



EU Business Climate Survey Azerbaijan 2016



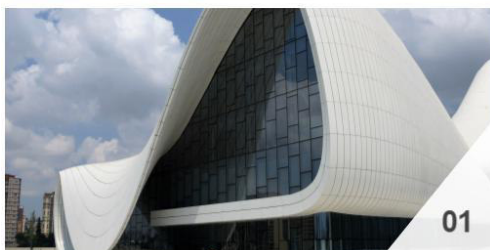
Perceptions of EU Businesses active in Azerbaijan

EU Business Climate Survey Azerbaijan Report 2016

Perceptions of EU Businesses active in Azerbaijan

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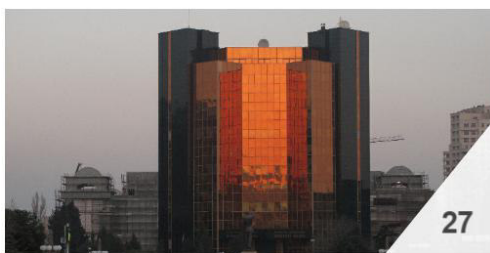
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EU Business Climate Survey Azerbaijan

Tumbling oil prices and consequently shrinking oil bounties have stimulated the Azerbaijani government to introduce and/or accelerate genuine reforms to diversify its economy. Diversification of its economy has, more than ever before, become the overriding economic policy priority of the country. In this context, the timing of this survey soon after the first wave of reforms took place (for instance in the area of customs and licensing) is intriguing.



The present 1st Business Climate Survey Azerbaijan aims to provide unbiased, up-to-date and comprehensive information on the economic situation and investment conditions in the Azerbaijani market and on the business climate in the country as perceived by EU businesses active in Azerbaijan.

The Survey was distributed to more than 300 EU businesses active in Azerbaijan representing 19 EU countries. 100 of them have chosen to respond, which corresponds to a response rate of around 30%. The aggregated findings should therefore be sufficiently representative for the views of EU companies active in Azerbaijan. The survey consisted of mainly two elements, i.e. a questionnaire with nineteen questions and additional structured interviews of 7 selected respondents.

This report was shaped by the valuable insights of CEOs, General Managers and Department Heads, among others, regarding the *current situation and prospects for short-term growth, business environment and investment climate in the country, and their company demographics*. Individual interviews conducted with EU business leaders from major economic sectors in Azerbaijan (energy, consulting, tourism, and construction), served to underpin and further clarify the findings of the questionnaire.

In 2017, following the same methodology¹, the 2nd Business Climate Survey Azerbaijan will be conducted. This will allow for contrasting and comparing the results of both surveys and consequently identifying potential changes from 2016 to 2017, which EU entrepreneurs perceive regarding the business climate in Azerbaijan.

¹ The methodology of the survey is described in Appendix to this report.

Key Report Highlights



of EU businesses active in Azerbaijan believe that the short-term economic growth outlook remains weak

INSIGHTS OF THE EU COMPANIES ON 2016



60%

EXPECT THEIR REVENUES TO DECLINE



47%

PLAN TO IMPLEMENT COST-CUTTING MEASURES



WOULD CHOOSE AZERBAIJAN AS AN INVESTMENT DESTINATION AGAIN

Top 3 factors influencing EU businesses



Devaluation and uncertain market development



Bureaucracy.



Corruption and Customs

Top 3 priorities to be achieved by the government

1

eliminating corruption & ensuring transparency

2

improving tax & custom procedures



3

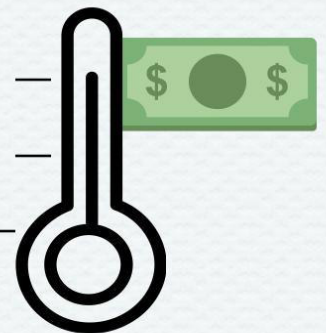
mitigating skill mismatch

Best 3 indicators of the business climate

QUALIFICATION AND PRODUCTIVITY OF EMPLOYEES

POLITICAL AND SOCIAL STABILITY

INFRASTRUCTURE



Next 2 years are not going to be easy, but entrepreneurs are positive about the next 3-5 years and believe that current reforms are likely to bring positive improvements.

02

Recent Structural Reforms

Acceleration of structural reforms has been witnessed since the last quarter 2015. The reforms aim to compensate for diminishing oil revenues by stimulating alternative export-oriented (non-oil) sectors, substituting imports through local production, and by further attracting foreign investments into the country through improvements in business climate.



Suspension of inspections and simplification of licensing procedures to stimulate businesses

Oct
2015

One of the key decrees by the President concerned a “suspension of inspections related to entrepreneurial activities” for two years. As a result, the number of inspections carried out declined significantly, from 19.300 in the first quarter of 2015 to 34 in the same period of 2016 (excluding tax audits).

Another decree signed by the President aims to facilitate doing business, by simplifying the licensing procedure and reducing the number of licensable activities from 56 to 37. Moreover, particularly welcome is the provision of services related to the issuing of business licenses by ASAN services (Azerbaijan Service and Assessment Network)², given that they are countrywide known for eliminating bribery and corruption in the provision of public services.

Liberalization of customs and taxes is a prerequisite to ensure transparency

Jan
2016

To attract investments from abroad, the President signed a decree on *Additional Measures to Promote Investment* modifying tax and customs incentives for investors.

The changes made to the Tax Code, effective from 1 January 2016, aim at simplifying the taxing system in the construction and trade and the catering sectors and introducing a 7-year exemption from paying 50% of the income/profit tax and a full exemption from property tax and land tax. According to the amendments to the Law on Customs Tariffs, investment certificate holders will be exempt for seven years from paying customs duties and value added tax on machinery, technological equipment and devices imported for investment purposes in priority branches (e.g. industrial parks, manufacturing plants, research work).³

² “ASAN” is the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan meaning “easy” in English. It is the Azerbaijani model of service delivery mechanism to render public and private services from one single space.

³ Doing Business in Azerbaijan, 2016, Baker McKenzie

Floating currency and the Financial Supervisory Agency

Feb
2016

After using up a considerable amount of its foreign exchange reserves, Azerbaijan started on 21 December, 2015 stopped pegging its currency to a basket of currencies and moved towards a managed floating exchange rate regime against major international currencies. To stabilize the financial sector and to alleviate uncertainty in the market, the President signed another decree establishing the Financial Supervisory Agency which has taken over a number of responsibilities from the Central Bank of Azerbaijan, while consolidating the banking sector. Furthermore, the Azerbaijani Deposit Insurance Fund now insures all eligible deposits, regardless of the amount, for a period of three years.

Yet another step towards improving transparency and the legal framework for appeals of physical and legal persons engaged in business activities has been the establishment of the Board of Appeal under the President of Azerbaijan.

Additional measures to stimulate the export of non-oil products

Mar
2015

As early as December 2012, the President signed a decree approving the development concept "Azerbaijan 2020: vision to future". This document foresees the stimulation of local production and the adoption of an export-oriented economic model.

A decree foresees to maintain growth in the non-oil sectors by expanding their export capabilities and by providing export incentives with funds from the state budget in the years 2017-2020. In this context, the government signals further investments into infrastructure, transport corridors and logistics facilities in the country to prompt trade all the way from Northern Europe to Southeast Asia.⁴

Finally, it should be noted that in March 2016 a working group has been established by Presidential decree that is to advise the President of Azerbaijan on a "strategic roadmap for main directions of economic reforms". The working group supported by McKinsey consultants-is to develop a strategy for economic diversification in the period 2016-2020, a strategic plan covering the years up to 2025, and a vision for the post 2025 era.

⁴A major project is the East-West or the Trans-Caspian transport corridor, which is supposed to connect China with Europe via the territories of Kazakhstan, Azerbaijan and Georgia. In addition to that, the North-South international transport project will connect railways of Russia, Azerbaijan and Iran by reducing the delivery time twofold. The construction of the Alat international Sea Port is pending and introduction of the "free economic zone" is in the government's agenda.

03

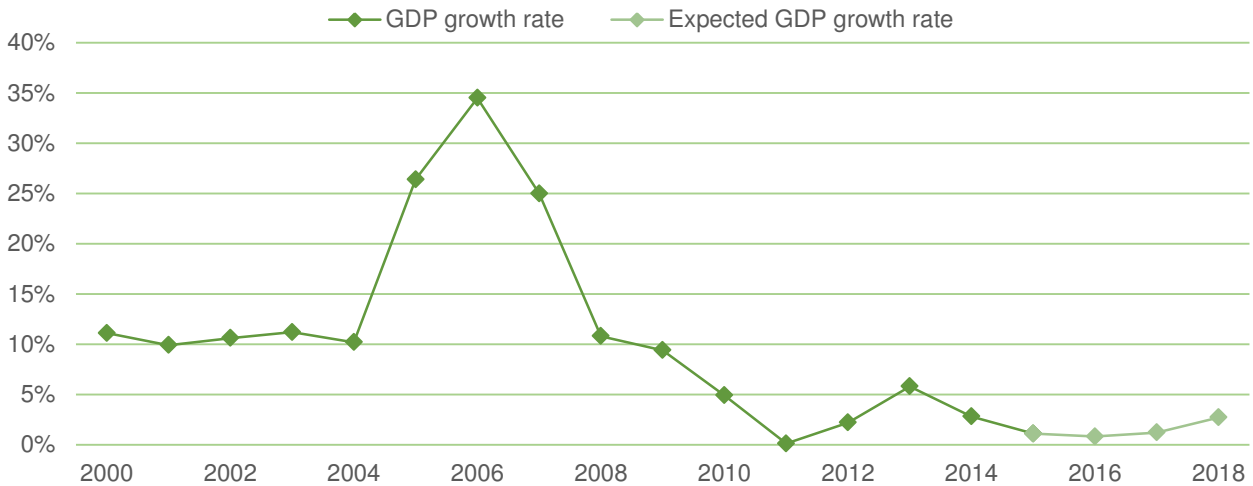
Azerbaijani Economy in the wake of falling oil prices

Sustained low oil prices (oil and gas account for 86% of exports in Azerbaijan), downward pressure on the exchange rate and adverse spillovers from Russia⁵ have limited the scope for further accommodative monetary policy and have intensified domestic challenges. A key policy challenge for the government is to bring the country on a more sustainable economic path through the transformation of its economic growth model led by the private sector.

⁵ Exports to Russia account for about half of Azerbaijan's non-oil exports while remittances from Russia constitute approximately 1 billion USD a year (World Bank Group, 2016, Global Economic Prospects, p.95)

Following substantial GDP growth over the last decade, declining oil prices have had a major bearing on Azerbaijan’s growth prospects. The World Bank forecasts GDP growth of Azerbaijan to be weaker in 2016. Looking forward, GDP is projected to pick up, albeit at a considerably slower pace, reaching 2.7% in 2018. Progress is already being made in shifting the focus from the oil-based economic growth into the non-oil based long-term growth and thus promoting a sustainable economic diversification.

Figure 3.1: GDP growth rate of Azerbaijan (%)



Source: World Bank Group, 2016

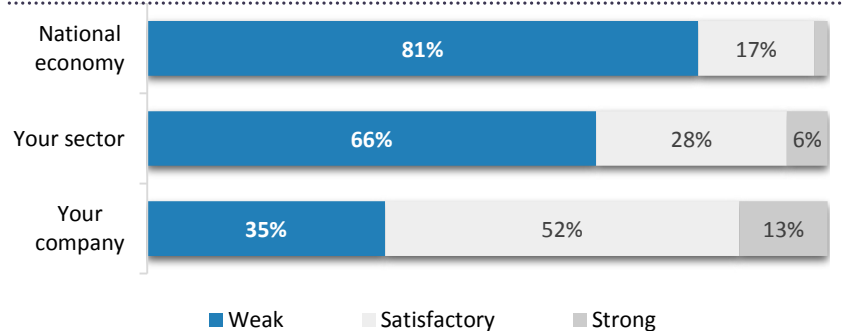
Current Economic Situation

While the above describes the more general economic situation of Azerbaijan, here comes the view of EU companies in Azerbaijan who participated in the 2016 survey. A majority of respondents assess the current situation of the Azerbaijani economy as weak.

