

# Investment Climate Surveys Draft Country Profile

## Azerbaijan

2005 SURVEY



Region: Europe and Central Asia (ECA)

Income Group: Lower Middle

Population (2004): 8.3 million

GNI per capita (2004): US\$950

<http://rru.worldbank.org/InvestmentClimate>

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# Introduction

## *Investment Climate*

The term “investment climate” describes the many factors that contribute to shaping the decisions of firms to invest productively. These factors can be accommodating or constraining and play an important role in whether a country prospers or not. A good investment climate encourages firms to operate efficiently and competitively by decreasing risks, costs, and barriers to competition. Such an environment strengthens incentives for firms to innovate and to increase their productivity—a key factor in sustainable development. A more productive private sector, in turn, expands employment and contributes taxes necessary for public investment in health, education, and other services. In contrast, a poor investment climate increases the obstacles to conducting business activities and decreases a country’s prospects for reaching its potential in terms of employment, production, and welfare.

## *Investment Climate Survey*

The Investment Climate Survey (ICS) is conducted by the World Bank and its partners across all geographic regions and covers firms of all sizes in many industries. For countries in the Europe & Central Asia (ECA) region, the project is administered in conjunction with the European Bank for Reconstruction and Development (EBRD) and branded as the Business Environment and Enterprise Performance Survey (BEEPS). The ICS collects a wide array of qualitative and quantitative information through face-to-face interviews with managers and owners regarding the investment climate in their country and the productivity of their firms. Topics covered in the ICS include the obstacles to doing business, infrastructure, finance, labor, corruption and regulation, contract enforcement, law and order, innovation and technology, and firm productivity. Taken together, the qualitative and quantitative data help connect a country’s investment climate characteristics with firm productivity and performance. The ICS database is intended to be useful for both policymakers and researchers, and the surveys are to be repeated over time to track changes and benchmark the effects of reforms.

## *Country Profiles*

The country profiles produced by the Investment Climate Unit (CICIC) of the World Bank Group provide an overview of key investment climate indicators for a country with benchmarks against their respective geographical region and a standard group of countries with similar incomes. Breakdowns by firm size are contained in tables at the back of the document along with all statistics used in the graphs.

A fixed set of topics is covered for all countries with slight variations in indicators (subject to data availability). This format allows comparisons of countries across topics. All indicators are based on the responses of firms.

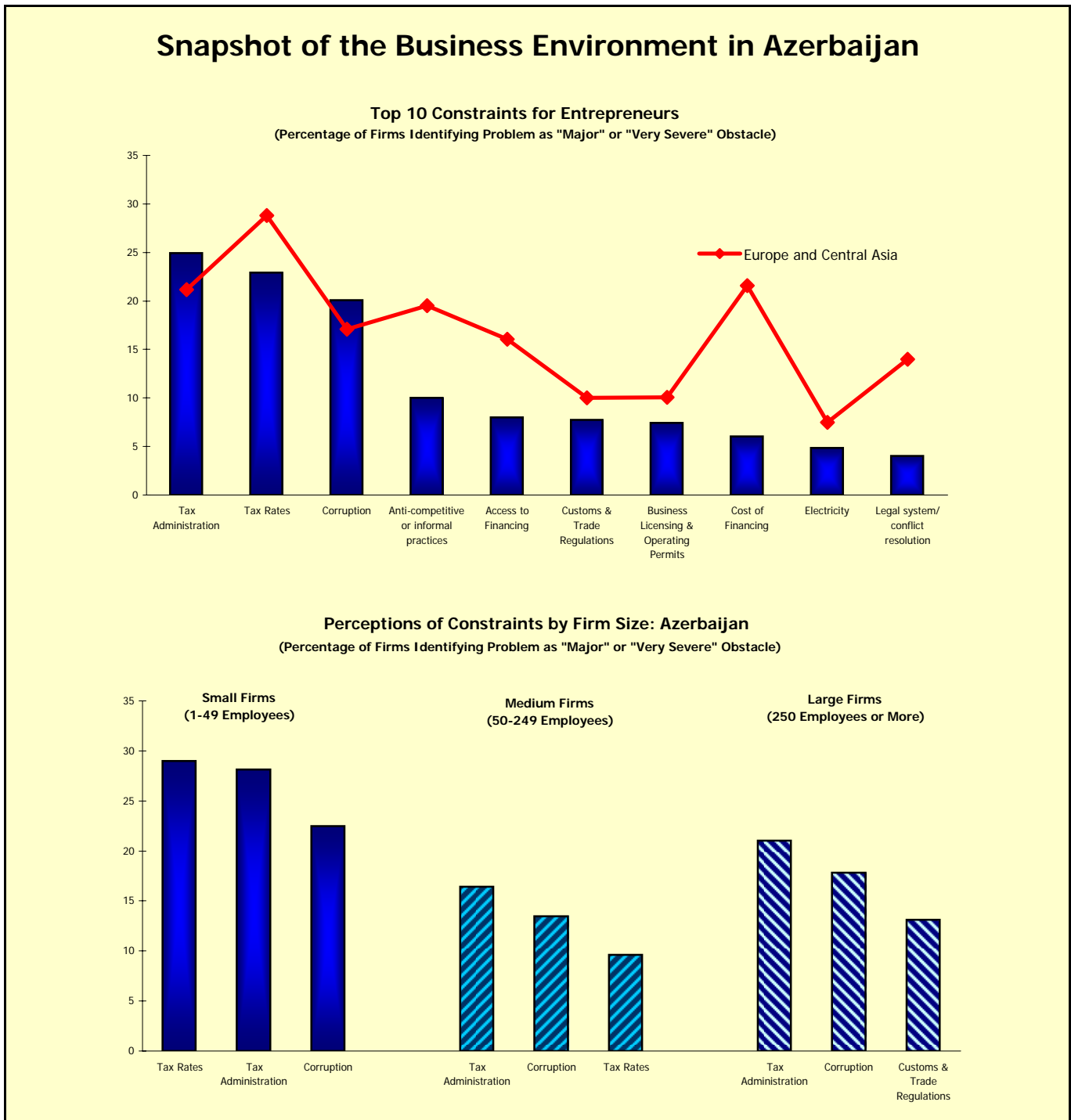
To learn more about the firms sampled for this country profile (additional indicators and tabulations by industry, exports, and ownership) or to download profiles of other countries, please visit the ICS home page listed below. Currently available at the ICS website are survey results on the investment climate in some 60 countries, based on data from more than 28,000 firms.

<http://rru.worldbank.org/InvestmentClimate>

## AZERBAIJAN 2005

The country profile for Azerbaijan is based on data from the Investment Climate survey conducted by the World Bank in 2005. The benchmarks include the averages of countries in Europe and Central Asia and the lower middle income group.

Below is a snapshot of the constraints to investment and doing business as perceived by firms. The first graph presents the top 10 constraints as identified by firms in Azerbaijan benchmarked against the regional average. The second graph shows the top 3 constraints for small, medium, and large firms in Azerbaijan.



