

Running a Business in Azerbaijan

New data from Enterprise Surveys indicate improvements in Azerbaijan's business environment, particularly in terms of increasing access to finance and also reductions in tax payment-related bribery. Firms interviewed in 2005 and 2009 report increasing use of credit-financed investments and increasing sales sold on credit. Nevertheless, firms face many severe constraints, including corruption and a business environment that is not conducive to international trade. For example, 32 percent of the firms in Azerbaijan report unofficial payments to public officials to get things done compared with 17 percent in all of Eastern European and Central Asian (ECA) countries. Female participation in ownership is the lowest in the whole region (figure 1). Firms in Azerbaijan are less likely to export their products, use their own Web site, or use email to communicate with their clients than firms in the rest of ECA region.

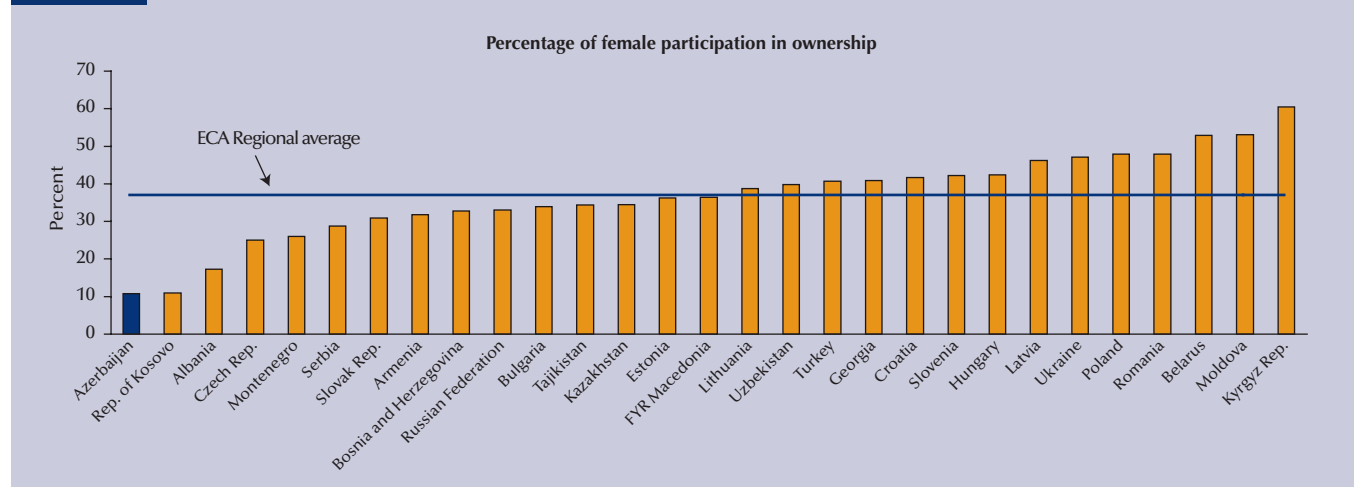
The Enterprise Surveys¹ use standard survey instruments to collect firm-level data on the business environment from business owners and top managers. The surveys cover a broad range of topics including access to finance, corruption, infrastructure, crime, competition, labor, obstacles to growth, and performance measures. The survey is designed to be representative of a country's private nonagricultural economy and firms sampled are stratified by size, location, and sector (figure 2)² to ensure that most major types of firms are covered. Only firms with five employees or more are included in the sample. In Azerbaijan, 380 firms were interviewed from September 2008 through February 2009.

The information collected refers to the characteristics of the firm at the moment of the survey, or to fiscal year 2007.

What Is the Average Firm in Azerbaijan?

