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What Challenges Force Small and Medium Enterprises and Business Start-ups in Armenia to Discontinue their Entrepreneurial Activity?

Survey with 100 companies that have ceased operations.

Survey carried out by “Businesin Andarag” LLC,
in coordination with the Republican Union of Employers of Armenia,
with the support of the International Labour Organization.

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RESEARCH NOTE

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Thriving small and medium enterprises (SMEs) and start-up businesses are indicators of dynamic development of a particular sector of the economy, and of the country's economy at large. But as much as is important to learn and to understand how and why businesses succeed, so much so is also important to understand why some businesses fail.

This research note examines the reasons that force economic entities to close or suspend their economic activities in Armenia. The analysis is written based on three focus groups and a brief survey results among 100 closed businesses, focusing the time-frame on businesses that had closed during 2017-2022. Data collection was conducted in February 2022.

We conceptualize closed businesses as those economic entities in Armenia as those that are forced to **suspend their activities (but maintain their entry in the State Registry of Legal Entities) or permanently terminate their entrepreneurial activity (and delete their entry from the State Registry of Legal Entities)**, hereafter referred to as **closed businesses**.

The year 2018 marked the velvet revolution in Armenia and the change of authorities. The 2019 was a relatively strong economic year as the New Government of Armenia introduced various reforms and measures to facilitate economic production in Armenia. In 2020 COVID-19 pandemic reached Armenia too, due to which the Government of Armenia introduced many measures to mitigate COVID-19 hardships on Armenia's economy (RUEA And WFP 2020). Several studies conducted jointly by the Republican Union of Employers of Armenia (RUEA) and the World Food Programme (WFP) during 2020-2021 on food security in Armenia revealed that financial hardships and losing customers were some of the main hardships for shops in Armenia during 2020-2021 years of the COVID -19 pandemic (RUEA and WFP 2020, 2021), and during the survey fieldwork the research team discovered that many businesses had closed.

The 2020 Nagorno-Karabakh war with Azerbaijan, combined with the COVID-19 pandemic even more increased challenges of operating a business in Armenia. The State Revenue Committee of the Republic of Armenia estimated that in 2020, mostly due to COVID-19 in Armenia, more than 22,000 businesses closed temporarily -- 50% more than in 2019 (Lurer.com 2021, News.am 2021). Another 4,918 businesses shut down permanently in 2020 (News.am 2021) and 74,000 persons lost their jobs in 2020 due to COVID-19 (Lurer.com 2021).

Closed businesses are not a random category. Closed businesses are usually clustered in certain time periods, particular sectors of the economy, geographic regions, and share other similarities, such as the size of the business (micro, small, medium or large), or trading partner-countries abroad, etc.

Most research in Armenia on economic development of SMEs typically focuses on operating businesses (RUEA 2019, RUEA/WFP 2020, 2021, etc.). Little research usually exists on closed enterprises or those that have suspended their economic activities. The reason is that once closed, these businesses leave the ‘documented’ domain of the economy (i.e. stop being taxed, the entry is deleted from the registry of operating legal entities, etc.).

In the meantime, it is exactly the closed businesses, that can shed the most insight into the hardships and challenges of operating and sustaining an entrepreneurial activity and the vulnerabilities that businesses face in the country’s economy.

In an effort to have a snapshot of reasons on what leads economic entities in Armenia to terminate or suspend their economic activities, the “Businesin Andarag” implemented a study with **short surveys among 100 closed businesses in Armenia**. The research was subcontracted from the Republican Union of Employers of Armenia (RUEA), and the funding for research was provided by the **International Labour Organization (ILO)**.

Methodology

The State Registry of Legal Entities of Armenia provided a small subsample of economic entities marked in the Registry as closed or having suspended economic activities since 2017. With an objective to conduct **100 standardized survey interviews**, the research team made 450 calls, of which 100 business participated in the survey, 30 refused to participate in the survey, 9 businesses were operating again, 70 contact numbers did not answer the call, 153 were not available and 88 entities had a wrong contact info.

Conducted survey interviews were based on a standardized questionnaire of 18 questions, and on average lasted 15-20 minutes. The research team also conducted **three follow-up focused groups** with companies that have ceased operations.

The majority of businesses in the sample (**table 1**) were businesses providing health, educational and other social services—38% of the sample, followed by public food sector, wholesale trade and retail, and light industry—each comprising 11% of the sample. Tourism and heavy industry entities comprised 8% of the sample.