# Infrastructure

A strong infrastructure enhances the competitiveness of an economy and improves the quality of life of its residents. Good infrastructure connects firms to their customers and suppliers, and enables the use of modern production technologies. Conversely, deficiencies in infrastructure create barriers to opportunities and increase costs for all firms, from microenterprises to multinational corporations.

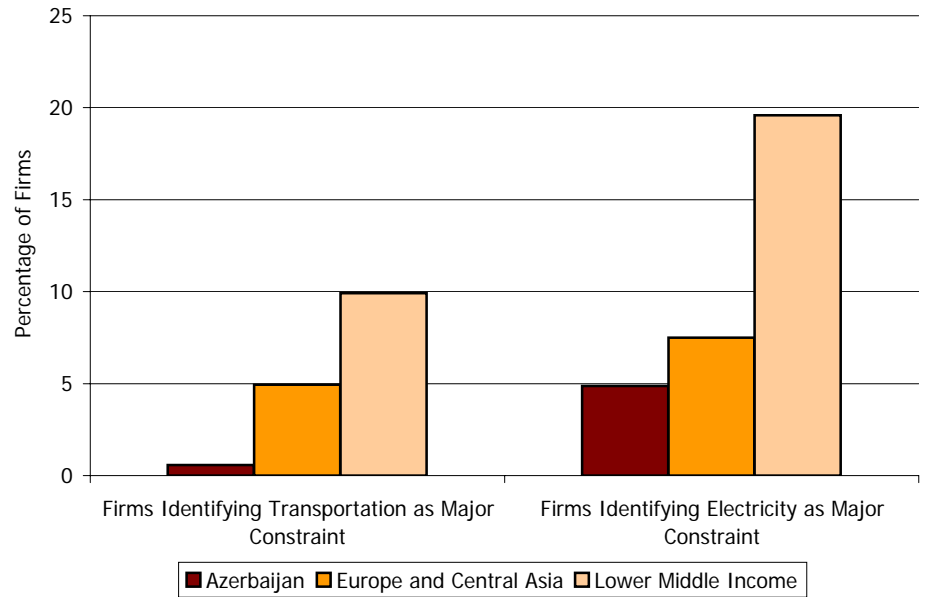
Investment Climate Surveys capture the dual challenges of providing strong infrastructure: the physical construction of roads, power lines, water systems, etc.; and the development of institutions that effectively provide and maintain public services.

The *first set of indicators* shows how firms perceive two components of infrastructure as constraints. Inadequate transportation and problems with electricity increase costs, disrupt production, and lower revenue.

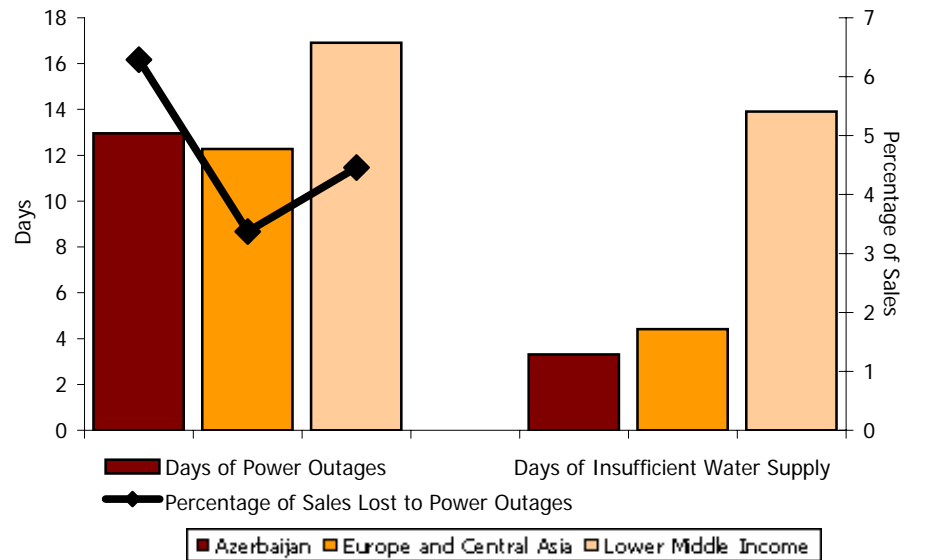
The *second set of indicators* measures the quality of infrastructure—the number of days with power interruptions, the related loss in sales, and the number of days of insufficient water supply.

The *third set of indicators* evaluates the efficiency of infrastructure services by quantifying the delays in obtaining electricity and telephone connections. Service delays impose unnecessary costs on firms and may act as barriers to entry and investment.

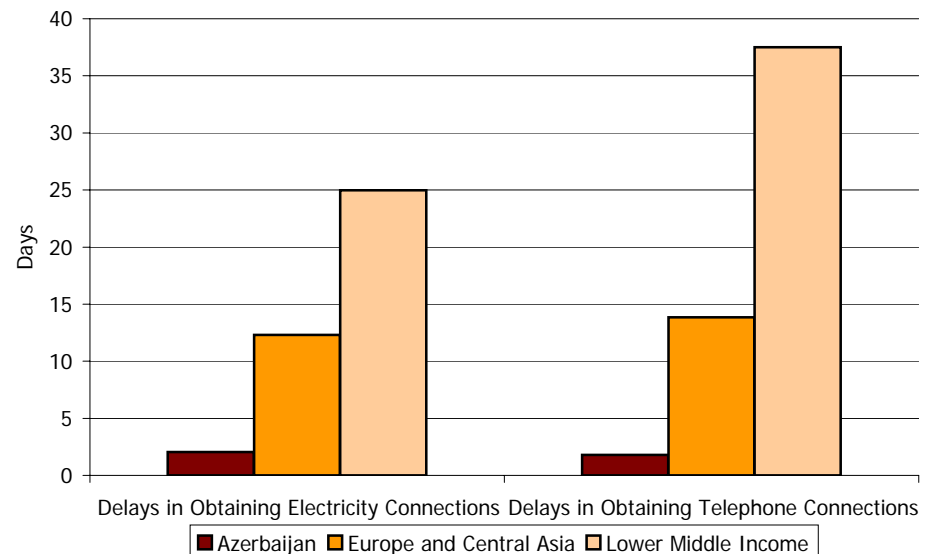
ICS: Infrastructure as a Constraint



ICS: Quality of Infrastructure



ICS: Service Delays



# Finance

Developed financial markets provide payment services, mobilize savings, and finance investment. Efficient financial markets reduce the reliance on internal funds and money from informal sources such as family and friends by connecting firms to a broad range of lenders and investors.