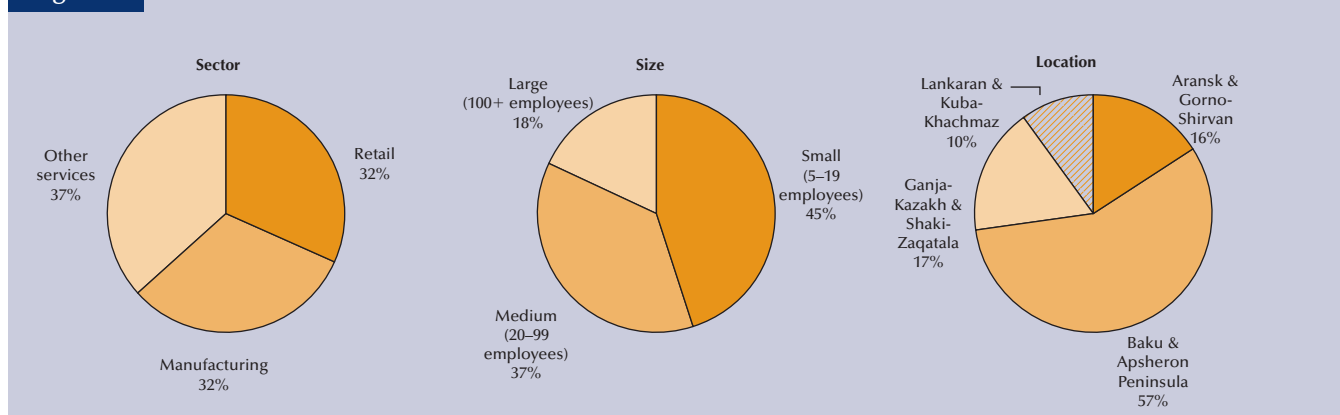
In Azerbaijan, female participation in ownership is the lowest in the region (figure 1). Businesses with female participation in ownership are more likely to have a female top manager and female permanent workers, and to rely on fewer temporary workers. The proportion of temporary workers in the total workforce in Azerbaijan is especially high in the other services sector (14 percent), followed by retail and manufacturing (2 percent). The proportion of fe-

Figure 1 Firms in Azerbaijan Have the Lowest Participation of Females in Their Ownership



Source: Enterprise Surveys.

Figure 2 Characteristics of the Firms Interviewed



Source: Enterprise Surveys.

male permanent workers in the total workforce is also low in Azerbaijan compared with the regional average (table 2). Within Azerbaijan, female permanent workers are most represented in the retail sector (42 percent of the workforce), followed by manufacturing (37 percent) and other services (20 percent).

A typical firm³ in Azerbaijan is more than 14 years of age. However, close to 75 percent of the firms are below the average age, and about 50 percent are 10 years old or less. Retail firms are younger than firms in other sectors by around four years and so are the

The proportion of female permanent workers in the total workforce is low in Azerbaijan compared with the regional average.

small firms. Small firms are on average 12 years old compared to medium and large firms (17 and 24 years, respectively).

Almost fifty percent of firms in Azerbaijan are closed shareholding companies. The next most common form of firms' legal status is sole proprietorship (33 percent). After Belarus, Azerbaijan has the highest proportion of government/state participation in ownership in ECA (table 1); government ownership is

Table 1 How Does Azerbaijan 2009 Compare within Eastern Europe and Central Asia?

| Ranking 1 assigned to the largest value | Descending ranking (out of 29 countries) |
|--|--|
| % of Firms Formally Registered when Started Operations in the Country | 29 |
| Private Domestic Ownership (%)* | 19 |
| Private Foreign Ownership (%)* | 15 |
| Government/State Ownership (%)* | 2 |
| % of Firms with Female Participation in Ownership | 29 |
| Bank Finance for Investment (%) | 25 |
| % of Exporter Firms | 28 |
| Domestic Sales (% of Sales) | 3 |
| % of Firms with Internationally Recognized Quality Certification | 16 |
| % of Firms with Annual Financial Statement Reviewed by External Auditor | 16 |
| Capacity Utilization (%) | 21 |
| % of Firms Using Their Own Web Site | 27 |
| % of Firms Using Email to Communicate with Clients/Suppliers | 28 |
| Ranking 1 assigned to the smallest value | Ascending ranking (out of 29 countries) |
| Value of Collateral Needed for a Loan (% of the Loan Amount) | 5 |
| Number of Power Outages in a Typical Month | 17 |
| Senior Management Time Spent in Dealing with Requirements of Government Regulation (%) | 2 |
| Average Number of Visits or Required Meetings with Tax Officials | 24 |
| Incidence of Graft Index ** | 28 |
| Losses Due to Theft, Robbery, Vandalism, and Arson against the Firm (% of Sales) | 8 |

Source: Enterprise Surveys.

typically concentrated in large firms and in the manufacturing sector. An average firm in Azerbaijan uses more temporary workers and fewer permanent workers than the rest of the ECA region (table 2). In Azerbaijan, government ownership in private firms is more than twice the regional average (3 vs. 1.2 percent). As we might expect, government ownership in Azerbaijan is particularly high in the manufacturing sector (5.8 percent) compared with 0.3 percent in retail; it is also higher among large firms (15.7 percent) compared to small and medium-size firms (1.1 and 2.8 percent).

