



## **Business outlook in Azerbaijan** Fourth Edition

Deloitte CIS Research Centre  
1H 2019

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# Introduction



**Nuran Kerimov**  
**Managing Partner**  
Deloitte Azerbaijan

We are delighted to present the fourth edition of the Business Outlook in Azerbaijan, the Deloitte Research Centre's macroeconomic journal.

We focus on the current trends in the Azerbaijani economy and present our key research findings.

In March-April 2019, Deloitte conducted a survey of the top management of leading Azerbaijani companies. This allowed us to identify the overall economic environment, scrutinize how the non-oil sector is developing and examine foreign direct investment attraction. Complex analysis helped reveal hidden trends, and comparisons with Russia and Kazakhstan produced additional insights.

The macroeconomic analysis in this edition features a in-depth study of Azerbaijan's financial system.

If you have any questions or suggestions regarding this research, please do not hesitate to contact us at: [cisresearchteam@deloitte.ru](mailto:cisresearchteam@deloitte.ru)

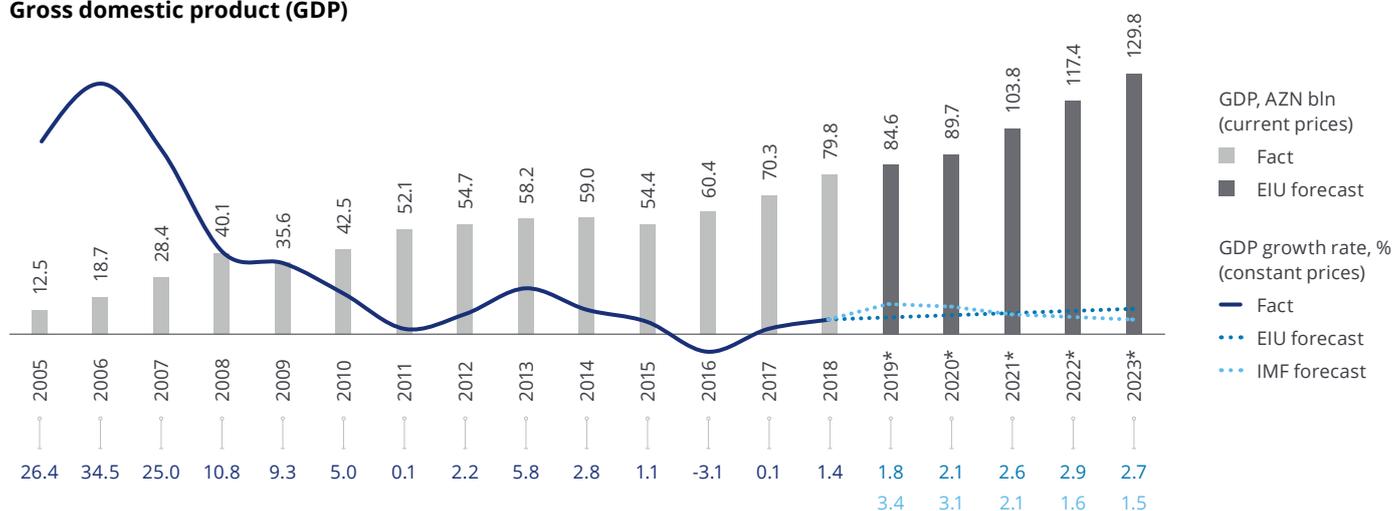
# 01 Azerbaijan in figures





## Key macroeconomic indicators

### Gross domestic product (GDP)



Source: UN statistics, State Statistical Committee of the Republic of Azerbaijan

\*Forecast: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

### Azerbaijan's Credit Rating

Agency	Rating	Forecast	Date
Moody's	Ba2	Stable	12 March 2019
S&P	BB+	Stable	25 January 2019
Fitch	BB+	Stable	15 February 2019

### Brent oil price forecast, USD/barrel

	2019	2020	2021	2022	2023
EIU	66.5	60.5	69.8	75.6	75.0
IMF	61.8	61.5	60.8	60.4	60.6
ECB	67.1	61.3	60.6	-	-

### Natural gas price forecast, USD/mmbtu

	2019	2020	2021	2022	2023
EIU	2.8	3.0	-	-	-
IMF	2.7	2.7	2.6	2.6	2.7
WB	2.7	2.7	2.8	-	-

*"We have plenty of resources to ensure macroeconomic stability in 2019. The 2019 is similar to 2018 in terms of the macroeconomic situation. The main policy was built on low inflation and the ideology of a sustainable exchange rate."*

**Elman Rustamov**  
Chairman of the Central Bank of Azerbaijan

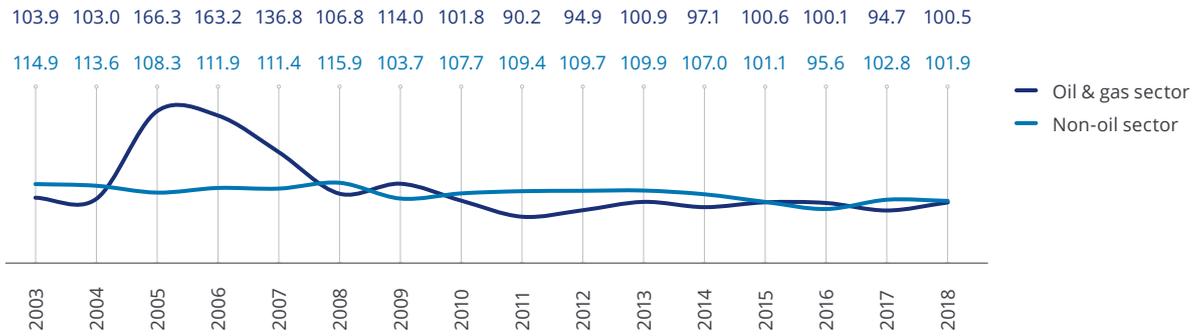
*"Azerbaijan's economy expanded at a moderate pace in 2018 aided by stable oil production and a modest pick-up in domestic demand, as higher oil earnings boosted fiscal spending and real wages rose. As natural gas exports rise, economic growth is forecast to accelerate over the medium-term."*

**"Europe and Central Asia Economic Update", an overview by World Bank**



## Key macroeconomic indicators

### Real GDP growth by sector, %



In 2018, both the oil and non-oil sectors demonstrated moderate growth; however, the growth rate of non-oil sector has been higher for the last two years.

### Real GDP growth by economic activity in 2018

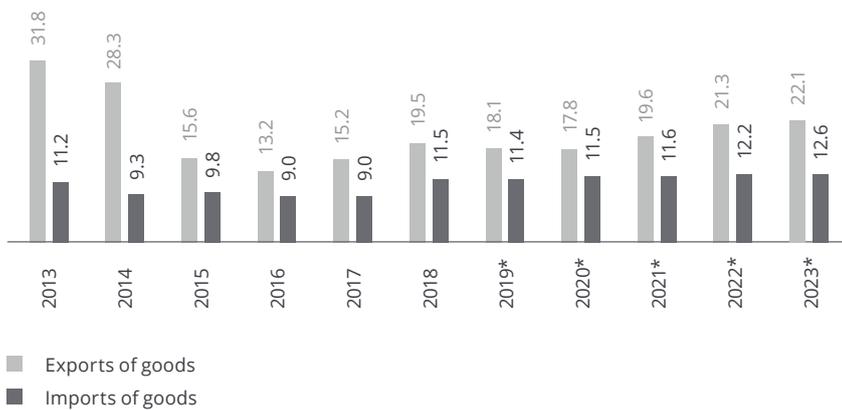
Activity	Growth Rate (%)	Activity	Growth Rate (%)
Information and communications	9.3%	Agriculture, forestry and fishing	4.6%
Transportation and storage	7.8%	Trade, repair of transport means	3.0%
Accommodation and food services	7.6%	Mining and quarrying	0.4%
Manufacturing	6.9%	Construction	-9.0%

Information and communications sector demonstrated the highest growth rate of real GDP in 2018 (**9.3 percent**) while construction fell by **9 percent**.



## Key macroeconomic indicators

### Foreign trade, USD bln



■ Exports of goods  
■ Imports of goods

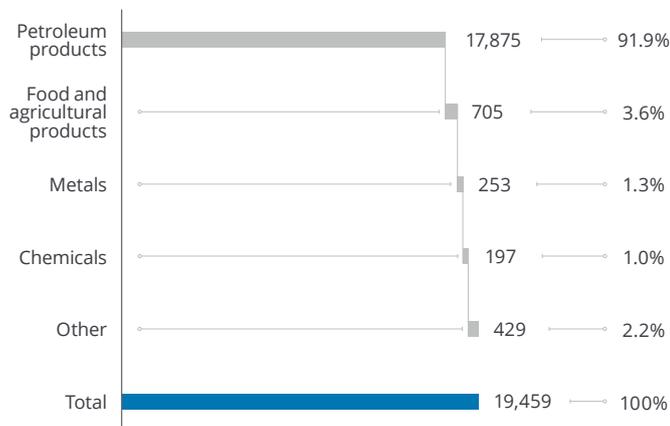
Source: EIU, State Customs Committee

\*EIU forecast

EIU forecasts for the period 2019–2023, the value of exports to be almost double that of imports. This will provide a solid positive trade balance and support Azerbaijan’s financial stability.