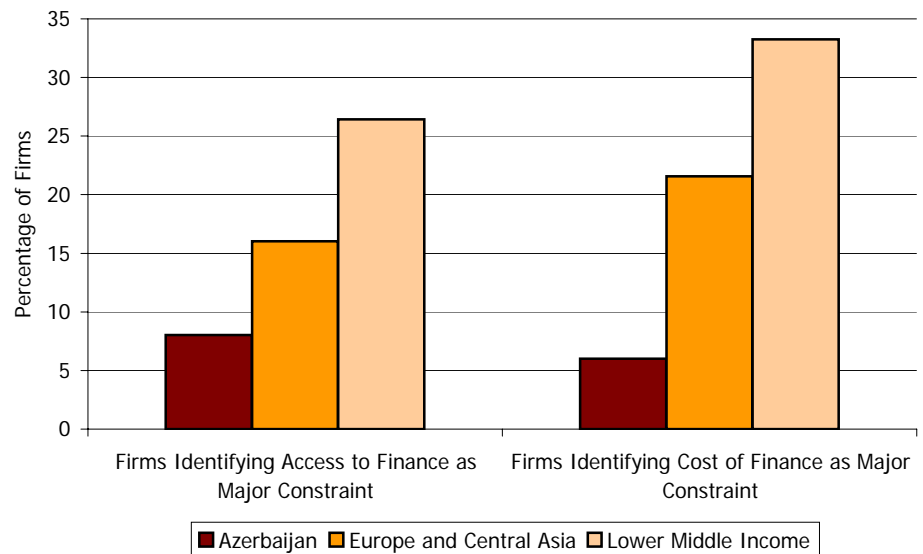
Investment Climate Surveys provide indicators of how firms perceive their financial environment and finance their investment.

The *first set of indicators* measures the degree to which firms perceive access and costs of finance as constraints to investment. Inadequate financing possibilities create difficulties in meeting short term payments for labor and supplies as well as longer term investment.

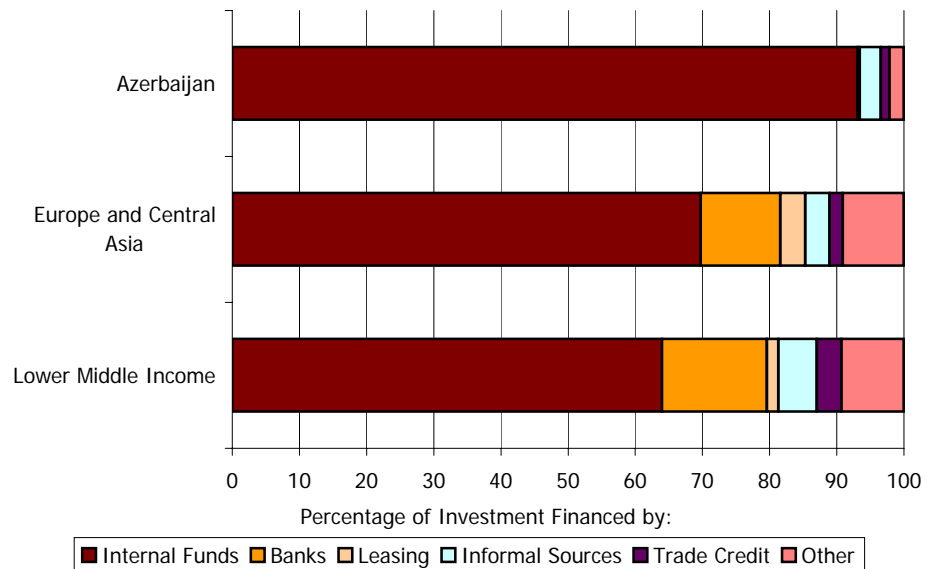
The *second indicator* compares the relative usage of various sources for financing investment. Excessive reliance on internal funds is a likely sign of inefficient financial intermediation.

The *third set of indicators* focuses on the burden imposed by loan requirements, which is measured by collateral levels relative to the value of the loan. Excessive loan collateral requirements are likely to constrain investment opportunities.

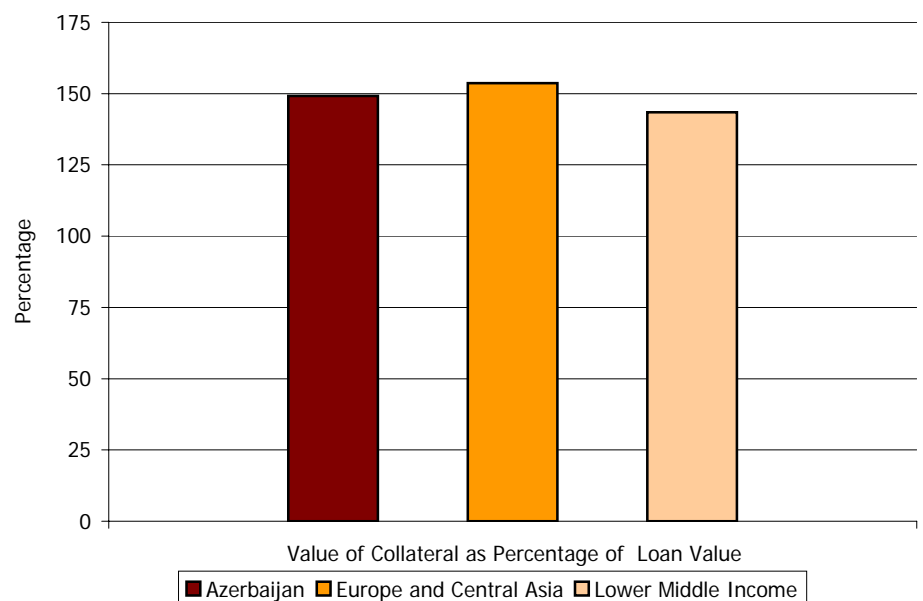
ICS: Access to Finance as a Constraint



ICS: How Firms Finance Investment



ICS: Bank Loans and Collateral



# Labor

Jobs are the main source of income for people—and the main pathway out of poverty for the poor. A sound investment climate contributes to the creation of employment opportunities, investment in the workforce, increases in wages, and, ultimately, a more productive and prosperous society.

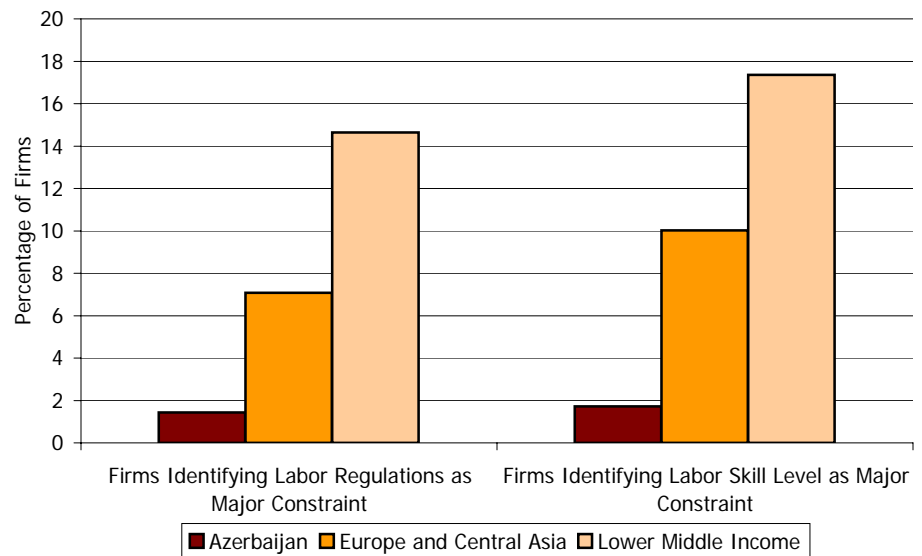
Investment Climate Surveys collect information on the labor market constraints faced by firms and also on the characteristics of workers in the firms surveyed, including human capital.

