

## 13. BUSINESS

### Summary

As of 2013, the private sector represents 85 per cent of Azerbaijan economy. The registration of a business is fairly easy from both a legislative and practical point of view. Recently, a "single window" registration system was created under the Ministry of Tax and ASAN centre to accelerate the process of business registration. Moreover, it is possible to register as an individual entrepreneur or as legal entities via electronic services. An electronic information portal on permissions (business licenses) was launched to provide information about all permits in Azerbaijan. Likewise, a single data registration centre of all inspection (<http://yoxlama.gov.az>) has been created under the Ministry of Justice in order to reduce the groundless inspection of business entities. Hopefully, the adoption of a new law on inspection and protection of the interests of business entities will contribute to the solution of problems.

On the negative side, small businesses suffer the most from the current market conditions (high cost of licences and permits, monopoly, limited access to finance, lack of skilled labour, foreign trade and custom regulations, tax rates and cases of corruption). The issuing of permits and licences can be very difficult in some areas. In addition, the provision of licences and permits is not centralised. Nor are they provided via e-services. Although the "single window" system has been installed in custom services, Azerbaijan shows poor performance, as told in the *Doing Business 2014* report. The procedure of registration of property has been simplified recently; however the property issue problems still remain a problem for business. The Code of Migration and the Code of Land ownership are restrictive for foreigners. Small businesses are not well aware of their rights – a situation that is very conducive to corruption.

The Ministry of Economy and Industry has introduced standards for corporate governance and samples of code of conduct for local businesses, though the corporate governance culture is traditionally very low in the country. Yet, these requirements are not enforced by law. Mainly, companies do not publish finance audit reports on their web pages. In June 2012, the Parliament adopted reactionary amendments to legislative acts, which will considerably restrict access to information of share-holders of companies. The Azerbaijani business sector is not seriously involved in the anti-corruption engagement, and does not support also civil society to combat the corruption.

## BUSINESS

Overall Pillar Score 48/100

DIMENSION	INDICATOR	LAW	PRACTICE
Capacity 63/100	Resources	75	50
	Independence	75	50
Governance 42/100	Transparency	50	25
	Accountability	50	50
	Integrity	50	25
Role 38/100	Interest aggregation and representation		25
	Anti-corruption commitment		50

### Structure and organisation

The GDP of the country reached US\$73 billion in 2013.<sup>1</sup> The share of oil and oil products accounts for 92 per cent of the export of the country in total.<sup>2</sup> The main economic strategy of the country is to reduce the dependence on oil revenue and to boost the non-oil sector. Compared to the previous year, the non-oil sector grew 10 per cent in 2013, constituting 57 per cent share of the GDP.<sup>3</sup>

As of 2013, the private sector produced 85 per cent of Azerbaijan GDP.<sup>4</sup> Nevertheless, the oil sector holds the largest share in the private sector. Transnational cooperation companies such as SOCAR, BP, TOTAL GDF SUEZ, STATOIL and LUKOIL operate in the petroleum sector under the product-sharing agreements<sup>5</sup> signed since 1994.

There are over 540 thousand business entities operating in Azerbaijan. Of these, 84.1 per cent are individual entrepreneurs, and only 15.9 per cent are registered as legal entities; 80 per cent are small business entities, while medium and big business entities constitute only 20 per cent of all enterprises.<sup>6</sup>

Business is self-regulated through a number of chambers of commerce - Commerce and Industry Chamber of Azerbaijan Republic, American Chamber of Commerce in Azerbaijan (AMCHAM), Azerbaijan-Italy Commerce Chamber, and Azerbaijan-Germany Commerce Chamber, representing both Azerbaijan and foreign companies.

Besides the National Fund for Entrepreneurship Support, Azerbaijan Investment Company, Azerbaijan Export and Investment Promotion Foundation (AZPROMO) are all under the Ministry of Economy and

1 Website of Azerbaijan Export and Investment Promotion Foundation, [www.azpromo.az](http://www.azpromo.az)

2 Website of Center for Economic and Social Development, [www.cesd.az](http://www.cesd.az)

3 Website of Center for Economic and Social Development, [www.cesd.az](http://www.cesd.az)

4 Website of Ministry of Economy and Industry, [www.economy.gov.az](http://www.economy.gov.az)

5 Website of State Oil Company of Azerbaijan, [new.socar.az/socar/en/company/production-sharing-agreements-offshore/absheron](http://new.socar.az/socar/en/company/production-sharing-agreements-offshore/absheron)

6 Website of the Ministry of Economy and Industry, <http://economy.gov.az/media/pdf/analitika-2013.pdf>

Industry. The National Confederation of Entrepreneurs (Employers) Organisations of Azerbaijan Republic (AEC) also operates within the Azerbaijan business environment.

## Assessment

### Resources (law): 75

*To what extent does the legal framework offer an enabling environment for the formation and operations of individual businesses?*

The legal framework for business is moderately developed. Two documents, namely, Civil Code of Azerbaijan Republic on Legal Entities<sup>7</sup> (Chapter 4) and the Law on State Registration of Legal Entities,<sup>8</sup> provide the main regulatory framework for doing business in Azerbaijan; covering issues such as the formation, operation, insolvency and closing of businesses. Besides, the Law on Entrepreneurship<sup>9</sup> – approved in 1992 – determines the rights and obligations of the subjects of entrepreneurial activity, and sets forth forms and methods of protection by the state, determined by the relationship between the state authorities and entrepreneurs. Several laws<sup>10 11 12</sup> regulate the foreign investment environment in Azerbaijan. At the same time, several crucial laws such as the Code of Competitive Conduct, the Law on Licences and Permits and the Law on Corporative Governance are yet to be adopted by the Parliament.

There are five legal forms for doing business in the country. These are: General Partnership (GP), Limited Partnership (LP), Limited Liability Company (LLC), Additional Liability Company (ALC) and Joint Stock Company (JSC).

General partnership is an enterprise established by two or more physical and/or legal persons. The owners of a general partnership have “unlimited” liability for the obligations of the general partnership.

Limited partnership may be established by two or more physical and/or legal persons, with at least one of the participants bearing unlimited liability for the obligations of the limited partnership and not participating in entrepreneurial activity.

A limited liability company is an enterprise which is established by one or more physical and/or legal persons. The legal fund of a limited liability company is divided into authorised shares as specified in its charter. The shareholders of a limited liability company have limited liability that is commensurate with their shares in the limited liability company.