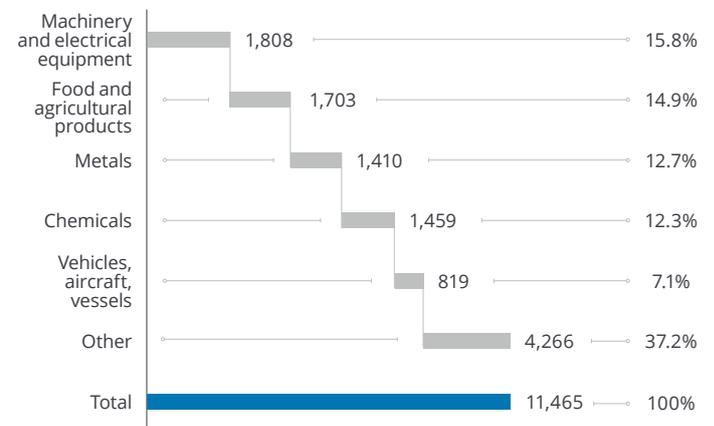
The EIU estimates that exports will recover in 2021 after a decline in 2019 (exports could be constrained by declining output from the oil sector and the sharp depreciation of the Turkish lira), and then demonstrate fast growth of up to **10 percent** per year, while imports will rise only slightly during the forecast period (at an average of **2 percent** annually).

### Structure of goods exported in 2018, USD mln



Source: State Customs Committee

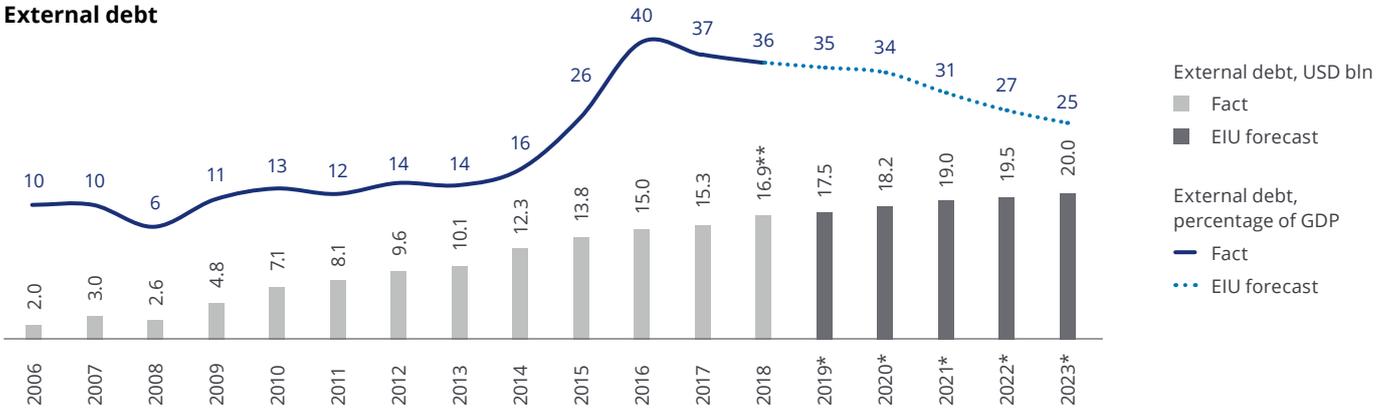
### Structure of goods imported in 2018, USD mln





## Key macroeconomic indicators

### External debt



Source: EIU, Central Bank of the Republic of Azerbaijan

\*EIU forecast

\*\*Including USD 8.9 bln of sovereign debt as of 31 December, 2018

According to the State Debt Management Strategy, sovereign debt will reach a peak of **USD 10.1 bln** at the end of 2019, then dropping to **USD 6.5 bln** by the end of 2025.

Source: Medium- and long-term strategy for public debt management in the Republic of Azerbaijan

### Foreign exchange reserves



Source: State Customs Committee, Central Bank of the Republic of Azerbaijan

Azerbaijan's currency reserves have declined since 2014 due to interventions by the country's Central Bank on the foreign exchange market to keep the AZN/USD exchange rate at a stable level. Nevertheless, they remained sufficient to cover about six to seven months of imports in 2015–2018.



## Key macroeconomic indicators

### Average monthly wages



Source: State Statistical Committee of the Republic of Azerbaijan, EIU

\*EIU forecast and estimate

Average monthly nominal wages and salaries are growing steadily: the EIU expects to see them increase by about **50 percent** by 2023. Despite the fact that average real wages have been declining over the past two years, the EIU gives a positive forecast for next 5 years (about **3 percent** per annum on average).

### Average consumer price index, %



Source: State Statistical Committee of the Republic of Azerbaijan

\*Forecast: EIU, IMF

### CPI in 2018 by components

<b>Total</b>	<b>2.3%</b>
Food products, beverages, tobacco	1.7%
Non-food products	2.6%
Services	2.7%

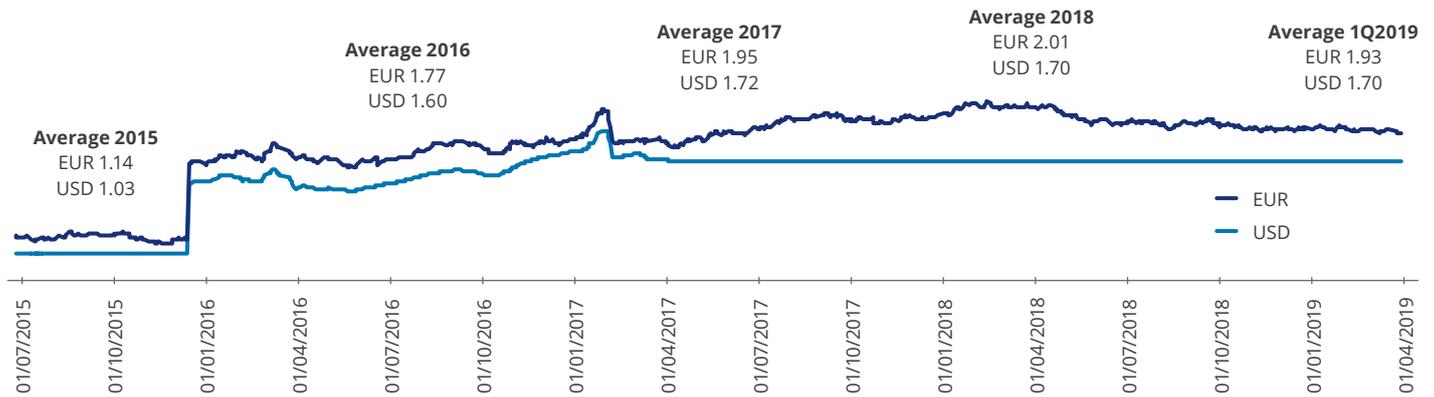
Consumer price inflation decelerated considerably in 2018 reflecting modest domestic demand and low external inflationary pressures.

Source: State Statistical Committee of the Republic of Azerbaijan



## Key monetary indicators

### EUR and USD vs. AZN, July 2015 – March 2019



Source: Central Bank of the Republic of Azerbaijan

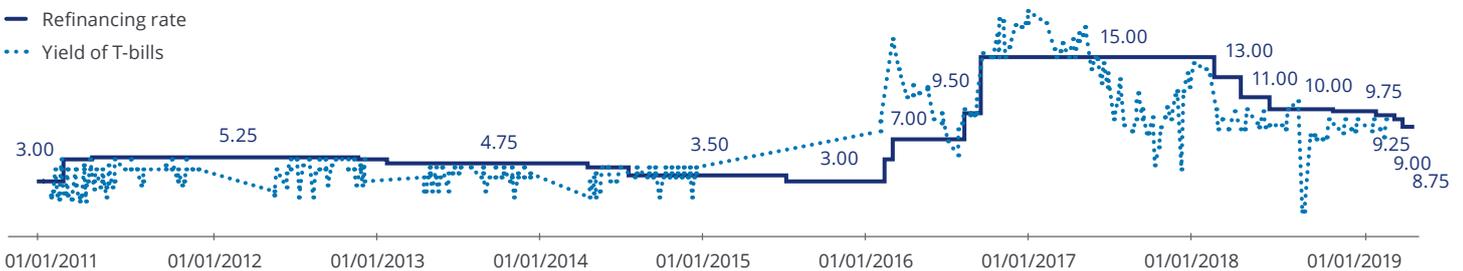
### Exchange rate, EIU forecast

	2019	2020	2021	2022	2023
EUR vs. AZN	1.97	2.06	2.02	2.03	2.01
USD vs. AZN	1.70	1.69	1.66	1.64	1.62

*“Monetary policy effectiveness remains significantly constrained by the weak domestic banking system, underdeveloped capital markets, high dollarization, and lack of operational independence by the Central Bank of Azerbaijan (CBA).”*

**Standard & Poor's**

### Refinancing rate and yield of Treasury bills, %



Source: Central Bank of the Republic of Azerbaijan

The Central Bank of Azerbaijan has decreased the refinancing rate three times in a row since the beginning of 2019 to **8.75 percent**.