The *first set of indicators* measures the extent to which firms perceive labor regulations and the skill level of workers as constraints. The inability to hire or fire for due causes and the lack of qualified workers leads to inefficient production and higher costs.

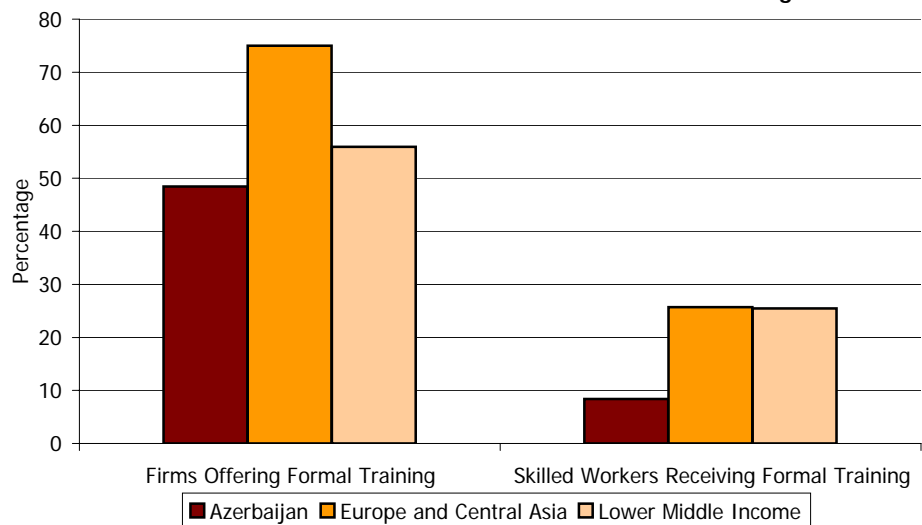
The *second set of indicators* highlights firm investment in the skills and capabilities of their workforce. Incidence and intensity of training is measured by the percentage of firms that offer formal training and the share of skilled workers receiving formal training.

The *third set of indicators* presents the composition of the firms' workforce by skill. Policies that encourage firms to invest in the human capital of their workforce can play a critical role in increasing the skills and wages of men and women.

ICS: Labor Regulations & Skill as Constraints



ICS: Investing in Workers



ICS: Skill Composition of Firms' Workforce



# Corruption & Regulatory Burden

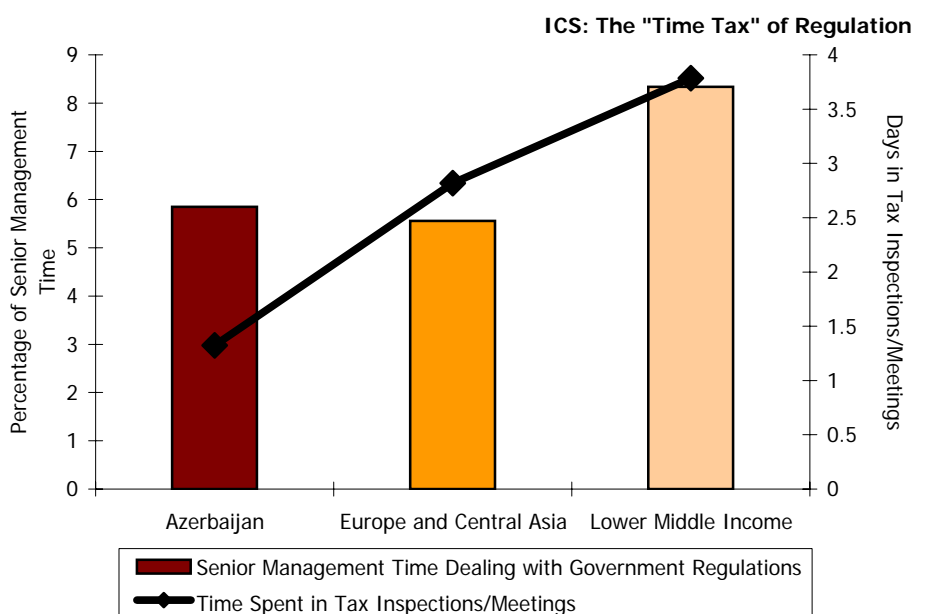
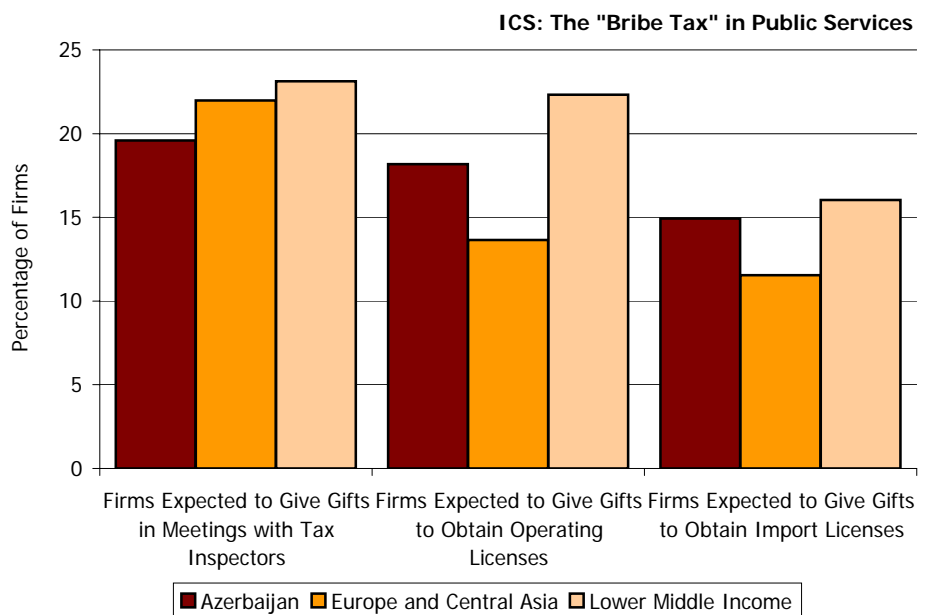
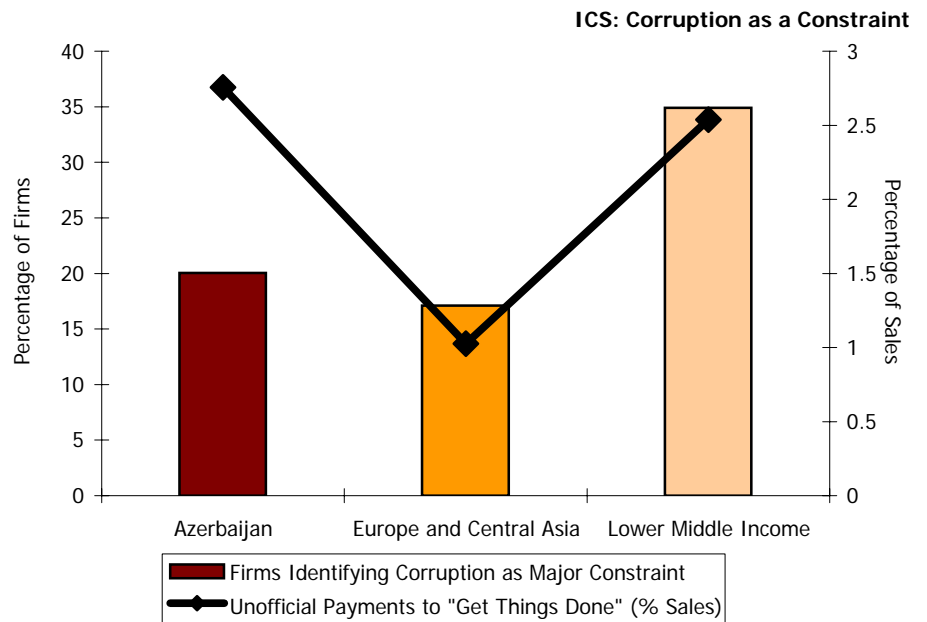
The manner in which governments regulate plays a significant role in shaping investment decisions and how firms do business. Effective regulations address market failures that inhibit productive investment and reconcile private and public interests. Yet, regulations present major administrative and financial burdens on firms when poorly designed or ineffectively implemented. Often, these costs are in the form of bribes when firms are required to make "unofficial" payments to public officials to get things done.

