrastructure, support to SMEs, etc.) is EUR 2.5 million. This programme is designed to support the SME policies of the ADS, as developed in the SME State Support Strategy.

2.2.2. Sector context: policies and challenges

Although Armenia has improved its position in the World Bank "Doing Business ranking" in 2014, moving from position 40 to 37, the impact of measures adopted is still very limited and Armenia still ranks very low in indicators such as "trading across borders", "enforcing contracts", "paying taxes" or "getting electricity". Armenia ranks 82 in the 2012-2013 Global Competitiveness Index, with very low ranking in "intensity of local competition", "effectiveness of anti-monopoly policy", "burden of customs procedures", "judicial independence", and "financing through local equity market". Other major problematic factors listed are (1) corruption, (2) inefficient Government bureaucracy, (3) access to finance, and (4) tax regulations.

The 2012 progress report on the implementation of the Small Business Act for Europe in the Eastern Partnership (EaP) countries draws similar conclusions and highlights the necessity to strengthen public-private dialogue in order to implement conducive and innovative SME development policies. There is a need to coordinate and rationalise public-private dialogue, as for the moment this dialogue takes place in four different thematic reform Councils; including the Business Support Council, the SME Council and the Industrial Council.

⁶ "Social Snapshot and Poverty in Armenia" <http://www.armstat.am/file/doc/99477213.pdf> accessed April 2014

According to estimates; the number of Micro, Small and Medium Enterprises (MSME) in Armenia is approximately 134 000 of which more than 90% are legally registered. Micro-enterprises and small enterprises represent respectively more than 75% and 16% of the total MSMEs and account for around 42% of the employed population, although contributing only 30% of GDP. This can be explained by a rather large informal or self-subsistence economy. In order to address this challenge and the risk it bears for the competitiveness of registered MSMEs, the Government, with the support of the EU financed e-governance project, has created an e-business registry system to facilitate the administration of formal businesses and discourage the informal economy.

In recent years, economic growth was driven mainly by exports from the mining industry and by agro-products where SMEs contribute only 17%. Most of the SMEs are operating in the trade sector with very low added value. The share of SMEs in capturing foreign direct investment (FDI) is also very low, representing only 8% of the total FDI. It is worth noting that several investments and development partners' initiatives started in the information and communications technology (ICT) sector, targeting more specifically start-up businesses and SMEs notably through the creation of incubators and techno parks. Very recently the Government and its implementing agencies have started to promote the development of other sectors with potential added value such as chemicals, pharmaceuticals, green technology, and precise engineering.

With respect to SMEs' access to finance, following the expansion of credit in the lead up to the global financial crisis, and a 14% decline in GDP in 2009, many Armenian SMEs have accumulated high levels of debt, and thus their owner/managers do not have sufficient financial resources or access to further borrowing.

2.3. Lessons learnt

The main lessons learnt from the implementation of EU projects related to economic governance and private sector development are:

- (1) It is essential to ensure strong coordination among the different EU programmes and implementing tools (budget support, twinning, technical assistance, NIF projects). Similarly, overall donor coordination is of utmost importance for the overall development impact. This programme will pay particular attention to coordination of the action with other relevant EU and other assistance, including through specific support to coordination efforts by the Government.
- (2) All equity funds for SMEs are regional and do not respond to the needs of Armenian SMEs. Equity funds favour investments both in Georgia and Azerbaijan rather than in Armenia. In particular, since 2012, the Caucasus Growth Fund managed by SEAF (Small Enterprise Assistance Fund) has realised only one operation in Armenia. A new project being prepared under the NIF, which is highly complementary to this action, will address this issue by creating a tailor-made Armenian-only facility designed to identify and establish a viable local portfolio.
- (3) There is a need to strengthen the sector policy dialogue with the Government in monitoring the implementation and impacts of the activities carried out. Different stakeholders, including civil society and the private sector, need to be involved to promote the inclusiveness of reform processes - such a mechanism is foreseen under this programme.

2.4. Complementary actions

The main complementary EU action is a project under preparation - financed through the NIF (EUR 15 million channelled from the Armenia bilateral 2014 allocation under the SSF) -

aiming to diversify the sources of financing for start-up businesses and SMEs. In particular, this project will allow companies to access equity finance and will help them to improve their financial management capacity.