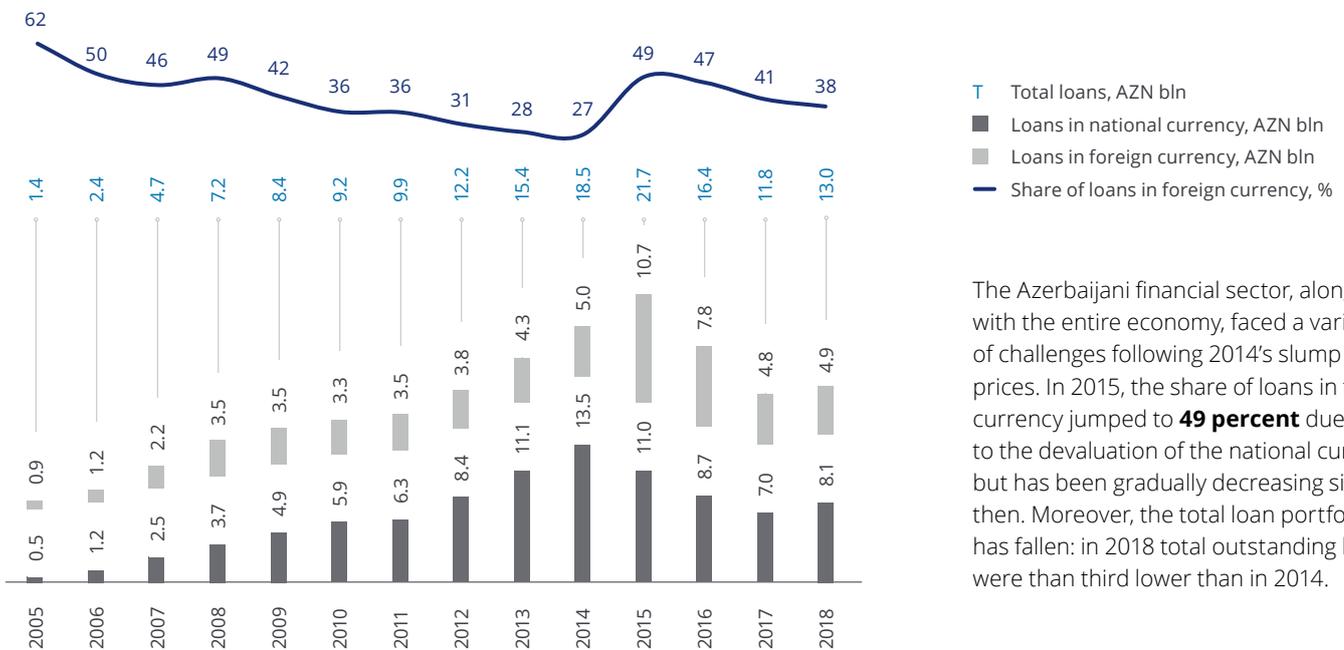


# 02 Key industries of economy



## Banking

### Loans of credit institutions



The Azerbaijani financial sector, along with the entire economy, faced a variety of challenges following 2014's slump in oil prices. In 2015, the share of loans in foreign currency jumped to **49 percent** due to the devaluation of the national currency, but has been gradually decreasing since then. Moreover, the total loan portfolio has fallen: in 2018 total outstanding loans were than third lower than in 2014.

### Overdue loans

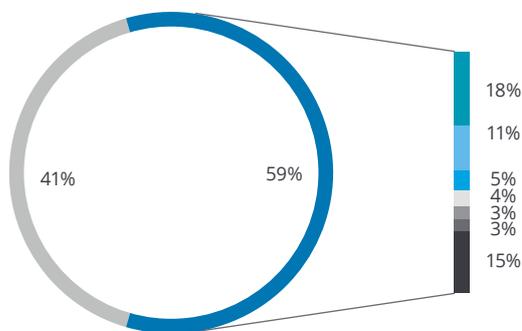


The overdue loan ratio increased almost two-fold in 2015–2018, reaching **12 percent** by the end of 2018. In 2018 for the loans in foreign currency the share of non-performing loans even higher and amount **16.4 percent** while for loans in national currency it's only **9.6 percent**.



## Banking

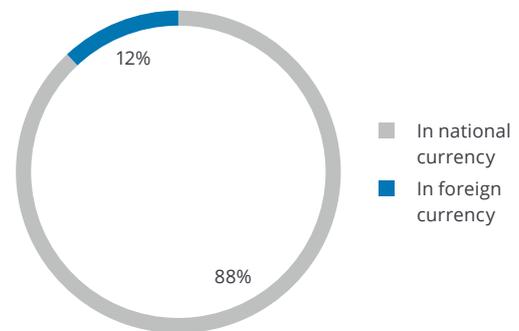
### Sectoral breakdown of loans in 2018



- Households
- Trade and services
- Transport and communication
- Industry and manufacturing
- Agriculture and processing
- Power engineering, chemical and natural resources
- Construction and real estate
- Other sectors

Corporate lending in Azerbaijan focused in Baku and is largely directed towards established medium and large enterprises. The largest share of the corporate loans was issued to trade and services companies (**18 percent**), followed by transport and communication (**11 percent**).

### Loans to households



Households accounted for almost half of all loans (**41 percent**). Almost **9 out of 10** loans to households (**88 percent**) were issued in national currency.

On 28 February 2019, Azerbaijani President Ilham Aliyev signed a decree on the resolution of problem loans of individuals issued after the devaluation of the national currency in 2015.

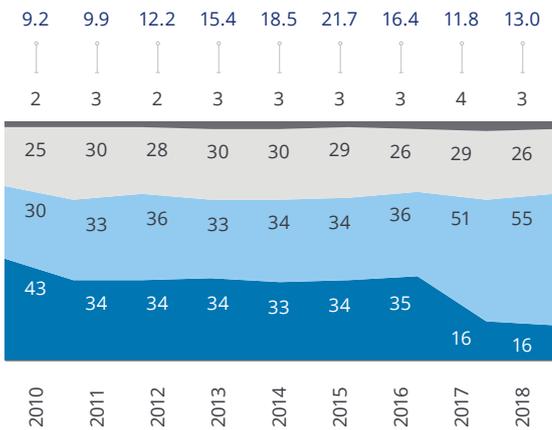
Under the decree, the part of an individual's loan debt under USD 10,000 (AZN 17,000), which increased after the devaluation in manat terms, will be repaid at the expense of the State Budget. The principal amount of loans taken out before 21 February 2015, will be compensated at AZN 0.25 (USD 0.15) for each US dollar, and of loans issued from 22 February to 21 December 2015 at AZN 0.6 (USD 0.35) for each US dollar.

The amount of compensation to each individual should not exceed USD 5,000.



## Banking

### The structure of loans in the economy by credit institution type



T Total loans, AZN bln

The structure of loans in the economy by credit institution type, %

- Non-bank credit institutions
- Private banks with foreign capital
- Private banks without foreign capital
- State owned banks

The share of private banks' loans rose dramatically in 2017 due to the restructuring of the state-controlled International Bank of Azerbaijan (IBA). Nevertheless, the state remains extensively involved in the banking sector.

### Average interest rates on loans in national currency, %



### Average interest rates on loans in foreign currency, %



*“Lower interest rates should filter through into increased lending from banks to the non-oil sector, implying scope for an acceleration in investment activity. Lower household lending rates should also support private consumption.”*

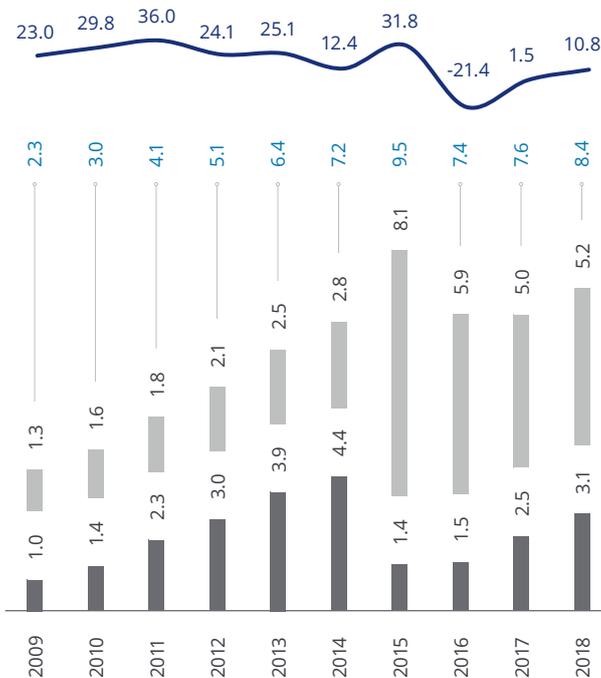
**Fitch**

High interest rates mean that many businesses prefer to finance investment with their own resources. The average interest rate on national currency loans for legal entities decreased between 2012 and 2016, and stabilized at around **9 percent** in 2017–2018. Average interest rates on loans in foreign currency are now lower than rates on national currency loans; however, only companies that earn in US dollars can afford them, while other borrowers are afraid of high currency risks.



## Banking

### Household savings



- T Total household savings, AZN bln
- Savings in foreign currency, AZN bln
- Savings in national currency, AZN bln
- Increase/decrease of savings, %

Household savings react sensitively to the refinancing rate and devaluation. Savings fell **(minus 21 percent)** in 2016 after 2015's devaluation. However, the high interest rate for deposits in national currency, in contrast to the low interest rate for deposits in foreign currency, has revived savings growth, and mainly in national currency.

### Average interest rates on deposits in national currency, %



### Average interest rates on deposits in foreign currency, %



- The average interest rate on national currency deposits and savings for individuals declined between 2009 and 2015, but demonstrated a short-lived increase in 2016–2017 before dropping back down to **10 percent**.
- The average interest rate on deposits and savings in foreign currency has been falling rapidly since 2015, stabilizing in 2018.

Source: Central Bank of the Republic of Azerbaijan



## Banking

### Credit and deposit dollarization



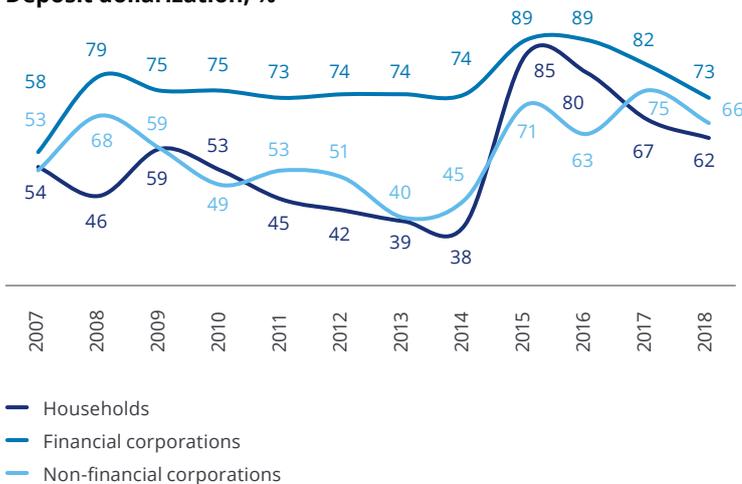
There has been a steady decline in dollarization since the devaluation in 2015 (**minus 17 percentage points** for deposits and **minus 11 percentage points** for credits).