How Do Businesses Operate in Azerbaijan?

Use of bank financing for investment in Azerbaijan is low by regional standards, even though the amount of collateral required (as a percentage of loan amount) is low compared to that in the rest of the region (table 3). Within Azerbaijan, use of bank financing for investment is particularly low among firms with female participation in ownership (3 vs. 16 percent for firms entirely male-owned), firms with some government ownership (they do not use bank financing at all), and firms with foreign owners (3 vs. 16 percent for domestically owned). These firm groups tend to rely more on internal financing for purchases of fixed assets. Somewhat surprisingly, there is not much difference in the use of bank financing or other sources of finance between small and large firms.

After Uzbekistan, Azerbaijan has the smallest proportion of exporters in the region. The percentage of exporter firms is four, well below the regional average of 22 percent. Only a small fraction (1.3 percent) of a typical firm's sales are directly exported, compared with 7 percent for the ECA region (table 3). Exporting directly in Azerbaijan is mainly restricted to large firms that export 5.6 percent of their output compared with less than 0.1 percent for small firms and 2.4 percent for medium firms.

By regional standards, use of a firm's own Web site and email to communicate with clients is low in Azerbaijan (table 3). In fact, Azerbaijan ranks third to last and second to last in these measures, respectively. For example, only 22 percent of the firms use their own Web site, compared with 49 percent in the whole region. Azerbaijan firms also stand out in the region for the disparity between large firms and the small and medium firms in email and Web site usage (figure 3). Azerbaijan is slightly below the ECA regional average in the use of internationally recognized certificates (table 3). The low prevalence of Web site and email usage suggest a technology gap between Azerbaijan and the rest of ECA.

What Constrains Firms in Azerbaijan?

Azerbaijani firms face many constraints. When asked to choose the biggest obstacle facing the establishment among 15 obstacles presented, 23 percent of firms chose access to finance and 22 percent of firms chose tax rates. As mentioned above, very few firms are integrated into global trade and the *Doing Business 2009* Trading across Borders rank of 174 out of 181 corroborates the low prevalence of exporter firms. Transparency International's 2008 ranking of Azerbaijan at 158 out of 180 in their Corruption Perceptions Index confirms the Enterprise Survey data Incidence of graft index rank of 28 (out of 29 ECA countries) (table 1); corruption is a tangible constraint for the private sector.

Various subgroups of Azerbaijani firms experience tax and regulatory burden differently. Medium firms experience significantly higher number of visits or required meetings with tax officials per year compared to small and large firms (3.2 vs. 1.9 and 1.5). Unsurprisingly, firms with government participation in ownership face on average one fewer visit per year. Also firms where the top manager is female have signif-

Use of firm's own Web site and email to communicate with clients is low in Azerbaijan.

Table 2 The "Average Firm" in Azerbaijan 2009

| | Azerbaijan | ECA† | EU-10‡ |
|---|------------------|------------------|------------------|
| Age (years) | 14.1 | 14.0 | 14.1 |
| % of Firms Formally Registered When Started Operations in the Country | 85.1 | 96.8 | 98.7 |
| Most Common Legal Form | Closed | Closed | Closed |
| | Shareholding Co. | Shareholding Co. | Shareholding Co. |
| Private Domestic Ownership (%)* | 90.3 | 91.3 | 90.2 |
| Private Foreign Ownership (%)* | 6.5 | 6.2 | 7.5 |
| Government/State Ownership (%)* | 3.0 | 1.2 | 0.5 |
| % of Firms with Female Participation in Ownership | 10.8 | 36.7 | 39.1 |
| % of Firms with Female in Top Management Position | 4.7 | 19.1 | 22.7 |
| Experience of the Top Manager (Years) | 13.7 | 16.1 | 17.1 |
| Average Number of Temporary Workers | 7.8 | 5.7 | 3.4 |
| Average Number of Permanent, Full-Time Workers | 37.1 | 44.0 | 37.3 |
| % of Full-Time Female Workers | 30.3 | 38.7 | 40.5 |

Source: Enterprise Surveys.