Table-1. Economic entities in the survey sample, by sector of economy, in percent of the sample size (sample size n=100)

| Economic Sector | % |
|--|-------------|
| Health, Educational, and social services | 38.0 |
| Wholesale trade and retail | 11.0 |
| Tourism and related activity | 8.0 |
| Public food sector | 11.0 |
| Heavy industry and related branches | 8.0 |
| Light industry and related branches | 11.0 |
| Construction | 5.0 |
| Information technologies and communication | 3.0 |
| Advertising | 3.0 |
| Service Sector | 1.0 |
| Transportation | 1.0 |
| Total | 100% |

This research focused on recently closed entities, and thus, as expected, around 84% of the entities in the sample had terminated their activities during 2017-2022 (**table-2**).

Table-2. Economic entities in the survey sample, by year their economic activity was terminated, in percent of the sample (sample size n=100).

| Termination Year | % |
|---------------------|-------------|
| 2008-2012 | 6.0 |
| 2013-2016 | 10.0 |
| 2017-2022, of which | 84.0 |
| 2017 | 8.0 |
| 2018 | 22.0 |
| 2019 | 19.0 |
| 2020 | 18.0 |
| 2021 | 15.0 |
| 2022 | 2.0 |
| Total | 100% |

Economic Entities in Armenia by the Branch of the Private Sector of the Economy

The vast majority of economic entities in Armenia are micro or small enterprises. **In almost all areas of the private sector of the economy more than 70% of entities are micro enterprises.** Using the European Communities/OECD (2008) differentiation of the enterprise size, the Statistical Committee of the Republic of Armenia differentiates micro businesses as entities with 0-9 wage-earning employees annually (**table 3**).

Table 3: Size of the Economic Entities in Armenia Defined by the Annual Average Number of Wage-Earning Employees

| Number of Wage-Earning Employees | Size of the Business Entity |
|----------------------------------|--|
| 0-9 | Micro (incl. companies with 0 wage-earners) |
| 10-49 | Small |
| 50-249 | Medium |
| 250 and more | Large |

Source: Table borrowed from Armstat (2021:4).

Several key findings emerge from official statistics:

- Over time, including during **2017-2020, in ALL sectors of the economy the number of operating economic entities has increased, and micro enterprises comprise the majority (table 4).**

In the last few years micro enterprises vastly dominate in wholesale & retail trade, repair of vehicles; real estate activities; among entities conducting professional, scientific & technical activities; providing administrative support services, and repair of computers & personal

good. Since 2017 consistently more than 90% of economic entities in these sectors are micro entities (see **table-4**). The only exception is the energy sector-- ‘electricity, gas, steam and air conditioning supply’ -- where only around 50% in 2017, but in 2020 already 60% of entities were micro entities. When micro and small-sized entities are combined together, in **each** economic sector, including the ‘electricity, gas, steam and air conditioning supply’, these entities comprise at least 95% of all enterprises. Thus, as is evident, Armenia’s economy is largely dominated by micro/small businesses.

- **As Armenia’s economy has been expanding, the trend has been towards micro-entrepreneurship while the SME entrepreneurship has been declining.** This is an important trend and is evident for 2017-2020 years: businesses have increasingly moved towards operating with smaller staffs (**table 4**).

Whether this trend is due to financial difficulties of businesses or their increased efficiency and higher staff professionalism should be explored with further research, but the trend clearly is towards micro-entrepreneurship.

But as **table-4** shows, in the highlighted in gray sectors (energy; water supply and sewage; construction; transportation and storage) during 2017-2020 the number of SMEs has declined by 10%, whereas in the same period the number of micro enterprises has increased accordingly. This trend is the sharpest in the transportation and storage where during 2017-2020 the number of small enterprises have decreased from 20% to 4.6% of total enterprises in that sector, and the micro entities have increased from 76% to 94% (see **table 4**).

- The only sector where there has been an **opposite trend**, i.e. **transition from micro-businesses to small businesses**, is the ‘**mining and quarrying**’ sector. During 2017-2020 number of small economic entities has increased by 5% from 10.7% to 15.8%, and the number of micro-entities has decreased with the same amount (**table 4**).

While there seems to be structural change in the ‘mining’ sector, the total number of economic entities operating in this sector almost had not changed in 2020 vs. 2017 and the proportion of increase in the total number of entities was the smallest among all economic sectors --10% increase only (table 4).

However, the number of persons employed in ‘mining’ has increased by around 40% (table 5), i.e. the enterprises working in ‘mining’ have grown in size, which is also evident in the shift from micro to small enterprises.