An additional liability company has a legal status similar to that of a limited liability company, with the exception that the participants of an additional liability company may assume liability in excess of their contributions.

A joint stock company’s structure is similar to that of a limited liability company. Joint stock companies may be established either as “open” or “closed” business entities. An “open” joint stock company is able to offer its shares to investors, while a “closed” joint stock company can only redistribute its shares among its founder shareholders and other predetermined persons.<sup>13 14</sup>

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7 Civil Code of Azerbaijan Republic on Legal Entities, 28 December 1999, [www.e-qanun.az](http://www.e-qanun.az)

8 Law on State Registration of Legal Entities, 12 December 2003, [www.e-qanun.az](http://www.e-qanun.az)

9 Law on Entrepreneurship, 15 December 1992, [www.e-qanun.az](http://www.e-qanun.az)

10 The Law on Protection of Foreign Investment, 15 January 1992, [www.e-qanun.az](http://www.e-qanun.az)

11 The Law on Investment Activity, 13 January, 1995, [www.e-qanun.az](http://www.e-qanun.az)

12 The Privatization Law, 16 May 2000, [www.emdk.gov.az/?/az/content/183/](http://www.emdk.gov.az/?/az/content/183/)

13 Legal and Tax Aspects of Doing Business in Azerbaijan, CABC, 2011, [www.cabc-global.com/pdf/Azeri-Tax-Legal-Overview-2011.pdf](http://www.cabc-global.com/pdf/Azeri-Tax-Legal-Overview-2011.pdf)

When creating a legal entity, state registration of persons engaged in entrepreneurial activities is carried out through a one-stop shop at the Ministry of Tax and since recently, also through ASAN centres.<sup>15</sup> The Law on the State Fee<sup>16</sup> exempts online registration of business from the state fee. According to the respective law,<sup>17</sup> registration shall be granted within 3 days.

Individual entrepreneurs shall obtain a Tax Payer Identification Number (TPIN). To apply for this, the following documents are required to be submitted:

- Standard application form.
- Founding documents – the charter of the entity approved by the founder or his/her legal representative and minutes of the foundation meeting.
- If the founder is an individual – a copy of his/her identity card.
- A document confirming the legal address of the entity.

Licences are still required for banking, insurance, auditing, transportation, dealing with securities and other types of activity. A licence's term of validity is usually five years, with the right to extend it. A respective Presidential Decree,<sup>18</sup> approving the Rules on Granting Licences (hereafter "Licencing Rules"), substantially reduced the number of licensable activities from 240 to 30.<sup>19</sup> Now Azerbaijan is the only state of the former USSR where licencing is not yet regulated by a separate law.<sup>20</sup> A Presidential Decree of 26 October 2011 assigned the Cabinet of Ministers to provide the new draft of the "Law on Licenses and Permits," but the draft law is not prepared yet.

There are nine state taxes in Azerbaijan. Under the Tax Code, Azerbaijan legal entities shall pay corporate (profit) tax of 20 per cent. The VAT rate is 18 per cent of the price of goods or services. All employers in Azerbaijan are required to make contributions to the State Social Protection Fund at 22 per cent of the gross salaries and other qualifying income of their employees. Employees are also obliged to contribute 3 per cent of their qualifying gross income for this purpose<sup>21</sup> and on average, 14 per cent of income tax.<sup>22</sup> Individual entrepreneurs or legal entities with total revenues of less than respectively 90,000 manat (US\$114,66) and 120,000 manat (US\$152,89) in 12 consecutive months, pay between 2 per cent and 4 per cent of the total revenues, plus monthly social tax tied to 20 per cent and less percent of minimum wage, depending on the region of the country.<sup>23</sup>

The Code of Migration,<sup>24</sup> which was adopted on 1 August 2013, provides the main legal framework for migration issues. The migration code places restrictions on the foreign workforce. Foreign individuals wishing to work in Azerbaijan must obtain a work permit from the Ministry of Labour and Social Protection of Population.<sup>25</sup> An individual permit is issued for a term of one year. A work permit is not required if an individual has a domicile in Azerbaijan, or holds a managerial position in an

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14 Law on State Registration and State Registry of Legal Entities, 12 December 2003, [www.e-qanun.az](http://www.e-qanun.az)

15 [www.asan.gov.az](http://www.asan.gov.az)

16 Law On State Fee, 4 December, 2001, [www.e-qanun.az](http://www.e-qanun.az)

17 Law on State Registration of Legal Entities and State Registry, 12 December 2003, [www.e-qanun.az](http://www.e-qanun.az)

18 Presidential Decree approving the Rules on Granting Licenses, 2 September, 2002, [www.e-qanun.az](http://www.e-qanun.az)

19 Business Licencing, IFC report, Website of International Finance Corporation, [www.ifc.org/](http://www.ifc.org/)

20 Website of Entrepreneurship Development Foundation, <http://edf.az/>

21 Website of Backer and Mckenzi Company, [www.bakermckenzie.com](http://www.bakermckenzie.com)

22 Minimum living standard at 120 manat (US\$150) as of date is deductible for income tax purposes and this rate works for the salaries of 2,500 manat (US\$3,125) and lower; for salaries over this threshold a different scheme is applied, i.e. the tax is calculated as follows: 350 manat (US\$437.5) plus 25per cent of the amount exceeding 2,500 manat (US\$3,125)

23 Website of Ministry of Tax, [www.taxes.gov.az](http://www.taxes.gov.az)

24 Website of State Migration Service, [www.migration.gov.az/](http://www.migration.gov.az/)

25 Website of the Ministry of Labour and Social Protection of Population, [www.mlsp.gov.az](http://www.mlsp.gov.az)

entrepreneurial organisation established under an international agreement.<sup>26</sup> The state fee for one year work permit is 1,000 manat (US\$1,274).<sup>27</sup> The legislation contains a penalty for employers that fail to obtain the work permit. The amount of such penalty is 3,000 to 5,000 manat (US\$3,823 to US\$6,371) for officials and 30,000 to 35,000 manat (US\$38,226 to US\$44,597) for legal entities.<sup>28</sup>

The laws on registration of property are quite favourable and have been simplified recently.<sup>29</sup> Now, there are 4 main procedures to follow:<sup>30</sup>

- Verification of a title and obtaining a non-encumbrance certificate at the Real Estate State Register.
- Notarisation of a sale-purchase agreement.
- Buyer applies to the State Registry for Real Estate to register the property.
- Registration of buyer's title for land and building at the State Registry for Real Estate.