This outcome was well anticipated given a series of negative developments in the world markets linked to the rapid decline of oil prices since July 2015.

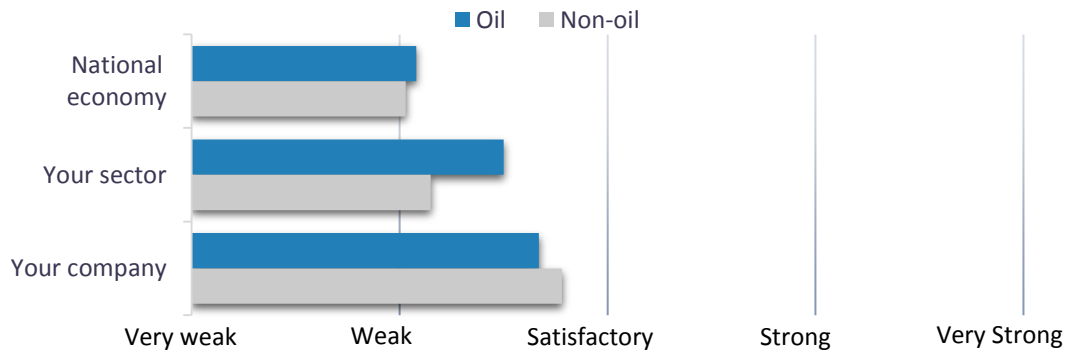
Only 35% describe the current situation in their respective sectors as satisfactory or strong whereas half of respondents feel confident about the current performance of their own companies.

Figure 3.2: How do you rate the current situation?



The same remains true if both oil and non-oil sectors are looked at separately.

Figure 3.3: Assessment of the current situation: Oil vs. non-oil companies



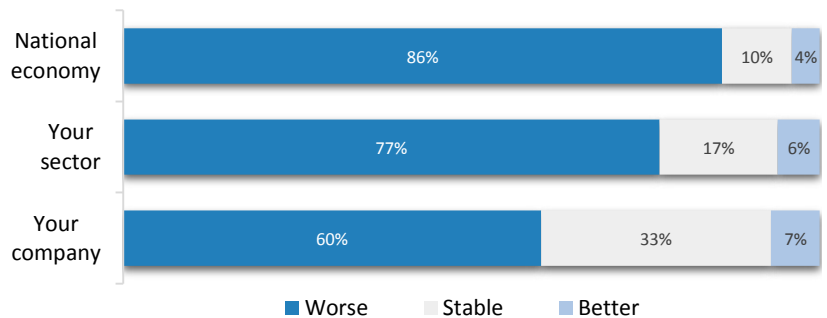
The findings explicitly indicate that, respondents have a more favorable view of their own businesses than of the national economy and their respective sectors. The same tendency was also apparent in another business climate survey conducted in 16 Central and Eastern European countries (CEE Business Survey 2015) by the German-Hungarian Chamber of Commerce and Industry. It can be assumed that the technologies, financial resources and international experience of the EU companies, which were subject to this survey, sustain their competitiveness considerably when compared to local Azerbaijani companies, who seem to suffer more significantly. Hence, the EU businesses' perception of their own competence and performance is relatively positive.

Economic Prospects for 2016

The EU companies were also asked about their view on economic prospects for the year 2016.

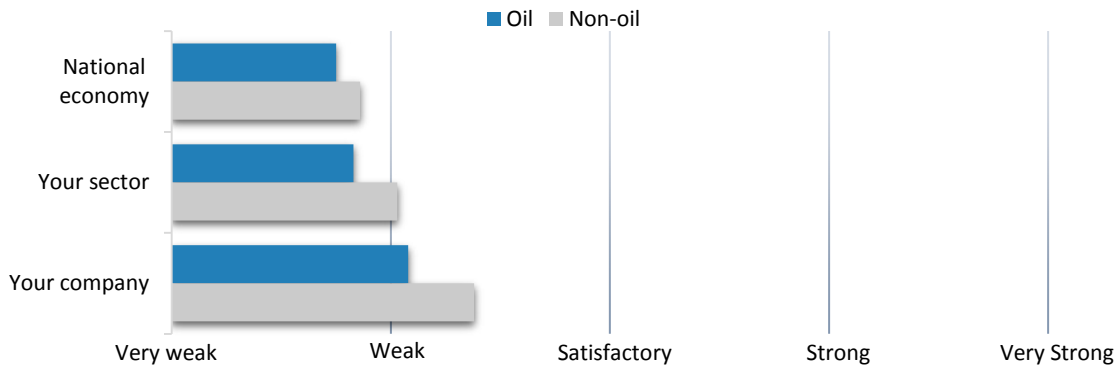
The results of the survey suggest a remarkably pessimistic outlook for the national economy as well as for the sectors to which the EU companies belong. And also here, the respondents' expectations on their own companies in 2016 are somewhat better.

Figure 3.4: How do you assess the prospects in 2016?



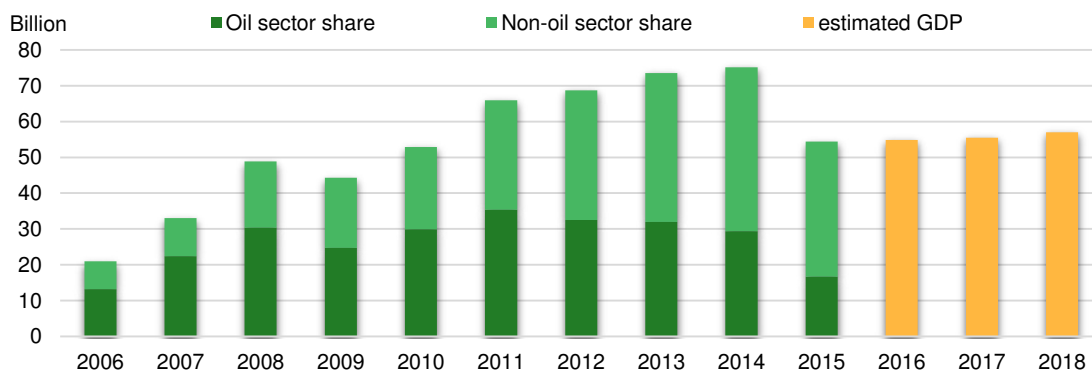
These views are consistent across oil and non-oil companies.

Figure 3.5: Economic prospects for 2016: Oil vs. non-oil companies



The negative outlooks are partly in line with the views of the government and certain international organisations for 2016 and evidently can be explained with the vulnerability of the current economic situation in the country and the intriguing timing of the survey with Azerbaijan being at a critical economic juncture.

Figure 3.6: Total GDP at market prices (current USD)



Source: Central Bank of Azerbaijan and World Bank Group, 2016

“Azerbaijan has certainly taken a good fiscal approach, is reassessing spending, is really trying to restore its position, and it is also using the exchange rate as a buffer.”

Christine Lagarde, The Managing Director of the IMF (February, 2016)

Following the fall in oil prices in 2015, the Azerbaijani government introduced several structural reforms with a significant focus on eliminating key impediments to growth of the non-oil sector in the country.⁶ Thus, given a current favourable environment to improve its business climate and investment conditions in Azerbaijan, the foremost task should be ensuring the implementation of the

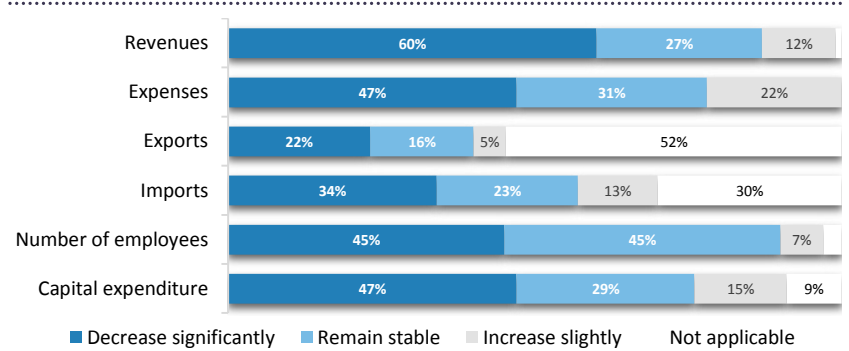
⁶ Please refer to the second chapter of this report.

announced structural reforms, while designing and implementing a roadmap for short-term, medium term and long-term reforms.

Key Performance Indicators of the companies

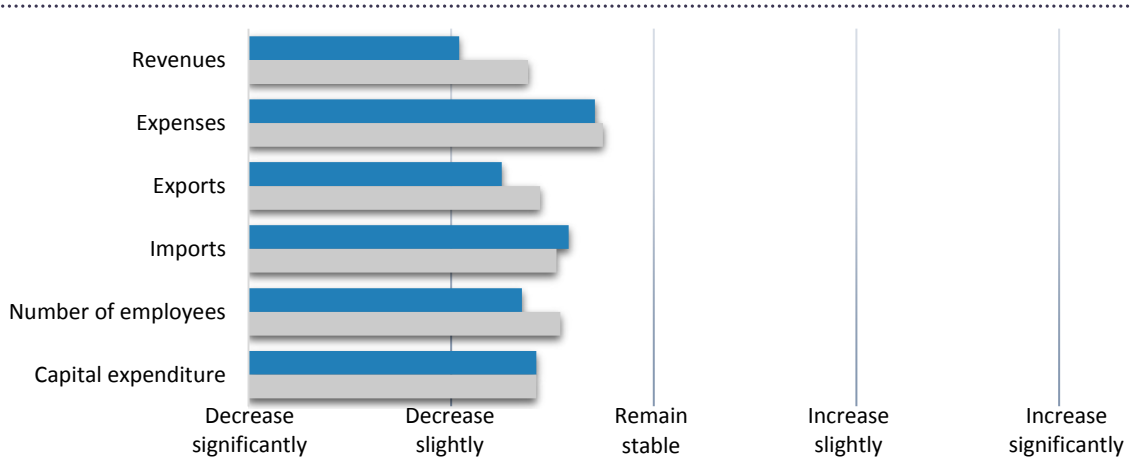
Clearly, the expectations of EU companies in Azerbaijan on their own performance are also influenced by the uncertainty about future economic developments. As the engines driving the revenues stop functioning, the businesses are using every opportunity to cut down their expenses.

Figure 3.7: How do you expect your company to perform in 2016?



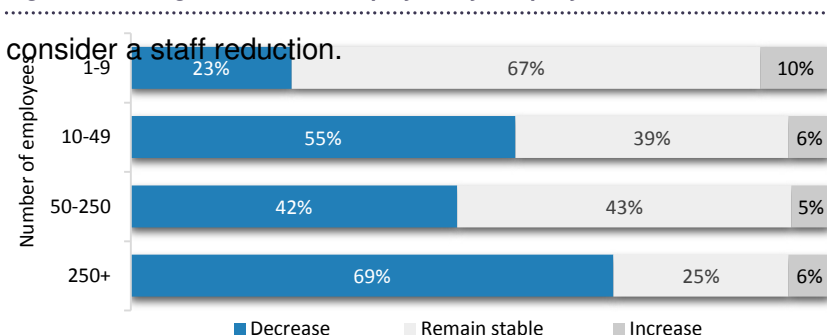
Overall, the respondents are pessimistic about the prospects of their own company’s growth in 2016. 60% of the EU companies active in Azerbaijan believe that their revenues will shrink in 2016, and 45% consider a staff reduction. 63 % and 59% of the companies representing the oil sector and non-oil sectors respectively think that their revenues will decline. These findings hold true across all companies independent on their respective sizes.