Table 4. The Number of Economic Entities in Armenia by Size of the Economic Entity and Economic Sector, by Year.

| Economic Sector | 2017 | | | | | 2018 | | | | | 2019 | | | | | 2020 | | | | |
|---|---------------|-------------|------------|------------|------------|---------------|-------------|------------|------------|------------|---------------|-------------|------------|------------|------------|---------------|-------------|------------|------------|------------|
| | Total Number | Micro % | Small % | Med. % | Large % | Total Number | Micro % | Small % | Med. % | Large % | Total Number | Micro % | Small % | Med. % | Large % | Total Number | Micro % | Small % | Med. % | Large % |
| Mining & Quarrying | 234 | 83.8 | 10.7 | 3.4 | 2.1 | 314 | 85.0 | 11.1 | 1.6 | 2.2 | 323 | 83.0 | 12.1 | 3.1 | 1.9 | 260 | 78.8 | 15.8 | 2.7 | 2.7 |
| Manufacturing | 5,771 | 86.7 | 10.3 | 2.2 | 0.7 | 6,741 | 86.6 | 10.3 | 2.5 | 0.7 | 7,508 | 85.4 | 11.3 | 2.7 | 0.6 | 10,573 | 90.3 | 7.4 | 1.9 | 0.4 |
| Electricity, gas, steam & air conditioning supply | 202 | 49.5 | 45.5 | 2.0 | 3.0 | 249 | 53.0 | 43.0 | 1.6 | 2.4 | 225 | 60.9 | 35.6 | 0.9 | 2.7 | 241 | 61.0 | 35.3 | 1.2 | 2.5 |
| Water supply, sewerage, waste management & remediation activities | 60 | | | | | | | | | | | | | | | 109 | | | | |
| | | 71.7 | 23.3 | 0.0 | 5.0 | 83 | 75.9 | 20.5 | 0.0 | 3.6 | 106 | 84.0 | 13.2 | 0.9 | 1.9 | | 81.7 | 14.7 | 1.8 | 1.8 |
| Construction | 1,224 | 69.9 | 24.1 | 5.6 | 0.4 | 1,517 | 73.8 | 20.6 | 4.9 | 0.6 | 1,783 | 74.5 | 19.9 | 5.3 | 0.3 | 2,185 | 80.3 | 14.9 | 4.3 | 0.4 |
| Wholesale & retail trade, repair of motor vehicles & motorcycles | 40,183 | 97.7 | 2.0 | 0.3 | 0.0 | 44,093 | 97.4 | 2.3 | 0.3 | 0.0 | 46,954 | 97.1 | 2.5 | 0.3 | 0.1 | 48,255 | 97.4 | 2.2 | 0.3 | 0.1 |
| Transportation & storage | 1,016 | 76.3 | 20.0 | 2.8 | 1.0 | 1,739 | 85.6 | 11.8 | 2.0 | 0.6 | 2,095 | 88.5 | 9.6 | 1.3 | 0.5 | 3,362 | 94.4 | 4.6 | 0.7 | 0.2 |
| Accommodation & food service activities | 2,559 | 83.9 | 14.0 | 2.1 | 0.0 | 4,053 | 85.0 | 13.1 | 1.8 | 0.1 | 4,805 | 84.2 | 13.7 | 1.8 | 0.2 | 5,034 | 88.8 | 9.8 | 1.2 | 0.1 |
| Information & communication | 1,636 | 82.6 | 14.2 | 2.6 | 0.6 | 2,161 | 84.1 | 13.3 | 2.1 | 0.5 | 2,538 | 83.9 | 13.4 | 2.1 | 0.5 | 2,799 | 85.2 | 12.3 | 2.1 | 0.4 |
| Real estate activities | 1,552 | 93.4 | 6.1 | 0.6 | 0.0 | 1,764 | 93.2 | 6.2 | 0.6 | 0.0 | 2,005 | 93.1 | 6.0 | 0.9 | 0.0 | 2,157 | 93.8 | 5.5 | 0.7 | 0.0 |
| Professional, scientific & technical activities | 3,030 | 92.8 | 6.3 | 0.9 | 0.0 | 3,607 | 93.4 | 5.8 | 0.8 | 0.0 | 4,122 | 92.9 | 6.3 | 0.8 | 0.0 | 5,008 | 94.7 | 4.7 | 0.5 | 0.0 |
| Administrative & support service activities | 1,596 | 89.3 | 8.1 | 2.3 | 0.3 | 1,971 | 88.6 | 8.7 | 2.4 | 0.3 | 2,245 | 89.6 | 8.0 | 2.2 | 0.3 | 2,555 | 92.3 | 5.8 | 1.6 | 0.3 |
| S95-Repair of computers & personal goods | 512 | 97.1 | 2.7 | 0.2 | 0.0 | 488 | 97.3 | 2.5 | 0.2 | 0.0 | 471 | 96.8 | 2.5 | 0.6 | 0.0 | 626 | 98.1 | 1.6 | 0.3 | 0.0 |
| TOTAL | 59,575 | 93.9 | 5.1 | 0.9 | 0.2 | 68,780 | 93.6 | 5.4 | 0.9 | 0.2 | 75,180 | 93.1 | 5.7 | 1.0 | 0.2 | 83,164 | 94.4 | 4.6 | 0.8 | 0.2 |