Land ownership is limited for foreigners in Azerbaijan. Thus, foreign individuals and legal entities cannot own land in Azerbaijan but have rights to lease land. If a land parcel was transferred to a foreigner as an inheritance or a gift, a foreign owner must sell the land parcel within one year.<sup>31</sup> Dealing with construction permits remains difficult in Azerbaijan. According to data collected by *Doing Business 2014*, dealing with construction permits requires 28 procedures.<sup>32</sup>

## Resources (practice): 50

*To what extent are individual businesses able in practice to form and operate effectively?*

In practice the procedure to register is easy, quick and inexpensive,<sup>33</sup> though there are cases reported when companies refused registration, connected the refusal with the protection of interests of monopolies.<sup>34</sup> Based on the principle of a one-stop shop, a new business registration mechanism was created by the government under the [Ministry of Taxes](#), allowing companies to register within three days. The government has also created a new online registration mechanism, which has been available since 30 December 2011,<sup>35</sup> and which is completed within three days,<sup>36</sup> exempt from state fees,<sup>37</sup> and available to holders of an electronic signature.<sup>38</sup>

Some types of entrepreneurial activity require permits (licenses). Obtaining required licences is an issue, which can become problematic in some cases for companies.<sup>39</sup> A presidential decree in 2002 reduced the business licences from 240 to 30, but over the last 12 years, these licences increased 3 times (90 permits).<sup>40</sup> High bureaucracy causes time wasting, additional costs, difficulties in access to market,

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26 Website of State Migration Service, [www.migration.gov.az/](http://www.migration.gov.az/)

27 Tax Guide 2009-2010, Deloitte, [www.deloitte.com/assets/Dcom-Azerbaijan/Localper cent20Assets/Documents/PDFper cent20forper cent20Insights/dtt\\_Foreghn\\_en\\_AZ.pdf](http://www.deloitte.com/assets/Dcom-Azerbaijan/Localper cent20Assets/Documents/PDFper cent20forper cent20Insights/dtt_Foreghn_en_AZ.pdf)

28 Guide to doing business in Azerbaijan, 2014, Ernst and Young Holding, [www.ey.com/](http://www.ey.com/)

29 Doing Business 2014, Azerbaijan, World Bank, [www.doingbusiness.org](http://www.doingbusiness.org)

30 Website of the State Property Committee, <http://emdk.gov.az/>

31 Guide to doing business in Azerbaijan, 2014, Ernst and Young Holding, [www.ey.com/](http://www.ey.com/)

32 Doing Business 2014, Azerbaijan, World Bank, [www.doingbusiness.org](http://www.doingbusiness.org)

33 Interview with Alipasha Qeybullayev, chairman of National Productivity and Competitiveness Centre, 3 Feb 2014

34 Interview with 2 anonymous owners of two SMES, customers of Advocacy and Legal Advice Centers run by Transparency Azerbaijan, dated 10 December 2013

35 Law on State Registration of Legal Entities and State Registry, Article 7.1., 12 December 2003, [www.e-qanun.az](http://www.e-qanun.az)

36 Law on State Registration of Legal Entities and State Registry, Article 7.1., 12 December 2003, [www.e-qanun.az](http://www.e-qanun.az)

37 Law On State Fee, Article 20.1.3, 4 December, 2001, [www.e-qanun-az](http://www.e-qanun-az)

38 An electronic signature is a pre-requisite to online registration and is issued by the State Certificate Center under the Ministry of Communications and Information Technologies within 10 days of application date.

39 Business Anti-corruption Portal: Azerbaijan Country Profile, 2013, [www.business-anti-corruption.org](http://www.business-anti-corruption.org)

40 Website of Support for Economic Initiatives, [www.sei.az/news-1114.html](http://www.sei.az/news-1114.html)

diminishing of productivity and the worsening of the competitive environment.<sup>41</sup> All of these problems push small businesses into corrupt practices. Local studies show that 37 per cent of businesses made under the table payments to obtain licences in 2007.<sup>42</sup> Another survey which took place in 2011 showed that 56 per cent of 95 respondents did not believe in obtaining licences without under-table payments.<sup>43</sup> In 2011, an information portal on permits and licenses was created to increase the awareness of entrepreneur.<sup>44</sup> Although this portal provides the necessary information on permits and licenses, it does not offer any e-services. More than that, there is no centralised agency to provide services on permits and licenses.

The *Doing Business 2014* report ranks Azerbaijan as 77th among 189 countries, in terms of the simplicity of payment of taxes (compared to placing in 102nd position in 2009). Accordingly, businesses are subject to 18 obligatory payments (including taxes), wasting 214 hours compared to 376 hours in 2009 and spending almost 40 per cent of profit.<sup>45</sup> Business is subject to two types of taxes: simplified and standard (VAT). Since 2009, Azerbaijani taxpayers can pay their taxes online. The electronic services provided by the Ministry of Taxes were scored at 4 out of 5 total points.<sup>46</sup>

According to another study, 95 per cent of individual entrepreneurs and 65 per cent of small and medium entrepreneurs benefit from the simplified taxation system.<sup>47</sup> The main motivation for shifting from the standard taxation system to the simplified taxation system is to bypass administrative burden and pay less taxes. Being subject to the standard taxation system, businesses pay for 18 per cent VAT, 20 per cent profit tax as well as finance operation costs; while in the simplified taxation system business pay for merely 2 – 4 per cent of turnover.<sup>48</sup> As it is already stated above, it is individual entrepreneurs or legal entities, with total revenues of less than respectively 90,000 manat (US\$114,664) and 120,000 manat (US\$152,886) in 12 consecutive months, that are subject to the simplified taxation system. Since businesses sometimes purchase goods or services from business subjects, which are either unregistered or do not provide financial reports as necessity, they lose the VAT they paid for and thus, the right to VAT return. Therefore, businesses tend to hide their turnover above this level in order not to be subject to VAT. Such a risky situation creates conditions for further corruption during financial audits.<sup>49</sup>