*“We estimate that resident deposit dollarization remains more than 60%, which we think severely limits the central bank’s influence on domestic monetary conditions.”*

**Standard & Poor's**

Source: Azerbaijani Banks Association

### Deposit dollarization, %



After the global financial crisis of 2008, financial companies deposited 75–80% of funds in foreign currency. This strategy was taken up by households and non-financial corporations after the devaluation in 2015 (soaring from **38–45 percent** deposit dollarization in 2014 to **71–85 percent** in 2015). The deposit dollarization of financial companies returned to the pre-crisis level (**73 percent** in 2018), but households and non-financial companies remain more cautious (**62–66 percent** in 2018).

Source: Central Bank of the Republic of Azerbaijan

### Top four banks in Azerbaijan in IVQ 2018, AZN mln

Bank	Total assets	Loans	Deposits	Shareholder equity	Net interest income	Net profit	Reserve allocations
International Bank of Azerbaijan	7,933	1,923	4,078	1,162	297	426	-130
Pasha Bank	4,696	1,321	3,923	418	139	77	-6
Kapital Bank	3,717	1,501	2,948	372	246	98	93
Xalq Bank	2,008	1,382	1,259	283	87	28	18
<b>National total</b>	<b>29,465</b>	<b>12,149</b>	<b>18,704</b>	<b>4,044</b>	<b>1,192</b>	<b>306</b>	<b>330</b>

Source: Azerbaijani Banks Association



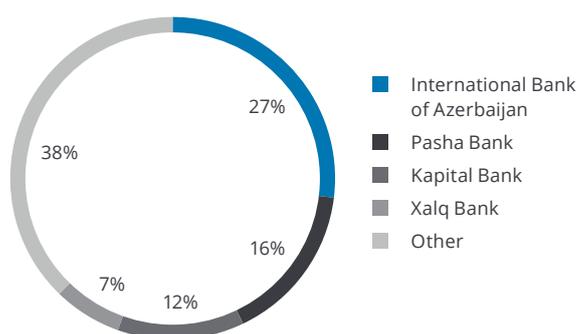
## Banking

### Banking system financial sustainability indicators

Date	Tier I Capital adequacy ratio, %	Aggregate capital adequacy ratio, %	Liquid assets to total assets, %	Net open position in FX to capital, %	FX loans to total loans, %	FX liabilities to total liabilities, %
31/12/2016	6.7	7.7	16.4	-314.4	47.9	66.8
31/03/2017	10.2	10.8	17.5	-201.8	48.3	71.1
30/06/2017	11.4	12.0	21.4	-182.3	44.6	72.5
30/09/2017	11.2	12.2	25.1	-117.2	43.7	68.1
31/12/2017	11.3	12.7	23.8	-112.0	41.3	67.1
31/03/2018	17.3	18.7	21.8	-71.7	39.9	64.1
30/06/2018	16.1	18.4	21.3	-66.9	39.0	63.1
30/09/2018	15.8	18.9	25.3	-57.6	39.0	61.7
31/12/2018	15.2	19.4	24.2	-42.5	38.5	59.9
31/03/2019	18.7	20.2	23.3	-46.5	37.2	60.4

Source: Financial Markets Supervisory Authority

### Banking system breakdown by assets



The banking sector in Azerbaijan is quite consolidated. The largest bank, the International Bank of Azerbaijan, owns almost a quarter of assets (**27 percent**). Moreover, **62 percent** of assets are concentrated in the four largest banks.

*“Decisive steps are needed to finalise banking sector restructuring. Privatisation of the International Bank of Azerbaijan is one of the key priorities for lowering risk in the banking system and should be pursued without delay. The large stock of non-performing loans (NPLs) needs to be resolved, capital deficiencies in some banks addressed, and the independence and operations of the financial regulator (FIMSA) strengthened.”*  
**European Bank for Reconstruction and Development**

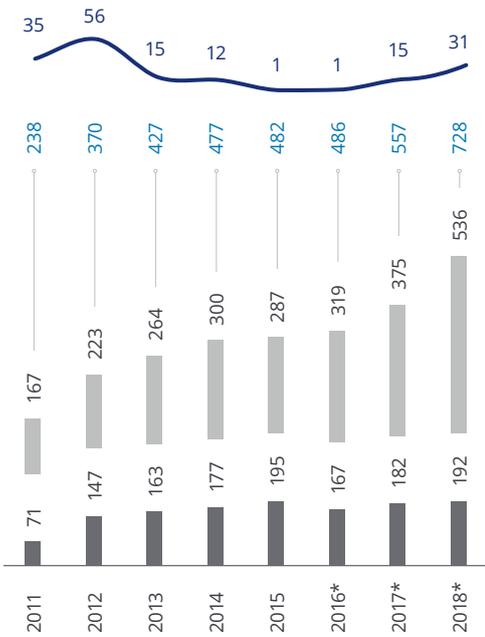
*“The outlook for banking sector risk in the near term is stable on the CCC level, and a further rating downgrade is unlikely, as the score for many of these metrics is already low. A large share of loans is denominated in foreign currency and is now non-performing following two devaluations of the manat in 2015. Dollarization of the economy, while declining, is still high, exposing banks to ongoing exchange-rate risks.”*  
**Economist Intelligence Unit**

Bank	Moody's	Fitch	S&P
International Bank of Azerbaijan	Ba3	B-	-
Pasha Bank	-	B+	BB-
Kapital Bank	Ba2	BB-	BB-
Xalq Bank	B1	-	-



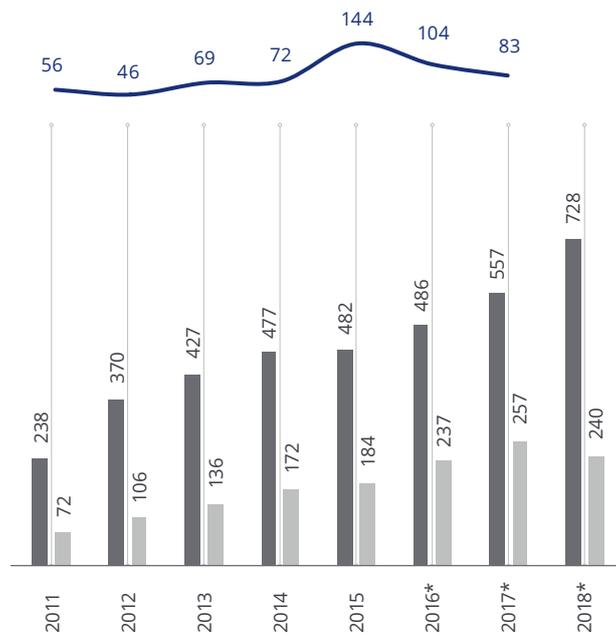
## Insurance sector

### Insurance premiums



- T Total insurance premiums, AZN mln
- Compulsory insurance premiums, AZN mln
- Voluntary insurance premiums, AZN mln
- Insurance premium growth, %

### Financial indicators of insurance companies



- Insurance premiums, AZN mln
- Insurance payments, AZN mln
- Balance profit, AZN mln

Azerbaijan is underinsured compared with other Central and Eastern European countries: the insurance premiums/GDP ratio, which represents the relative importance of the insurance industry in the domestic economy, stood at just **0.9%** in 2018, while most emerging economies usually have a ratio of between 2–4% and advanced markets range between 7–10%.

Insurance premiums have grown rapidly since 2011, reaching **AZN 728 mln** in 2018. Insurance payments also rose considerably from **AZN 172 mln** in 2014 to **AZN 240 mln** in 2018. At the same time the balance profit almost halved from **AZN 144 mln** in 2015 to **AZN 83 mln** in 2017, approaching the level of 2014.

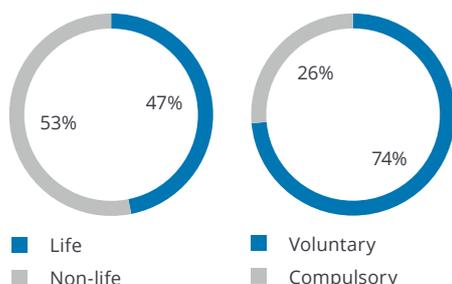
Source: State Statistical Committee of the Republic of Azerbaijan

\* Financial Markets Supervisory Authority

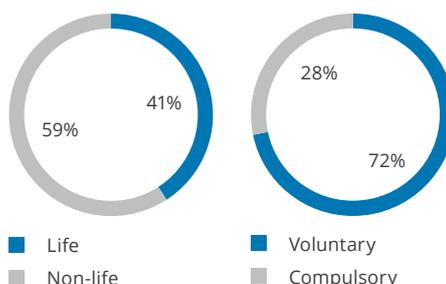


## Insurance sector

### Insurance premiums structure in 2018



### Insurance payments structure in 2018



The majority of insurance premiums are non-life (**53 percent**), but the share of life insurance has been rapidly growing at **9 percentage points** in 2018, reaching **47 percent** and approaching the level of nonlife insurance.

The lion's share of the Azerbaijani insurance market comprises of voluntary insurance, which accounts for three quarters of the market.

The EU is assisting the country in imposing the compulsory health insurance. Expected that this system will be applied throughout Azerbaijan from 2020.