Figure 3.8: Expectation of key performance indicators: Oil vs. non-oil companies



If we analyse the change in the number of employees by company size, 67% of micro enterprises (up to 9 employees) expect their number of staff to remain stable, whereas 55% of small enterprises (up to 49)

Figure 3.9: Change in number of employees by company size



“We are not planning any local lay-offs, but the recruitment of new staff is frozen”

Vice-President from a company in the oil and gas sector

52% of respondents state that they are not involved in exports, and 30% do not import. Nevertheless, half of all exporting companies believe that their exports will drop and imports will dwindle. While the volume of exports to the EU (see figure below) has been declining recently largely as a result of lower oil prices, the EU remains by far Azerbaijan's biggest export and import market with respectively 53 % and 34% share in total Azerbaijan's exports and imports.⁷ Top three EU importers from Azerbaijan are Italy, Germany and France.

Figure 3.10: Share of EU imports from Azerbaijan

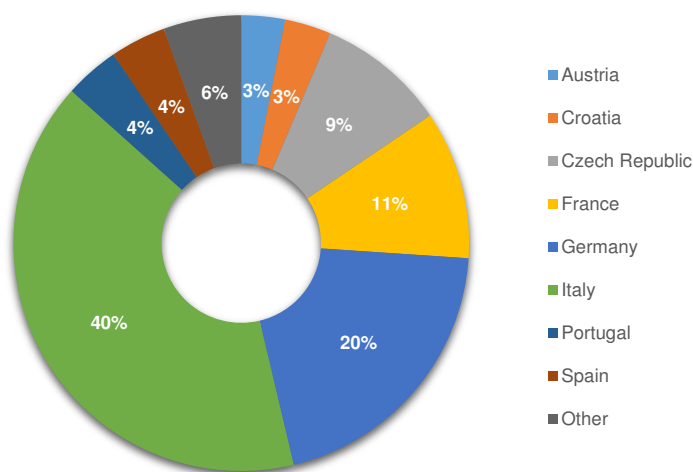
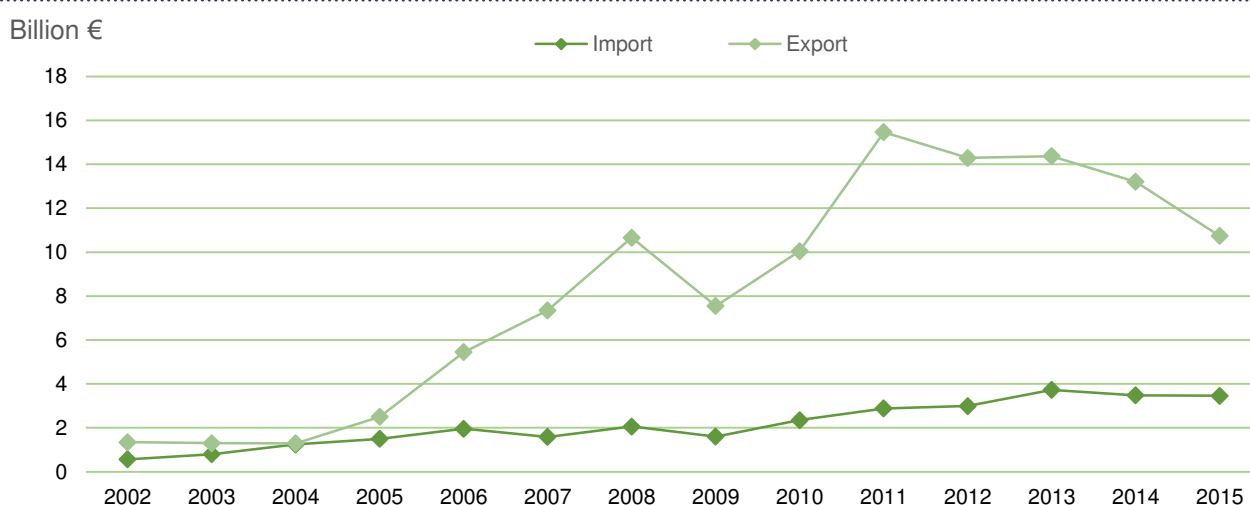


Figure 3.11: Azerbaijan's trade with EU countries



Source: EU Commission, 2016

⁷ EU-Azerbaijan Fact Sheet, Brussels, 2016

04

Business and Investment Climate in Azerbaijan

The actual environment in which businesses need to operate, are decisive considerations while making investment decisions. The survey aims to capture the view of EU businesses active in Azerbaijan with regard to three important dimensions: conditions in the labour market, the operational business environment and economic policies and institutions.



Conditions in the labour market



In our survey the proxy indicators for labour market conditions are *qualification and skills of employees, commitment and productivity of employees, labour costs, availability of skilled workers, labour law, quality and relevance of academic education and vocational training, flexibility of immigration policies.*

Operational business environment



This section includes factors directly affecting the production process or activities of the companies, such as *infrastructure, payment discipline, access to capital, local suppliers, conditions for Research and Development (R&D).*

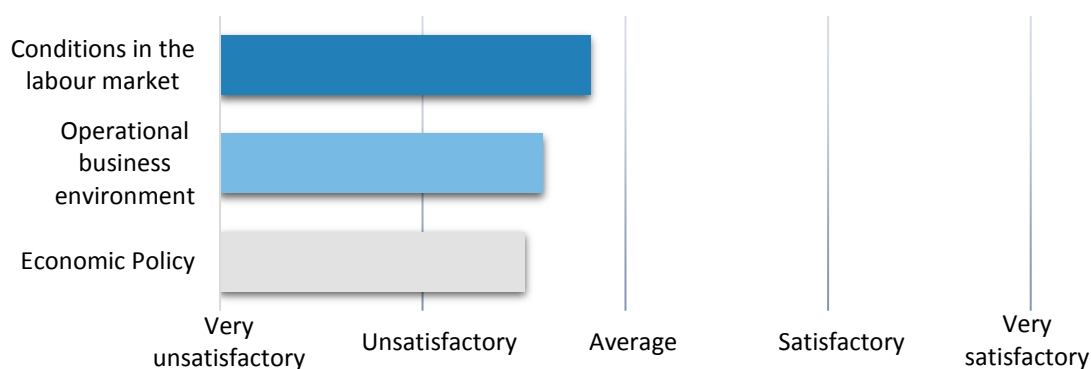
Economic policies and institutions



These are the conditions that are directly provided by the state: *political and social stability, public administration, tax burden, predictability of economic stability, legal certainty, taxation policy and authorities, access to public funds, measures to eliminate corruption, customs procedures, transparency of public procurement.*

When assessing the business climate, the EU companies active in Azerbaijan rate the conditions in the labour market and operational environment slightly better than the economic policies.

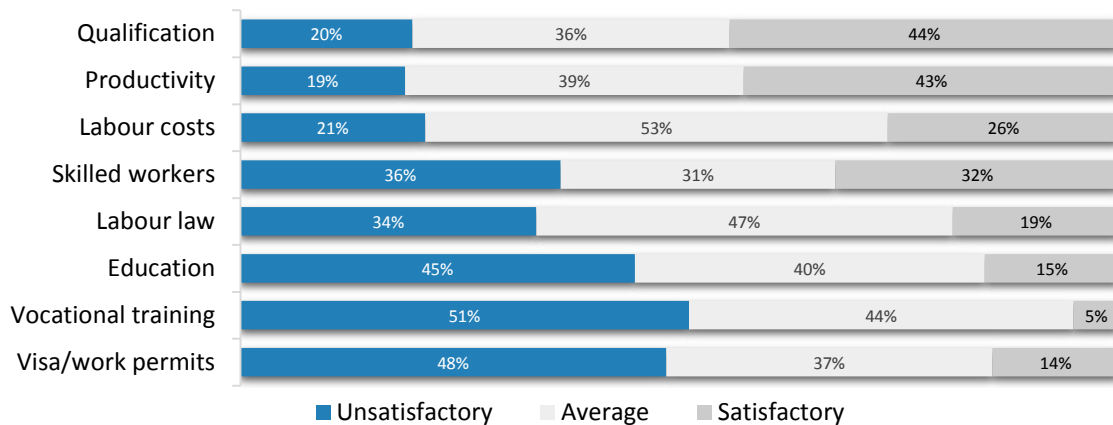
Figure 4.1: Average rating of the local business climate indicators



Conditions in the labour market

Certainly, labour law or labour costs are not the only factors for an entrepreneur when taking investment decisions, but the availability of (affordable) qualified professionals does play a role. Of all labour market indicators, vocational training received the lowest rating from EU entrepreneurs, whereas qualification of employees is rated best, between “average” and “satisfactory”.

Figure 4.2: How do you rate the following local indicators?



The quality of labour supply depends mainly on qualifications and skills of the workforce. 44% of respondents believe that the qualification of employees is satisfactory. As the figure above also suggests, the qualification and the productivity of employees are rated similarly.

Average monthly wages in Azerbaijan tripled in the last ten years, subsequently raising the cost of labour. In addition, following a new law adopted in May 2010, all employers have to insure their employees against occupational accidents and diseases. Although labour costs have thus consistently increased (in AZN terms) during the last six years, more than half of respondents rate labour costs as

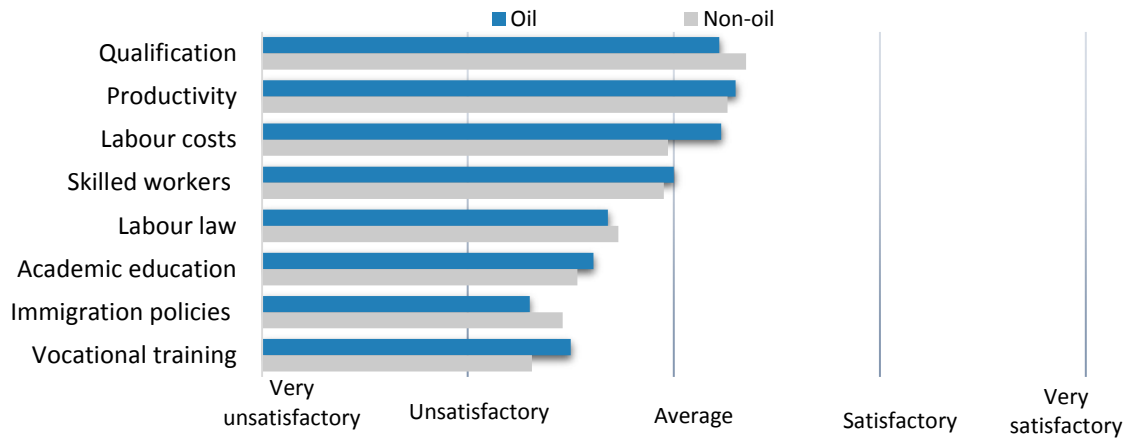
Figure 4.3: Average monthly wages



Source: World Bank Group, 2016

Interestingly, compared to their peers in the non-oil sector with current labour costs in the market than their peers in the non-oil sector.

Figure 4.4: Conditions in the labour market: Oil vs. non-oil companies



The education system in Azerbaijan needs serious reforms

Neither the quality of academic education nor the vocational education and training system comply with the expectations of respondents. A recent decree by the President (dated April 22, 2016) establishing the State Agency for Vocational Education and Training (VET) under the Ministry of Education signals that the government deems the modernisation of its VET system and the supply of a skilled workforce as one of its priorities.

Considering that the satisfaction rate with the availability of skilled workers is merely 32%, the local education and training system requires a comprehensive approach and profound reforms in the near future. On the one hand, this includes legislative and institutional improvements; on the other hand, the attitude of the population towards vocational training also needs to change.