As of the first quarter of 2014, there are 43 banks and 154 credit organisations operating in Azerbaijan.<sup>50</sup> In the *Doing Business 2014* report, Azerbaijan is ranked 55th among 189 according to the easiness of access to credit.<sup>51</sup> In general, the rate of business credit remains very high in Azerbaijan, as the average rate of business credit changes between 20 per cent and 25 per cent, which is very high in comparison with the corresponding figures in the American and European credit markets. The studies indicate that the main reason for this is the high risk for the re-payment of credits. This risk can be explained by two factors: the underdevelopment of the mortgage system and the problems in the judiciary system, for example, dispute resolutions.<sup>52</sup> In order to decrease credit risks, the Central Bank established a credit

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41 Licences in Azerbaijan and international practices, Kanan Aslanli, 2013,

[http://edf.az/ts\\_general/azl/ksid/downloads/lisenzivashdirma\\_Az.pdf](http://edf.az/ts_general/azl/ksid/downloads/lisenzivashdirma_Az.pdf)

42 Study small and medium size enterprises in Azerbaijan, 2009, International Financial Corporation [www.ifc.org/](http://www.ifc.org/)

43 Survey among 700 entrepreneurs, 2011, Support for Entrepreneurship Development,

[http://edf.az/ts\\_general/download/Hesabat\\_09\\_09\\_11\\_a.pdf](http://edf.az/ts_general/download/Hesabat_09_09_11_a.pdf)

44 [www.icazeler.gov.az](http://www.icazeler.gov.az)

45 Doing Business Report, 2014, [www.doingbusiness.com](http://www.doingbusiness.com)

46 E-service monitoring report, 2014, Transparency Azerbaijan, not published

47 Study small and medium size enterprises in Azerbaijan, 2009, International Financial Corporation [www.ifc.org/](http://www.ifc.org/)

48 Study small and medium size enterprises in Azerbaijan, 2009, International Financial Corporation [www.ifc.org/](http://www.ifc.org/)

49 Interview with anonym entrepreneur, 30 May 2014

50 Website of Central Bank of Azerbaijan, [www.nba.az/assets/](http://www.nba.az/assets/)

51 Doing Business Report, 2014, [www.doingbusiness.com](http://www.doingbusiness.com)

52 Assessment of factors influencing the high rate of credits in Azerbaijan, 2011, Support for Economic Initiatives, <http://sei.az/upload/files/bankkredititedqigati.pdf>

registry<sup>53</sup> in 2010 which allows banks to have access to the financial information of customers and thus, to assess the related financial risks properly. However, this has not led to the decrease of credit rates.

Local banks provide small to medium businesses with credits between 100,000 and 500,000 manat (US\$127,405 to US\$637,024) to support small to medium business, but the percentage of loan interest remains high at 20 to 25 per cent.<sup>54 55 56</sup> In order to support the business sector's access to finance, the National Fund for Entrepreneurship Support was created under the Ministry of Economy and Industry and offers credits between a minimum of 5,000 manat (US\$6370) and a maximum of 10 million manat (US\$12.75 million) with the loan recovery term of a maximum of ten years. This foundation aims to provide 250 million manat (US\$318.5 million) in loans to the business sector for each year.<sup>57</sup> As of 2013, allocations of 193 million manat (US\$245.8 million) were made from the state budget to the support of entrepreneurship which was 30 per cent higher than the same indicator in 2012. Of those funds, 150 million manat (US\$191.1 million) was allocated to the National Fund for Entrepreneurship Support; 35 million manat (US\$44.6 million) to Agrolizing OJSC, and 8 million manat (US\$10.19 million) to the State Agency for Agriculture Credits. The concerning issue is that no effective public supervision mechanism is in place to monitor the transparency of these public funds. This can be explained by the low level of accountability of the abovementioned state organisations on use of public funds.<sup>58</sup>

One of the biggest obstacles to the development of business in Azerbaijan is customs or foreign trade regulations. In spite of the application of the "single window" system and the electronic information exchange system, there have been insignificant changes in this field. Thus, the *Doing Business 2014* report ranks Azerbaijan in 168th position out of 189 countries, according to the trade across border sub-index.<sup>59</sup> In another study, 66 per cent of individual entrepreneurs and 38 per cent of small and medium entrepreneurs consider the procedures of import problematic.<sup>60</sup> For the export of a standard container, 9 documents, 28 days and US\$3,540 are needed, while for the import of the same kind of container, the requirements are for 11 documents, 25 days and US\$3,560. The simplification of the custom procedures is one of the main conditions set for the admission to WTO.<sup>61</sup>

Reforms in the real estate management allowed the World Bank<sup>62</sup> *Doing Business 2014* to rate registration of real estate in Azerbaijan as number 13 out of 185 countries surveyed, though a minor decline from the score of 9 in 2013 is obvious. However, experiences of Transparency Azerbaijan's advocacy and legal advice centre's customers testify that, in practice, the process is much more complicated than its legal framework suggests, it takes a long time, and the reforms need to be continued.<sup>63</sup>

## Independence (law): 75

*To what extent are there legal safeguards to prevent unwarranted external interference in activities of private businesses?*

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53 Website of Central Bank of Azerbaijan, [www.nba.az/standalone/ccrs/](http://www.nba.az/standalone/ccrs/)

54 Website of Unibank, [www.unibank.az/az](http://www.unibank.az/az)

55 Website of Demirbank, [www.demirbank.az/](http://www.demirbank.az/)

56 Website of Access Bank, [www.accessbank.az/](http://www.accessbank.az/)

57 Letter from the Ministry of Economic Development, 2 August 2013, N-IIN-X/O-6662/2013

58 Review for the state budget of Azerbaijan, 2012 – 2014, National Budget Group

59 Doing Business Report, 2014, [www.doingbusiness.com](http://www.doingbusiness.com)

60 Study small and medium size enterprises in Azerbaijan, 2009, International Financial Corporation [www.ifc.org/](http://www.ifc.org/)

61 Azerbaijan's accession to World Trade Organization, July 2010, <http://cesd.az/>

62 World Bank Doing Business 2013: Azerbaijan, [www.doingbusiness.org](http://www.doingbusiness.org)

63 Report on Results of Monitoring of Implementation of Recommendations to Four Public Agencies under Azerbaijan Partnership for Transparency project: Ministry of Labour and Social Protection of the Population; Ministry of Justice; State Registry of Real Estate; Baku Electric Network, publication by Transparency Azerbaijan, presented to government at the round table of 24 January 2014, [www.transparency.az](http://www.transparency.az)

The Civil Code establishes the regulatory framework for entrepreneurs to protect their businesses from unnecessary state interference. There are several other legal acts, which protect interests of entrepreneurs and prohibit unauthorised inspections in the field of business regulation.