Source: Table constructed by authors based on data from Armstat (2021, 2020, 2019, 2018).

- **The largest sector** is the ‘**wholesale & retail trade, repair of motor vehicles & motorcycles.**’ However during 2017-2020 this sector **has not changed in structure** and micro and small and medium enterprises have continued to maintain the same share in this sector in the last four years—withstanding 2018 **velvet revolution, then Covid-19 pandemic and the Nagorno-Karabakh conflict (table 4).** **The expansion in this sector has also been slow** relative to other sectors, and during 2017-2020 the number of enterprises operating in the wholesale trade sector grew by only 20%.

That said, **the number of persons working in this sector has during 2017-2020 increased by around 40%,** an indication of a very slow expansion of this very large sector (table 5).

- **The fastest expanding sectors** are the ‘manufacturing,’ ‘accommodation and food services,’ ‘construction’ and ‘transportation and storage.’ During the last 4 years (2017-2020) **the total number of economic entities operating in ‘transportation/storage’ has tripled,** and has almost **doubled in manufacturing; accommodation and food services; and in construction (table 4).**

- The total **workforce engaged in the private sector has during 2017-2020 increased by 33%** from 253,939 wage-earning persons to 338,998 wage-earners (table 5).

- **The two largest employers of the population are ‘manufacturing’ and ‘wholesale and retail trade’ sectors – around 80,000-90,000 wage-earning persons worked in these sectors in 2020 (table 5).**

Both ‘manufacturing’ and ‘the wholesale trade and retail’ each contributed equally 10% to the GDP in 2020—the largest proportion among all branches of the private sector (Armstat 2021). Construction, mining and the energy sector are the next largest contributors with each contributing around 4% to the GDP (Armstat 2021).

But given that manufacturing had only 10,500 businesses working in the sector in 2020 as opposed to 48,000 businesses in the ‘wholesale and retail trade’ sector (see table 4), the importance of the manufacturing is even higher for the economy of Armenia in terms of contributing to the employment of people.

- As expected from the discussion above, **in those sectors where the structure of the sector has not changed, but the number of economic entities has increased, then the number of persons employed in the sector has also increased.**

- Specifically, **the fastest expanding sectors have grown not only by the number of economic entities operating in the sector, but also in the number of wage-earning persons working in these sectors—in ‘manufacturing,’ ‘accommodation and food services,’ ‘construction’ and ‘transportation and storage.**

The largest growth in workforce has by far occurred in the ‘accommodation and food services’ where the number of wage-earning persons during 2017-2020 grew by around 70% (table 5). In ‘manufacturing,’ ‘construction’ and ‘transportation and storage, and even in ‘real-estate’ the workforce has increased by 40%.

- In two sectors—the ‘energy’ sector and the ‘water supply, sewerage, waste management & remediation activities’ -- while the number of economic entities working in these sectors has increased, the size of the personnel has been reduced (table 5).

Table 5. Number of Wage-Earners in Economic Entities Implementing Economic Activity, by Year & Number of Persons