Investment Climate Surveys provide qualitative and quantitative measures of corruption and regulatory burden.

The *first set of indicators* focuses on the perceptions of firms regarding general corruption and the amount of unofficial payments, i.e., the "bribe tax".

The *second set of indicators* identifies the extent to which specific administrative and regulatory functions require bribe payments.

The *third set of indicators* captures the "time tax" imposed by regulation. Excessive time taken away from managing the productive aspects of their firms and spent dealing with government regulations and tax inspectors impose additional costs on firms.



# Courts & Crime

Commercial disputes between firms occur regularly in the course of doing business, yet resolving these disputes can be challenging when legal institutions are weak or absent. When avenues to the resolution of disputes that may arise with buyers, customers, or suppliers are limited, firms will be less willing to engage in arm's length transactions or risky activities with high payoffs. Often, the only recourse for firms is the court system and the rendering of a legal decision. Not only are outcomes uncertain, but also this process can be lengthy and expensive. Similarly, crime imposes costs on firms when they are forced to divert resources from productive uses to protection.

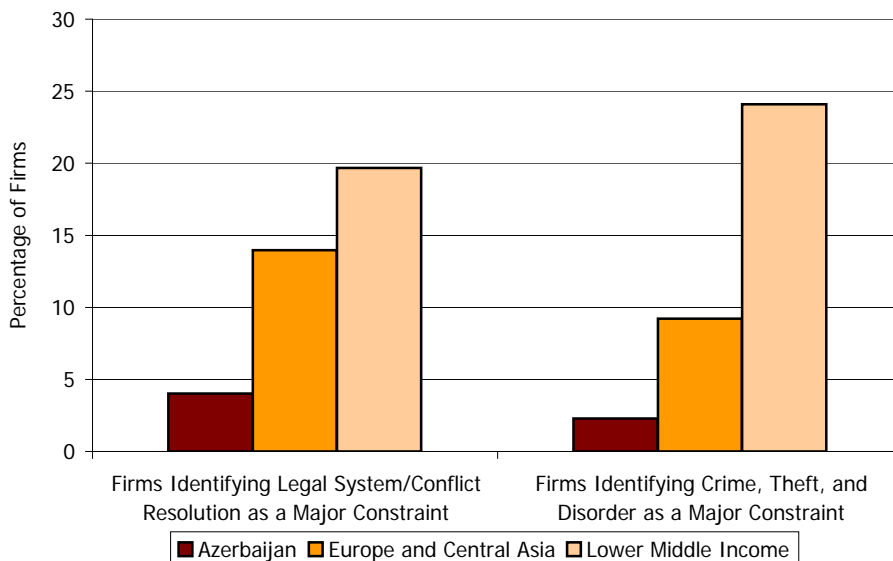
Investment Climate Surveys capture key dimensions of contract enforcement problems and the effect of crime on firm revenue.

The *first set of indicators* shows the share of firms that identify the legal system and crime as major obstacles.

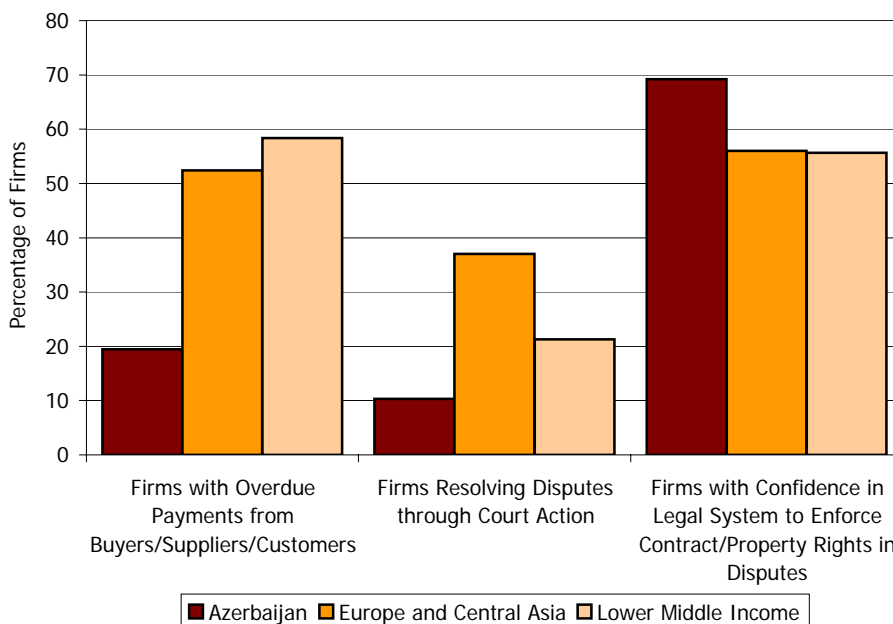
The *second set of indicators* reflects the demand for effective institutions that help enforce contracts—measured by the level of overdue payments, the use of courts to resolve disputes, and confidence in the legal system.

The *third set of indicators* measures the direct costs of security and losses from crime, resources that could have been invested in productive activities.