The government has taken a number of steps to remove the undue interference into entrepreneurial activity in the country. In particular, the presidential decree of 28 September 2002 has especially changed the situation in this field. According to this decree, all state inspections of any business entities (except for the Ministry of Tax) should be carried out in the presence of an official representative of the Ministry of Economy and Industry.<sup>64</sup>

The decree of the president of the Republic of Azerbaijan of 15 February 2011, "... on regulating business inspections and protecting entrepreneurial interests ..." was another step to improve the situation for the better.<sup>65</sup> This decree stipulates that any state inspection in the field of entrepreneurship should be registered in a single-data register as of 1 May 2011. In this regard, each agency should report its planned inspection of any business entity to single-data registry under the Ministry of the Justice. At the same time, all data registry information should be reported quarterly to the Cabinet of Ministers and to the President by the Ministry of Justice.

Recently, the Parliament has passed a law on regulation of inspections in the sphere of entrepreneurship and protection of the rights of the entrepreneurs, which came into force on 1 March 2014.<sup>66</sup> The law sets forth goals and principles of inspection, defines rights and powers of inspection agencies and the requirements for the protection of rights and interest of entrepreneurs. This law does not apply to tax auditors. The main points of this law are as follows:

- **Audit should be carried out on the basis of risk assessment of business groups.** Thus, this law divides the entrepreneurs into risk groups (high, medium and low risk) and accordingly envisions inspections for high risk group once a year, for medium risk group once every two years, while low risk groups will be audited once every three years. The inspection for low and medium groups will last 5 days, and for high risk groups 10 days.
- **Business shall be supported by the consulting services of auditors.** According to this law, a business body has a right to receive advice and assessment of the situation from the inspecting agency.
- **Audit should notify business in advance (with the exception for cases when a business submits false information).** The law sets for a single registry of inspections to be created by the Ministry of Justice so that the businesses can obtain the information about the period, sequence, repetition, and results of the audits.

According to the presidential decree supporting execution of this law,<sup>67</sup> the Cabinet of Ministers defines inspection bodies and inspection areas and prepares the risk assessment criteria for the inspection of small, medium and large business. At the same time, the Ministry of Justice and Ministry of Economy and Industry must twice a year organise trainings for inspection bodies on recent legal changes, as per the new law.

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64 Letter from the Ministry of Economic Development, 2 August 2013, N-IIN-X/O-6662/2013

65 Presidential decree On regulating business inspections and protecting entrepreneurial interests, 15 February 2011.  
[www.president.az](http://www.president.az)

66 Law on regulation of inspections in the sphere of entrepreneurship and protection of the rights of the entrepreneurs , 2 July 2013,  
<http://e-qanun.az>

67 <http://president.az/articles/9105>

Along with these positive developments, amendments to the Civil Code, adopted in 2004 and 2007, that allow authorities to forcibly purchase and expropriate property for the state needs, have created opportunities for the abuse of property rights.<sup>68</sup> Also, amendments recently made to the Law on Insurance Activity,<sup>69</sup> setting forth special reinsurance licenses for insurance companies, were assessed by experts as a possibility for over-interference into business of the insurance community.<sup>70</sup>

## Independence (practice): 50

*To what extent is the business sector free from unwarranted external interference in its work in practice?*

The presidential decree of 28 September 2002<sup>71</sup> made it possible to sharply reduce the number of inspections of business entities and interference in their activities without grounds.<sup>72</sup> Also, a Single Data Registry system for inspections<sup>73</sup> has been launched since May 2011. The registry can be addressed through an automated phone service "1650" and e-services section of the website of the Ministry of Justice. Despite this fact, as a result of the investigations it was found that 92 per cent of entrepreneurs are not aware of this.

However, groundless interference and non-systematic inspections were quite a challenge for the development of the business sector in Azerbaijan. The study conducted by International Finance Cooperation (IFC) for the 2008 – 2012 periods is particularly important. It was found that the average number of inspections was 11 and 12 in 2008 and 2012, respectively. For the sake of comparison it should be mentioned that the corresponding figures in 2008 were 1 in Georgia, 5 in Belarus and 13 in Tajikistan. In Azerbaijan, 57 per cent of the inspections conducted in 2008 and 61 per cent of inspections in 2012 did not result in follow-up measures. The business entities in the surveys who reported making non-official payments decreased from 58 per cent in 2008 to 20 per cent in 2012.<sup>74</sup> Hopefully, the adoption of a new law on inspection and protection of the interests of business entities, which entered into force on 1 March 2014, will contribute to the solution of problems.

The state interference in business shows its monopolistic dimension in some public utility areas and the oil and gas sector. Thus, though formally there are no state-owned companies which have been delegated governmental powers, the State Oil Company of the Azerbaijan Republic (SOCAR) (oil and gas), Azerenerji (electricity) and Azersu (water) legally are closed joint-stock companies, with majority state ownership and limited private investment, creating a monopoly in each of their spheres, and meaning that they are, in fact, state entities.

There are no problems with filing a legal case with the judicial system, contesting interference of the government or any other actor, but the outcome of litigation is a problematic matter.<sup>75</sup> Therefore, entrepreneurs prefer to bargain with state officials. According to the results of the survey conducted among entrepreneurs, 47 per cent of respondents reported not to take business disputes to court, or

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68 US Department of State, March 2013, "Investment Climate Statement Azerbaijan", Bureau of Economic And Business Affairs, [www.state.gov/e/eb/rls/othr/ics/2013/204596.htm](http://www.state.gov/e/eb/rls/othr/ics/2013/204596.htm)

69 Law on Insurance Activity, 25 December 2007, <http://cis-legislation.com/document.fwx?rgn=24584>

70 Amendments to Law on Insurance contradict to state policy and provoke capital flight from Azerbaijan, Fineco/abc, 31 October 2013, <http://abc.az/eng/news/77082.html>