| Economic Sector | 2017 | 2018 | 2019 | 2020 | change in 2020 vs. 2017% in % |
|---|----------------|----------------|----------------|----------------|-------------------------------|
| Mining & Quarrying | 9,364 | 10,804 | 12,669 | 12,979 | 138.61 |
| Manufacturing | 56,411 | 70,369 | 80,408 | 80,602 | 142.88 |
| Electricity, gas, steam & air conditioning supply | 19,981 | 20,190 | 19,032 | 18,362 | 91.90 |
| Water supply, sewerage, waste management & remediation activities | 4,025 | 3,906 | 3,330 | 3,731 | 92.70 |
| Construction | 17,677 | 20,130 | 22,317 | 23,785 | 134.55 |
| Wholesale & retail trade, repair of motor vehicles & motorcycles | 66,182 | 81,846 | 97,437 | 91,544 | 138.32 |
| Transportation & storage | 17,113 | 21,734 | 21,278 | 18,677 | 109.14 |
| Accommodation & food service activities | 16,630 | 26,850 | 34,233 | 28,054 | 168.70 |
| Information & communication | 18,407 | 22,408 | 25,759 | 25,235 | 137.09 |
| Real estate activities | 5,158 | 6,007 | 7,689 | 7,320 | 141.92 |
| Professional, scientific & technical activities | 10,579 | 12,463 | 14,435 | 13,540 | 127.99 |
| Administrative & support service activities | 11,533 | 14,280 | 15,776 | 14,308 | 124.06 |
| S95-Repair of computers & personal goods | 880 | 1,019 | 1,067 | 861 | 97.84 |
| TOTAL | 253,939 | 312,005 | 355,429 | 338,998 | 133.50 |

Source: Table constructed by authors based on data from Armstat (2021, 2020, 2019, 2018).

- **Most businesses are located in Yerevan**-- the largest populated settlement of Armenia—where trade and the service sector, real estate, and scientific sectors have the most opportunity to develop, and thus also have the largest number of economic entities working in these sectors (Armstat 2021, 2020, 2019, 2018).

- **Even though the vast majority of enterprises in Armenia’s economy are micro and small enterprises, their volume of turnover of production of goods and services comprises a disproportionately very small amount in the total economic turnover in each of the sectors.**

For example, in 2019 and 2020 in ‘**mining and quarrying,**’ ‘**electricity, gas, steam and air conditioning supply,**’ and ‘**water supply, sewerage, waste management and remediation activities**’ more than 80% of the turnover volume was dominated by large enterprises (Armstat 2021, 2020) given that in 2020 micro entities continued to comprise a whopping 80% of enterprises in ‘mining,’ and ‘water supply, sewerage, waste management’ sectors and 60% of all enterprises in ‘electricity, gas, steam and air conditioning supply’ (table 4).

In ‘**manufacturing**’ and ‘**information and communication**’ large enterprises comprise around 50% of the total volume of the turnover in these sectors (Armstat 2021, 2020), and micro and small businesses alone contribute 25-30% of the total volume of turnover in this sector.

In ‘**construction,**’ and ‘**accommodation and food service activities**’ micro and small enterprises contribute to at least 40% of the produced goods and services turnover volume, at least 50% in ‘**wholesale and retail trade, repair of motor vehicles and motorcycles,**’ ‘**transportation and storage,**’ and ‘**administrative and support service activities**’ (Armstat 2021, 2020).

- **The areas in the private sector where micro and small enterprises dominate in the volume of turnover of goods and services are the ‘real estate activities,’ ‘professional, scientific and technical activities’ and ‘repair of computers and personal goods:’ here micro and small enterprises contribute more than 80% of the turnover of production of goods and services (Armstat 2021, 2020).**

The most dynamics sectors where most businesses are created, and where, due to the large size of the sector, a higher number of entities are liquidated are ‘manufacturing’ and ‘wholesale trade and retail’ (table 6).

- **Very importantly, in 2020 around 70% of newly created economic entities, i.e. start-ups, and around 60% of annually liquidated economic entities were entities with zero (0) wage-earners, i.e. individual entrepreneurs (Armstat 2021).**

In 2019, the pre-pandemic year the data were even more grim- 50% of newly created economic entities and 70% of liquidated businesses were entities with zero wage-earners (Armstat 2020).

This number has a large subcontext: According to Armenia’s banking regulations, an individual can take a loan from the bank in the amount not exceeding **five** times of the person’s income. As we discovered during focus groups conducted within this study, in order to become eligible for a much larger amount of a loan from a bank, many individuals artificially create economic entities and then apply for bank loan on the name of the economic entity. This loan however, is not used to prosper to newly established business, but is instead used to meet the individual’s/family’s financial needs. Thus, individual businesses comprising both the largest proportion of established start-ups and the largest proportion of failed businesses is partially an artifact linked to the person’s eligibility to acquire large loans from the banks.