Other bilateral complementary EU programmes include two ongoing multi-sector budget support operations addressing public finance management, public sector transparency and trade related areas, whereas another ongoing budget support programme targets vocational education and training (VET) reform and employment policy. New programmes from the Annual Action Programme 2013 in the areas of agricultural and rural development – ENPARD⁷ Armenia (budget support), and regional development (project approach) are due to be launched in 2014. Further trade related assistance is planned to support the modernisation of the national quality infrastructure, in order to protect consumers through the adoption of higher safety standards for Armenian products.

Complementing the ENPI regional East Invest programme, this action will specifically focus on SME associations and support to local structures representing the smallest segment of SMEs. The EU also delivers assistance through regional NIF projects such as SME Finance Facility and Small Business Support Programme (Business Advisory Services – BAS and Enterprise Growth Programme – EGP) implemented by EBRD, and the European Neighbourhood Small Business Growth Facility (through the European Fund for Southeast Europe - EFSE) implemented by the German Development Bank (Kreditanstalt für Wiederaufbau - KfW) and the Austrian Development Bank (Oesterreichische Entwicklungsbank - OeEB). EBRD is also setting up a new regional NIF project called SME Direct Finance Facility.

This programme will complement the following support provided by GIZ:

- GIZ is implementing a regional project (South-Caucasus private sector development programme from 2013 to 2016) with an estimated financial envelope for Armenia of EUR 2.5 million. This project focuses on job creation and poverty alleviation and aims at increasing the competitiveness of export-oriented SMEs. It supports the elaboration and implementation of private sector development policies, contributes to increase competitiveness of SMEs, provides technical assistance to improve VET curricula, and develops sector strategies such as in the wine sector.

Other development partners involved in the different areas are:

- EBRD is contributing to the SEAF (Small Enterprise Assistance Funds) Caucasus Growth Fund in addition to its role in implementing the regional NIF projects mentioned above,.
- The World Bank (WB), under its Development Policy Operation loan scheme (2014-15), is supporting access to finance, financial sector development, customs, tax revenue mobilisation, and business inspection reforms. Furthermore, WB is currently advising the Government on the improvement of the institutional setup of the private sector development agencies. A regional WB programme (Strengthening Auditing and Reporting in the Countries of the Eastern Partnership - STAREP) also aims at creating a transparent policy environment and effective institutional framework for corporate reporting.
- The Organisation for Economic Co-operation and Development (OECD) has been providing support, notably through an assessment of the implementation of the Small Business Act, the SME policy index in the EaP countries, and is currently implementing an EU co-funded regional programme supporting SME competitiveness in the EaP region.

⁷ European Neighbourhood Programme for Agriculture and Rural Development

2.5. Donor coordination and policy dialogue

An informal donor coordination group led by the United Nations Development Programme (UNDP) has been set up in all the areas supported by development partners. The EU with WB is co-chairing donor coordination in the economic area. In particular, the EU Delegation chairs the donor sub group dealing with trade, investment, and private sector development. However, this donor coordination mechanism is not driven by the Government but this programme will support it in assuming such a role.

3. DETAILED DESCRIPTION

3.1. Objectives

The overall objective is to create employment opportunities by enhancing private sector development in Armenia.

The specific objective is to improve the national business and investment climate and support the creation and development of SMEs.

3.2. Expected results and main activities

The main expected results and activities will be:

1. Improved policy making process and coordination of support to SME development - Technical assistance will strengthen the institutional capacities of SMEDNC and the Ministry of Economy (MoE) to implement the SME strategy and its action plan. This includes the setup of a result-based monitoring system and steering mechanism, which will enable MoE to better coordinate different SME support programmes. In this respect, a result-oriented public-private dialogue will also be supported, ensuring in particular the participation of micro businesses. This technical assistance will be accompanied by a financial contribution (up to 50%) to the participation fee of Armenia in the EU programme COSME (Competitiveness of Enterprises and SMEs), including the Europe Enterprise Network (EEN).
2. Strengthened private sector organisation to implement SME policies - Technical assistance will strengthen the capacity of existing local business associations and ensure the participation of micro businesses. GIZ will manage a fund and provide action grants to the business associations in view of (1) engaging more effectively in public-private dialogue, (2) providing better services to companies and promoting regularisation of informal businesses, and (3) expanding their networking with the European business community.
3. Improved process of commercialisation of ideas linking research institutions and businesses - Technical assistance will identify existing practices, advise the Government on EU best practices, and create a platform linking research institutions and SMEs. The SMEDNC and the Enterprise Incubator Foundation (EIF) capacities will be strengthened to properly to run this platform.
4. Improved design and management of existing incubators and Free Economic Zones (FEZ) - Technical assistance will provide assistance to MoE to better manage FEZ, and to EIF to improve the management of incubators (techno parks), creating a more conducive environment and coordinating efficiently the different related initiatives.
5. Diversified access to finance for innovative start-up and small businesses - Technical assistance will be provided to reinforce the capacity of the EIF in managing the "science