71 Presidential decree on Improvement of Regulations of Granting Special Permissions (Licenses) for Some Types of Activities, 28 September 2002, [www.e-qanun.az](http://www.e-qanun.az)

72 National business agenda for the improvement of the business climate in Azerbaijan in 2009,

Entrepreneurship Development Foundation, [www.cipe.org/sites/default/files/publication-docs/azerbaijanNBA\\_2009.pdf](http://www.cipe.org/sites/default/files/publication-docs/azerbaijanNBA_2009.pdf)

73 [www.yoxlama.gov.az](http://www.yoxlama.gov.az)

74 Reform in the field of inspections, needs and recommendations, IFC, 2012,

[http://edf.az/ts\\_general/download/SME\\_Conference\\_IFC\\_19\\_12\\_2012.pdf](http://edf.az/ts_general/download/SME_Conference_IFC_19_12_2012.pdf)

75 Interview with Alipasha Qybullayev, chairman of National Productivity and Competitiveness Centre, 3 Feb 2014

prefer to bargain with state officials, while 13 per cent of them refer to Ministries, 12 per cent to other organisations, 10 per cent to the President and 2 per cent to the Parliament.<sup>76</sup>

## Transparency (law): 50

*To what extent are there provisions to ensure transparency in the activities of the business sector?*

The legal framework needs further development to ensure transparency in the activities of the business sector. This area is mainly regulated by the Tax Code, the Law on Audit Services,<sup>77</sup> the Anti-Money Laundering Law,<sup>78 79</sup> the Law on Internal Audit<sup>80</sup> and several other legal acts.

In June 2012, the Parliament adopted amendments to legislative acts that considerably restrict access to corporate information.<sup>81</sup> According to the amendments, information about the founders and financial resources of legal entities, the amount of their charter capital, and other similar data, will be accessible only to law-enforcement bodies.

Normally, the Tax Code requires all companies to submit an annual tax return by the end of the first quarter of the next year. There are differences between tax accounting and financial accounting and therefore, companies have to keep double accounting books. Since 2008, all companies have to transfer accounting records into the new National Accounting Standards based on International Financial Reporting Standards (IFRS).

Auditing is a licensed activity in Azerbaijan. It is regulated by the Law on Audit<sup>82</sup> and the Law on Chamber of Auditors.<sup>83</sup> Companies are not obliged to publish their auditors' reports which creates difficulties in ensuring their transparency.

## Transparency (practice): 25

*To what extent is there transparency in the business sector in practice?*

In practice not all spheres of the business sector are believed to be transparent. Some information about companies is available online. This includes the company's date of incorporation, the name of its directors and members of its management board. Database of the Ministry of Tax until 9 July 2012 was open for everybody.<sup>84</sup> The 2012 amendment to the law<sup>85</sup> makes information about the founders of legal entities (participants) and their shares in the charter capital a commercial secret.

Furthermore, there are many areas in which transparency is still needed, such as the disclosure of production-sharing agreements between the government and foreign companies (some of those are available at the National Library), and publicly disclosed disaggregated revenue reporting, an area in

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76 The results of a face-to-face poll conducted among 700 (seven hundred) small businesses in the Azerbaijan Republic, by Entrepreneurship Development Foundation: center for Support to Development of Small and Medium Business, 2011

[http://edf.az/ts\\_general/download/Preliminary\\_analysis\\_09\\_09\\_11\\_e.pdf](http://edf.az/ts_general/download/Preliminary_analysis_09_09_11_e.pdf)

77 The Law on Audit, 16 September 1994, [http://e-qanun.az/files/framework/data/9/c\\_f\\_9236.htm](http://e-qanun.az/files/framework/data/9/c_f_9236.htm)

78 Law on the Prevention of the Legalization of Criminally Obtained Funds or Other Property and the Financing of Terrorism, dated 10 February 2009, [www.e-qanun.az](http://www.e-qanun.az)

79 Law on amendments to individual legislative acts of the Republic of Azerbaijan to enhance the prevention of the legalization of criminally obtained funds or other property and the financing of terrorism, dated 5 March 2010, [www.e-qanun.az](http://www.e-qanun.az)

80 The Law on Internal Audit, 22 May 2007, [http://e-qanun.az/files/framework/data/13/f\\_13241.htm](http://e-qanun.az/files/framework/data/13/f_13241.htm)

81 Amendments dated 12 June 2012 to the Law on Registration of Legal Entities and State Registry, dated 12 December /2003 and the Law on Commercial Secret, dated 4 December 2001 and Law on the Right to Obtain Information, dated 30 September 2005

82 The Law on Audit, 16 September 1994, [http://e-qanun.az/files/framework/data/9/c\\_f\\_9236.htm](http://e-qanun.az/files/framework/data/9/c_f_9236.htm)

83 Law on Chamber of Auditors, 19 September 1995,

[http://e-qanun.az/files/framework/data/9/c\\_f\\_9418.htm](http://e-qanun.az/files/framework/data/9/c_f_9418.htm)

84 [www.bridgewest.eu/article/trade-register-azerbaijan](http://www.bridgewest.eu/article/trade-register-azerbaijan)

85 Amendments to the Law on Commercial Secret of the Republic of Azerbaijan, 9 July 2012, [www.president.az](http://www.president.az)

which Western companies other than BP and Statoil should be leading.<sup>86</sup> In terms of internal company control, the legislation is quite loose. Companies are free to have one such system or not. The business sector is not obliged under the law to have business ethics rules.<sup>87</sup>

The [Ministry of Taxes](#) has very efficient online tools used by the individual entrepreneurs and companies to submit their tax declarations online, however, this information is not open to public, also most companies do not place this kind of information or their audit reports on their websites.

## Accountability (law): 50

*To what extent are there rules and laws governing oversight of the business sector and governing corporate governance of individual companies?*

Corporative governance legislation in Azerbaijan needs further development. Azerbaijan does not have a law on corporate social responsibility, though some provisions regulating this area are scattered in the legislation (such as Tax Code, Labour Code, etc). Even if the Law on Corporative Governance has not been adopted so far, the Ministry of Economic Development has made a first step in this direction and in 2011 approved Corporative Governance Standards.<sup>88</sup> The Corporative Governance Standards are voluntary recommendations aimed at improving and guiding the governance practices of corporations. They attempt to address the most evident corporate governance problems, such as shareholders' rights abuses, checks and balances between governance bodies, and disclosures to shareholders and the general public.<sup>89 90</sup>

According to the legislation, entrepreneurs must report about the state of their activities to statistical and financial institutions in the specified form.<sup>91</sup> Other types of reports are identified in the statutes of each individual legal entity, as the Civil Code stipulates.