Inflexible immigration policies may impede foreign investments

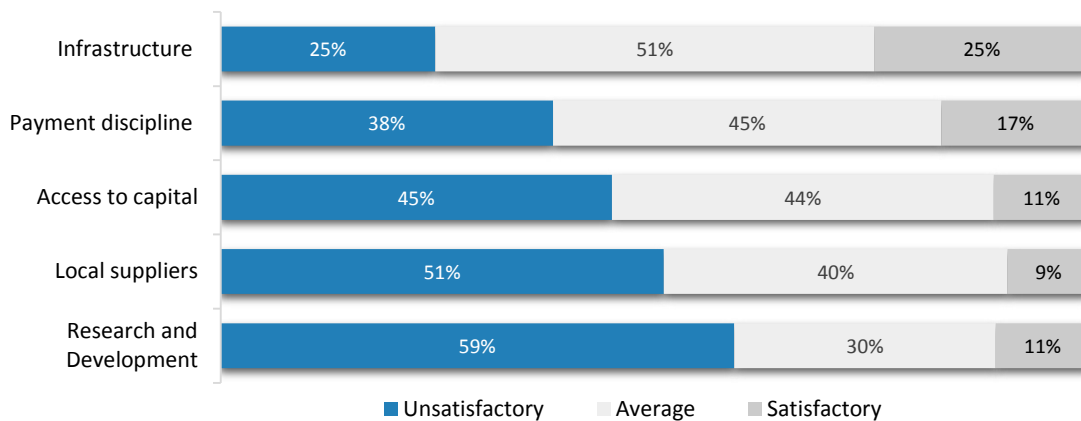
Foreign employees working in Azerbaijan (except those who have an employment contract with a legal entity of a foreign country and fulfil their labour duties in a branch or representative office)⁸ are subject to the Azerbaijani labour law; and they asses it mainly as average. In this context, half of respondents are dissatisfied with immigration policies, which refers to visa regulations and work permits for foreigners. As also emphasized during the interviews with selected EU business leaders, this is one of the main barriers to conducting effective business operations in Azerbaijan.

⁸ Baker McKenzie, Doing Business in Azerbaijan, 2016

Operational business environment

Development of the domestic supply landscape and infrastructure should be one of the top priorities of the economic policy and it is obviously in the interest of international companies working in Azerbaijan. EU businesses operating in Azerbaijan consider the operational environment to be below average. Infrastructure receives the most positive rating, whereas conditions for R&D are considered worst.

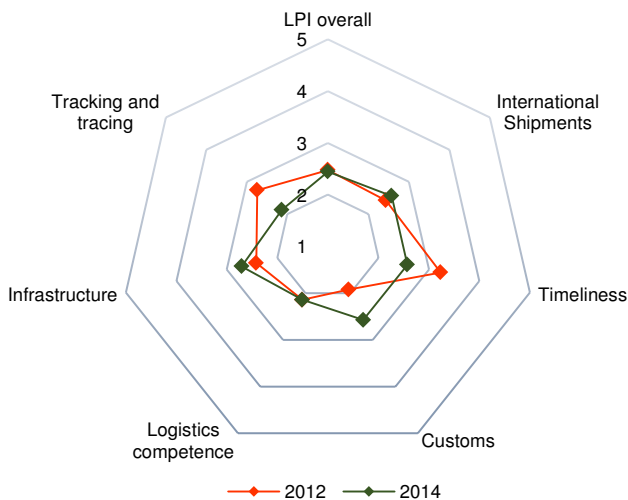
Figure 4.5: How do you rate the following business climate indicators?



Good infrastructure fosters competitiveness

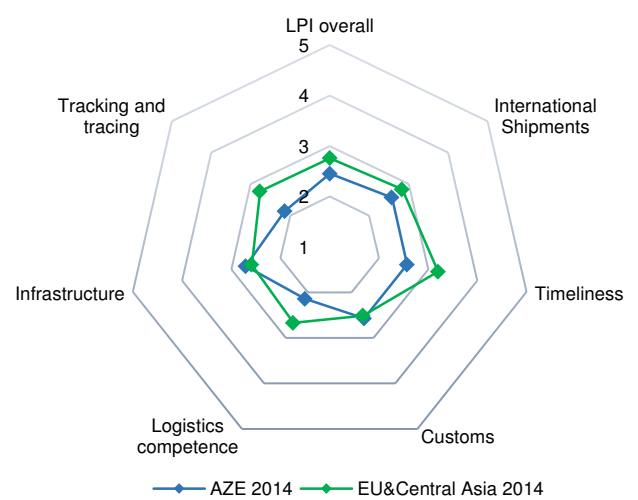
Statistics from the World Bank suggest that infrastructure in Azerbaijan has evolved in the recent years and largely corresponds with the EU and Central Asia.

Figure 4.6: Logistic Performance Index 2014



Source: www.lpi.worldbank.org

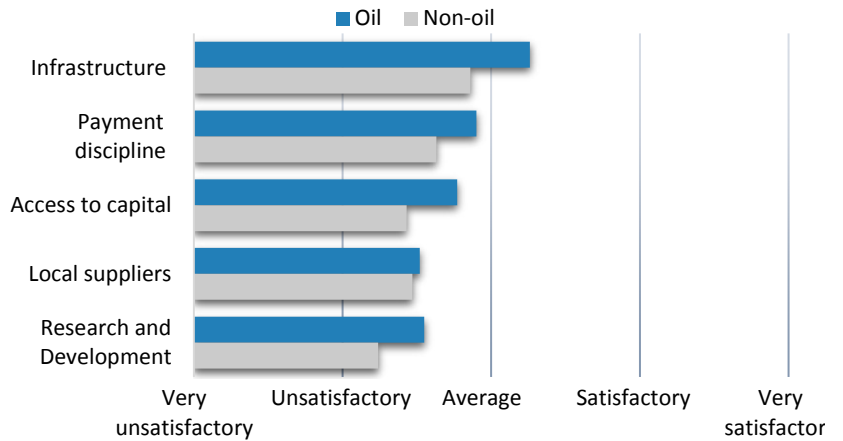
Figure 4.7: Logistic Performance Index 2014 (AZE vs. EU & Central Asia)



Source: www.lpi.worldbank.org

Overall 76% of respondents evaluate infrastructure as average or above. Given the importance of the oil and gas sector in Azerbaijan and the associated huge long-term capital investments into infrastructure, it is not surprising that the oil companies seem more satisfied with infrastructure than the non-oil businesses operating in Azerbaijan.

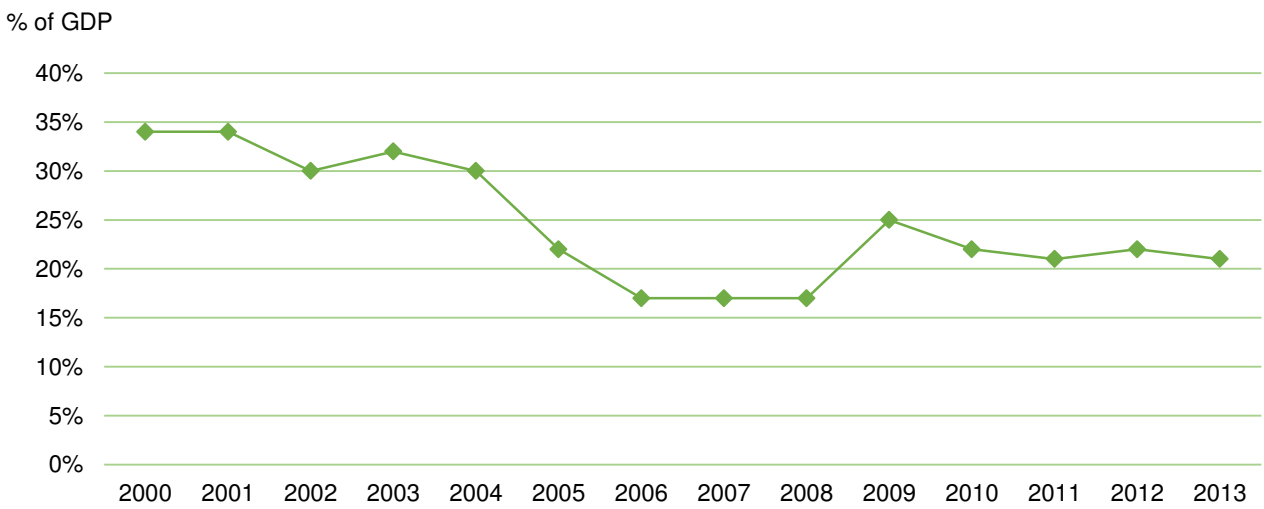
Figure 4.8: Operational business environment: Oil vs. non-oil companies



Half of respondents are dissatisfied with the quality and availability of local suppliers and 45% indicate payment discipline as average. 45% of EU businesses seem to encounter barriers in accessing capital in Azerbaijan.

As Figure 4.9 depicts, the percentage of GDP spent on R&D has dropped consistently since the start of the century. Therefore, it does not come as a surprise to observe that 59% of entrepreneurs are dissatisfied with the conditions for R&D.

Figure 4.9: R&D expenditure (% of GDP) in Azerbaijan

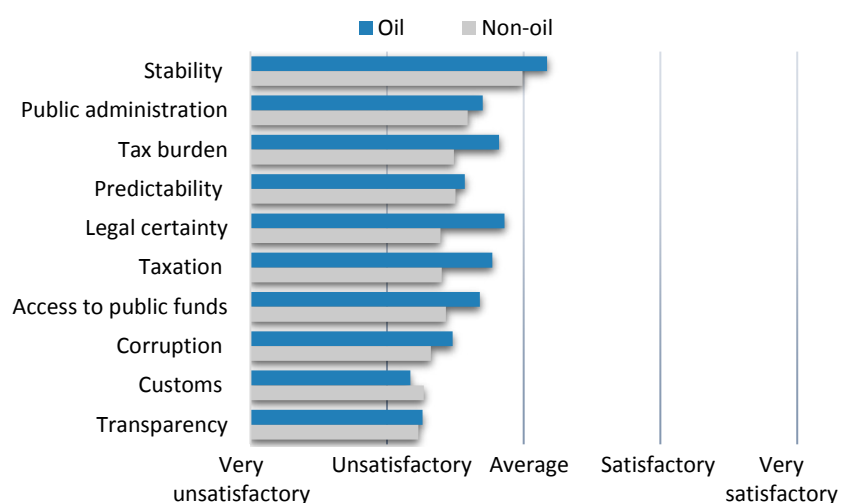


Source: <http://www.tradingeconomics.com/azerbaijan/research-and-development-expenditure-percent-of-gdp-wb-data.html>

Economic policies

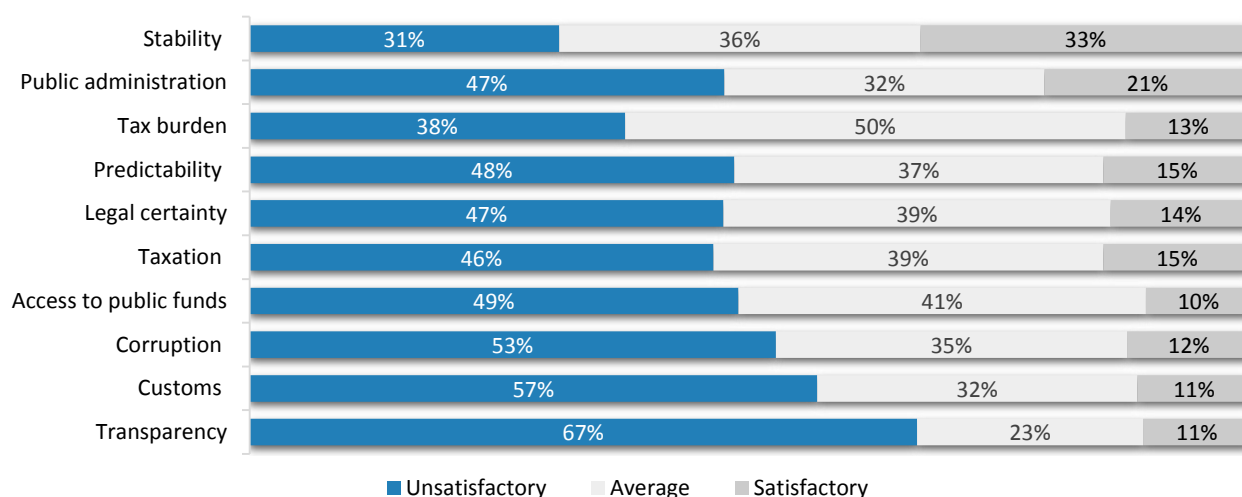
Economic policies affect the economic viability of a company not only directly through, for instance, taxation policies, but also indirectly through the quality of the public administration, legal certainty and transparency. Clearly, well-functioning institutions and economic policies are prerequisites for promoting investment inflows into the country. In general, oil companies feel more confident about the economic policies compared to their peers from the non-oil sector.