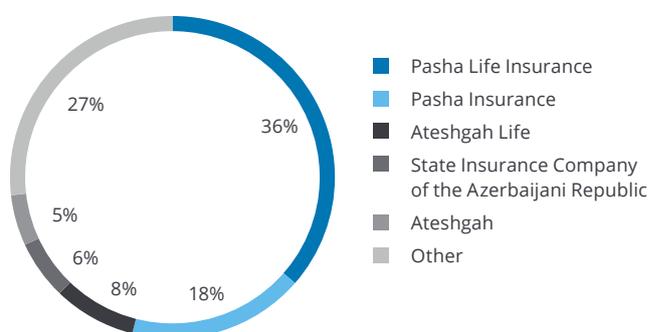
*"Expensive medical technologies should be covered by compulsory medical insurance and should be accessible to the public. In the health care, the share of public funding should be increased. <...> With the use of the compulsory medical insurance system, the population's needs in the field of medicine will be more and more covered, illegal payments will be eliminated, medical workers will be provided with a profitable income."*

**Gediminas Chernyauskas**  
**Advisor on Twinning Projects**  
**of the European Union**

### Top five insurers in Azerbaijan in 2018, AZN mln

Insurance company	Total premiums	Total claims
Pasha Life Insurance	265	71
Pasha Insurance	128	50
Ateshgah Life	60	15
State Insurance Company of the Azerbaijani Republic	43	15
Ateshgah	37	20
<b>National total</b>	<b>728</b>	<b>240</b>

### Insurance sector breakdown by premiums in 2018



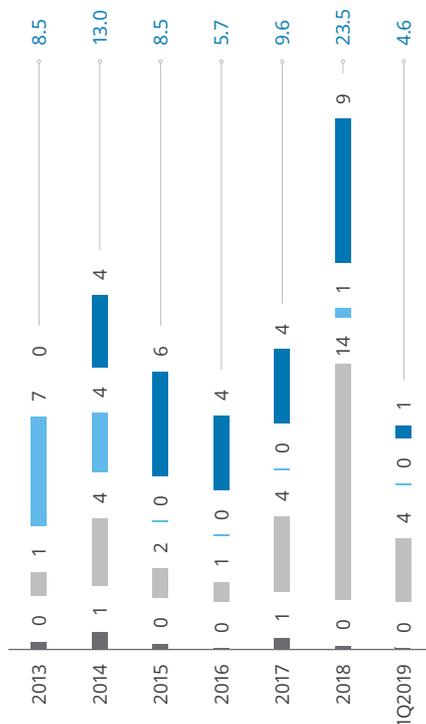
The insurance sector in Azerbaijan, like the banking system, is quite consolidated. The largest insurance company, Pasha Sigorta, accounts for more than a half of premiums in 2018 (**54 percent**), while the second one, Ateshgah, concentrates **13 percent** of premiums.

Source: Financial Market Supervisory Authority



## Financial markets

### BSE turnover, AZN bln



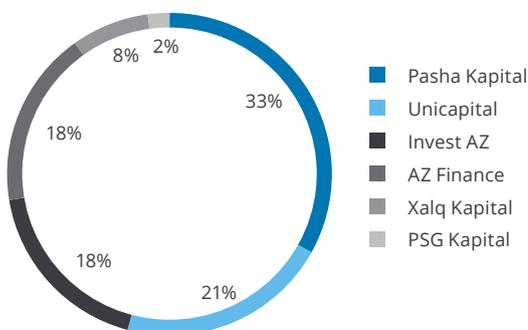
- T Total
- Derivatives
- Repo
- Debt instruments
- Equity instruments

The Azerbaijan securities market is relatively small with just **AZN 23.5 bln** volume of trading operations in 2018. There is only one stock exchange in Azerbaijan: Baku Stock Exchange (BSE), which supervised by Financial Market Supervisory Authority (FIMSA). FIMSA implements state policy and ensures the effective functioning of the financial markets, as well as protection of the rights of creditors, investors and insurers.

### Top brokerages in Azerbaijan, AZN mln (April 2018 – March 2019)

Name of institution	Volume of trading operations
Pasha Kapital	8,338
Unicapital	5,317
Invest AZ	4,605
AZ Finance	4,461
Xalq Kapital	1,951
PSG Kapital	542
<b>National total</b>	<b>25,214</b>

### Brokerages in Azerbaijan



Six brokerages currently operate as active members of the BSE. The leading brokerage is Pasha Kapital, with nearly **33 percent** of the market by annual turnover.

# 03 Business outlook in Azerbaijan

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Deloitte Azerbaijan would like to thank everyone who participated in the survey we conducted in March–April 2019. We appreciate your time and interest in our research.

After recovering in 2017–2018, various sectors of the Azerbaijani economy are expecting growth. The non-oil sector is the primary driver of this trend. Leading companies are demonstrating interest in new opportunities, including attracting investment and taking full advantage of financial infrastructure.

The expert opinions collected in this survey allowed us to conduct an integrated analysis of Azerbaijan’s business environment, as well as to study the sentiment market participants and their expectations for the development of their companies and the market overall.

We are pleased to present the key findings of our research and hope that you will find this report useful and informative. We would be grateful if you would participate in our next survey.

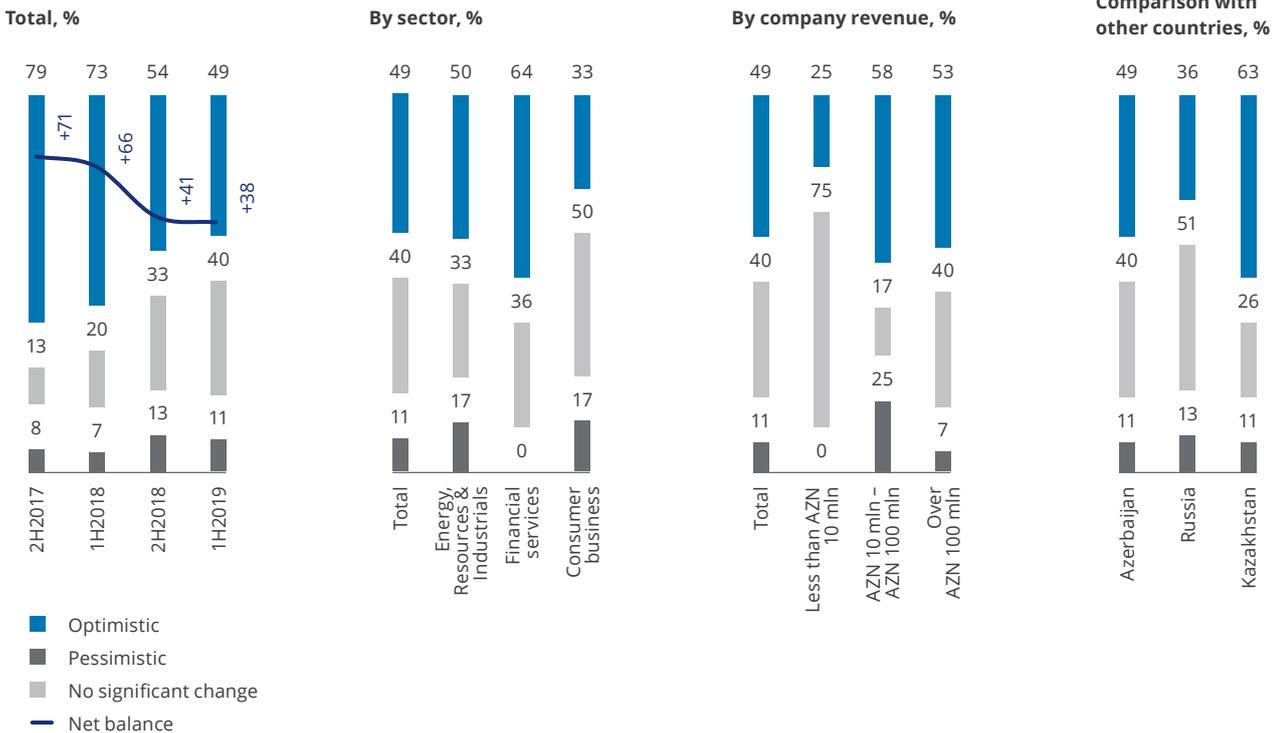
Please feel free to contact us if you have any questions.



## Financial outlook

### Respondents' assessment of the financial outlook of their companies

#### How do you assess your company's current financial outlook compared to the situation six months ago?



#### Trends

Respondents' assessment of their companies' outlook became more conservative due to the high base of the preceding periods: the outlook of businesses that were already optimistic about their financial position remained unchanged.

#### Highlights

Notably, Financial services is the most upbeat sector with **64 percent** of optimistic responses (**15 percentage points** above average).

Azerbaijani companies with annual revenues of less than AZN 10 mln have the most conservative outlook: **75 percent** of respondents are not expecting significant changes.

Companies with annual revenues of between AZN 10 mln and AZN 100 mln are the most polarized: more than half are optimistic (**58 percent**), but a quarter are pessimistic.

The overall financial outlook of companies in Azerbaijan is more optimistic than in Russia, which has the most conservative assessment (by **15 percent**), but less positive than in Kazakhstan (by **14 percent**).

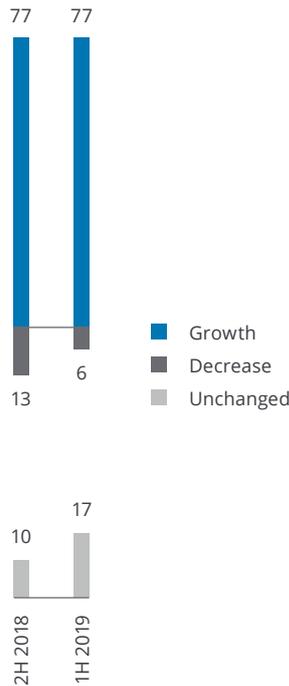
However, no more than **13 percent** of respondents in any country gave a pessimistic response.



## Business environment in Azerbaijan

The respondents were asked about expected changes in key financial metrics over the next 12 months

Revenue (in AZN), %



Our survey indicated that **77 percent** of respondents expect the revenue of their companies to increase, while only **6 percent** anticipate a decline, and **17 percent** believe that revenue will remain the same.