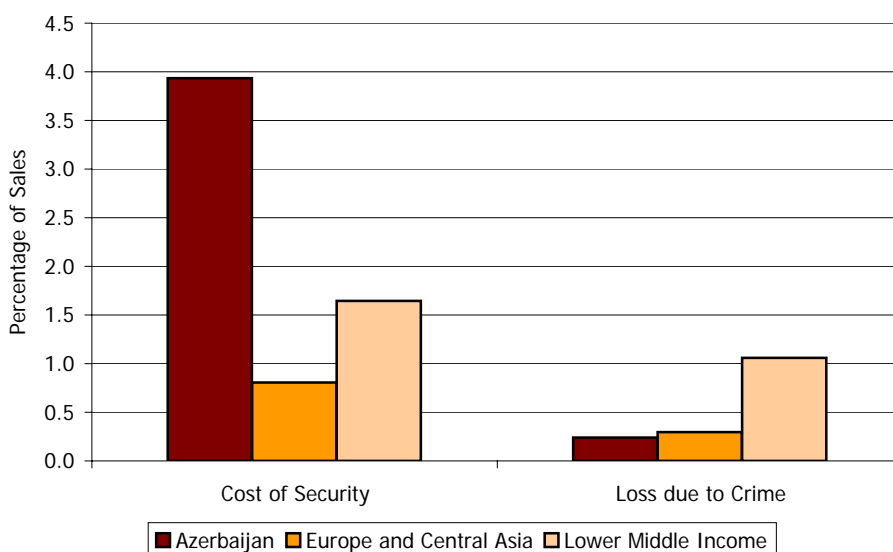
ICS: Courts and Crime as a Constraint



ICS: Demand for Contract Enforcement



ICS: The Costs of Crime and Disorder



# Innovation & Technology

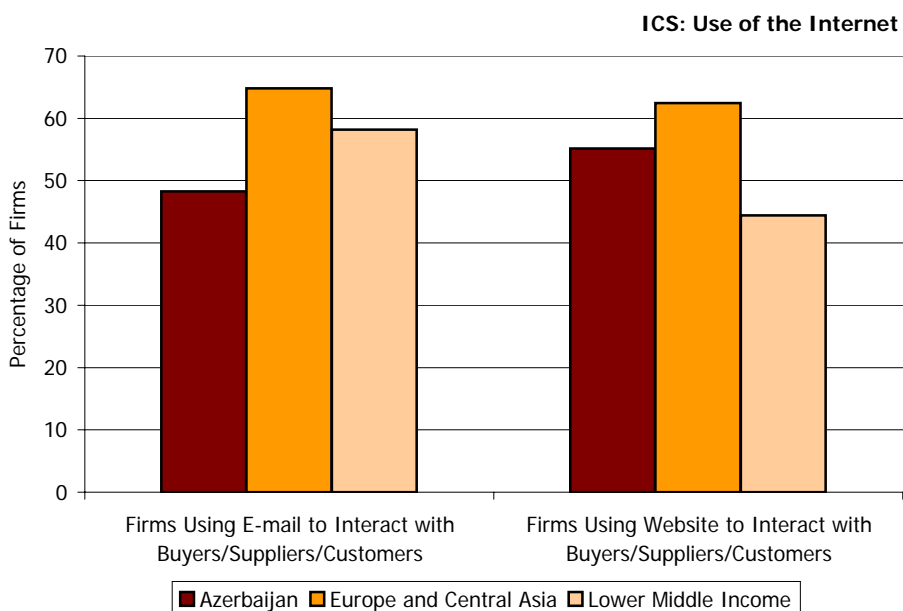
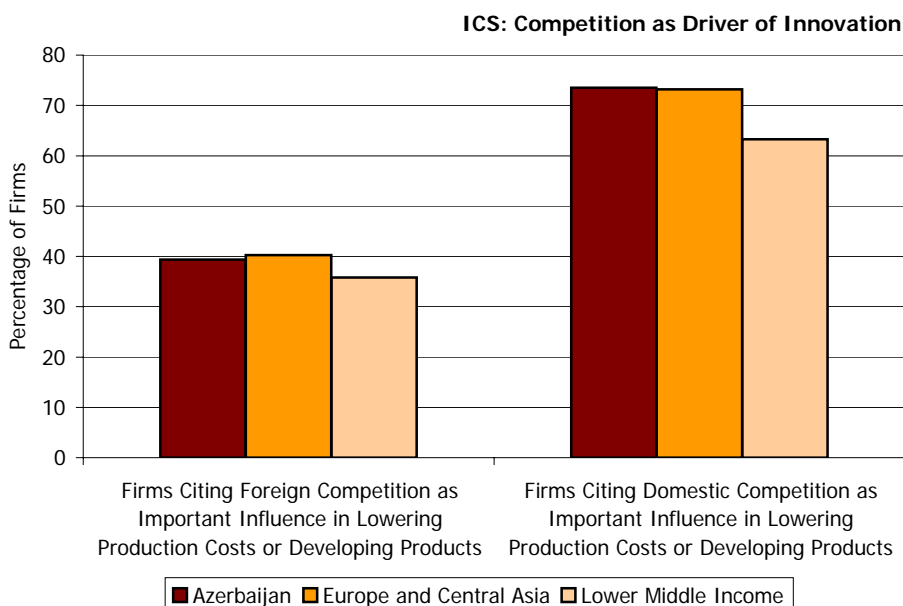
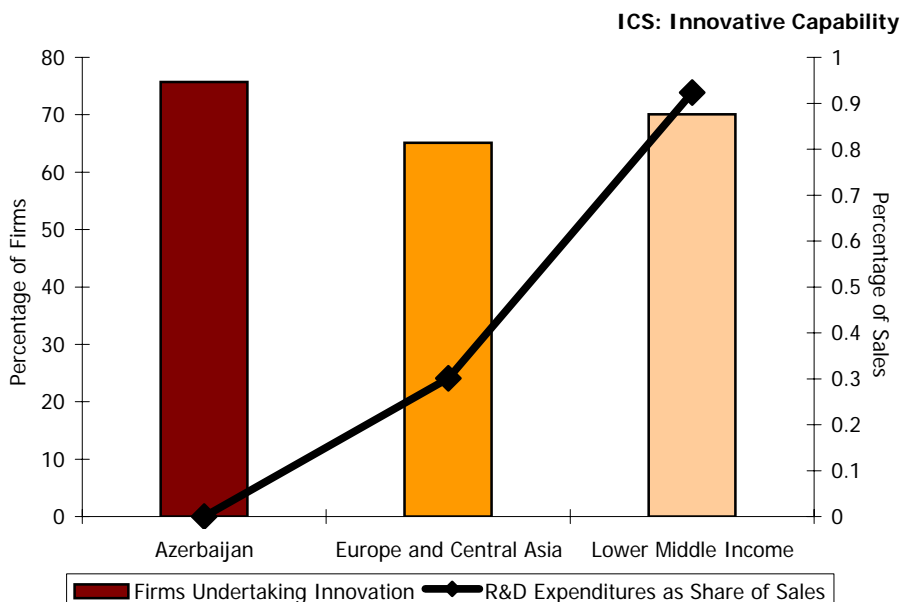
In order to survive and prosper in a competitive marketplace, firms must innovate and increase their productivity in response to the pressures they face from rival businesses. A sound investment climate encourages firms to experiment and learn; it rewards success and punishes failure.