Figure 4.10: Economic policies: Oil vs. non-oil companies



Political and social stability stands out as the best-rated indicator in this category, and the third-best rated among all local indicators of the business environment following qualification/productivity of employees and infrastructure.

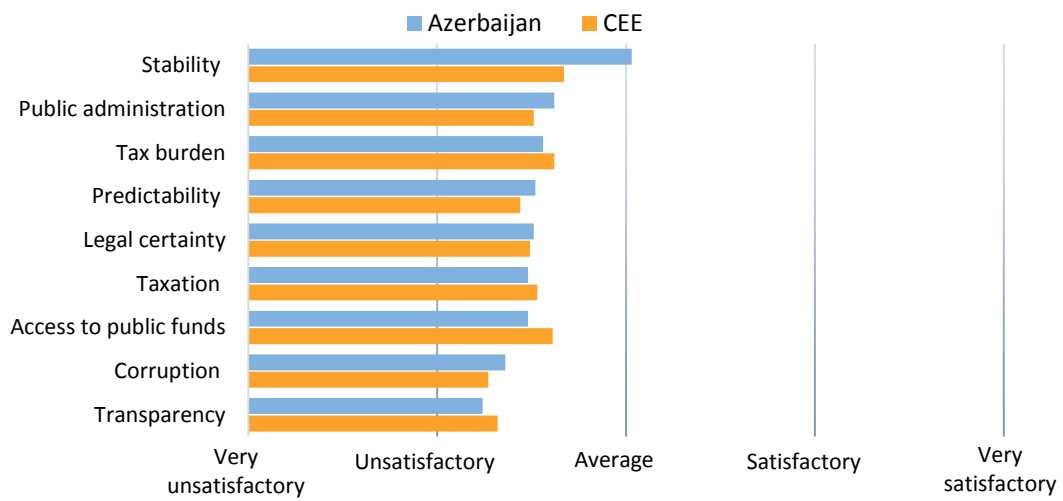
Figure 4.11: How do you rate the following institutional indicators?



Almost half of all respondents express concern about the level of legal certainty and about the predictability of economic stability. Similarly, they indicate that the current public administration is ineffective.

In general, economic policies and institutions received a relatively lower average rating than the conditions in the labour market and the operational business environment. This is very similar to the perceptions EU businesses had in a similar survey in the Central and Eastern European region.

Figure 4.12: Economic policy indicators: Azerbaijan vs. CEE

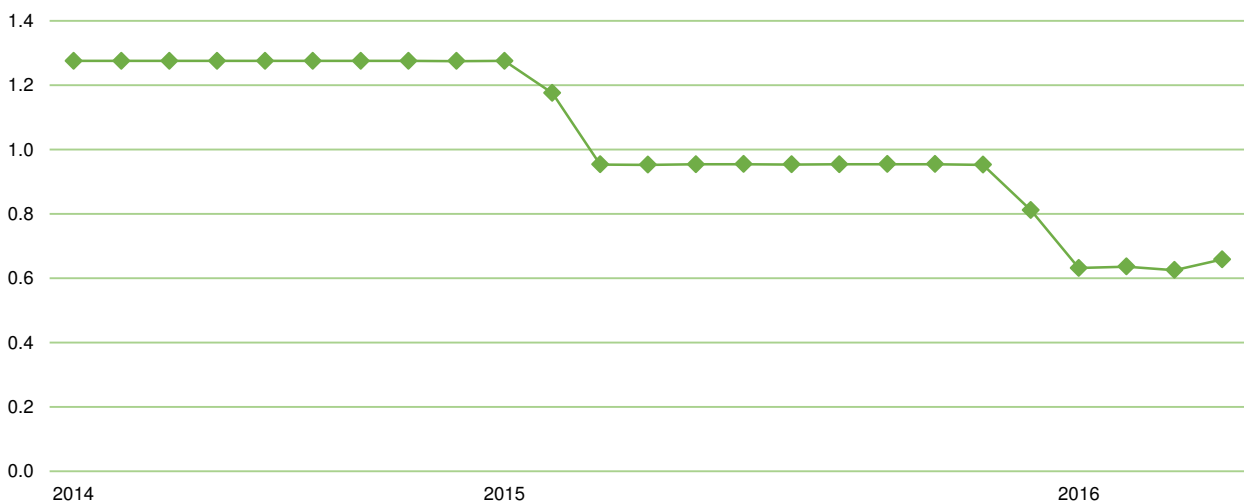


Ranking of the economic and political conditions affecting the companies

The surveyed EU companies were also asked to rank unfavourable economic conditions that they were affected by. The top three cited factors having the greatest impact on the EU businesses appear to be devaluation, an uncertain market development and the bureaucracy.

Confronted with an intensification of long lasting external economic shocks, the Central Bank of Azerbaijan decided to adopt a managed exchange rate regime starting 21 December, 2015. This has consequently triggered a depreciation of the national currency by almost 50% vis-à-vis the US Dollar from the first devaluation in February 2015 to the second one in December 2015. Given that imports are still to be paid with US Dollars, prices in local currency for imported goods shot up almost simultaneously, thereby leading to an increased inflationary pressure predicted to reach 12% in 2016. Not surprisingly, 70% of EU companies indicate that devaluation affects their businesses the most.

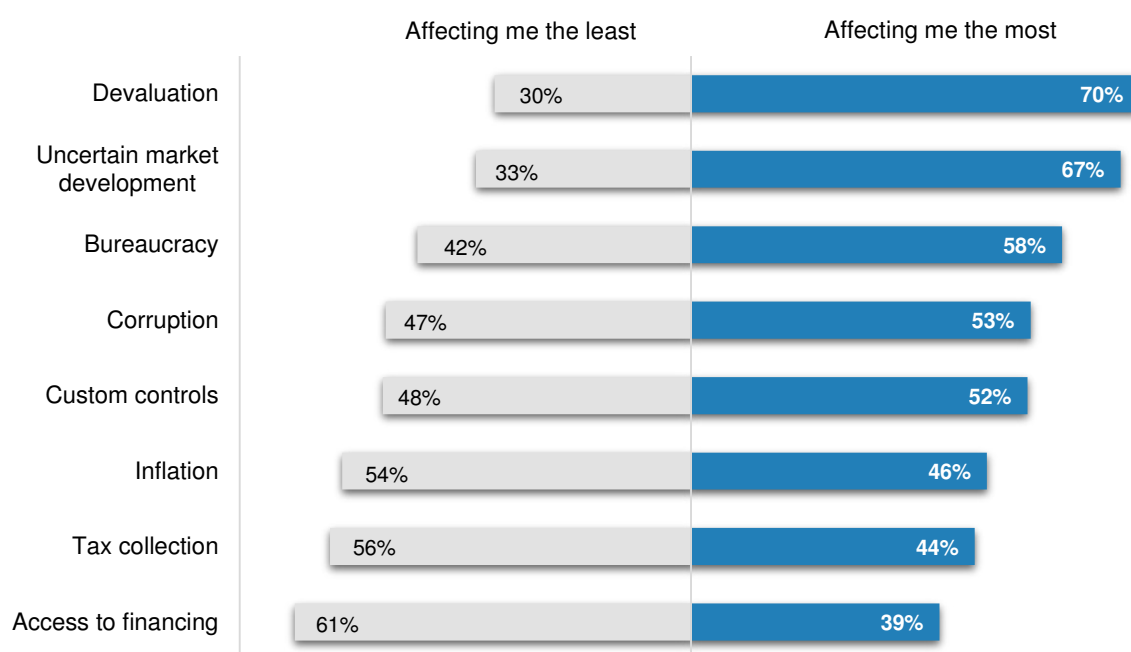
Figure 4.13: Exchange Rate (AZN vis-à-vis USD)



Source: World Bank Group, 2016

After the indicators devaluation, uncertain market development and bureaucracy, over half of survey participants identify corruption and customs controls as indicators affecting their business operations the most. It is worth mentioning that most of the respondents cite eliminating corruption as “one specific change” required to facilitate doing business and improving the investment climate in Azerbaijan.

Figure 4.14: Ranking of the unfavourable conditions affecting the companies

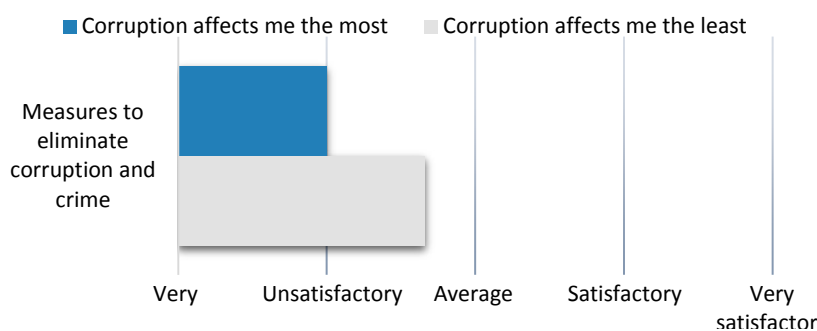


Corruption and transparency stand out negatively in tandem with taxation and customs procedures

Corruption creates additional costs and impedes doing business to a considerable extent. Considering that public procurement is particularly vulnerable to corruption, the survey findings from these two phenomena should not come as a surprise.

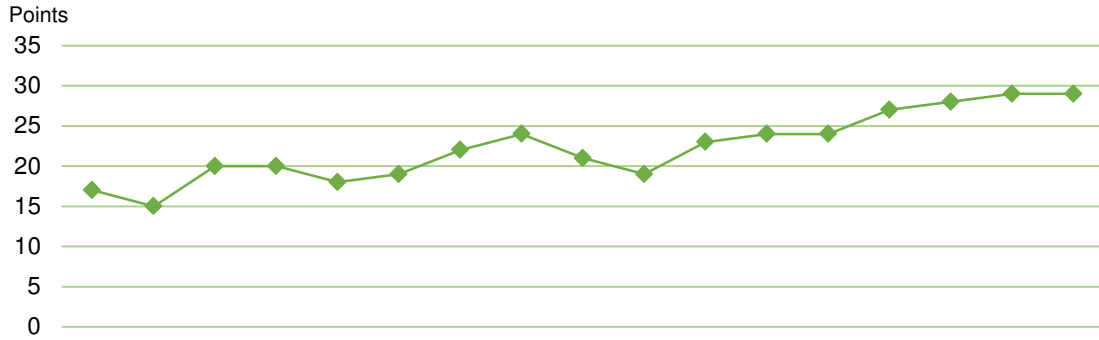
Although the Corruption Perception Index for Azerbaijan has gradually improved since 2008 (see figure below), particularly companies that were strongly affected by corruption think that the measures taken to eliminate corruption and crime are currently ineffective.

Figure 4.15: Rating of measures to eliminate corruption depending on the impact of corruption



Laws and regulations aiming to combat corruption need to be effectively enforced to alleviate this widely discussed barrier to business operations in the country.

Figure 4.16: Corruption Perception Index, 2015



Compared with 1999 Central and Eastern Europe where a similar survey was carried out in 2015, it is worth noting that corruption also there has been a challenge for many years with increased discontent of EU businesses active in the 13 Central and Eastern European countries in question. ⁹

⁹ AHK Survey Report Central and Eastern Europe, 2015

Taxes policies (and enforcement) are one of the main instruments when it comes attract a foreign capital into the country. 46% of respondents consider the taxation policy in Azerbaijan as unsatisfactory, while exactly half of them evaluate the tax burden as average. Interestingly, those who emphasize tax collection as the factor affecting their operations in Azerbaijan the most, feel more discontented with the taxation policies.