Table 6. Number of Newly Formed and Liquidated Economic Entities by Economic Sector, by Year and Number of Entities.

| Economic Sector | Newly Formed Entities | | | | Liquidated/Terminated Activities* | | | |
|---|-----------------------|---------------|---------------|---------------|-----------------------------------|--------------|--------------|--------------|
| | 2017 | 2018 | 2019 | 2020 | 2017 | 2018 | 2019 | 2020 |
| Mining & Quarrying | 9 | 34 | 12 | 9 | 21 | 23 | 19 | 24 |
| Manufacturing | 598 | 917 | 1,027 | 1,592 | 849 | 851 | 633 | 783 |
| Electricity, gas, steam & air conditioning supply | 5 | 9 | 21 | 12 | 3 | 2 | 5 | 6 |
| Water supply, sewerage, waste management & remediation activities | 4 | 14 | 21 | 12 | 10 | 9 | 6 | 11 |
| Construction | 108 | 190 | 314 | 376 | 145 | 133 | 98 | 143 |
| Wholesale & retail trade, repair of motor vehicles & motorcycles | 5,486 | 6,784 | 6,939 | 6,133 | 4,947 | 5,475 | 4,754 | 6,123 |
| Transportation & storage | 150 | 443 | 435 | 802 | 136 | 127 | 131 | 222 |
| Accommodation & food service activities | 416 | 1,021 | 1120 | 871 | 459 | 463 | 342 | 697 |
| Information & communication | 262 | 348 | 552 | 468 | 190 | 150 | 134 | 250 |
| Real estate activities | 37 | 77 | 98 | 85 | 126 | 112 | 100 | 95 |
| Professional, scientific & technical activities | 299 | 526 | 698 | 711 | 304 | 302 | 332 | 310 |
| Administrative & support service activities | 231 | 371 | 384 | 323 | 247 | 233 | 159 | 242 |
| S95-Repair of computers & personal goods | 46 | 56 | 35 | 83 | 97 | 82 | 63 | 43 |
| TOTAL | 7,651 | 10,790 | 11,656 | 11,477 | 7,534 | 7,962 | 6,776 | 8,949 |

Source: Table constructed by authors based on data from Armstat (2021, 2020, 2019, 2018).

*The economic activity of the economic entity is considered terminated if the entity had worked for at least 6 months two years prior the reporting period but did not carry out any economic activities during the next two years, as defined in European Communities/OECD (2008).

In Which Economic Sector Do Most of The Businesses Suspend or Permanently Terminate Their Economic Activities?

To be considered a liquidated entity, the entity must have stopped operating for two years prior after having operating for at least 6 months (Armstat 2021). Thus, for example, a liquidated entity enlisted in 2020 official statistics has closed its business doors in 2018, and the liquidated entity enlisted in 2019 official statistics has closed its business in 2017.

Using this information, we tried to examine how widespread is the failure rate of businesses by various sectors of the economy. Because we were not able to obtain data for years prior to 2016, our calculations are based only on entities operating and closing the business in 2017 (to be enlisted in 2019 official statistics) and 2018 (to be enlisted in 2020 official statistics).

According to **table-7, the highest proportion of businesses closing in 2017 and 2018** were in **‘repair of computers and goods’** where around 17-19% of operating businesses were closed, followed by entities in **tourism** (accommodation and food services)—11-18% closing, and **manufacturing** -- 12-14% closing, **wholesale trade and retail**—12% closing.

| |
|---|
| On average, around 12% of operating entities close each year , as is evident from 2017 and 2018 data (table 7). |
|---|

As focus groups, conducted by the research team, revealed the hardest for new businesses are the first 12-18 months as the businesses enters the market and accumulates clientele. During this period the major limitation is the small domestic market for sales, which makes conducting business especially hard in Armenia.

Businesses often had closed due to the lack of professional expertise in accounting or legal matters, which had resulted in the business being unaware that due to the business’ profile of operations they had qualified for lower taxes.

Some businesses in our focus groups also mentioned conflicts with their clients abroad as reasons for failure of the business: often in the winter months the import/export of products was delayed due to the closure of Lars transportation corridor (due to the winter weather), and the production and delivery of products to clients was delayed. Due to these delays, some businesses in our focus group lost competition to other businesses abroad, and had to close.

For those working in trade and services, the hardships are also related to the overall ‘business culture’ as often traders are forced to without-pay lend the product to the client (based on oral promise to be paid later) to maintain personal relationship or the business relationship with the client. This is widespread, but also limits the financial capital of the business to acquire/produce new products. As a result of which businesses default and are forced to close. Past research also has found similar challenges for traders (see RUEA and WFP 2020, 2021).

Creation of the Eurasians Custom Union facilitated to imports of new products with lower prices that some businesses were unable to compete with. In some sectors many businesses operated in shadow and thus, the competition was not fair. The lower import prices gave competitive advantage to these businesses in the local market, such as those working in the construction sector.