Investment Climate Surveys provide indicators that describe several dimensions of technological efficiency and innovation.

The *first set of indicators* measures the degree to which firms innovate and their investment in research and development. Innovation here encompasses the development or upgrade of product lines, the introduction of new production technologies, and the acquisition of new licensing agreements.

The *second set of indicators* measures the impact of competition on the innovative activities of firms. Driving forces of innovation in open markets include pressure from domestic and foreign competitors.

The *third set of indicators* demonstrates the utilization of information and communications technologies (ICT) in business transactions by firms. ICT, such as the Internet, are important tools for firms because they provide even the smallest of enterprises with the ability to reach national and international markets.



# Trade

Open markets allow firms to expand and force greater efficiencies on exporters who must compete internationally, while the ability to import cheaper supplies from abroad enables firms to minimize costs. Competitive pressures may subsequently build within local economies and compel all firms to improve productivity as well. However, trading also exposes the firm to additional constraints when dealing with customs and trade regulations, such as export and import license requirements and the possibility of bribes.

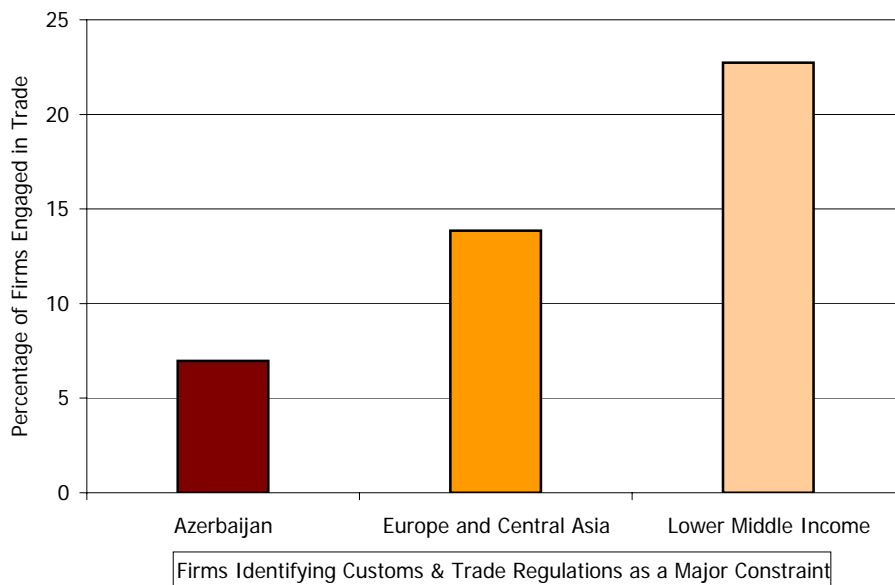
Investment Climate Surveys collect information on the constraints faced by exporters and importers and also capture the trade activity of firms.

The *first set of indicators* shows the extent to which firms that trade directly—those that export or import without going through a distributor—consider customs and trade regulations to be a constraint.

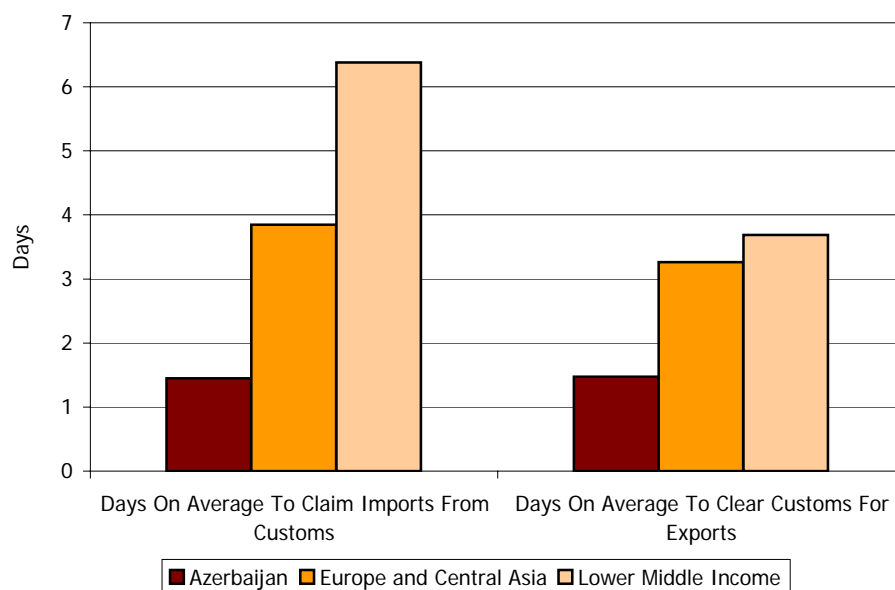
The *second set of indicators* measures how many days imports and exports are delayed by customs. The delay in clearing customs for imports or exports presents additional costs to the firm and can interrupt production, interfere with sales, and result in damaged supplies and merchandise.

The *third set of indicators* displays the share of inputs that firms import directly and the extent to which additional gift payments are required to obtain import licenses.

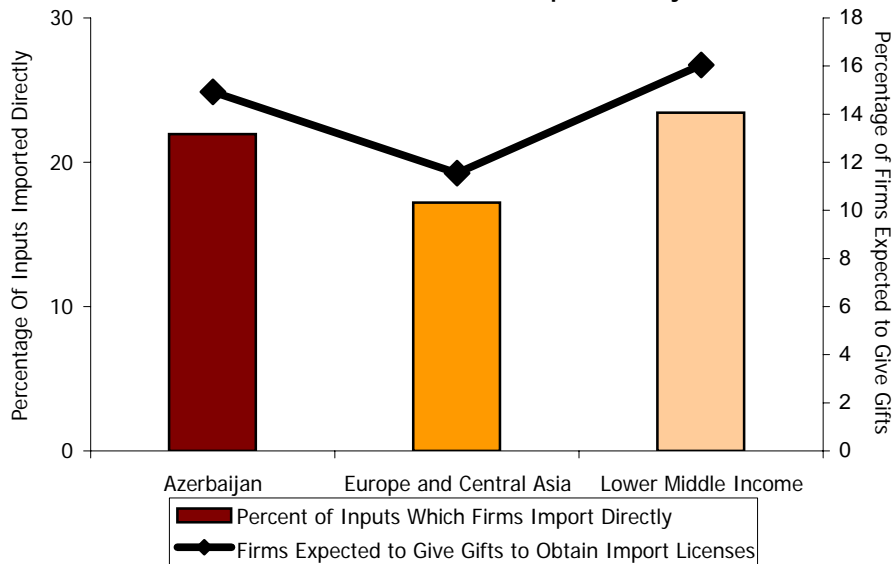
ICS: Customs and Trade Regulations as a Constraint