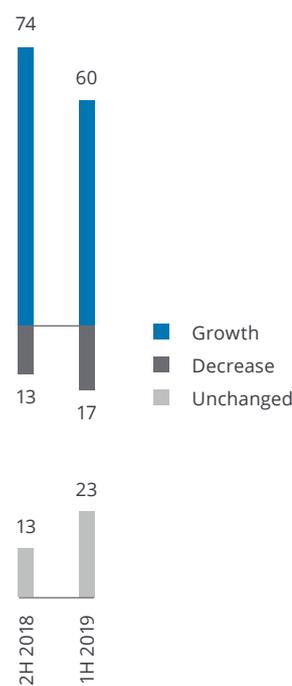
The share of respondents who expect revenue to decline has fallen by **7 percentage points** since the second half of 2018.



**Specific patterns:**

Respondents from Consumer business and companies with annual revenues of over AZN 100 mln were most likely to expect revenue to increase (**83 percent** and **87 percent** respectively).

Operating profit (in AZN), %



We found the opposite trend for operation profit expectations: the share of respondents forecasting a decline increased by **4 percentage points** in the last six months.



**Specific patterns:**

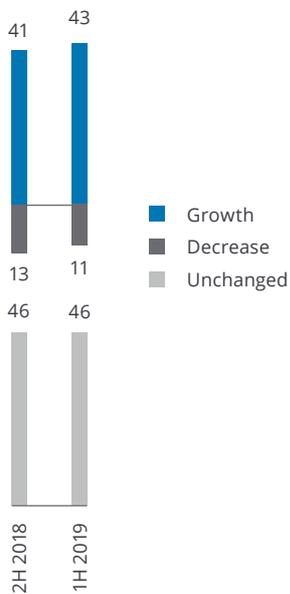
About one out of four (**25 percent**) respondents from Consumer business and Energy, Resources & Industrials expect a decrease in operating profit. Big companies with annual revenues of over AZN 100 mln have similar expectations (**27 percent**).



## Business environment in Azerbaijan

The respondents were asked about expected changes in key financial metrics over the next 12 months

Capex (in AZN), %



About half of respondents (**46 percent**) expect that capex will remain unchanged. However, another **43 percent** of surveyed experts forecast an increase in capex.

**Eleven percent** think that capex will decline.

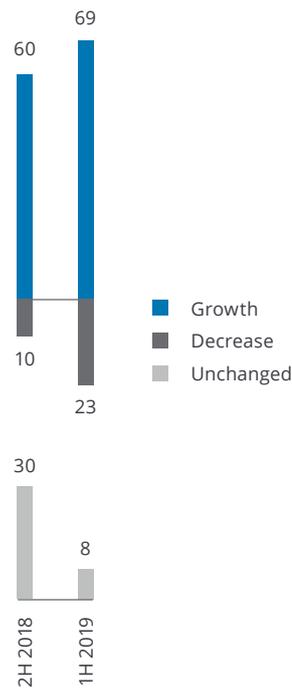
Since the second half of 2018, the share of respondents, who expect an increase in capex, has risen by **2 percentage points**.



### Specific patterns:

One out of four (**25 percent**) Energy, Resources & Industrials company respondents expect a decrease in capex.

Operating costs (in AZN), %



Two third (**69 percent**) expect an increase in operating costs, while **23 percent** of respondents anticipate a decline.



### Specific patterns:

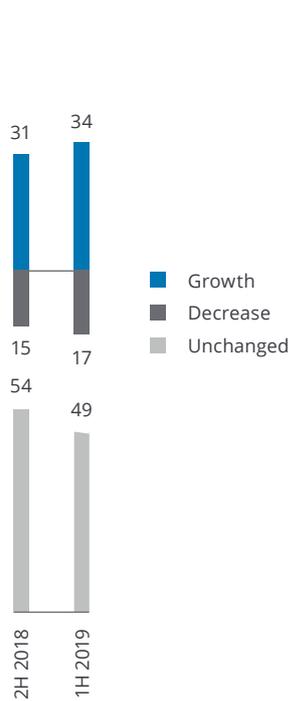
All respondents from Consumer business expect a increase in operating costs.



## Business environment in Azerbaijan

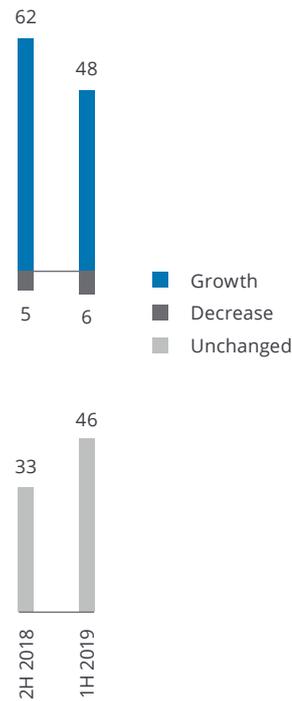
The respondents were asked about expected changes in key financial metrics over the next 12 months

Number of staff, %



About a half of the companies (**49 percent**) are not planning to change staff numbers, while **34 percent** of respondents predict an increase and only **17 percent** are expecting cuts. Compared to the situation six months ago, the share of companies that are planning to hire additional staff has risen by **3 percentage points**.

Average wages (in AZN), %



About a half of the respondents surveyed (**48 percent**) expect average wages to increase, while another **46 percent** are not considering wage adjustments.

The share of companies planning to increase average wages has fallen by **14 percentage points** compared to the situation six months ago.



### Specific patterns:

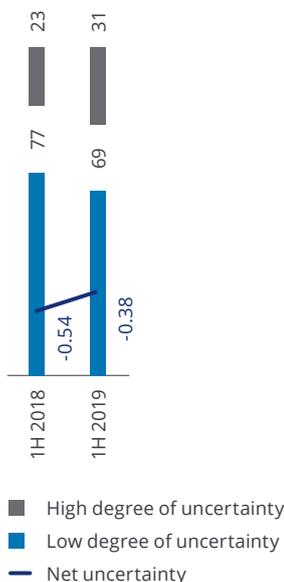
About half (**46 percent**) of respondents from Financial services companies expect an increase in staff numbers. Consumer business respondents are most likely to expect an increase in wages (**83 percent**).



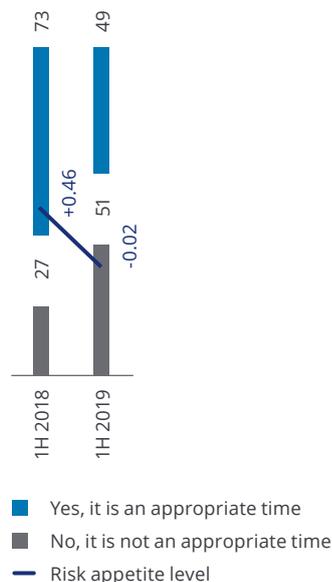
## Business environment in Azerbaijan

### Risks and uncertainty

**How would you assess the level of financial and economic uncertainty affecting strategic decision-making in your company?**



**Is now an appropriate time for risky decisions that may affect the balance sheet?**



### Trends

Companies in Azerbaijan perceive a low level of economic uncertainty: only about third of respondents (**31 percent**) cited high uncertainty (the net uncertainty level is **-0.38**). However, the level is **0.16 points** higher than a year ago.

At the same time market participants are undecided on whether this is an appropriate time for risky decisions, with a medium risk appetite level (**-0.02**), which is much lower than year ago (down **0.48 points**).

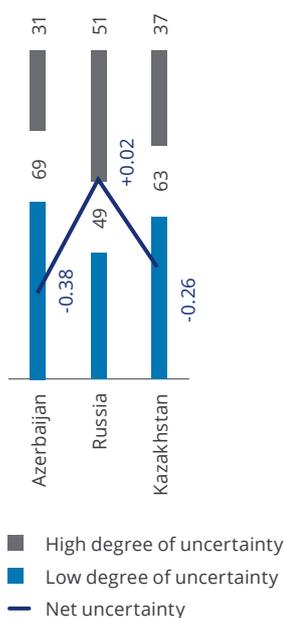


### Specific patterns:

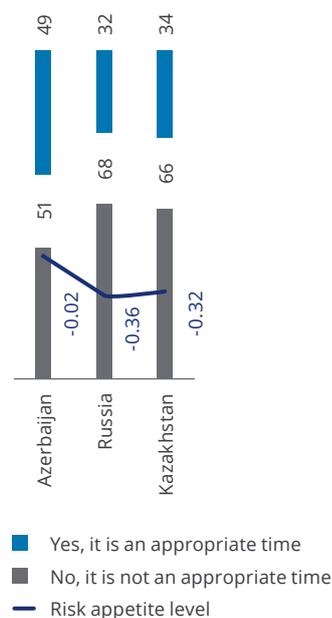
Three in four (**75 percent**) Consumer business respondents assessed the level of financial and economic uncertainty as low.

Only **37 percent** of Financial services companies are ready to take risky decisions.

**Comparison with other countries, %**



**Comparison with other countries, %**



Azerbaijan have low level of perceived economic uncertainty (**-0.38**) in comparison with Russia (**+0.02**) and Kazakhstan (**-0.26**).

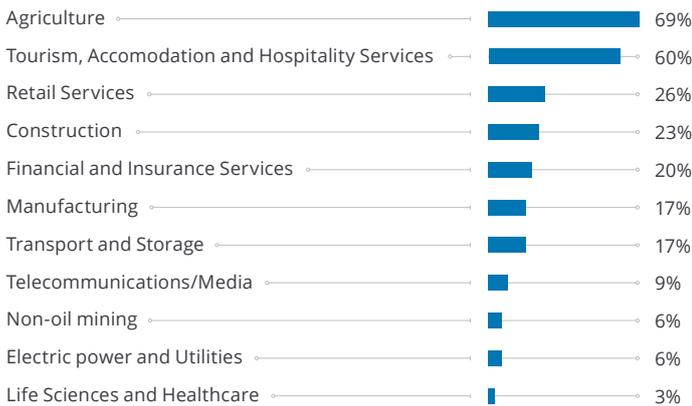
Given the low uncertainty level, the overall willingness of the top management of leading Azerbaijani companies to take on additional risk is higher than in Russia or Kazakhstan (**-0.02** against **-0.36** and **-0.32**).