& technology entrepreneurship programme" and the "innovation matching grants". To complement these programmes, GIZ will manage a fund and provide action grants to support technology start-ups and SMEs promoting new products/services. Such grants aim at stimulating the rate of technology absorption, technology transfer, innovation and commercialization in the private sector, and fostering collaboration between research centres and SMEs.

The activities of this programme are in line with the principles set out in the recent Commission Communication on "A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries"⁸.

3.3. Risks and assumptions

The primary assumptions are:

- The Government remains firmly committed to its reform agenda (as set out in the ADS);
- The implementing institutions allocate the necessary human, financial and technical resources to support the implementation of the programme;
- Businesses are ready to absorb the financial and technical assistance.

Major risks can be summarised as follows:

- Lack of capacity and high turnover of civil servants and other relevant staff undermines the implementation and coordination of the programme activities;
- Lack of political will to implement policies and reforms to improve the business climate for SME;
- Corruption, fraud and lack of public sector reform;
- Duplication with other initiatives financed by the EU and other development partners.

The main mitigation measures are:

- Capacity assessment of key stakeholders to ensure that the assistance to be provided responds to the needs and requests of the beneficiaries;
- Enhanced policy dialogue with the government, at various levels, involving civil society and business associations;
- EU assistance to reforms in the public sector including civil service reform and anti-corruption efforts;
- Enhanced donor coordination mechanisms between all development partners.

3.4. Cross-cutting issues

The implementation of the programme will directly contribute to good governance by improving the work of public institutions and management of public resources. It will also directly contribute to poverty reduction through the improvement of economic opportunities for employers and employees. Furthermore, the programme will participate in improving the corporate governance of the SMEs, in particular their financial transparency.

The programme will support the introduction of gender-responsive approaches to private sector development policies and the expansion of economic opportunities for women. Specific

⁸ COM(2014) 263 of 13 May 2014

trainings on women's access to entrepreneurship, gender equality in corporate governance, and business management skills for women will be provided. In addition, campaigns to promote women's employment in SMEs will be organised, surveys will be conducted, and success stories about women entrepreneurs will be disseminated. Moreover, gender criteria in the selection of grantees will be introduced during the specific design of the grant components.

The impact on the environment will be carefully measured when developing and implementing projects or supporting specific economic sectors. Sustainable development will be promoted in all the activities of this programme.

3.5. Stakeholders

MoE is responsible for the overall coordination of private sector development related policies in Armenia and is the main counterpart for policy dialogue. In addition, the National Competitiveness Foundation of Armenia (NCFA) plays a role in coordinating the general competitiveness agenda, ensuring policy coherence and coordination across the different sectors and entities in Armenia. For specific targeted areas, SMEDNC and EIF will directly benefit from the programme and play a significant role in implementing the activities and planned reforms.

Target groups will be SMEs, business community representatives, such as Union of Banks in Armenia, Armenian Chamber of Commerce and Industry. The Union of Employers will also receive support to facilitate the implementation of reforms.

4. IMPLEMENTATION ISSUES

4.1. Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 184(2)(b) of Regulation (EU, Euratom) No 966/2012.

4.2. Indicative operational implementation period

The indicative operational implementation period of this action, during which the activities described in sections 3.2. and 4.3. will be carried out, is 60 months from the date of entry into force of the financing agreement, subject to modifications to be agreed by the responsible authorising officer in the relevant agreements. The European Parliament and the relevant Committee shall be informed of the extension of the operational implementation period within one month of that extension being granted.

4.3. Implementation components and modules

4.3.1. Indirect management with a Member State Agency

A part of this action with the objective of fostering the development of SMEs may be implemented in indirect management with Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012. This implementation is justified because GIZ has a proven expertise in the areas of intervention. In Armenia, GIZ is managing a complementary support through its regional programme to the SME sector. Furthermore, GIZ is well placed to promote alignment with EU best practices. The entrusted entity will implement the activities through technical assistance (experts), facilitate policy dialogue in the areas under its responsibility, and manage

a fund providing grant schemes to support innovative start-up and existing businesses. Budget implementation tasks are a core element of the activities entrusted to GIZ.