Table 7. Proportion of Newly Formed and Liquidated Economic Entities by Economic Sector, by Year and Number of Entities.

| Economic Sector | Total Number of Operating Entities | | | | Proportion of the Liquidated as % of Total Operating Entities | | Proportion of Newly Created as % of Total Operating Entities | | | |
|---|------------------------------------|---------------|---------------|---------------|---|--------------|--|--------------|--------------|--------------|
| | 2017 | 2018 | 2019 | 2020 | 2017 | 2018 | 2017 | 2018 | 2019 | 2020 |
| Mining & Quarrying | 234 | 314 | 323 | 260 | 8.97 | 7.32 | 3.85 | 10.83 | 3.72 | 3.46 |
| Manufacturing | 5,771 | 6,741 | 7,508 | 10,573 | 14.71 | 12.62 | 10.36 | 13.60 | 13.68 | 15.06 |
| Electricity, gas, steam & air conditioning supply | 202 | 249 | 225 | 241 | 1.49 | 0.80 | 2.48 | 3.61 | 9.33 | 4.98 |
| Water supply, sewerage, waste management & remediation activities | 60 | 83 | 106 | 109 | 16.67 | 10.84 | 6.67 | 16.87 | 19.81 | 11.01 |
| Construction | 1,224 | 1,517 | 1,783 | 2,185 | 11.85 | 8.77 | 8.82 | 12.52 | 17.61 | 17.21 |
| Wholesale & retail trade, repair of motor vehicles & motorcycles | 40,183 | 44,093 | 46,954 | 48,255 | 12.31 | 12.42 | 13.65 | 15.39 | 14.78 | 12.71 |
| Transportation & storage | 1,016 | 1,739 | 2,095 | 3,362 | 13.39 | 7.30 | 14.76 | 25.47 | 20.76 | 23.85 |
| Accommodation & food service activities | 2,559 | 4,053 | 4,805 | 5,034 | 17.94 | 11.42 | 16.26 | 25.19 | 23.31 | 17.30 |
| Information & communication | 1,636 | 2,161 | 2,538 | 2,799 | 11.61 | 6.94 | 16.01 | 16.10 | 21.75 | 16.72 |
| Real estate activities | 1,552 | 1,764 | 2,005 | 2,157 | 8.12 | 6.35 | 2.38 | 4.37 | 4.89 | 3.94 |
| Professional, scientific & technical activities | 3,030 | 3,607 | 4,122 | 5,008 | 10.03 | 8.37 | 9.87 | 14.58 | 16.93 | 14.20 |
| Administrative & support service activities | 1,596 | 1,971 | 2,245 | 2,555 | 15.48 | 11.82 | 14.47 | 18.82 | 17.10 | 12.64 |
| S95-Repair of computers & personal goods | 512 | 488 | 471 | 626 | 18.95 | 16.80 | 8.98 | 11.48 | 7.43 | 13.26 |
| TOTAL | 59,575 | 68,780 | 75,180 | 83,164 | 12.65 | 11.58 | 12.84 | 15.69 | 15.50 | 13.80 |

Source: Table constructed by authors based on data from Armstat (2021, 2020, 2019, 2018).

*The economic activity of the economic entity is considered terminated if the entity had worked for at least 6 months two years prior the reporting period but did not carry out any economic activities during the next two years, as defined in European Communities/OECD (2008).

Combined with the increase of online shopping in Armenia and the lower prices of products online (because many businesses went fully online and were able to cut expenses for the facility rent, personnel or electricity, etc.), hardships for many micro and small businesses even more increased.

As our survey among businesses confirmed, the most common reason in closing the business, among the entities in our survey, was the difficulty to compete in the business due to small domestic market for product sales and the high value of initial production (**table 8**).

Table 8: Challenges that Surveyed Economic Entities Considered as Reasons that Lead to Closing their Business, as % of the Total Sample Size (n=100).

| Challenges | % |
|--|------|
| Taxes (taxes were high, profit was low). | 13.0 |
| Difficulties in Production and Sales of the Products and Services /uncompetitive products, high initial value of the product, expensive raw materials, small market for sales) | 45.0 |
| Personal Reasons | 25.0 |
| Changed the Business Sector | 7.0 |
| COVID-19 Related Difficulties to Operate a Business | 9.0 |
| Other | 1.0 |

In our sample, most entities were micro businesses had 1-2 employees (28%), 3-5 employees (36%) and 6-10 entities (19%), see **table 9**. Upon closing around 56% of businesses had to lay off 1-2 employees, and another 25% terminated contracts for 3-5 employees (**table 9**).