A similar tendency can be observed for customs, where the level of satisfaction is somewhat worse than that for taxes. The first feedback received since the introduction of reforms early 2016 suggests improvements in transparency of custom procedures. On the other hand, some comments point to the still existing artificial barriers, as for instance requests for unnecessary documentation.

Figure 4.17: Rating of taxation policies depending on the impact of taxes

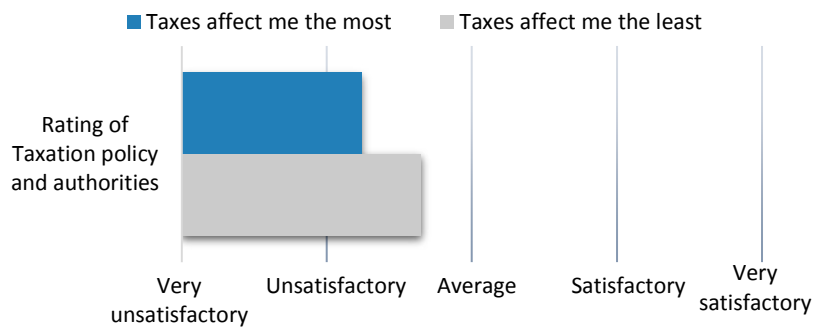
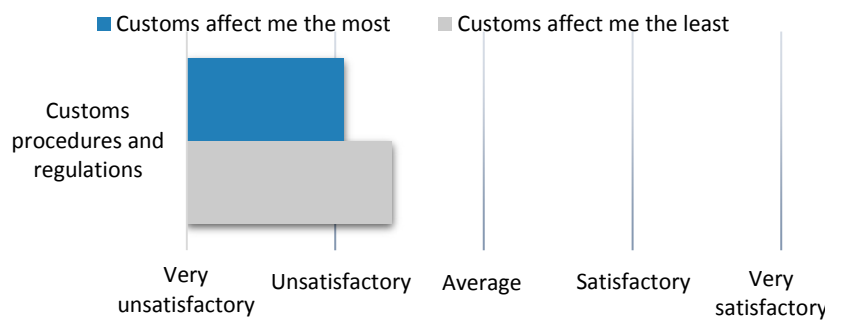


Figure 4.18: Rating of customs procedures depending on the impact of customs



“Customs became transparent starting from January 2016. They, however, demand additional papers which are not essential. It is time for the taxes to ease the procedures and to be totally transparent to reach the European level”

Anonym

It is noteworthy that, the comments from respondents to the questionnaire as well as the individual interviewees representing some prominent EU companies were very constructive in that they consider ongoing structural reforms to be truly promising. They believe that if the governmental bodies and local authorities will be capable of implementing and enforcing existing legislations, significant progress will be made.

05

Azerbaijan as an Investment Destination

The trend of declining non-oil investments would need to be addressed by taking structural reform measures that would transform the economy into a private sector led growth model.



The share of investment inflows as percentage of the GDP of the country climbed to record highs in the early 2000s and was predominantly driven by the seminal energy projects of Azerbaijan in partnership with the international oil giants. In the first three quarters of 2014, the stock of foreign direct investment (FDI) in the Azerbaijani economy amounted to \$5.8 billion and 85% of these investments were intended for the oil and gas sectors.¹⁰

Figure 5.1: FDI in % of GDP of Azerbaijan

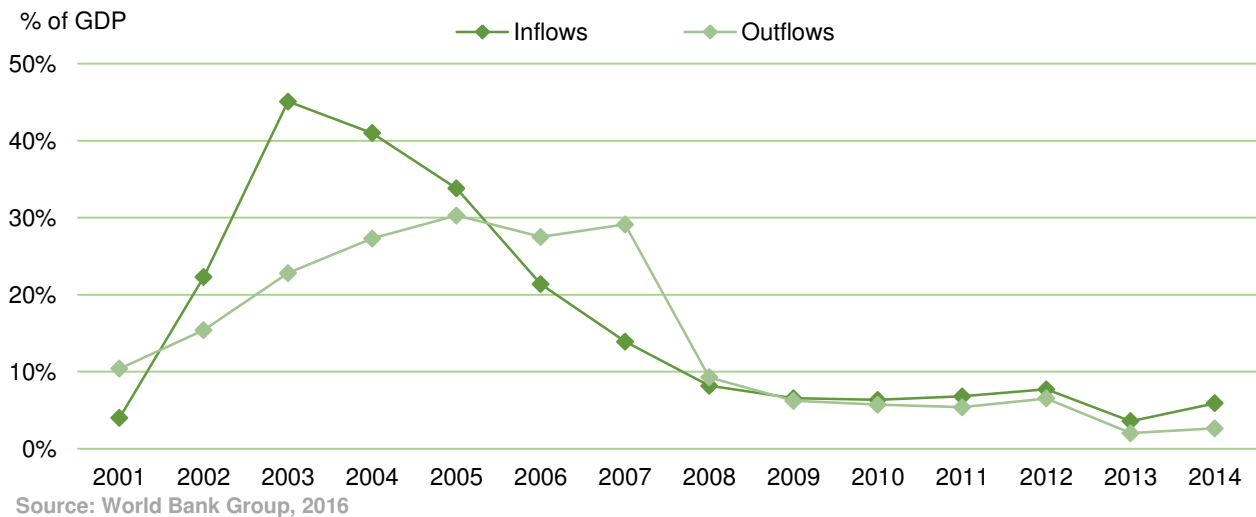
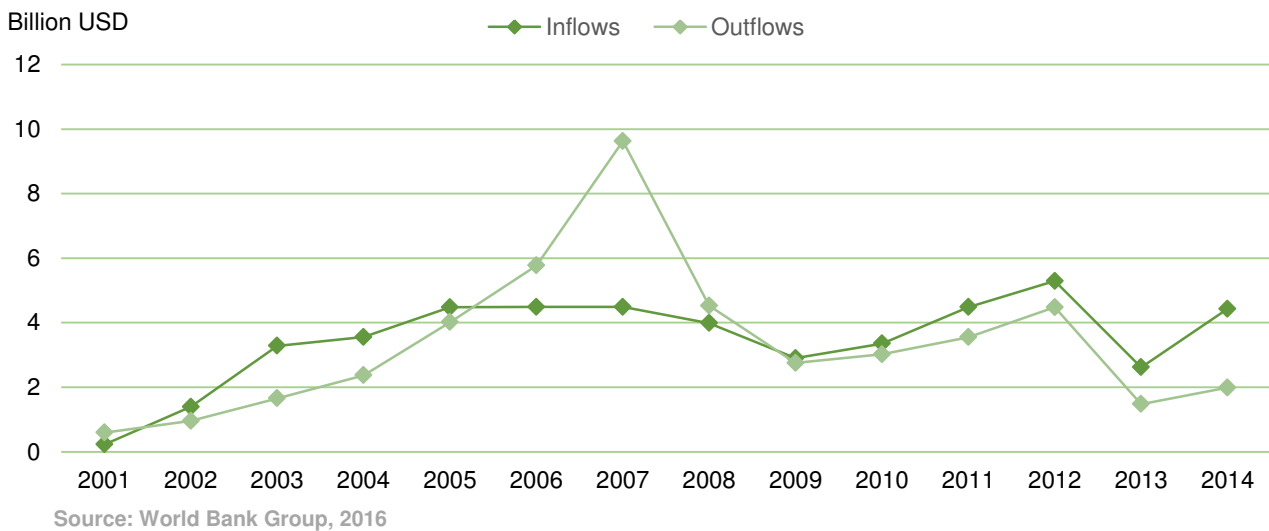


Figure 5.2: FDI in Billion USD, Azerbaijan



¹⁰ Doing Business in Azerbaijan, 2015, PWC

Would you again invest in Azerbaijan?

There are a number of attributes attracting investments into a country. The most important ones are the availability of skilled labour, favourable taxes and subsidies, access to financing and natural resources. Albeit visible concerns about the growth prospects, 40% of respondents state that, they would choose Azerbaijan as an investment location again, whereas 20% remain undecided.

The oil and gas sector in Azerbaijan appears to have taken advantage of more favourable investment conditions through the Production Sharing Agreements and important tax exemptions thus far. This leads to a more positive perception of Azerbaijan among these companies than among companies belonging to non-oil sectors.

Weak growth prospects have heavily weighed on investment perceptions of companies representing the non-oil sectors, 43% of which would not invest in Azerbaijan again.

Figure 5.3: Azerbaijan as an investment destination for oil companies

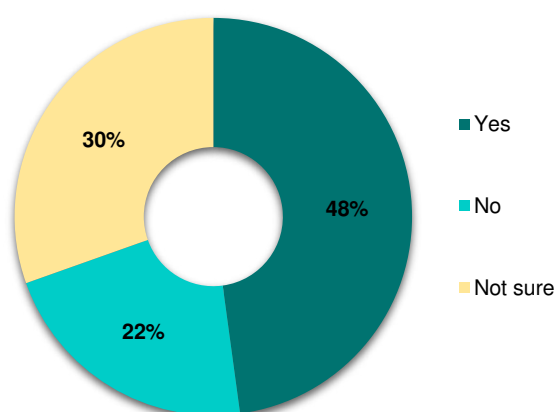
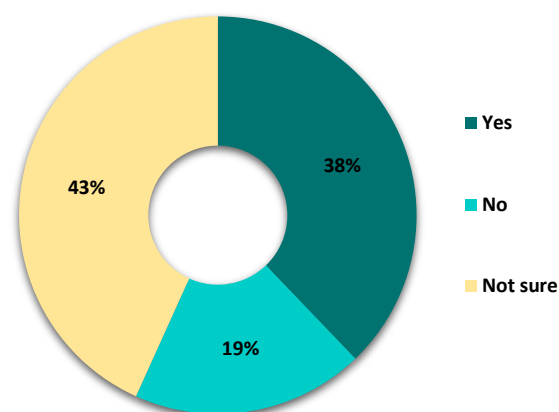


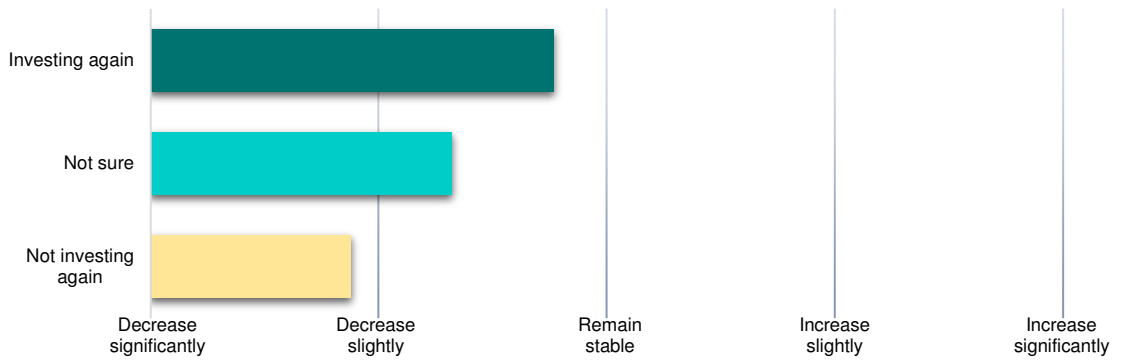
Figure 5.4: Azerbaijan as an investment destination for non-oil companies



Companies from the EU are key foreign investors in Azerbaijan. In 2013, the FDI from the EU to Azerbaijan constituted €4.7 billion representing 57% of total FDI flows to Azerbaijan that year. Besides, between 2009 and 2013 FDI from the EU to Azerbaijan more than doubled.¹¹ FDI inflows suggest employment growth, an influx of new technologies, a transfer of know-how, and new export markets for the investor. The findings suggest that, the EU entrepreneurs not willing to invest in Azerbaijan again, are more likely to reduce or postpone their capital expenditures than the companies that are positive about the future investment prospects.