The entrusted entity is currently undergoing the ex ante assessment in accordance with Article 61(1) of Regulation (EU, Euratom) No 966/2012. In anticipation of the results of this review, the responsible authorising officer deems that, based on a preliminary evaluation and on the long-standing and problem-free cooperation with this entity, it can be entrusted with budget-implementation tasks under indirect management.

4.3.2. Grant: direct award (direct management)

(a) Objectives of the grant, fields of intervention, priorities of the year and expected results

The objective is to co-finance by means of reimbursement of a share of the annual participation fee of Armenia to COSME (EU programme) for the duration of the present action. The grant will be subject to signature of a Participation Agreement of Armenia to COSME. Should this Participation Agreement not be concluded, the corresponding funds would be allocated to other components of the action.

(b) Justification of a direct grant

Under the responsibility of the authorising officer by delegation, the grant may be awarded without a call for proposals to the Government of Armenia (or to the Armenian public entity appointed as responsible for this task).

Under the responsibility of the authorising officer by delegation, the recourse to an award of a grant without a call for proposals is justified because it is identified as beneficiary in the basic act on which this decision is based. The Government of Armenia, particularly MoE and SMEDNC, is in charge of implementation of the SME development strategy at national level.

(c) Eligibility conditions

Not applicable.

(d) Essential selection and award criteria

The essential selection criteria are financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the programme: design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(e) Maximum rate of co-financing:

The maximum possible rate of co-financing for this grant is 50%.

(f) Indicative trimester to contact the potential direct grant beneficiary

4th trimester 2015.

4.3.3. Procurement (direct management)

Subject	Type	Indicative number of contracts	Indicative trimester of launch of the procedure (Q)
Visibility / Communication	Service	1	Q3 2015
Audit	Service	1	Q1 2018

Evaluation	Service	2	Q3 2017, Q3 2019
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4.4. Scope of geographical eligibility for procurement and grants

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act shall apply.

The responsible authorising officer may extend the geographical eligibility in accordance with Article 9(2)b of Regulation (EU) No 236/2014 on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or other duly substantiated cases where the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

4.5. Indicative budget

Categories	EU contribution	Government contribution	Grant beneficiaries	Total
	in EUR thousands			
4.3.1 Indirect management with a Member State Agency	6 400	800	200	7 400
Indirect management with GIZ	6 400	800	200	7 400
4.3.2 Grant: direct award (direct management)	200	200	N.A.	400
Participation in COSME (EU programme)	200	200	N.A.	400
4.3.3 Procurement (direct management)	400	N.A.	N.A.	400
Communication / Visibility	200	N.A.	N.A.	200
Evaluation and Audit	200	N.A.	N.A.	200
TOTAL	7 000	1 000	200	8 200

4.6. Performance monitoring

The continuous technical and financial monitoring of the activities under this programme is the responsibility of the EU Delegation. Additionally GIZ as an implementing partner and contractors/grant beneficiaries will be responsible for monitoring their respective components. The EU Delegation, GIZ, and contractors/grant beneficiaries shall accordingly establish a technical and financial monitoring system for the programme, which will generate progress reports and safeguard internal control, and which will ensure the complementarity of this programme with other complementary actions. A steering committee co-chaired by the Ministry of Economy and the EU Delegation, with the involvement of business associations, civil society and the donor community, will be set up to monitor the programme implementation. Such monitoring will be based on indicators to be specified in the financing agreement (including relevant indicators specified in the Armenia SSF 2014-2017).

The EU may carry out results oriented monitoring via independent consultants, starting from the sixth month of project activities, which will be finalised at the latest 6 months before the end of the operational implementation phase.

4.7. Evaluation and audit

The programme may be subject to evaluations in order to assess the relevance, efficiency, effectiveness, impact and sustainability of its achievements. Independent evaluators may be contracted by the European Commission. Audits will be carried out respectively by the implementing partners according to the provisions set out in the respective agreements. The EU may decide to carry out external audit of the grant contracts.

4.8. Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU.

This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated before the start of implementation and supported with the budget indicated in section 4.5 above.

The measures shall be implemented (a) by the Commission, and (b) by the partner country, contractors, grant beneficiaries and entrusted entities. Appropriate contractual obligations shall be included in, respectively, financing agreements, procurement and grant contracts and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations.