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## **The Current Situation and Problems of State-Owned Enterprises in Azerbaijan**

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## 1. Introduction

State-Owned Enterprises (SOEs) are identified as entities that the state possesses directly or indirectly, more precisely, if the government owns more than 50.01% of shares of the companies they are considered as the SOEs (Orbis and other databases). Approximately 10% of the largest companies in the world are owned by the states. In most cases, being a state-owned firm is more favorable as the company receives advantageous treatments by the state such as discounted funding, government-supported guarantees, directly provided subsidies, favorable regulatory treatment and also being exempted from antitrust enforcement as well as insolvency regulations. In the domestic level, there can be justifications for favorable treatments by the government such as increasing economic growth, supply of public goods and services and fixing up the market fails. However, if it outstretches its boundaries then there will be a breach of market principles.<sup>1</sup>

Many experts argue whether the state should become a shareholder of banks and companies or not. There is not a unified opinion. On the one hand, belonging to the state inspires confidence in the population, such as the company will always have the security of the state, government will try to prevent the risks of bankruptcy and profits go to the state budget. Additionally, social security of the employees of these enterprises, confidence in the future and economic stability are other factors affecting public opinion. However, it is not as simple as it seems. There are many examples from history, when enterprises with state shares have either gone bankrupt, or have accumulated huge amounts of debts.

The state takes control of the enterprises when they inevitably go bankrupt. In order to mitigate negative economic consequences, the state takes those kinds of enterprises onto the state balance. However, as often happens in most cases, the government tries to save the enterprise hopelessly, but unfortunately the enterprises still go bankrupt, and the money allocated from the state budget is simply thrown to the wind.

After the devaluation of the national currency of Azerbaijan, the debts of most companies with state participation increased almost two fold. This trend negatively affects the state budget of the Republic of Azerbaijan. Most companies that are under state support often use the funds allocated to them inappropriately, which often leads to crisis, and showed complete technological backwardness. Consequently, it affected the competitiveness of Azerbaijani companies in an adverse way.

Currently, there are a lot of problems that State-Owned Enterprises of Azerbaijan encounter although some entities exist that are in a healthy condition in the country. In this research, the principal problems of SOEs in Azerbaijan will be identified and they will be assessed and grouped according to their problems as well as the current situation in the market.

## **2. State-Owned Enterprises of Azerbaijan –evaluation of the current situation**

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<sup>1</sup>Przemyslaw Kowalski et al. "State-Owned Enterprises: Trade Effects and Policy Implications", *OECD Trade Policy Papers* (2013): 4-20 , <http://www.oecd-ilibrary.org/docserver/download/5k4869ckqk7l-en.pdf?expires=1509006713&id=id&accname=guest&checksum=FDCA1A328B80D73C9ACD386538807DE9>

The State-Owned Enterprises of Azerbaijan are involved in the resource sector such as power generation, production of oil and gas, supply of water and airway, railway and freight services as well. Azerbaijani SOEs, such as the State Oil Company of the Azerbaijan Republic (SOCAR), "Azerenerji" and "Azersu" are Closed Joint-Stock Companies that enjoy a monopoly status in their own fields. The majority of the SOEs in Azerbaijan use their granted power to block new firms which are planning to enter the market. State-Owned Entities of the country have access to both financial and material aid. However, in Azerbaijan SOEs are not free from taxes, firms pay the tax burden that is allocated to them.<sup>2</sup>

There is no released list of the State-Owned Enterprises of Azerbaijan; however, the primary SOEs of the country are identified as follows:

1. State Oil Company of the Republic of Azerbaijan
2. "Azerenerji" Open Joint Stock Company
3. "Azerbaijan Airlines" Closed Joint-Stock company
4. "Azerbaijan Railways" Closed Joint-Stock company
5. "Azersu" Open Joint-Stock Company
6. "Azerishiq" Open Joint-Stock Company
7. "Azeristiliktechizat" Open Joint-Stock Company
8. "Azerbaijan Melioration and Water Management" Open Joint-Stock Company
9. "Azerbaijan Caspian Shipping company" Closed Joint-Stock company
10. "Azeravtoyol" Open Joint-Stock Company
11. "Aqrarkredit" Closed Joint-Stock Non-Banking Credit Organization
12. "International Bank of Azerbaijan" Open Joint-Stock Company
13. "Azer-Turk-Bank" Open Joint-Stock Company
14. State Insurance Commerce Company of the Republic of Azerbaijan
15. "Aqrolizing" Open Joint-Stock Company
16. "Port of Baku" Closed Joint-Stock Company
17. "Baku Metropolitan" Closed Joint-Stock Company
18. "AzerCosmos" Open Joint-Stock Company
19. "Aztelecom" Limited Liability Company
20. "Baku Telephone Communication" Limited Liability Company

There is limited information about the SOEs of Azerbaijan as many of them provide financial and overall annual reports but unfortunately, there are some entities that have not provided these financial statements for the last couple of years. These state entities have various problems related to debt and credit, technology and innovation and financial loss. The main cause of the high indebtedness of these enterprises was the devaluation of the national currency of Azerbaijan in 2015 which increased the amount of unpaid loans extremely. Other reasons for these problems can be the structure, management and level of corruption in the companies. Nevertheless, in Azerbaijan there are many State-Owned Enterprises that are in healthy conditions and operate according to international standards, not experiencing any considerable financial problems and which are accountable and transparent companies who have become the main operators in their sectors.

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<sup>2</sup> U.S. Department of State, "Azerbaijan. Investment Climate Statement 2015" (2015):15, <https://www.state.gov/documents/organization/241680.pdf>

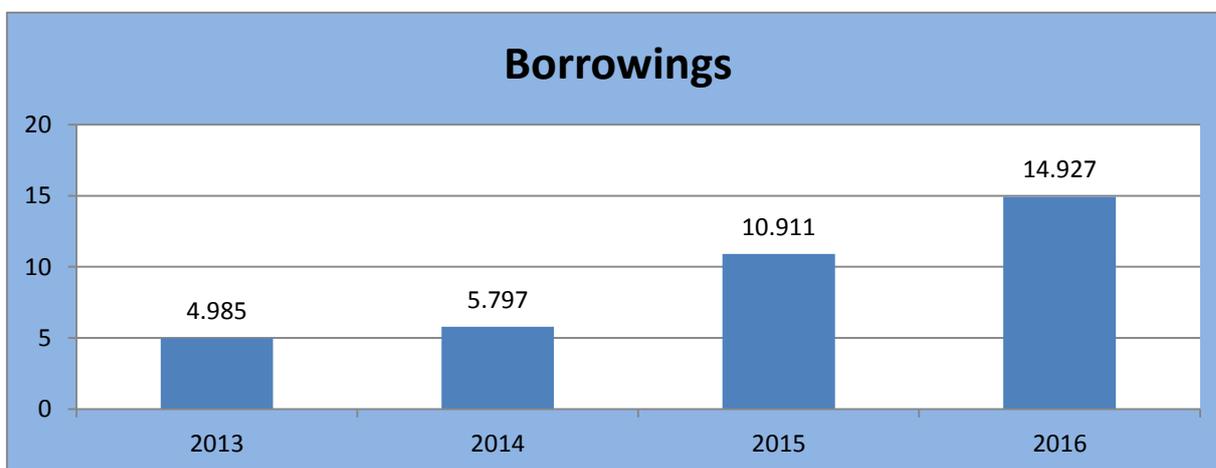
## 2.1. Debt Problems – SOEs of Azerbaijan

SOEs have soft budget constraints meaning government support, in terms of financial aid and bankruptcy avoidance. This also includes zero risks for the investments made by the state-owned entities and leads to huge capital spending. As a result, SOEs are not utilized well when it comes to maximizing their revenues.<sup>3</sup>

The companies that are owned by the Azerbaijani government have debt problems, because they engage in different projects, cooperating with international companies, purchasing products and technologies of foreign countries which require huge amounts of loans. Particularly, foreign debt has become very problematic following the devaluation of the national currency of Azerbaijan as the companies are required to pay twofold the price of their loans. The following agencies are identified, particularly, according to their huge debt problems.

**State Oil Company of the Republic of Azerbaijan (SOCAR)** which extracts and processes oil and gas has significant debt problems. SOCAR sponsors and develops many projects, both on the territory of the Republic of Azerbaijan and abroad. In order to successfully develop projects and the company as a whole, SOCAR attracts credit and investment funding. Since early 2017, SOCAR has received loans worth \$1.4 billion. According to figure1, the total borrowing of SOCAR has increased by about 10 billion during the four years (2013-2016). The main reasons for such high debt are the implementation of oil and gas projects in foreign countries, the acquisition of foreign assets, and overestimation of the work performed, corruption, the lack of high-level management specialists, the devaluation of the national currency, as well as the company's high taxation rate and social obligations to the population.<sup>4</sup>

**Figure1. Borrowings of the State Oil Company of the Republic of Azerbaijan for short and long term, billion manat**



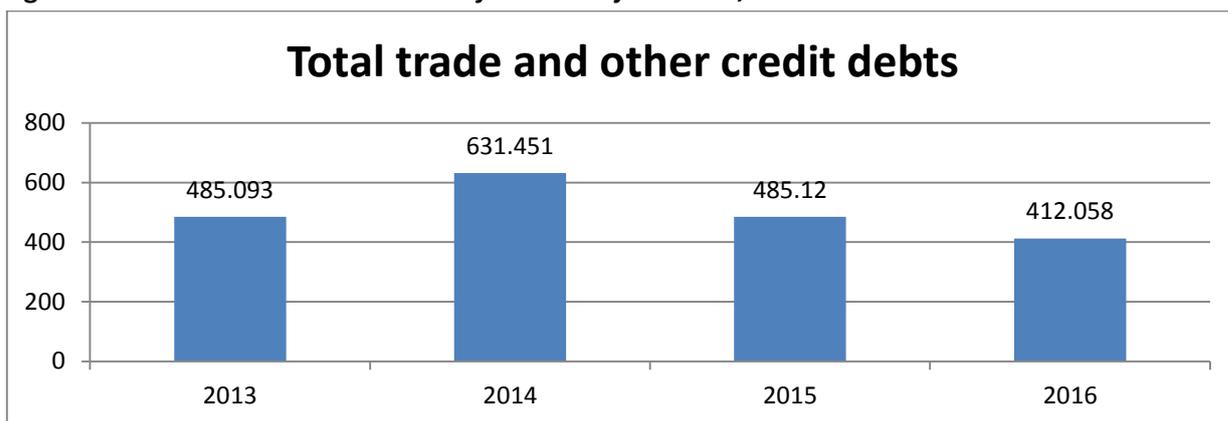
*Source: SOCAR, 2013-2016*

**"Azerenerji" Open Joint-Stock Company** as the monopolist in Azerbaijan on supplying electricity to industrial and strategic enterprises this firm has faces difficulties relating to its debt.

<sup>3</sup>Wojciech Maliszewski et al. "Resolving China's Corporate Debt Problem", *IMF Working Paper* (2016): 7-8, <https://www.imf.org/external/pubs/ft/wp/2016/wp16203.pdf>

<sup>4</sup> State Oil Company of the Azerbaijan Republic, Economics&Statistics, SOCAR Financial Reports (2013-2016) <http://www.socar.az/socar/en/economics-and-statistics/economics-and-statistics/socar-reports>

**Figure2. Trade and other credit debts of “Azerenerji” in total, million manat**



**Source: “Azerenerji” OJSC, 2013-2016**

According to figure2, it can be said that, the company still has plenty of credit debt, although it decreased slightly in 2016 compared to 2015. The reason for this is the devaluation of the national currency, accumulated loans in foreign currency and payment delays of its customers.<sup>5</sup> In fact, by the end of 2015, more than 70% of the total debt of “Azerenerji” was due to fluctuations in foreign currency. Fitch announced the default rating of “Azerenerji” for the long and short term as negative. It is mainly related to government support in the form of guaranteed debt.<sup>6</sup> It should also be noted that one of the major debtors of SOCAR is “Azerenerji”. The management is negotiating with SOCAR on debt restructuring, which will take time to find a way out of the crisis situation. It is worth noting that, in addition to external debt, the company has internal debt as well. State subsidies designed to help modernize the company, reduce the cost of electricity and introduce innovative technologies, often only tighten the debt loop around the neck of the company.<sup>7</sup>

Another SOE of Azerbaijan, "**Azerishiq**" **Open Joint Stock Company** which is the largest electricity distribution company in the country has huge debt problems. As indicated earlier, the main reason for the sharp increase in its financial debt is the devaluation of the national currency. Another factor of relating to its high indebtedness is the overall decline in the socioeconomic level of the population, thus the population cannot pay the company (in 2015, the debt of the population to the company amounted to 524.257 million manat). Therefore, according to the Asian Development Bank, the arrears of “Azerishiq” in 2015 amounted to 270 million manat, and in 2016 it was 316.3 million manat. In addition to foreign debts, “Azerishiq” also owes money to other national companies. As is well known, the largest producer of electricity in Azerbaijan is Azerenerji. A conflict situation broke out between “Azerenerji” and “Azerishiq”, since the former accused the latter company of late and incomplete debt repayment.<sup>8</sup>

For a long time, **the International Bank of Azerbaijan (IBAR)** was considered the largest bank in the Caucasus and also the most reliable, as the state was the guarantor of the bank. However, after the devaluation of the national currency of the Republic of Azerbaijan, the bank's foreign currency debts

<sup>5</sup> “Azerenerji” OJSC, Consolidated Financial report for 31.12.2016, 5,

<http://www.azerenerji.gov.az/index/page/11/>

<sup>6</sup> “Fitch Affirms Azerenerji at 'BB+'; Outlook Negative”, *Reuters*, December 6, 2016,

<https://af.reuters.com/article/africaTech/idAFFit982648>

<sup>7</sup> “Fitch: Government will help Azerenerji to pay off SOCAR debts”, *Minval.az*, May 4, 2017,

<http://m.minval.az/news/123685693>

<sup>8</sup> Asian Development Bank, “Proposed Multitranches Financing Facility Azerishiq Open Joint-Stock Company Power Distribution Enhancement Investment Program (Guaranteed by the Republic of Azerbaijan)” (2016),

<https://www.adb.org/sites/default/files/project-document/184900/42401-014-fam.pdf>

rose sharply. A main investor of IBAR has been Kazakhstan Pension Fund which has invested a total amount of \$250 million with the bank. On May 11, 2017, the international bank filed for bankruptcy in a New York court. In order to pay back the bank's debt, the Azerbaijani state restructured the debt of IBAR and began to pay its debt from the country's budget in a separate graph.<sup>9</sup>

Taking into account all the negative factors, the level of debt of the international bank has reached 9 billion manat. The problems of such a high level of debt are not only due to the devaluation of the national currency, but also to the irresponsible management of the bank by its administration. It would be advisable to make a change in the management structure of the bank, removing the chairman and leaving the directors of the departments, so that they can direct the meeting with the Ministry of Finance of the Republic of Azerbaijan (the main holder of the shares of the international bank). What could also be recommended is to remove the state monopoly and make the bank private.

Excessive state support has enabled the bank to take foreign currency loans in unlimited amounts. The government of the Republic of Azerbaijan was responsible for all these risks. A combination of negative factors and irresponsible management has led to huge debt and the result has been the bankruptcy of one of the largest banks in the region.

**The "Azer-Turk-Bank" Open Joint-Stock Company** is also experiencing debt problems and in 2016 the bank almost lost 100 million manat. Bank Standard which took a loan from "Azer-Turk-Bank" in the amount of 100 million manat went bankrupt and lost its license. As a result, the Bank's loan portfolio decreased by 2.5 times compared to 2015 and reached 171,424 thousand manat as of December 31, 2016. 19.7% of the portfolio was made up of client loans, and 37.8% - loans to state-owned enterprises. By the end of 2016, the value of the Bank's impaired assets was 16,539 thousand manat, while overdue but not depreciated assets - 25,439 thousand manat, of which 31.4% are state-owned and 23% are consumer loans. In order to remedy the situation, the bank took another loan from the Central Bank in the amount of 100 million manat.<sup>10</sup>

**"Azerbaijan Railways" Closed Joint-Stock Company** is considered one of the most vulnerable state enterprises in Azerbaijan. The company has not provided any yearly financial statements since its establishment. According to the Chamber of Accounts of Azerbaijan Republic, as of December 31, 2016, 5% (\$545.3 million) of public debt belongs to "Azerbaijan Railway" CJSC (7.3% or \$37 million more than in 2016).<sup>11</sup> There are frequent discussions regarding the existence of this debt, amounting to 2.1 billion manat, as well as the risk of the company defaulting in the daily press.<sup>12</sup> However, the Baku-Tbilisi-Kars railway which will connect Trans-Asia and Trans-Europe was officially opened on 30<sup>th</sup> October, 2017. MP of Azerbaijan, Aydin Mirzazade emphasized that the BTK railway will have a great importance not only for the region, but also for the world. Initially, the railway will carry one million people and also 6.5 millions of cargo which is planned to reach 17 million tons in the future.<sup>13</sup> As a result of this project,

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<sup>9</sup> International Bank of Azerbaijan, IFRS Financial Reports,

<https://www.ibar.az/en/about-bank/disclosure-of-information/financial-statements/>

<sup>10</sup> Azer-Turk Bank Open Joint Stock Company, Financial statements Year ended 31 December 2016 together with independent auditor's report (2017), [http://azerturkbank.az/docs/w/illik\\_en\\_2016.pdf](http://azerturkbank.az/docs/w/illik_en_2016.pdf)

<sup>11</sup> Chamber of Accounts of Republic of Azerbaijan, Feedback of the implementation of the state budget of 2016 ,418, [http://sai.gov.az/upload/files/ICRA-2016-SON\\_FINAL.pdf](http://sai.gov.az/upload/files/ICRA-2016-SON_FINAL.pdf)

<sup>12</sup> "Azerbaijan Railways in debt", *Opengovernment.az*, July 19, 2017,

<http://opengovernment.az/en/topics/analytics/az-rbaycan-d-mir-yollar-da-borc-icind-dir-1/>

<sup>13</sup> "MP: BTK railway's opening – historic event not only for region, but also for the world", *Trend News Agency*, October 30, 2017, <https://en.trend.az/azerbaijan/politics/2814663.html>

“Azerbaijan Railways” CJSC is expected to gain a lot of profit in the long-run, thereby being able to solve its current financial problems.

One of the biggest companies in the road infrastructure industry, **“Azeravtoyol” Open Joint-Stock Company**, is likewise experiencing severe credit problems.<sup>14</sup> “Azeravtoyol” OJSC spent 403.9 million manat for the same year of which the main expenses were on current reparation (23,186%) and loans and interest rates (22,458 %). Debt of the company from last year was 609.2 million manat, in 2016 the current debt was around 142.9 million manat, the payables stood at 412.9 million manat and by the end of the year 339.1 million manat remained in arrears for long-term bank loans. On the other hand, the numbers for the short-term loans of “Azeravtoyol” OJSC were: 4.9 million manat in debt for 2015, 46 million manat debts was accumulated and 46.4 million manat was paid by the company in 2016, however, 4.5 million manat debts still remains. The company had debtor debt in the amount of 17.4 million manat (78.4 thousand manat overdue debtor debts) and 23.3 million manat creditor debt (35 thousand manat overdue creditor debts) for the year 2016. For the purpose of financing capital investments, 691.8 million manat was borrowed from the budget.<sup>15</sup>

**“Baku Metropolitan” Closed Joint-Stock Company** finds itself in financial problems. At the end of 2016, the total debt of “Baku Metropolitan” was 64.52 million manat, of which 24.2 million manat, or 37.5%, were creditors' debt.<sup>16</sup>

## 2.2. Loss Problems of SOEs in Azerbaijan

Loss of the state-owned enterprises reflects strategic investments that cause value formation. Here the perfect model is considered SOEs which create value and are profitable at the same time. However, evaluation of SOEs should not be exclusively based on financial indicators such as profit or loss, by contrast, contribution to the societal value creation should be the focus by taking into account holistic perspective.<sup>17</sup>

In Azerbaijan, many of the state-owned entities have financial loss problems and they are experiencing deficit in their revenues. This is particularly the case for entities that are supported in the form of subsidies and investments by the government for public services. The main aim of these agencies is to provide public value while having negative amounts of profit.

**“Baku Metropolitan” CJSC** has been ending with a financial loss and unable to pay its amortization costs. For this reason, subsidies are allocated to the “Baku Metropolitan” CJSC from the budget every year. State subsidies are spent on maintaining the staff as a whole. State subsidies are one of the main sources of income for the “Baku Metropolitan”. The annual budget subsidy is determined without depreciation. The volume of subsidies from the state budget in 2016 was about 38 million manat.

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<sup>14</sup> “Azeravtoyol” OJSC, General Information, <http://azeravtoyol.gov.az/az/pages/40/>

<sup>15</sup> “Azeravtoyol” OJSC, Consolidated Financial Report for the date of 31.12.2016 (2017), <http://azeravtoyol.gov.az/az/pages/247/>

<sup>16</sup> “Baku Metropolitan” Closed JSC, Financial figures 2016, <http://metro.gov.az/uploads/pdf/2016%20MALIYY%C6%8F%20HESABATLARINA%20QEYDL%C6%8FR.pdf#page=10&zoom=auto,-13,672>

<sup>17</sup> PricewaterhouseCoopers, “State-Owned Enterprises Catalysts for public value creation?” (2015), 22-24, <https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf>

However, the losses of the company amounted to 78.7 million manat which increased almost 2.8 times compared to 2015.<sup>18</sup>

**“Agroleasing” Open Joint-Stock Company** has very huge loss problems as well. The company purchases equipment and components using funds from the government budget, later leasing these equipments to individuals and legal entities over a 10 year period with an initial 10% payment.<sup>19</sup> On August 13, 2014, the Cabinet of Ministers approved new rules for acquiring equipment for leasing and applying discounts to certain lease agreements. According to the rules, a company may take a lease of 5 years at a 40% discount if they give an initial payment of 20%. This discount is made at the expense of the company and is compensated by the state budget.<sup>20</sup>

According to figure 3, total revenue of the “Agroleasing” OJSC was about 127.9 million manat in 2016. However, expenses of the company were around 139 million manat for that year, leading to approximately 11 million manat losses. Generally, the company profit was 6.7 million manat. “Agroleasing” OJSC lost 13.835,777 million manat due to discounts made to the firms.<sup>21</sup>

**Figure3. “Agroleasing” OJSC, financial indicators for 2016, million manat**

<b>Total revenue</b>	<b>127.886,447</b>	
	Expenses	138.961,633 (including the cost of sales)
	Total loss	11.075,187
<b>General Profit</b>	<b>6.692,479</b>	
<b>Loss on discounts</b>	<b>13.835,777</b>	

Source: Agroleasing” Open Joint Stock Company, 2016

Another SOE, **“Azersu” Open Joint-Stock Company** had a gross profit in the amount of 75.3 million manat in the year 2016. Nevertheless, the total comprehensive loss for this year was about 612.9 million manat of which a loss of 39.8 million manat was due to foreign exchange rates. Accumulated losses for the year were around 5.6 billion manat, although the government made investments in the amount of 3.3 billion manat to the company.<sup>22</sup>

### 2.3. Technology Problems – SOEs of Azerbaijan

Some SOEs of Azerbaijan don’t have proper modern technology and equipments which are another significant problem. Presently, the growing development of modern technology requires companies to adapt to new methods and facilities. Some of the entities owned by the Azerbaijan government already possess new technologies, although many still have problems in acquiring advanced technology. The

<sup>18</sup> “Baku Metropolitan” Closed JSC, Financial figures 2016, 9, <http://metro.gov.az/uploads/pdf/2016%20MALIYY%C6%8F%20HESABATLARINA%20QEYDL%C6%8FR.pdf#page=10&zoom=auto,-13,672>

<sup>19</sup> E-qanun.az, <http://www.e-qanun.az/framework/2059>

<sup>20</sup> “Agroleasing” Open Joint Stock Company, “Decision of the Cabinet of Ministries of Azerbaijan Republic on the application of the discounts by the “Agroleasing” OJSC “ (2014), <http://agrolizing.gov.az/az/menu/212>

<sup>21</sup> “Agroleasing” OJSC, Financial Statements and Independent Auditors' Opinions of 31 December 2016 (2017), 3-19, <http://agrolizing.gov.az/upload/newsayt/Maliyye%20hesabati.pdf>

<sup>22</sup> “Azersu” Open Joint-Stock Company, Consolidated Financial Reports for 31.12.2016 (2017), 1-3, <http://www.azersu.az/userfiles/file/Hesabatlar/2016aze.pdf>

main problem lies in old equipment which undermines operations and need to be repaired or completely changed. Another reason is the lack of professional staff with up to date technological skills and abilities.

**“Azerbaijan Caspian Shipping Company” Closed Joint-Stock Company** is another important State-Owned Enterprises of Azerbaijan which plays a connecting role in the transport corridor of Europe - Caucasus - Asia (TRACECA) and provides services for offshore oil and gas operations, as well as transportation of cargo and passengers in the Trans-Caspian direction. In 2016, 34% of the company’s cargo shipments were in the Caspian Sea and 66% in international waters outside of the Caspian Sea. There are 11 company vessels in international waters outside the Caspian Sea.<sup>23</sup> Most of the company’s vessels are over 25 years old. This creates problems with carriage insurance by car insurance companies in cargo carriers, encouraging cargo owners to apply to other shipping companies.<sup>24</sup> As a result, the cargo transportation role of the company becomes undermined.

**“Baku Metropolitan” CJSC** has problems with the old trains it operates through the stations. The majority of its trains do not work properly and become stuck in the tunnels for several minutes sometimes.<sup>25</sup> Starting from 2014 until now, 18 trains of the “Baku Metropolitan” CJSC have already been updated and repaired locally.<sup>26</sup> In 2015, there were different courses organized by Russian specialists for machinists on how to drive and control the new modern trains in Baku Metropolitan.<sup>27</sup> Despite that, there needs to be a greater focus on human capital development.

#### 2.4. Non-transparent and Unaccountable SOEs of Azerbaijan

Transparency and disclosure should be the two basic principal for SOEs to enable both internal and external auditors to control the activity of the entities. There are some SOEs regulations about the accountability of the State-Owned Enterprises. It is necessary for SOEs to undergo yearly independent outside audit and it should also be noted that internal state monitoring procedures do not replace the external audit. SOEs should publish financial and non-financial statements according to international standards. These statements should include explicit information about the firm’s objectives and their implementation, financial aid such as state-backed guarantees, subsidies, commitments, negotiations and arrangements with other relevant agencies. However, states have a tendency to count on inside auditor institutions which tends to be controlled by the government for the assessment of SOEs. According to SOE guidelines, external observers should conduct audit at a minimum in the large SOEs of

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<sup>23</sup> “Azerbaijan Caspian Shipping Company” Closed JSC, <http://www.acsc.az/az/pages/7/50/information/397>

<sup>24</sup> “Sea transportation in Azerbaijan: problems, perspectives”, *Republic Newspaper*, 2016, <http://www.respublica-news.az/index.php/dig-r-x-b-rl-r/dig-r-x-b-rl-r/item/14049-azaerbaydzanda-daeniz-naegliyyat-problemlaer-perspektivlaer>

<sup>25</sup> “The train was stuck in the tunnel for 9 minutes because of malfunction”, *Trend News Agency*, April 24, 2017, <https://az.trend.az/azerbaijan/incident/2746030.html>

<sup>26</sup> “Baku Metropolitan: the trains are repaired under the local conditions”, *Trend News Agency*, January 30, 2017, <https://az.trend.az/azerbaijan/society/2714922.html>

<sup>27</sup> “The courses organized for the machinists of Baku Metropolitan on the usage of new trains”, *Azerbaijan State News Agency*, August 17, 2015, [https://azertag.az/xeber/Baki\\_Metropoliteninin\\_masinistlerine\\_yeni\\_qatarlardan\\_istifade\\_uzre\\_kurslar\\_kechirilir-878069](https://azertag.az/xeber/Baki_Metropoliteninin_masinistlerine_yeni_qatarlardan_istifade_uzre_kurslar_kechirilir-878069)

the countries on the basis of internationally recognized standards. It is essential for the government to give a justification for SOE ownership by openly identifying and revealing its intentions.<sup>28</sup>

Corruption is one of the main problems in Azerbaijan, which the country accepts and takes steps in order to improve the situation through the adoption of several anti-corruption laws and regulations as well as joining international agencies' programs against corruption. However, the enforcement of these measures remains problematic.

**Azerbaijan Airlines (AZAL) Closed Joint-Stock Company** as the primary aviation company of Azerbaijan, AZAL plays an important role in the aviation industry of the country. The outstanding airline ranking company- Skytrax, rated AZAL as the best airline company among the CIS countries and Russia.<sup>29</sup> According to the decision of the Cabinet of Ministries on the confirmation of the charter and structure of the Azerbaijan Airlines CJSC on 30<sup>th</sup> of April 2008, the company has to provide an annual financial report as well as consolidated reports with the auditor review no later than four months after the end of every financial year.<sup>30</sup> However, there are no publicly available financial statements provided in the official website of the company or in the media. In fact, AZAL pursued a policy of blocking new companies from entering the market because of its business interests due to the influence it has as a state-owned enterprise.<sup>31</sup>

**"Azeristiliktechizat" Open Joint-Stock Company** which is responsible for thermal power generation, transmission, distribution, sale, and service functions implementation has also not provided any financial statements since 2011.<sup>32</sup> Another SOE of Azerbaijan that controls water resources, water amelioration, water management and irrigation systems – **«Azerbaijan Amelioration and Water Management" Open Joint-Stock Company** has likewise not issued financial statements of the company's activities. Although they have a separate internal audit sector in the structure of the company which is confirmed by the decision of the Cabinet of Ministries on 17 June 2016, there are not any financial reports for recent years in the official website of the entity.<sup>33</sup>

On June 14 2017 the World Bank Group held a workshop in Baku on transparency and efficiency of SOEs in Azerbaijan. The main objective of the event was to raise awareness on the significance of good governance structure as well as transparent disclosure of SOEs of Azerbaijan. The World Bank Group emphasized during this workshop that the Azerbaijani government needs to place more emphasis on improving transparency and financial accountability.<sup>34</sup>

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<sup>28</sup> OECD, "SOEs OPERATING ABROAD: An application of the OECD Guidelines on Corporate Governance of State-Owned Enterprises to the cross-border operations of SOEs", 14,

<https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/44215438.pdf>

<sup>29</sup> Azerbaijan Airlines CJSC, History of CJSC Azerbaijan Airlines, <https://www.azal.az/en/about/history>

<sup>30</sup> "Decision of the Cabinet of Ministries of Azerbaijan on the confirmation of the structure and charter of Azerbaijan Airlines", *E-qanun.az*, [www.e-qanun.az/framework/doc/27430](http://www.e-qanun.az/framework/doc/27430)

<sup>31</sup> Global Investment Center-USA, Azerbaijan, Mineral, Mining Sector and Business Guide, Strategic Information and Regulations Volume I, (*International Business Publications*, USA Washington DC), 43,

<https://books.google.az/books?id=C41jxGGn5YgC&printsec=frontcover&hl=ru#v=onepage&q&f=false>

<sup>32</sup> "Azeristiliktechizat" OJSC, Annual Reports, <http://azeristilik.gov.az/index.php?page=sp&n=18>

<sup>33</sup> "Azerbaijan Amelioration and Water Management" OJSC, [http://mst.gov.az/index\\_1\\_az.html](http://mst.gov.az/index_1_az.html)

<sup>34</sup> The World Bank, "Promoting Transparency and Efficiency of State-Owned Enterprises in Azerbaijan" workshop, *Events*, June 14, 2017, <http://www.worldbank.org/en/events/2017/06/14/promoting-transparency-and-efficiency-of-state-owned-enterprises>

## 2.5. SOEs of Azerbaijan that are in a healthy condition

There are some State-Owned Enterprises of Azerbaijan that have good economic performance compared to other SOEs. They do not have huge debt problems; they are becoming the main operators in their fields via their good level of performance and they also do not have any transparency problems and provide timely financial reports based on international standards.

As one of the most developed SOEs of Azerbaijan, **the Port of Baku** managed to transport 3.1 million tons of cargo in 2015. There was a downward tendency in the cargo carriage operations of the Port of Baku, because of the financial and economic troubles caused by the fall of the oil prices.<sup>35</sup>

Vahid Ahmadov, Azerbaijani MP called the creation of the company a big project as it will lead to the establishment of the first free trade zone (FTZ) in Azerbaijan. The Port of Baku will bring millions of dollars to the country if the project works according to the formulated procedures and via this project the improvement of the non-oil sector will be achieved.<sup>36</sup>

There was a recorded increase in cargo transportation in all directions from and to Port of Baku in the first half of the year 2017. The volume of the general cargo handling (oil products excluded) was 1900 ton by an increase of 43.5% compared to the same period of last year. 89% of the cargo is handled by transit cargo. Simultaneously, significant growth has been noted in the transshipment of wheeled vehicles, particularly, of large vehicles. As a result, the number of large vehicles that are using the services at the Port of Baku has increased by 53.7% reaching, 16204, than the previous year. 10154 (62.7%) of them moved in the direction of Baku-Turkmenbashi-Baku while 6050 (37.3%) vehicles were in the Baku-Aktau-Baku direction. The general number of transshipped wagons by the company was 21775.<sup>37</sup>

Another well-performing SOE, **"AzerCosmos" Open Joint-Stock Company** is considered the only satellite operating company in the Caucasus. The company launched the Azerspace-1, the first satellite in the country, on February 8<sup>th</sup> 2013. "AzerCosmos" OJSCo provides high quality and reliable broadcasting through satellite services (DTH, video, voice, data etc.) for the companies and government agencies. The company has an important role in space which connects more than 50 countries in Europe, Middle East, Africa and Central Asia. In 2014, "AzerCosmos" OJSCo launched another satellite Azersky which is an optical Earth observation satellite. Due to its professional staff and developed technical potential, the company is becoming the main figure in the ICT field both in Azerbaijan and region over the short period of time. The Future plans of the company include launching a new telecommunication satellite-Azerspace2 in 2017 as well as another earth observation satellite with very high resolution in the coming years.<sup>38</sup>

Ernst & Young, a well renowned professional audit and consulting company conducted an audit on "AzerCosmos" OJSCo for the year 2013. The results were positive and emphasized the operating of the

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<sup>35</sup>Baku International Sea Trade Port CJSC, Statistics Overview 2015,

<http://portofbaku.com/uploads/fayllar/2016%20Statistics%20Overview.pdf>

<sup>36</sup> "Port of Baku to bring billions of dollars to Azerbaijan", *Trend News Agency*, October5, 2016,

<https://en.trend.az/business/economy/2668777.html>

<sup>37</sup> "Port of Baku" Closed Joint-Stock Company, Facts and Figures, <http://portofbaku.com/az/Facts-and-Figures/>

<sup>38</sup> "AzerCosmos" Open Joint Stock Company, <http://azercosmos.az/en/about-us/about-azercosmos-2>

company under the accountability and transparency principles. The company's financial statements are prepared on the basis of International Financial Reporting Standards.<sup>39</sup>

Although **"Azerbaijan Caspian Shipping Company" CJSC** has problems with its technology, generally the company can be considered in a better state if the financial figures of the CJSC are taken into account.

According to figure 4, in 2016 the number of the total assets of the company equalled 904.7 million manat of which 74% are long-term assets and 26% short-term assets. The total income of the company was about 501.3 million manat. Regarding expenditures, around 266.8 million manat was the cost of sales and 126.3 million manat was spent on bureaucratic, tax and social issues. As a result, the company gained 108.266 million manat as a profit that same year. "Azerbaijan Caspian Shipping Company" invested a total of 153.965 million manat in vessels, fixed and intangible assets.<sup>40</sup>

**Figure4. "Azerbaijan Caspian Shipping Company" financial figures for 2016, million manat**

<b>Total assets</b>	<b>904.666</b>	
	Long-term assets	668.835
	Short-term assets	232.831
<b>Total capital</b>	<b>807.409</b>	
	Share capital	440.051
	Undistributed earnings	367.358
<b>Total liabilities</b>	<b>94.257</b>	
	Long-term liabilities	37.768
	Short-term liabilities	59.489
<b>Total revenues</b>	<b>501.291</b>	
	Total expenses	266.762 (cost of sales)
		126.263 (social, administrative, tax, etc.)
	Total profit	<b>108.266</b>
<b>Total investment</b>	<b>153.965</b>	
	Purchase of ships, fixed assets	153.070
	Intangible Assets	0.895

Source: "Azerbaijan Caspian Shipping Company" CJSC, 2016

As of the first quarter of 2017, "Azerbaijan Caspian Shipping Company" hasn't take any loans from foreign banks with state guarantees, overdue or unpaid loan commitments. Over the next five years, existing loans and interest rates will amount to only 1.5% of the annual income of the company.<sup>41</sup>

**"Aqrarkredit" Closed Joint-Stock Company** which is a financial-credit organization serving the agrarian sector of Azerbaijan has improved its financial position. According to the annual report of the company (2014), "Aqrarkredit" CJSC has given loans worth over 113 million manat to both physical and legal

<sup>39</sup> "AzerCosmos" Open Joint Stock Company, "The Financial Statements of Azercosmos OJSCo has been announced", September 18, 2014, <http://azercosmos.az/en/the-financial-statements-of-azercosmos-ojsco-has-been-announced>

<sup>40</sup> "Azerbaijan Caspian Shipping Company" Closed JSC, Consolidated financial statements, [http://www.acsc.az/maliyye/2016\\_az2.pdf](http://www.acsc.az/maliyye/2016_az2.pdf)

<sup>41</sup> "Ilham Aliyev chaired Cabinet meeting on results of first quarter of 2017 and future tasks", *Prezident.az*, 10 April, 2017, <http://www.president.az/articles/23317>

entities as well as family peasant households and people who want to borrow money in general. By the end of 2014 year, the general income of the company was about 3.9 million manat and expenditures were 3.7 million manat. The profit that the credit organization gained was 131.4 thousand manat. The company has granted loans of up to 21.1 million manat to the implementation of 4844 projects (small and medium sized) in the framework of the "State Program for socio-economic development of the regions of Azerbaijan Republic in 2014-2018". During the last ten years (2005-2014) given credits by the company increased by 3.5 times and the company's balance of the loans amounted to 26.5 million manat by the end of 2014. One of the main priorities of the company is to improve its personnel and Information Technologies policies. The credit organization has an audit department and also cooperates with external audit companies since 2005.<sup>42</sup>

By the decision of the "Aqrarkredit" Closed Joint-stock Company, one of the most prestigious rating companies, "MicroFinanza Rating", conducted an audit of its financial and operational information from May to July in 2015. According to the financial assessment of the auditor company, the financial situation of "Aqrarkredit" CJSC is evaluated as good ("BB") and the prognosis of the company was defined as "Stable".<sup>43</sup>

### 3. Conclusion and Recommendations

In the end, it should be noted that Azerbaijan has State-Owned Enterprises that are becoming advanced in their fields, although the government also owns entities that are in a poor condition with high levels of indebtedness, extreme losses, and lack of up to date technology. The primary reason for the financial problems that SOEs of Azerbaijan experience was the devaluation of the national currency-manat in recent years that, in turn, affected loans borrowed from the international sources in a negative way by increasing the amount of credits twofold. Regarding technology, SOEs of Azerbaijan use a lot of outdated equipments and machinery which is the main obstacle in the proper function of the companies. Moreover, staff adaptation to the new technology is also a problematic issue for the SOEs. However, these entities are working on the development of their operational capacity by purchasing new technological facilities and providing training for their personnel by experienced experts in their sector. In addition, there are several government bodies that do not provide timely and quality official data, thereby making the performance evaluation of the SOEs difficult. Although it is required of them to provide financial statements for an annual base, according to the decisions of the Cabinet of Ministries of Azerbaijan on the confirmation of the structure and charter of relevant SOEs, yearly financial reports have, as of yet, not been revealed.

There are several recommendations provided for the solution of the existing problems of State-Owned Enterprises of Azerbaijan:

- Apart from the national currency devaluation, the biggest damage to the efficiency of SOEs in Azerbaijan is due to financial misuse of these entities and of the investment provided to them by the state. Modifications are needed to address the improper allocation of loans as well as financial recovery of SOEs. Hardening budget control on the SOEs will be a very effective

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<sup>42</sup>"Aqrarkredit" Joint-Stock Credit Organization, Annual Report 2014, 21-22,  
<http://aqrarkredit.az/upload/File/report/report-1-report-en.pdf>

<sup>43</sup> "Aqrarkredit Stock Credit Organization's financial rating is identified", *Azerbaijan State News Agency*, 16 October, 2015,  
[https://azertag.az/xeber/Aqrarkredit\\_Sehmdar\\_Kredit\\_Teskilatinin\\_maliyye\\_reytingi\\_mueyyen\\_edilib-893173](https://azertag.az/xeber/Aqrarkredit_Sehmdar_Kredit_Teskilatinin_maliyye_reytingi_mueyyen_edilib-893173)

measure if implemented together with privatization or restructuring. In order to address this issue a proactive strategy would be useful where we can expect long-term economic growth while short-term pains will be a rise in unemployment and output cuts in the overleveraged sectors. Reallocation of the labor to more productive sectors will lead to future sustainable economic development and require lower levels of investment and loans. Although this strategy has temporary monetary costs such as assistance to the employees that are laid off and the capitalization of the banks again, in the long-run it will be beneficial.<sup>44</sup>

- The constraints on the technological mechanism of the SOEs need to be resolved via the purchase of modern equipments which will improve the operational performance of the entities as well as the organization of trainings and seminars for the employees in order to accelerate adaptation process to the new system.
- Transparency and accountability are the key problems of SOEs in Azerbaijan and can be solved through the strengthening of the legal structure. In this sense, establishment of Boards which will increase accountability and transparency of the entities and improve their financial statistics, as was underlined in the transparency workshop of the World Bank in Azerbaijan. A further step could be performing an investigation of the successful practices of SOEs from other countries and applying these experiences into the national context of Azerbaijan. It would also be beneficial for the government to provide aggregate reporting on the SOEs annually which will in turn strengthen the accountability of these entities. An additional emphasis should be placed on SOEs to provide internal and external audits via the formation of powerful audit system. Furthermore, publication of financial statements should be web-based in order to ease public and media access to them. Finally, this set of comprehensive measures will be helpful in strengthening a transparent and accountable system for SOEs in Azerbaijan.

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<sup>44</sup>“Resolving China’s Corporate Debt Problem”, *IMF Working Paper* (2016), 24, <https://www.imf.org/external/pubs/ft/wp/2016/wp16203.pdf>

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