## Non-oil sector development

### Potential for growth

The respondents were asked to indicate industries of Azerbaijan non-oil sector that will have the fastest growth over the next five years.



### Trends

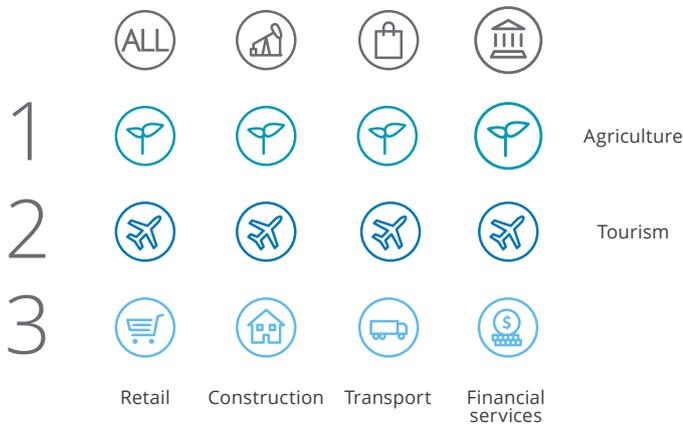
More than half of respondents said that agriculture and tourism will have the fastest growth in the non-oil sector (**69 percent** and **60 percent** respectively), followed by retail services (**26 percent**), construction (**23 percent**) and financial and insurance services (**20 percent**). **Seventeen percent** of respondents thought that manufacturing and transport and storage sector would see the fastest growth.

### Highlights

Companies from the Energy, Resources & Industrials sector put construction in third place instead of retail. Every third company (**33 percent**) predicted that construction would see some of the fastest growth

A third of companies from the Consumer business sector (**33 percent**) thought that transport and storage will be one of the fastest growth industries.

More than a third of Financial services companies (**36 percent**) said that financial and insurance services will show the fastest growth.





## Non-oil sector development

### Issues

The respondents were asked to evaluate the issues that are hindering the growth of Azerbaijan's non-oil sector.



### Trends

The main issue hindering the growth of Azerbaijan's non-oil sector is inadequate government regulation (**1.17 points**). The next most important problems are the small domestic market, poor prospects for foreign investors, currency risks and corruption (about **0.60 points** each). Insufficient government support and financing and an inability to compete on competitive foreign market rounds off the top issues (**0.49 points**).

### Highlights

Companies from Energy, Resources & Industrials were more likely (by **0.65 points**) to indicate currency risks as the main issue holding back the growth of Azerbaijan's non-oil sector. Insufficient government support and financing is a bigger issue for companies with annual revenues of less than AZN 10 mln than for others (by **0.64 points**).



We asked the same question as part of our Kazakhstan survey, and respondents there also choose inadequate government regulation as the main barrier to growth in the non-oil sector.



## Non-oil sector development

### Measures

The respondents were asked to evaluate the measures could stimulate growth in Azerbaijan's non-oil sector.



### Trends

Respondents selected tax and financial incentives (**1.29 points**) and supporting foreign investment (**1.11 points**) as the most effective measures for stimulating growth in Azerbaijan's non-oil sector. Support for innovation (**0.94 points**) and decreasing the share of state-owned companies (**0.80 points**) were in the second tier of possible measures. Finally, investments in infrastructure and creating industrial clusters and special economic zones were also popular possible measures for boosting non-oil sector growth (about **0.60 points** each).

### Highlights

Companies from Financial services were more likely (by **0.38 points**) to consider decreasing the share of state-owned companies as a good growth-stimulating measure. Companies without foreign capital in equity and companies with annual revenues of more than AZN 100 mln were more likely (by **0.28 points**) to choose investments in infrastructure.



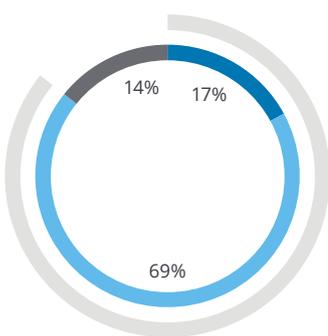
We asked the same question as part of our Kazakhstan survey, and respondents there also choose inadequate government regulation as the main barrier to growth in the non-oil sector.



## Non-oil sector development

### Government effectiveness

How would you assess the effectiveness of the government's efforts to support and develop the Azerbaijani non-oil sector?



- Effective
- Quite effective
- Not effective

**86%** The majority of respondents acknowledge that the government's efforts to support and develop the Azerbaijani non-oil sector are effective to some degree.



For comparison, the majority of respondents in Kazakhstan assessed the government's effort as not effective (**67 percent**).



#### Specific patterns:

Companies from the Energy, Resources & Industrials sector evaluated the effectiveness of the government's efforts lower: a quarter (**25 percent**) said their efforts are not effective, **11 percentage points** above average.



## Attracting investment

### Attractiveness

Please rate the attractiveness of the financing sources listed below from the standpoint of your business development goals.



### Trends

The most attractive financing sources are state subsidies and Azerbaijani investment: **63 percent** of respondents rate them positively and only about **9 percent** see them as unattractive. Equity issuance is the only financing source with more negative responses than positive (balance **-0.03**).

### Highlights

- **73 percent** of Financial services companies said that loans from Azerbaijani banks was an attractive financing source, while only **42 percent** of Consumer business respondents agreed with them.
- Respondents from Energy, Resources & Industrials companies considered equity issuance attractive (**58 percent**), while this was an unattractive source for Consumer business companies.
- Every fourth Consumer business company (**25 percent**) marked foreign investment as unattractive.

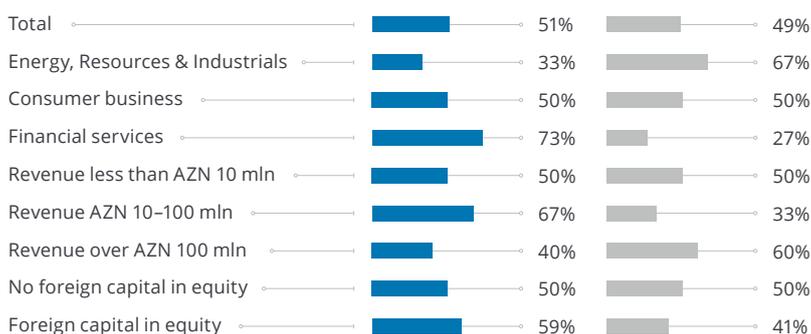


## Attracting investment

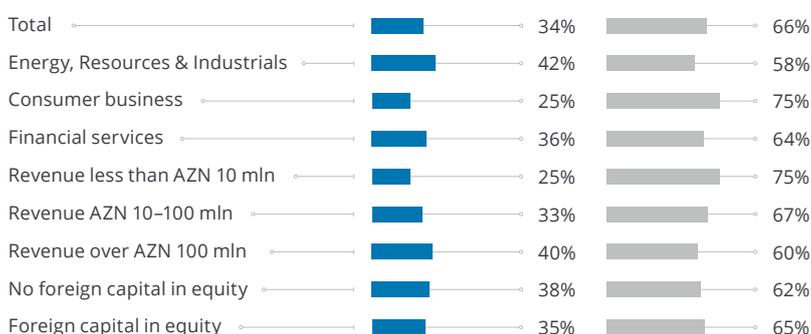
### Plans

#### Does your company plan to raise funds from external sources to support and develop its business?

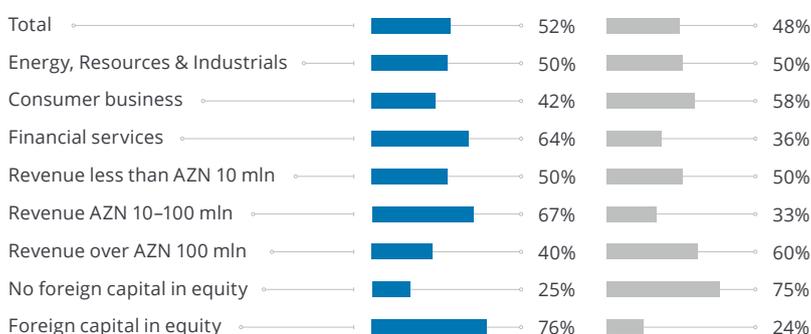
##### Azerbaijani private investment



##### Azerbaijani government investment



##### Foreign investment



■ Yes

■ No

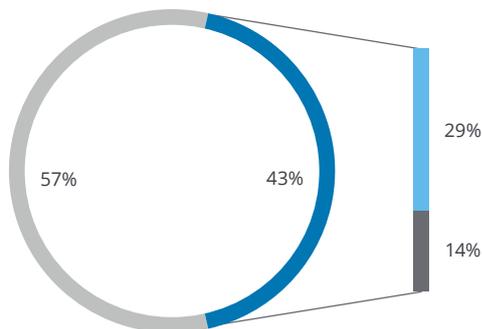
- Azerbaijani private investment is a popular funding source for Financial services companies (**73 percent**), but not for companies from the Energy, Resources & Industrials sector: **67 percent** said that they have no plans to raise funds from this source. Only third of companies with revenues of AZN 10–100 mln have no plans to raise funds from Azerbaijani private investment; however, this jumps to **60 percent** for companies with annual revenue over AZN 100 mln. Half of companies with no foreign capital in equity (**50 percent**) have private investment plans, with this figure rising to **59 percent** for companies with foreign capital in equity.
- Azerbaijani government investment is the least popular source of financing: **66 percent** of all companies are not considering this as a potential option. Only a quarter of companies from the Consumer business industry (**25 percent**) are planning on raising funds from Azerbaijani government investment, while Energy, Resources and Industrials sector companies are most likely to consider government investment (**42 percent**). **Three in four** small companies have no plans to obtain financing from the Azerbaijani government (**75 percent**), while big companies, with annual revenue over AZN 100 mln, are more likely to consider this option (**40 percent**). The amount of foreign capital in equity does not affect the attractiveness of Azerbaijani government investment: all companies have similar opinions, with **35–38 percent** responding “Yes”.
- Funding from foreign investment is the most popular source for all companies (**52 percent**). More than a half of Financial services companies are planning to raise funds from this source (**64 percent**), this figure falls to **42 percent** for Consumer business companies, while Energy, Resources & Industrials companies are split in half. Companies with foreign capital in equity are three times more likely to be planning foreign investment (**76 percent** against **25 percent**) than companies without it.