ICS: Inefficiencies in Customs



ICS: Import Activity and the "Bribe Tax"



# Summary of Investment Climate Indicators

	Azerbaijan	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Europe and Central Asia	Lower Middle Income
<b>Infrastructure Indicators</b>						
% of Firms Identifying Transportation as a Major Constraint	0.6	0.8	0.0	0.0	4.9	9.9
% of Firms Identifying Electricity as a Major Constraint	4.9	6.3	2.7	0.0	7.5	19.6
Days/Year of Power Outages	13.0	16.0	8.0	3.6	12.3	16.9
% of Sales Lost to Power Outages	6.3	6.4	8.2	2.0	3.4	4.5
Days/Year of Insufficient Water Supply	3.3	4.1	2.5	0.3	4.4	13.9
Delays in Obtaining Electricity Connections (Days/Year)	2.0	2.3	1.4	1.8	12.3	25.0
Delays in Obtaining Telephone Connections (Days/Year)	1.8	1.9	1.5	1.8	13.8	37.5
<b>Finance Indicators</b>						
% of Firms Identifying Access to Finance as a Major Constraint	8.0	8.0	9.6	5.3	16.0	26.4
% of Firms Identifying Cost of Finance as a Major Constraint	6.0	5.1	9.5	5.2	21.6	33.2
% of Investments Financed by Internal Funds	93.1	91.4	97.6	94.2	69.8	64.0
% of Investments Financed by Banks	0.4	0.5	0.0	0.3	11.9	15.6
% of Investments Financed by Leasing	0.0	0.0	0.0	0.0	3.7	1.7
% of Investments Financed by Informal Sources	3.1	3.7	1.9	1.9	3.6	5.7
% of Investments Financed by Trade Credits	1.3	1.5	0.4	1.9	2.0	3.7
% of Investments Financed by Other Sources	2.1	2.9	0.0	1.7	9.1	9.3
Value of Collateral (% of Loan Value)	149.1	135.8	164.3	162.5	153.7	143.4
<b>Labor Market Indicators</b>						
% of Firms Identifying Labor Regulations as a Major Constraint	1.4	1.7	0.0	2.6	7.1	14.6
% of Firms Identifying Labor Skill Level as a Major Constraint	1.7	1.7	0.0	5.1	10.0	17.4
% of Firms Offering Formal Training	48.5	39.6	62.1	53.3	75.0	55.9
% of Skilled Workers Offered Formal Training	8.4	7.9	10.3	8.0	25.7	25.5
Managers/Professionals (as % of Total Workforce)	44.5	45.2	42.8	43.2	32.0	26.1
Non-production Workers (as % of Total Workforce)	6.3	6.8	5.0	5.8	9.7	10.7
Skilled Production Workers (as % of Total Workforce)	40.5	39.4	42.8	43.1	47.5	40.6
Unskilled Production Workers (as % of Total Workforce)	8.7	8.5	9.5	7.8	10.8	22.7

	Azerbaijan	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Europe and Central Asia	Lower Middle Income
<b>Regulatory Burden and Corruption Indicators</b>						
% of Firms Identifying Corruption as Major Constraint	20.1	22.5	13.5	17.8	17.1	34.9
Unofficial Payments to Get Things Done (% of Sales)	2.8	2.7	3.3	2.1	1.0	2.5
% of Firms Expected to Give Gifts in Meetings with Tax Inspectors	19.6	15.9	25.0	31.6	22.0	23.1
% of Firms Expected to Give Gifts to Obtain Operating Licenses	18.2	16.4	22.2	21.6	13.6	22.3
% of Firms Expected to Give Gifts to Obtain Import Licenses	14.9	15.8	12.9	13.5	11.5	16.0
% Senior Management Time Dealing with Government Regulations	5.9	5.5	6.2	7.5	5.6	8.3
Time Spent in Tax Inspection Meetings (Days/Year)	1.3	1.3	1.5	1.4	2.8	3.8
<b>Courts and Crime Indicators</b>						
% of Firms Identifying Legal System/Conflict Resolution as a Major Constraint	4.0	5.4	1.4	0.0	14.0	19.7
% of Firms Identifying Crime, Theft and Disorder as a Major Constraint	2.3	2.5	1.4	2.5	9.2	24.1
% of Firms with Overdue Payments from Buyers/Suppliers/Customers	19.4	16.7	21.9	31.6	52.4	58.4
% of Firms Resolving Disputes through Court Action	10.3	12.5	6.3	8.3	37.0	21.3
% of Firms with Confidence in Legal System to Enforce Contract/Property Rights in Disputes	69.2	67.7	65.7	86.1	56.0	55.6
Costs of Security (% of Sales)	3.9	3.5	4.6	5.6	0.8	1.6
Losses due to Crime (% of Sales)	0.2	0.2	0.4	0.0	0.3	1.1
<b>Innovation and Technology Indicators</b>						
% of Firms Undertaking Innovation	75.7	69.9	84.9	94.7	65.1	70.1
R&D Expenditures (% of Sales)	.	.	.	.	0.3	0.9
% of Firms Identifying Foreign Competition as Important Influence in Lowering Production Costs or Developing Products	39.4	35.9	50.7	39.5	40.3	35.8
% of Firms Identifying Domestic Competition as Important Influence in Lowering Production Costs or Developing Products	73.5	77.2	65.3	65.8	73.2	63.3
% of Firms Using E-mail to Interact with Buyers/Suppliers/Customers	48.3	40.2	61.6	73.7	64.8	58.2
% of Firms Using Website to Interact with Buyers/Suppliers/Customers	55.1	46.4	71.2	78.9	62.5	44.4

Azerbaijan	Small (1-49 Employees)	Medium (50-249 Employees)	Large (250+ Employees)	Europe and Central Asia	Lower Middle Income
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### Trade Indicators

% of Firms That Trade Identifying Customs & Trade Regulations as a Major Constraint	7.0	7.1	4.7	9.7	13.8	22.7
Days on Average to Claim Imports From Customs	1.4	1.5	1.4	1.5	3.8	6.4
Days on Average to Clear Customs for Exports	1.5	1.5	1.3	1.6	3.3	3.7
% of Inputs Which Firms Import Directly	21.9	18.6	27.5	32.0	17.2	23.4
% of Firms Expected to Give Gifts to Obtain Import Licenses	14.9	15.8	12.9	13.5	11.5	16.0

**Note:** Country-level indicators denoting percentage of firms use as denominators the number of firms for which data for the respective question is available. Country-level indicators denoting quantities (i.e. the number of days, percentage of sales, percentage of loan value, etc.) represent averages of responding firms that are not considered to be outliers. Outliers are defined as firms with values greater than the mean plus 3 times the standard deviation or less than the mean minus 3 times the standard deviation for that particular indicator. Regional and income group indicators are calculated as averages of country-level indicators in the respective region and income groups.



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