Table 3 Choices by the “Average Firm” in Azerbaijan 2009

| | Azerbaijan | ECA† | EU-10‡ |
|---|------------|-------|--------|
| Internal Finance for Investment (%) | 67.5 | 62.2 | 62.3 |
| Bank Finance for Investment (%) | 14.4 | 23.8 | 26.7 |
| Value of Collateral Needed for a Loan (% of the Loan Amount) | 102.4 | 132.8 | 124.6 |
| Loans Requiring Collateral (%) | 87.2 | 81.1 | 74.3 |
| % of Firms with a Checking or Savings Account | 75.9 | 88.9 | 85.2 |
| % of Exporter Firms | 4.3 | 21.8 | 28.3 |
| Domestic Sales (% of Sales) | 98.2 | 91.0 | 88.6 |
| Sales Exported Directly (% Sales) | 1.3 | 7.0 | 9.2 |
| Sales Exported Indirectly (% Sales) | 0.4 | 2.0 | 2.2 |
| Sales That Are Prepaid (%) | 29.0 | 22.9 | 10.9 |
| Sales Sold on Credit (%) | 23.4 | 49.4 | 66.5 |
| % of Firms with Internationally Recognized Quality Certification | 18.2 | 19.9 | 25.6 |
| % of Firms with Annual Financial Statement Reviewed by External Auditor | 37.3 | 37.9 | 38.7 |
| Capacity Utilization (%) | 70.5 | 73.7 | 81.3 |
| % of Firms Using Their Own Web Site | 21.7 | 48.5 | 63.4 |
| % of Firms Using Email to Communicate with Clients/Suppliers | 40.3 | 73.2 | 88.5 |

Source: Enterprise Surveys.

icantly less visits than male-managed counterparts: 2.3 vs. 1.6. While the overall average of senior management time spent dealing with requirements of government regulation is low compared to ECA (table 4), the average significantly varies by regions within Azerbaijan (figure 4). Interestingly, domestically owned firms spent twice as much time compared to foreign-owned; also retail and services firms spend twice as much time as manufacturers.

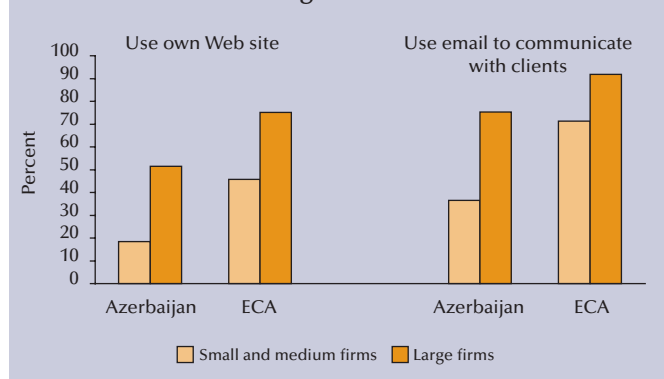
Corruption is pervasive in Azerbaijan, and firms report some of the highest levels of bribery and corruption throughout ECA. Forty-three percent of Azerbaijani firms report having to give bribes to tax inspectors, only Uzbekistan has a higher percentage (52 percent). Thirty-five percent of firms report having to provide bribes in order to obtain an operating license. Only Ukraine, Tajikistan, and Uzbekistan report higher percentages.

Medium firms experience significantly higher number of visits or required meetings with tax officials per year compared to small and large firms.

Almost one-third of firms report having to bribe public officials in order to “get things done” regarding procedures such as customs, licenses, and services. Predictably firms with government participation in ownership report significantly less of this type of corruption: 11 vs. 34 percent for fully private firms. Large firms report significantly less corruption compared to small and medium-size firms: 12 percent vs. 31 and 41 percent. This particular type of corruption also varies significantly by geographic region (figure 4). An inverse

pattern is evident in this figure, as regions with higher reported bribery of public officials have lower percentages of senior management time spent complying with regulatory burden. Conventional crime, as opposed to corruption, does not appear to be a major issue for firms in Azerbaijan relative to ECA (table 4), although Azerbaijani firms pay higher security costs as a percentage of annual sales (1.9 percent) than most countries. Only 3 other countries have higher percentages: Kyrgyz Republic (2.4 percent), FYR Macedonia (2.5 percent), and Rep. of Kosovo (8.1 percent).