¹¹ EU-Azerbaijan Fact Sheet, Brussels, 2016

Figure 5.5: Capital expenditure depending on the future investment decision



“One specific change” needed to improve the investment climate

While Azerbaijan remained committed to fiscal consolidation in these turbulent times, it is equally planning to better target public investment to enhance economic productivity and create jobs. The government signals greater investments into the modernization of infrastructure and transportation to reinforce competitiveness, which will presumably have favorable medium- and longer-term consequences to FDIs and economic growth.¹²

The EU businesses were asked to name “one specific change” that they think is necessary to make in order to facilitate doing business and improving the investment climate in the country. According to respondents, the top priorities to be achieved by the government are eliminating corruption, ensuring transparency, reforming the tax and customs system, and improving the visa regime and work permit procedures.

Looking ahead, streamlining taxes and customs procedures and liberalizing tariffs would further stimulate investment and thus raise the prospects for capital inflows. In this context, providing transparency will play a key role and “ASAN” services, which have eliminated corruption and removed bureaucracy in public service delivery, can act as instructive models amidst institutional reforms. In addition to that, the comments indicate that further improvements in visa and work permit regimes are necessary to stimulate capital inflows and support industry professionals active in Azerbaijan.

While the outcomes of ongoing reforms cannot yet be felt, and it is too early to draw conclusions the 2nd Business Climate Survey Azerbaijan, which is to be conducted in 2017, will provide a good indicator as regards the effectiveness of the reforms undertaken as evidenced by changes in the perception of the business climate by EU entrepreneurs.

¹² A decree by the President dated April 21, 2016

Appendix

Methodology and Analysis

1. About the Survey and Report

In early 2016 the German-Azerbaijani Chamber of Commerce (AHK) conducted among EU businesses and with the support of the Eurochambres and the EU Delegation to Azerbaijan the first-ever Business Climate Survey Azerbaijan. It is designed to reflect the assessment of EU companies being active in Azerbaijan and is based not only on historical conditions but also on expectations about conditions prevailing over the next year. The questionnaire could be filled in from 1 March till 8 April 2016. The survey is based on the written questionnaire which was distributed online via SurveyMonkey, and which was strictly anonymous. It was circulated to over 300 companies representing 19 EU countries. With 100 complete responses the AHK Azerbaijan could reach a response rate of nearly 30%. Added to that, 78 responses were partially filled in, and unfortunately these results could not be used for the survey report.

To support the survey results, the AHK Azerbaijan organized seven interviews with companies representing important sectors of the Azerbaijani economy.

The questionnaire consisted of three parts, which were:

- Economic situation in Azerbaijan
- Impact of Azerbaijan's economic situation and business environment on the company
- Company demographics

This survey particularly follows a similar survey conducted by the AHK Hungary in Central-Eastern European countries in 2015 and uses similar indicators to examine the macroeconomic environment and investment climate in Azerbaijan. Where possible the results of both surveys were compared to each other.

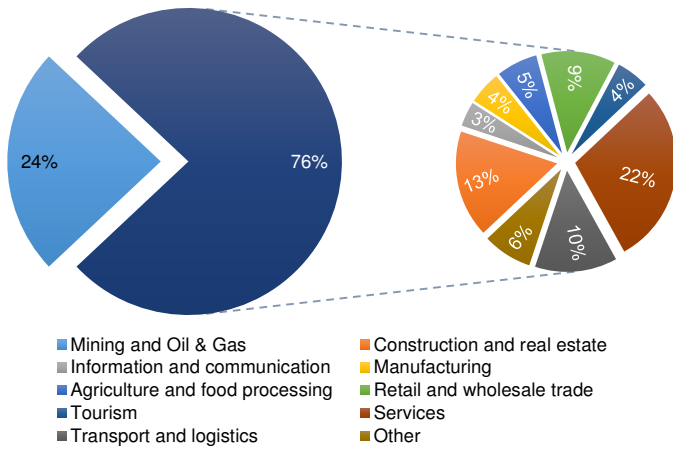
A connection between newly started reforms and the survey results was made throughout the report and underlined with statistics of the World Bank and the State Statistical Committee of the Republic of Azerbaijan.

2. Calculations

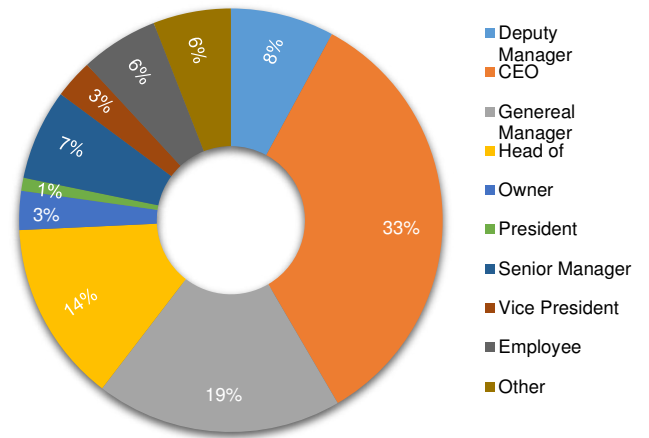
The average numbers were calculated using the arithmetical mean.

Respondents

D1: Area of Operation



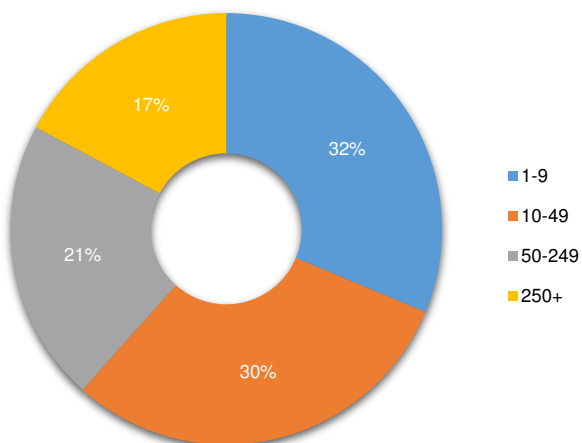
D2: Position of the Respondent



What is the main area of your operations?		
Answer Options	Response Percent	Response Count
Mining and Oil & Gas	24%	24
Non-Oil	76%	76
Construction and real estate	13%	13
Information and communication	3%	3
Manufacturing	4%	4
Agriculture and food processing	5%	5
Retail and wholesale trade	9%	9
Tourism	4%	4
Services	22%	22
Transport and logistics	10%	10
Other	6%	6
Answered question	100%	100

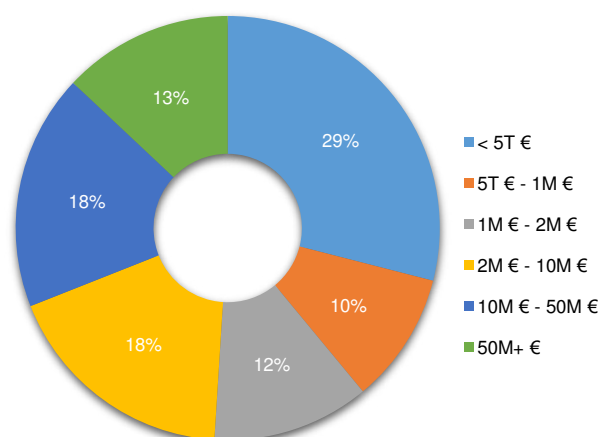
Please specify your current position within the company?		
Answer Options	Response Percent	Response Count
Deputy Manager	8%	8
CEO	34%	34
General Manager	19%	19
Head of	14%	14
Owner	3%	3
President	1%	1
Senior Manager	7%	7
Vice President	3%	3
Employee	6%	6
Other	6%	6
Answered question	100%	100

D3: Number of Employees



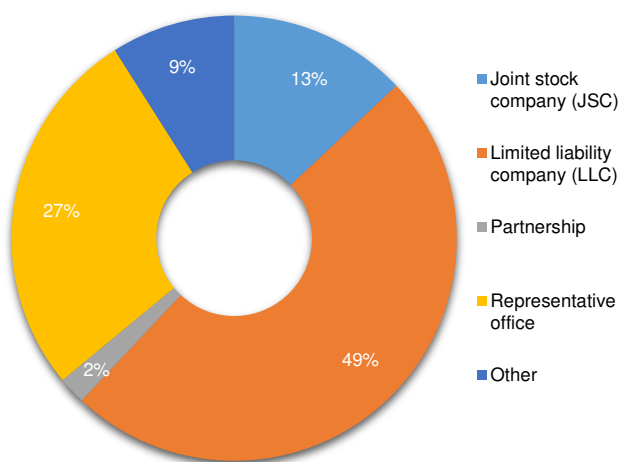
Please specify the number of employees in your company?		
Answer Options	Response Percent	Response Count
1-9	31,3%	31
10-49	30,3%	31
50-249	21,2%	21
250+	17,2%	17
Answered question	100%	100

D4: Revenue



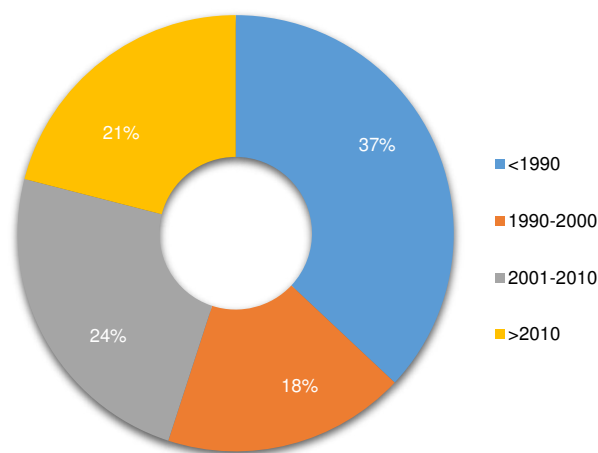
What is the total revenue of your company?		
Answer Options	Response Percent	Response Count
< 5T €	29%	29
5T € - 1M €	10%	10
1M € - 2M €	12%	12
2M € - 10M €	18%	18
10M € - 50M €	18%	18
50M+ €	13%	13
Answered question	100%	100

D5: Legal Set-Up



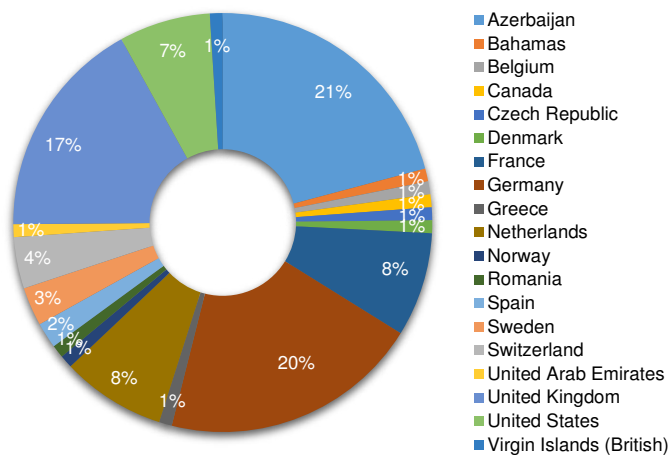
What is the legal set-up of your company?		
Answer Options	Response Percent	Response Count
Joint stock company (JSC)	13%	13
Limited liability company (LLC)	49%	49
Partnership	2%	2
Representative office	27%	27
Other	9%	9
Answered question	100%	100

D6: Year of Establishment



When was your company established?		
Answer Options	Response Percent	Response Count
<1990	37%	37
1990-2000	18%	18
2001-2010	24%	24
>2010	21%	21
Answered question	100%	100

D7: Country of Registration



In which country are your company's headquarters registered?		
Answer Options	Response Percent	Response Count
Azerbaijan	21%	21
Bahamas	1%	1
Belgium	1%	1
Canada	1%	1
Czech Republic	1%	1
Denmark	1%	1
France	8%	8
Germany	20%	20
Greece	1%	1
Netherlands	8%	8
Norway	1%	1
Romania	1%	1
Spain	2%	2
Sweden	3%	3
Switzerland	4%	4
United Arab Emirates	1%	1
United Kingdom	17%	17
United States	7%	7
Virgin Islands (British)	1%	1
Answered question	100%	100

Detailed Survey Findings

Q 1: How do you rate the current situation in Azerbaijan?