Table 9: Size of the Economic Entities in Armenia Defined by the Annual Average Number of Wage-Earning Employees

| Number of Employees | During Operation % | Terminated Upon Closing % |
|-----------------------|--------------------|---------------------------|
| 1-2 employees | 28 | 56 |
| 3-5 employees | 36 | 25 |
| 6-10 employees | 19 | 8 |
| 11-20 employees | 11 | 8 |
| 21-50 employees | 4 | 0 |
| 51 and more employees | 2 | 1 |
| Total | 100 | 100 |

As examination of official statistics reveals (**table 7**), on average, around 14% of economic entities operating each year are newly founded entities

The most booming sector in the last three years has consistently been ‘transportation and storage’, where one in every 4-5 is a newly founded business: since 2018 around 20-25% of operating companies in this sector have been new businesses (**table 7**).

The other dynamically developing sectors of the economy are ‘information and communication’ ‘accommodation and food services’ and ‘construction’ where in 2020 around 17% of operating businesses were newly founded businesses (table 7). This is followed by ‘manufacturing’ and ‘professional, scientific and technical service producers’ where 15% of operating companies were newly founded in 2020.

As our survey revealed (table 10), most entities – around 80% in the sample, had founded their business using personal means of capital, such as real-estate, land, personal finances, followed by 11% of businesses that had borrowed loans to found their business. Only 5% of the businesses were founded using various Governmental support measures (subsidies, leasing, state grants).

Table 10: Financial Means Used to Found a Business by Surveyed Entities, as % of the Total Sample Size (n=100).

| Financing Used | % |
|---|-------------|
| Personal Means of Capital (real-estate, land, personal finances) | 80.5 |
| Loans | 10.6 |
| Governmental Support Measures (loan subsidies, leasing subsidies, state grants, etc). | 5.3 |
| Difficult to Answer | 3.5 |
| Total | 100% |

Most entities in our sample – 69%-- used more than USD 100,000 to found their business (i.e. AMD 50 mln. or more), see table 11. However, around 85% of surveyed businesses refused to answer how much capital they lost when the business was liquidated.

Table 11: The Maximum Financial Capital the Entity Possessed during the First 6 months of the Founding of the Business, in Armenian Drams, as % of Economic Entities in the Surveyed Sample, sample size n=100.

| Armenian Drams | % |
|--------------------------------|-------------|
| Less than AMD 1,000,000 | 1.0 |
| AMD 1,000,001-2,500,000 | 7.0 |
| AMD 2,500,001-5,000,000 | 7.0 |
| AMD 5,000,001-10,000,000 | 5.0 |
| AMD 10,000,001- 15,000,000 | 6.0 |
| AMD 15,000,001-25,000,000 | 3.0 |
| AMD 25,000,001-37,000,000 | 1.0 |
| AMD 37,000,001-50,000,000 | 1.0 |
| AMD 50,000,001 and more | 69.0 |
| Difficult to Answer | 1.0 |
| Total | 100% |

Around 62% of surveyed business had closed permanently and their entry was deleted from the State Registry of Legal Entities, and 38% of the entities had suspended their business activities.

That said, **every single entity in our surveyed sample indicated that they do not plan starting a business again, and none had applied to any organization that supports the rights of businesses/employers.**

What Type of Support Do Businesses Most Need & What Can the Government of Armenia Do?

Focus groups revealed that **businesses, especially start-ups, most needed the following** that the Government of Armenia can support with or implement and organize:

- **Classes in marketing, doing business, accounting and legal matters of operating a business.**
- **More and up-to date information about taxes and business-related legislation.** Specifically, the Government of Armenia can expand routes and opportunities for micro and small and medium economic entities to learn about changes in the business-related legislation, especially in taxing legislation, such as conduct classes, awareness campaigns, creating consultation support centers, hotlines about changes in the legislation.
- **Financial support provided to businesses for certain time period, but without interest, i.e. not a loan /ժամկետային ֆինանսական աջակցություն առանց սուկնսի/.** This would facilitate start-ups to increase their standing in the market.
- **Exempt the labour force employed as hourly-wage employees from taxing.** This is especially important for kindergartens or educational businesses that employ and pay their staff based on hourly contract, and high taxes often create difficulties to attract employees that are hired and paid on hourly basis, the tax-deducted salary is very low.
- During COVID-19, the lockdowns and the Government support measures were not always accessible for employers. Hence, there is **need to make these support measure more targeted by business needs.**
- Government to pay particular focus on unequal competition and make efforts to decrease unequal competition, especially those taking place during state inspections among companies.

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