## Attracting investment

### Foreign investments

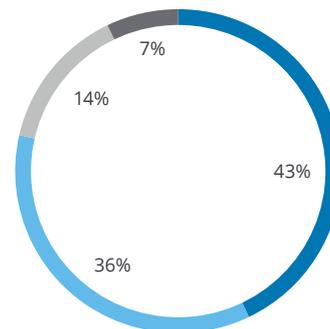
**Do you have experience with attracting foreign investment? If yes, how would you assess the non-financial effect of this (e.g. reputational, impact on the corporate culture)?**



- Yes, we have experience with attracting foreign investment
- Positive non-financial effect
- No non-financial effect
- No experience

About a half of companies (**43 percent**) have experience with attracting foreign investments. In most cases attracting foreign investment had a positive non-financial effect (**29 percent**), but **14 percent** of companies did not feel any non-financial effect from foreign investment, and no one cited a negative impact.

**You stated that your company has previously raised foreign investment. Please indicate how these funds were provided the last time.**



- Equity infusion
- Provision of a conventional loan
- Provision of a convertible loan
- Creation of a joint venture

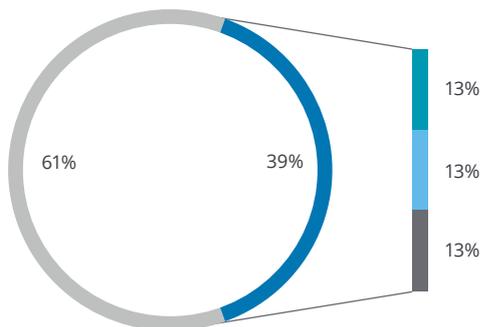
The most popular ways of providing foreign investment are equity infusions (**43 percent**) and conventional loans (**36 percent**).



## Attracting investment

### Foreign investments

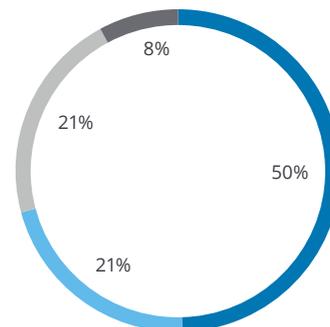
**What effect did foreign investment have on the ownership structure and management of your company?**



- There were changes to the company's ownership structure, but the controlling owner(s) remained unchanged
- There were changes to the company's ownership structure and the controlling owner(s) changed
- There were changes to the structure and/or number of executive directors on the board
- There were no changes to the ownership structure or management of the company

More than a half of companies (**61 percent**) saw no changes to the ownership structure or management after foreign investments. Another **39 percent** of companies underwent ownership structure changes, with an equal share of companies seeing the controlling owner(s) change, the controlling owner(s) remain, and changes to the number and structure of executive directors on the board (**13 percent**).

**Where were the latest funds that you raised from foreign sources mainly allocated?**



- Capex
- Operational activities
- Implementation of a complex project
- Technology development

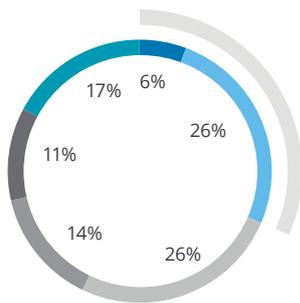
A half of companies mainly allocated foreign investments to Capex. Just over one in five companies (**21 percent**) principally allocated foreign investment to operational activities and the same share allocated it to implement a complex project. Only **8 percent** of companies used it for technology development.



## Attracting investment

### Foreign investments

**In your opinion, how have the conditions for attracting direct foreign investment to Azerbaijan changed compared to 2014?**



**32%** A third of respondents acknowledged that conditions for attracting foreign investment to Azerbaijan have improved.

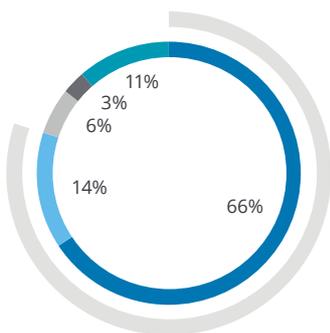


**Specific patterns:**

More than third of companies with foreign capital in equity said that conditions have worsened (**35 percent**) compared to **19 percent** of companies without foreign capital in equity.

- Conditions have improved considerably
- Conditions have improved somewhat
- Conditions have not changed
- Conditions have worsened somewhat
- Conditions have worsened considerably
- Difficult to say

**In your opinion, what impact does direct foreign investment have on the Azerbaijani economy?**



**80%** The majority of respondents indicated that direct foreign investment has a positive impact on the Azerbaijani economy.



**Specific patterns:**

**Eighty-two percent** of companies with foreign capital in equity marked the impact of foreign investment as “positive” compared to only half of companies without foreign capital in equity.

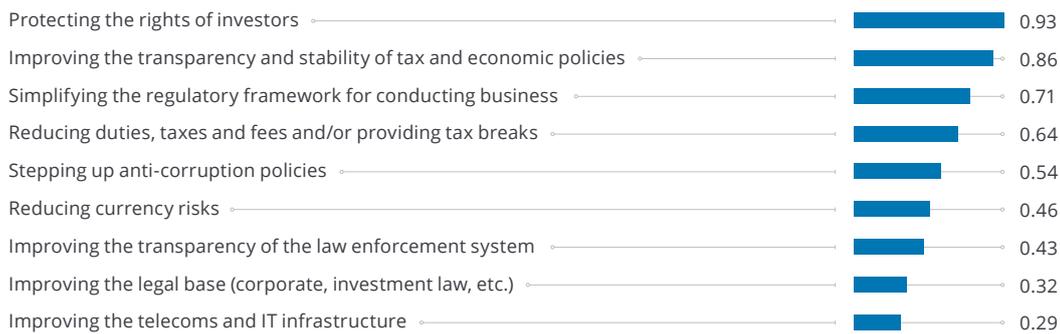
- Positive
- Quite positive
- Neutral
- Quite negative
- Negative
- Difficult to say



## Attracting investment

### Foreign investments

The respondents were asked to evaluate the measures that could increase Azerbaijan's attractiveness as a destination for foreign direct investment.



### Trends

Survey participants said that protecting the rights of investors (**0.93 points**) and improving the transparency and stability of tax and economic policies (**0.86 points**) are the best measures for increasing Azerbaijan's attractiveness for foreign investment.

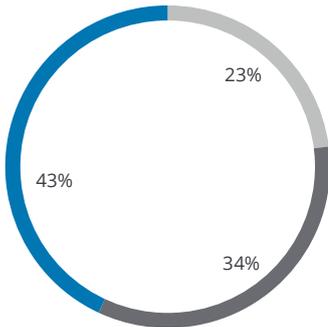
### Highlights

Respondents from the Energy, Resources & Industrials sector and from companies with annual revenues of less than AZN 10 mln are most likely to see simplifying the regulatory framework for conducting business as the best measure (by **0.67 points** and **0.43 points** respectively).



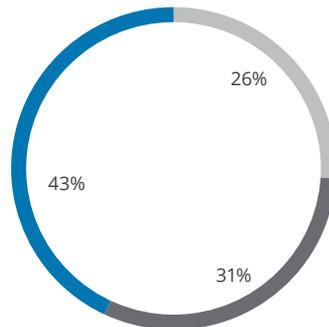
## About respondents

Annual gross revenue in 2018



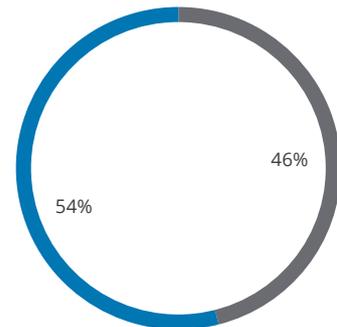
- Less than AZN 10 mln
- AZN 10-100 mln
- Over AZN 100 mln

Total number of permanent employees



- Less than 125
- 125-500
- More than 500

Companies by foreign capital in equity



- With foreign capital in equity\*
- Without foreign capital in equity

### Companies by industry



\*Amount of foreign capital in equity is at least 10 percent

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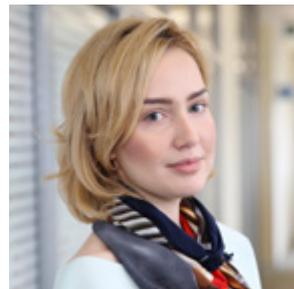
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If you have any questions regarding the survey, please do not hesitate to contact us.



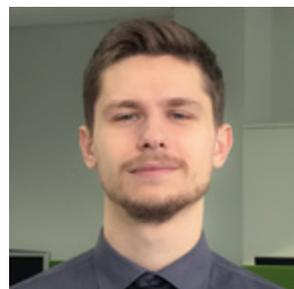
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