## Accountability (practice): 50

*To what extent is there effective corporate governance in companies in practice?*

Corporate governance culture is not widespread in Azerbaijan business sector, which is a major obstacle to attract foreign investment. In terms of the quality of auditing and reporting standards in 2013- 2014, Azerbaijan ranks 99th out of 148 countries.<sup>92</sup> In spite of the low level of corporate culture in business, some progress has been made in recent years.

In order to attract investments, banks and some limited liability companies are cooperating with IFC in the framework of corporate governance projects and this cooperation has yielded some results. Thus, Davachi Brolyer managed to attract investment from the Azerbaijan Investment Company, which now owns shares at 25 per cent of Davachi Brolyer.<sup>93</sup>

In order to stimulate the corporative governance in the business sector, Ministry of Economy and Industry organised evaluation of the application of corporative standards within 33 local companies.

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86 Crude Accountability, October 2012. "After the BTC Pipeline and EITI Validation: Where are Prosperity and Transparency in Azerbaijan?" [www.crudeaccountability.org](http://www.crudeaccountability.org)

87 Third Round of Monitoring: Azerbaijan, Monitoring Report, by OECD, Anti-corruption Network for Eastern Europe and Central Asia, Istanbul Anti-corruption Action Plan, Paris, 25 September 2013, [www.oecd.org](http://www.oecd.org)

88 Corporative Governance Standards, 28 January 2011, [www.economy.gov.az](http://www.economy.gov.az)

89 Azerbaijani Corporate Governance Standards, 2011, IFC [www.ifc.org/](http://www.ifc.org/)

90 Azerbaijani Corporate Governance Standards, 2011, <http://economy.gov.az/>

91 Law on Entrepreneurship, 15 December 1992, [www.e-qanun.az](http://www.e-qanun.az)

92 Global Competitiveness Report, 2013-14 [www3.weforum.org/](http://www3.weforum.org/)

93 Website of Azerbaijani Investment Company, <http://aic.az/>

Demir Bank (85 per cent), Azerbaijan Lizing Company (92.9 per cent), and İsmayilli Qushchilug (90 per cent) were found to be the best among local companies.<sup>94</sup>

Very few companies in Azerbaijan officially report on corporate responsibility and sustainability (CSR), however, there are several commendable examples. BP is one of a few multinationals in Azerbaijan which releases a Sustainability Report.<sup>95</sup> Furthermore, companies acting in the mobile service market, in many cases publish information about the projects on CSR, among them Azercell.<sup>96</sup> PASHA Holding and Access Bank present a brief description of activities under the heading of social responsibility on its website.<sup>97 98</sup> However, state owned companies are not known to report on corporate responsibility and sustainability. As for SMEs, the idea of CSR is an alien concept which they do not even comprehend,<sup>99</sup> apart from rudimental philanthropy.

International oil companies operating in Azerbaijan could lead the process of accountability. The NGO Coalition for Improvement of Transparency in Extractive Industries reports, that although some of the oil producing companies operating in Azerbaijan are ready to transfer individual accountability on their deductions to the Azerbaijan government, still some companies: (Devon, Chevron, ExxonMobil, Total, Petro-Hong Kong-Pirsaat, Azgerneft, Karasu Operating Company, Itochu Oil Exploration (Azerbaijan) Inc., Rafi Oil FZE, Shirvan Oil, Anshad Petrol, Absheron Operating Oil Limited Commonwealth) are not. However, some companies such as the State Oil Company of Azerbaijan Republic and Hess (ACG) Limited Company stated they would be ready for individual accountability only when other companies support the idea. Companies ready for individual accountability are: BP, Middle East Petroleum Company, Shell, Statoil-Hydro, and Binagadi Oil Company.<sup>100</sup>

## Integrity Mechanisms (law): 50

*To what extent are there mechanisms in place to ensure the integrity of all those acting in the business sector?*

The legal framework to ensure integrity mechanisms in the business sector has a long way to go. Still, the Law on Conflict of Interest, and Law on Whistle-Blowers is yet to be adopted.

Despite it, there is no specific provision to render the punishment for commercial bribes in the business sector. However, Azerbaijan has passed several pieces of anti-corruption legislation, including laws regulating [gifts](#) to civil servants, and administrative relations with private companies. According to Azerbaijan legislation, the receipt by officials of a bribe for illegal actions (inaction) – is punished by imprisonment for the term of from five and up to ten years.<sup>101</sup>

In order to meet this gap in this field, the Ministry of Economy and Industry presented the example of code of conduct to business entities on its website.<sup>102</sup> The Code of Ethics of SOCAR covers conflict of interest, bribery and corruption, good commercial practices, gifts and entertainment policies, and whistle blowing.

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94 Evaluation Table of Local Companies in terms of the application corporate standards, [www.economy.gov.az/](http://www.economy.gov.az/)

95 BP Sustainability Report, 2012, [www.bp.com](http://www.bp.com)

96 Background to Azercell and telecommunications in Azerbaijan, Supporting Children, 2014

[www.teliasonera.com/en/newsroom/news/2012/background-to-azercell-and-telecommunications-in-azerbaijan/](http://www.teliasonera.com/en/newsroom/news/2012/background-to-azercell-and-telecommunications-in-azerbaijan/)

97 Social Responsibility of Pasha Holding, 2014, <http://pasha-holding.az/>

98 Website of Access Bank, [www.accessbank.az/](http://www.accessbank.az/)

99 Interview with Alipasha Qybullayev, chairman of National Productivity and Competitiveness Centre, 3 Feb 2014

100 Most companies are against individual accountability, NGO Coalition held conference on "Improvement of EITI reports" [www.eco-az.org/?p=136](http://www.eco-az.org/?p=136)

101 Criminal Code of Azerbaijani Republic, [e-qanun.az](http://e-qanun.az)

102 Example of Code of Corporate Conduct, 2011, <http://economy.gov.az/>

## Integrity Mechanisms (practice): 25

*To what extent is the integrity of those working in the business sector ensured in practice?*

Corruption is perceived to be the most problematic factor for doing business in the country by companies surveyed for the World Economic Forum's *Global Competitiveness Report 2013-2014*.<sup>103</sup> According to the *Corruption Barometer Index*, one third of all respondents evaluating the sector believed it to be "corrupt/extremely corrupt".<sup>104</sup> These findings suggest that despite measures taken to improve the business climate, corruption still represents a major obstacle to foreign investment and economic development in the country.