Azerbaijan fares well in terms of infrastructure compared to the ECA region. For instance, the number of power outages is lower than the ECA average (table 4). Only 4 percent and 12 percent of firms consider transportation and electricity as major constraints; these are the smallest percentages among all 29 ECA countries. Despite these positive infrastructure indicators, corruption is a large issue regarding the provision of services. In all of ECA, Azerbaijani firms report the highest percentages of expected bribery in order to obtain multiple infrastructure services: phone connection, electrical connection, water connection, and construction permits.

Figure 3 Larger Firms Use of Technology Is Closer to Regional Standards

Source: Enterprise Surveys.

Table 4 Constraints on the “Average Firm” in Azerbaijan 2009

| | Azerbaijan | ECA† | EU-10‡ |
|--|------------|------|--------|
| Number of Power Outages in a Typical Month | 3.5 | 5.8 | 2.5 |
| Senior Management Time Spent in Dealing with Requirements of Government Regulation (%) | 3.0 | 10.6 | 9.5 |
| Average Number of Visits or Required Meetings with Tax Officials | 2.3 | 1.7 | 1.1 |
| % of Firms Expected to Pay Informal Payment to Public Officials (to Get Things Done) | 32.0 | 16.8 | 7.4 |
| Incidence of Graft Index** | 26.0 | 9.9 | 4.7 |
| Losses Due to Theft, Robbery, Vandalism, and Arson against the Firm (% of Sales) | 0.3 | 0.5 | 0.4 |
| % of Firms Paying for Security | 62.0 | 57.7 | 62.0 |

Source: Enterprise Surveys.

How Has the Business Environment Changed over the Past Three Years?

The Enterprise Surveys data provide the tools to monitor changes in the business environment across different rounds of surveys. In Azerbaijan, of 380 firms interviewed in 2009, 106 were also previously surveyed in 2005⁴. Since the same firms are interviewed over time this subset of data is more appropriate to evaluate the evolution of the business environment and the impact of business environment reforms than the full data sets for both years. Considering the full data sets would introduce effects that are the result of variations in the sample composition over the two years⁵. Therefore, the following analysis refers only to those firms that were interviewed in both rounds of surveys.

Improvements regarding access to credit and corruption in tax collection are evident in the cross-year data (figure 5). Internal financing for investment has significantly decreased (99 to 73 percent), while bank fi-

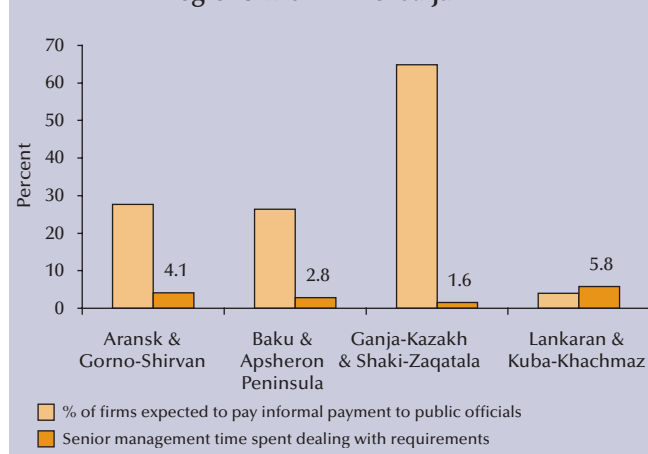
ancing for investment has significantly increase from 0 to 11 percent. Sales sold on credit have significantly increased from 20 to 32 percent, and supplier credit financing has increased from 0 to 10 percent. Despite tax reforms, panel firms report on average one more required visit or meeting with tax officials per year, from 1.3 to 2.7. However, the percentage of firms reporting bribes with these tax officials has significantly decreased over time, from 63 to 46 percent.

Firms have also reported a significant three-fold increase in internationally recognized quality certification (from 12 to 33 percent). However, despite this improvement in technology, capacity utilization significantly decreased from 85 to 69 percent.