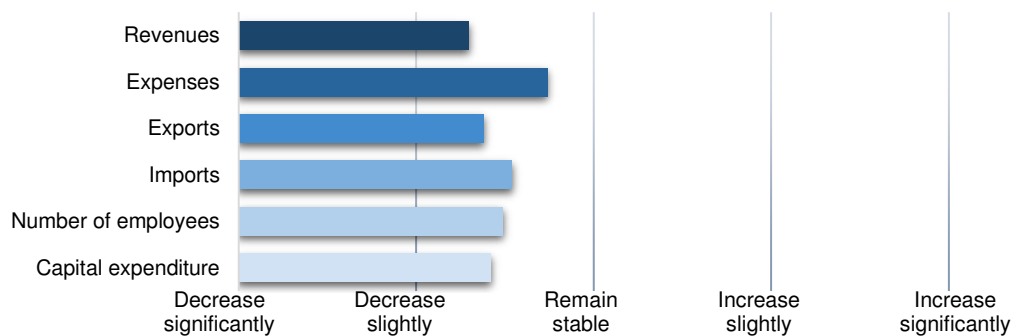
Answer Options	Very weak	Weak	Satisfactory	Strong	Very strong	Rating Average	Response Count
National economy	17	62	17	2	0	2,04	98
Your sector	16	47	27	6	0	2,24	96
Your company	4	30	50	12	1	2,75	97
Answered question							99

Q 2: How do you assess the prospects in Azerbaijan for 2016 compared to the previous year?



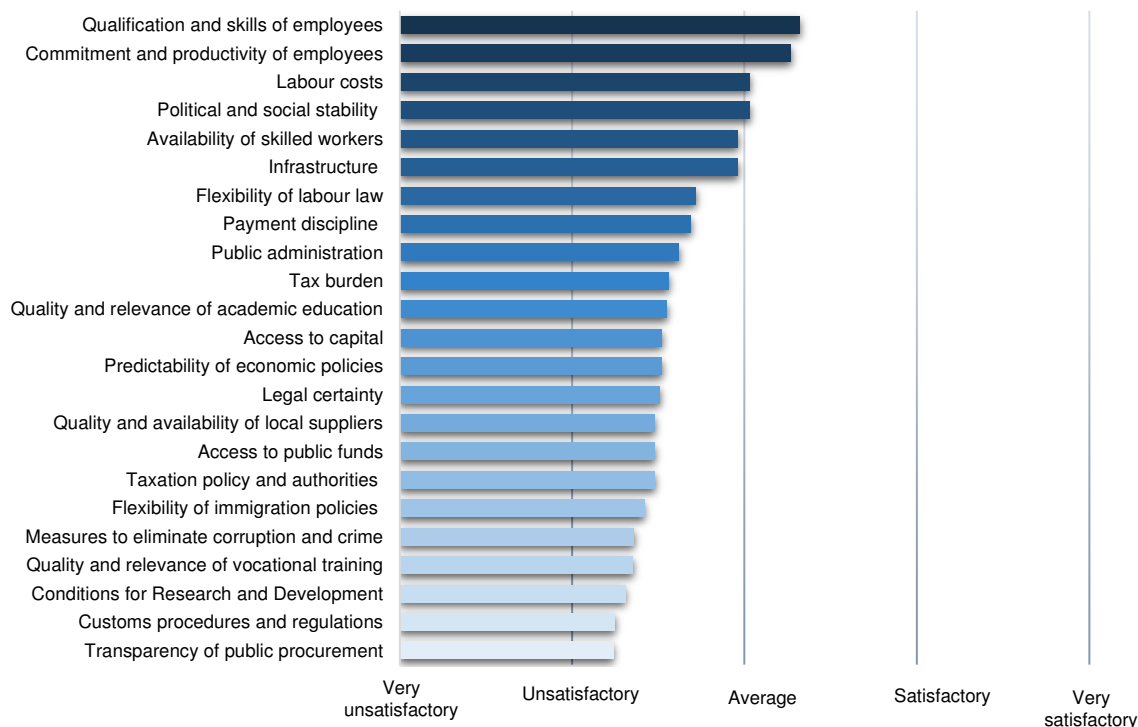
Answer Options	Worse	Slightly worse	Stable	Better	Much better	Rating Average	Response Count
National economy	35	47	10	3	1	1,83	96
Your sector	30	43	16	6	0	1,98	95
Your company	17	40	31	6	1	2,31	95
Answered question							75

Q 3: How do you expect your company to perform in 2016 compared to the previous year?



Answer Options	Decrease significantly	Decrease slightly	Remain stable	Increase slightly	Increase significantly	Not applicable	Rating Average	Response Count
Revenues	24	36	27	10	2	1	2,30	100
Expenses	13	33	30	11	11	0	2,74	98
Exports	10	10	15	5	0	51	2,38	91
Imports	17	15	22	6	6	29	2,54	95
Number of employees	12	32	45	7	0	2	2,49	98
Capital expenditure	22	24	28	14	1	9	2,42	98
Answered questions								100

Q 4: How do you rate the following local indicators of business environment for your company/sector?

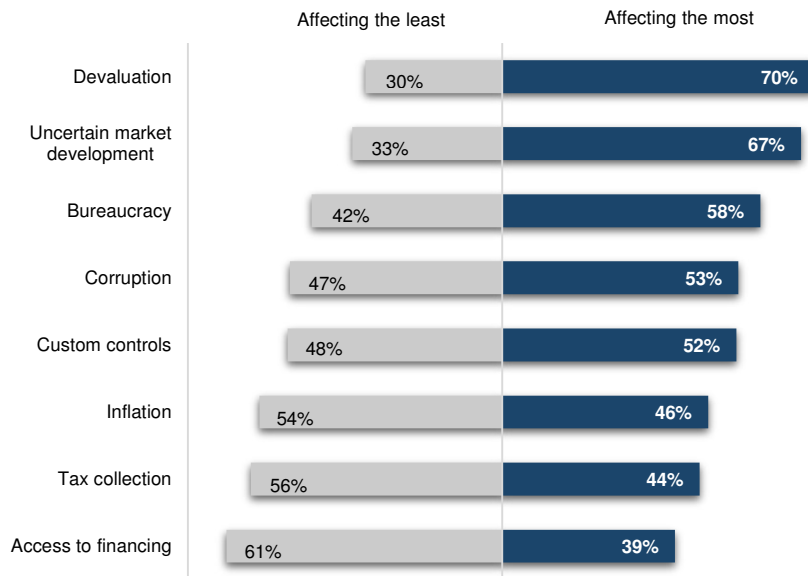


Answer Options	Very unsatisfactory	Unsatisfactory	Average	Satisfactory	Very satisfactory	Rating Average	Response Count
Qualification and skills of employees	0	19	35	36	7	3,32	97
Commitment and productivity of employees	2	16	37	36	5	3,27	96
Labour costs	3	17	50	24	1	3,03	95
Political and social stability	5	25	35	26	6	3,03	97
Availability of skilled workers	6	29	30	25	6	2,96	96
Infrastructure	6	18	49	22	2	2,96	97
Flexibility of labour law	14	18	45	17	1	2,72	95
Payment discipline	11	25	42	14	2	2,69	94
Public administration	14	32	31	17	3	2,62	97
Tax burden	20	16	48	10	2	2,56	96
Quality and relevance of academic education	16	28	39	14	1	2,55	98
Access to capital	14	27	40	9	1	2,52	91
Predictability of economic policies	14	32	35	14	0	2,52	95
Legal certainty	16	28	36	12	1	2,51	93
Quality and availability of local suppliers	10	39	38	9	0	2,48	96
Access to public funds	15	27	35	6	3	2,48	86
Taxation policy and authorities	21	23	37	12	2	2,48	95
Flexibility of immigration policies	24	23	36	13	1	2,42	97
Measures to eliminate corruption and crime	24	27	34	11	1	2,36	97
Quality and relevance of vocational training	18	31	42	5	0	2,35	96
Conditions for Research and Development	19	36	28	10	0	2,31	93
Customs procedures and regulations	31	24	31	9	2	2,25	97
Transparency of public procurement	21	41	21	8	2	2,24	93

answered question

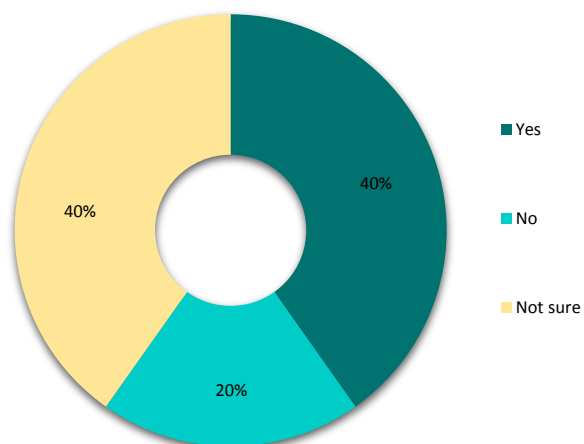
99

Q 5: Which of the below mentioned current conditions are affecting your company/sector the most? (Drag and drop to rank the conditions, 1 = affecting the most...8 = affecting the least)



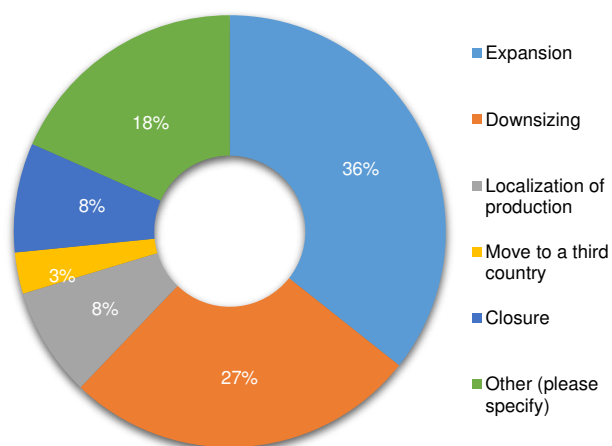
Answer Options	8	7	6	5	4	3	2	1	Rating Average	Response Count
Devaluation	4	5	7	5	4	10	8	26	5,78	69
	-30,43%				69,57%					
Uncertain market development	5	3	8	12	7	10	17	22	5,63	84
	-33,33%				66,67%					
Bureaucracy	2	7	7	12	16	13	8	2	4,70	67
	-41,79%				58,21%					
Corruption	7	11	9	8	10	9	8	12	4,65	74
	-47,30%				52,70%					
Custom controls	6	9	9	8	9	13	12	1	4,45	67
	-47,76%				52,24%					
Inflation	7	11	12	10	8	10	11	5	4,35	74
	-54,05%				45,95%					
Tax collection	14	12	9	12	14	9	9	5	4,05	84
	-55,95%				44,05%					
Access to financing	22	5	9	7	7	3	7	10	3,84	70
	-61,43%				38,57%					
Answered questions										98

Q 6: Would you again choose Azerbaijan as preferred location for your investment?



Would you again choose Azerbaijan as preferred location for your investment?		
Answer Options	Response Percent	Response Count
Yes	40,2%	39
No	19,6%	19
Not sure	40,2%	39
Answered question		97

Q 7: What is the most likely direction of your company's development over the next one to two years in Azerbaijan?



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