Some companies set a good example by having approved "road maps", more exactly policies, to rectify the situation. For example, the State Oil Company of Azerbaijan Republic (SOCAR) has taken the necessary steps according to the "National Strategy on Increasing Transparency and Combating Corruption".<sup>105</sup> SOCAR's policy on anti-corruption and several internal standards – aimed to reduce corruption and enhance transparency – were approved by the order of the President of the Company, dated 10 August 2012. The SOCAR, being the leading state owned company, will hopefully set a pattern for other local businesses to follow.

Civil society also makes its contributions into this sphere. In order to promote the business ethics within the Azerbaijan business community, Transparency Azerbaijan developed the Promoting Business Ethics in Azerbaijan Project. This project included the development of 10 sample draft business ethics codes for different sectors of industry,<sup>106</sup> and a Business Ethics manual for Azerbaijan companies.<sup>107</sup>

## Interest aggregation and representation: 25

*To what extent is the business sector active in engaging the domestic government on anti-corruption?*

In practice the business sector is not active in engaging the domestic government on anti-corruption. There are no known effective examples of such cooperation and there are no known examples of business associations publicly calling on the government to fight corruption.<sup>108</sup>

The National Anti-Corruption Plan for 2012-2015 envisaged improving transparency in the business environment,<sup>109</sup> but the business sector is not represented in the Anti-Corruption Commission.<sup>110</sup>

The legislation in force does not envision protection for those who report cases of corruption in the private sector. In other words, no specific protection is provided to private sector whistleblowers reporting corruption cases other than general security measures for witness protection, prescribed by the Law on State Protection of Persons Participating in Criminal Proceedings.<sup>111</sup>

Despite the fact that there is no law to protect whistle-blowers, the biggest company in the country, SOCAR also established the reporting system about violations of business ethics standards and

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103 World Economic Forum's Global Competitiveness Report 2013-2014, [www3.weforum.org/](http://www3.weforum.org/)

104 Global Corruption Barometer, 2013, [www.transparency.org](http://www.transparency.org)

105 National Strategy on Increasing Transparency and Combating Corruption for 2012-2015, [www.commission.gov.az](http://www.commission.gov.az)

106 Business Ethics codes for 10 Azerbaijan companies, publication by Transparency Azerbaijan, 2005, [www.transparency.az](http://www.transparency.az)

107 Business Ethics Manual, publication by Transparency Azerbaijan, 2004 [www.transparency.az](http://www.transparency.az)

108 Interview with Sabit Bagirov, chairman, Entrepreneurship Development Foundation, board member of Transparency Azerbaijan, dated 4 February 2014

109 National Anti-Corruption Action Plan 2012 – 2015, [www.commission-anticorruption.gov.az/](http://www.commission-anticorruption.gov.az/)

110 Members of Commission on Combating Corruption, [www.commission.gov.az](http://www.commission.gov.az)

111 Law on State Protection of Persons Participating in Criminal Proceedings, 1998, [www.e-qanun.az](http://www.e-qanun.az)

anticorruption requirements via whistleblowing channels (a hotline).<sup>112</sup> This is a good example for public and business companies to develop its internal whistle-blowing channels.

## Anti-corruption commitment: 50

*To what extent does the business sector engage with/provide support to civil society on its task of combating corruption?*

The business sector in Azerbaijan is not engaged with support to civil society in its task of combating corruption.<sup>113</sup> There are no effective examples of joint business/civil society initiatives, where business provides financial support to civil society initiatives seeking to combat corruption.

However, there are some examples that businesses engage with civil society to fulfill anti-corruption commitments. For instance, some local companies have subscribed to the UN Global Compact, which was set up in 2011. Moreover, four local companies (Pasha Insurance, Garant Sigorta, Risk Company and Caspian Technology Company), one bank (Access Bank), and four business associations (National Confederation of Entrepreneurs, Azerbaijan Micro-finance Association, Azerbaijan Turkey Business Association and the Azerbaijan Marketing Society) agreed to support the ten principles of the Global Compact, particularly with respect to human rights, labour, environment and anti-corruption. They also committed to report annually on progress within two years of joining the Global Compact. At the moment, one of them – Caspian Technology Company – has a non-communicating status within the project.<sup>114</sup>

Simultaneously, some companies in the oil and mining industry committed to disclose financial information in the framework of EITI (Extractive Industry Transparency Initiatives) project. Within this project, coalition made up of government, company, and civil society representatives is charged to oversee the EITI implementation in a country. This multi stake group develops the country work plan and publishes the EITI annual report in which companies disclose aggregated tax and other payments, and government discloses what it has received.<sup>115</sup> The publication of their annual report should be prepared on the basis of consensus approach of three parties: government, civil society and companies.

## Recommendations:

- To award business permits and licenses through e-services (e-license).
- To provide license provision services under the centralised agency (ASAN centres).
- To enhance legal framework by accelerating the adoption of the Code of Competitive Conduct, Law on Corporative Law, Law on Social Responsibility, Law on Whistle Blowers and Law on Conflict of Interest.
- To mandate by the law and enforce application of ethics codes and anti-corruption policies in business entities.
- To create an anti-corruption fund that is funded by large business entities.

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112 "The reporting system about violations of business ethics standards and anticorruption requirements of the State Oil Company of the Azerbaijan Republic", 2012, <http://socar.az/>

113 Interview with Sabit Bagirov, chairman, Entrepreneurship Development Foundation, board member of Transparency Azerbaijan, dated 4 February 2014

114 UN Global Compact, Global Compact Launches Local Network in Azerbaijan, [www.unglobalcompact.org/](http://www.unglobalcompact.org/)

115 Extractive Industries Transparency Initiatives, [www.eiti.az/](http://www.eiti.az/)

- To invite large business companies to be corporative members of the NGOs that are involved in anti-corruption activities.
- To create instruments of free legal aid services to small businesses.
- To create a Business Ombudsman institution to protect the interests of small and medium size business entities.