To summarize, firms in Azerbaijan face many challenges. Widespread corruption and difficulty in trading across borders are two of the most severe constraints on firms. However, over time, improvements in the business environment such as increased

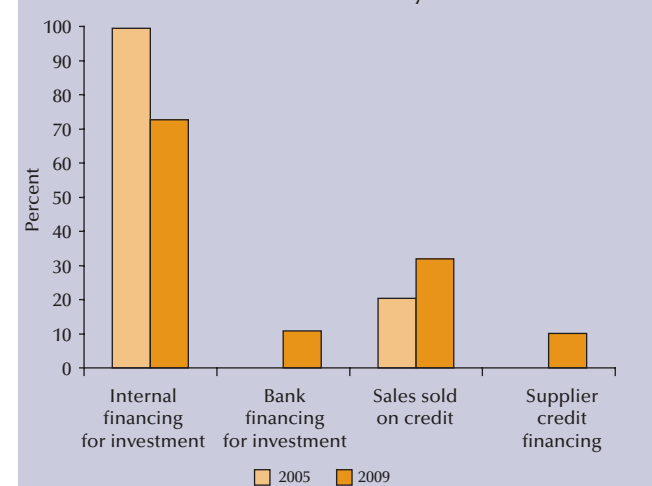
Capacity utilization significantly decreased from 85 to 69 percent over the three year period.

Figure 4 Time Spent Dealing with Regulations and Bribery of Public Officials Vary by Regions within Azerbaijan



Source: Enterprise Surveys.

Figure 5 Access to Credit Increased Between 2005 and 2009 Surveys



Source: Enterprise Surveys.

availability of credit and some reduction of corruption have been observed. Streamlining regulation in order to diminish opportunities for bribe collection and expanding the opportunities for international trade can be future reforms aimed at improving Azerbaijan's business environment.

Notes

1. The Enterprise Surveys, implemented in Eastern Europe and Central Asia countries, are also known as Business Environment and Enterprise Performance Surveys (BEEPS) and are jointly conducted by the World Bank and the European Bank for Reconstruction and Development for this geographic region.

2. This figure presents the unweighted distributions by size, sector, and location of the firms interviewed without any inferences to the whole economy.

3. The term "Average Firm" is used to convey the average firm characteristics from the Azerbaijan 2009 Enterprise Survey. The sample of firms interviewed is representative of the manufacturing and services sectors of the economy. For more information on the survey methodology please consult <http://www.enterprisesurveys.org/Methodology/>.

4. The information collected in 2005 refers to the characteristics of the firm at the moment of the survey or to fiscal year 2004.

5. The firms surveyed in both years may not be representative of the Azerbaijan's private nonagricultural economy since these are a subset of the

full sample. Firms with fewer than five employees may be included among the firms surveyed in both years. The analysis presented is purely descriptive and does not aim at establishing causality between reforms and their intended effects.

* The ownership variables represent the average ownership composition within a firm. These variables do not represent the ownership composition across firms.

** Incidence of Graft Index is the proportion of instances in which firms were either expected or requested to pay a gift or informal payment over the number of total solicitations for public services, licenses or permits for that country. The Graft Index is defined in Gonzalez, Alvaro S., Ernesto Lopez-Cordova, J. and E. Valladares, Elio, The Incidence of Graft on Developing-Country Firms. World Bank Policy Research Working Paper Series, 2007.

† ECA includes Albania 2009, Armenia 2009, Azerbaijan 2009, Belarus 2009, Bosnia and Herzegovina 2009, Bulgaria 2009, Croatia 2009, Czech Republic 2009, Estonia 2009, Georgia 2009, Hungary 2009, Kazakhstan 2009, Republic of Kosovo 2009, Kyrgyz Republic 2009, Latvia 2009, Lithuania 2009, FYR Macedonia 2009, Moldova 2009, Montenegro 2009, Poland 2009, Romania 2009, Russian Federation 2009, Serbia 2009, Slovak Republic 2009, Slovenia 2009, Tajikistan 2008, Turkey 2008, Ukraine 2008, and Uzbekistan 2008.

‡ EU-10 includes 2009 data from Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

The Enterprise Surveys measure the business environment in over 100 countries in the world. A standardized questionnaire, universe under study, and implementation methodology is used to make sure information is comparable across countries and time. The full data and documentation explaining the methodology are available at www.enterprisesurveys.org.

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