Azerbaijan Corporate Governance Project

The State of Corporate Governance in Azerbaijan 2011

Project and Survey Results

Baku
2011
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ABOUT THE INTERNATIONAL FINANCE CORPORATION

IFC, a member of the World Bank Group, creates opportunity for people to escape poverty and improve their lives. We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital, and providing advisory and risk mitigation services to businesses and governments. Azerbaijan joined IFC in 1995. As of September 30, 2011, IFC had a committed portfolio in Azerbaijan of $139 million. IFC supports diversification of the country’s economic base, and sustainable growth in the non-oil economy.

IFC’S FOCUS ON CORPORATE GOVERNANCE

IFC is a leader among multilateral financial institutions in integrating corporate governance considerations into all phases of the investment process. IFC’s long history of direct involvement in structuring investments, appraising investment opportunities and nominating board members has allowed it to put corporate governance principles into action. By focusing on good corporate governance practices in client companies, IFC can manage risk and add value to its clients. In addition to the benefits to individual client companies from IFC’s work in improving corporate governance, these efforts contribute to IFC’s broader mission to promote sustainable private sector investment and strengthen capital markets in developing countries.

ABOUT SECO

IFC’s Corporate Governance Project is financed by the Swiss Government. Swiss funding for the project is provided by the State Secretariat for Economic Affairs (SECO), which is responsible for economic and trade policy measures within Switzerland’s development cooperation and transition assistance. SECO’s main aims are to integrate partner countries into the global economy and to promote the sustainable economic growth of these countries, thus contributing to poverty reduction. The priorities include promoting stable economic conditions, strengthening competitiveness, supporting trade diversification, mobilising domestic and foreign investment, and improving basic infrastructure. Particular emphasis is placed on energy, environmental and climate issues. Each year, Switzerland spends over USD 2 billion on official development assistance. For more information, visit www.swisscoop.az
Introductions

Philipp Keller, Deputy Regional Director Swiss Cooperation Office for the South Caucasus

“SECO, the Swiss State Secretariat for Economic Affairs, has a longstanding strategic partnership with IFC, and the Azerbaijan Corporate Governance Project has been one of our flagship projects in the region.

We believe that good corporate governance brings professional practices like well established shareholder rights, good internal controls, improved transparency and disclosure practices. These practices lead to better competitiveness of companies, but also indirectly contribute to growth through better access to finance. This is evident by one of the key impact results of the Project – the corporate governance improvements that the Project promoted in companies has facilitated financing over USD 132 million.

We are satisfied with the project here: it has achieved all, and even surpassed many of its objectives. There were many seminars, workshops and consultations, many publications, much improvement in the legislative framework, as well as the work directly with companies and banks. This all led to the impressive results and impact on the ground shown in this report. IFC has a very dedicated and capable team on the ground here, but it can also rely on experts from the region and also from headquarters. They have a well-proven methodology which has been applied in many countries elsewhere. All this together makes IFC really a strong implementing partner.

We can definitely see that -- especially in the financial sector - corporate governance practices are much better now compared to five or six years ago. There is much more awareness and also demand for good corporate governance.

The Project has tackled the issue of improving corporate governance from many aspects. One of the main activities was working directly with businesses to improve their corporate governance practices. But the Project has also worked with educational institutions – with universities – in order to improve curricula and increase the knowledge of students, and with it Azerbaijan’s future business leaders in corporate governance. Another aspect was working to improve the legal framework, where the Project helped, among other things, to create listing rules at the stock exchange, and also more recently the Azerbaijani Corporate Governance Standards. Other activities have included the work with investors and banks to encourage them to demand better corporate governance practices from their clients. Public awareness has also been significantly raised through media work and publications. All these different angles from which the Project has promoted corporate governance has made this a comprehensive project which should also lead to sustainable changes.

SECO is especially pleased to see the emphasis that IFC put on building its exit strategy and building up the capacity of local organizations to continue to promote corporate governance improvements in Azerbaijan. SECO will continue to provide support via IFC on institutional building of the Project’s exit partners going forward, and to continue to promote good corporate governance practices in Azerbaijan’s companies and banks.”
Aliya Azimova, Azerbaijan Country Officer, IFC

“We often hear from companies in developing and developed economies alike about the difficulties they have in attracting financing. Another area of concern usually centers around questions about how they can enable their company to grow, perform better and reduce risks. One of the things IFC does is to help companies to address these issues, and this is why we established the IFC Azerbaijan Corporate Governance Project back in 2005. Good corporate governance, including having appropriate structures to provide direction and control over the organization, can help companies respond to these issues and enable the company to work sustainably and effectively.

It is positive to see how company practices and the enabling environment for corporate governance have improved in Azerbaijan over the duration of the Project. The credit for this goes to the individual companies and banks that have put in the effort to make those changes, and to the authorities who have introduced the reforms.”

Caroline Bright, Project Manager, Azerbaijan Corporate Governance Project, IFC

“Since 2005 corporate governance practices in firms have improved substantially, as the survey results in this document show. Awareness of the key elements of corporate governance, and how the implementation of good structures can help enhance operations, has increased greatly. Practices in major Azerbaijani firms and banks are significantly better, with better protection of shareholders’ rights, more broad disclosure and transparency, better control over operations and stronger oversight over management and strategy setting.

This document outlines the results of a survey of the corporate governance practices of companies and banks undertaken in 2011, and the results of the activities of the IFC’s Azerbaijan Corporate Governance Project between 2005 and 2011. The Project team would like to take this opportunity to thank all our clients and partners for their positive contributions and cooperation over the duration of the Project. We encourage all to continue to work on promoting good corporate governance practices and IFC will continue to help Azerbaijan move forward along this path.”
Summary of Azerbaijan Corporate Governance Project Results

Between 2005 and 2011 the Project worked to improve corporate governance practices in Azerbaijani companies and banks to help them enhance their operations and increase their ability to attract financing and investment. To promote good practices nationally, the Project worked with policymakers to improve corporate governance regulations and standards throughout Azerbaijan. The Project assisted educational institutions to assist them in developing corporate governance courses, and also with local partners to create sustainability in corporate governance services in the country. As well as working with investors and banks to promote good practices amongst their clients, the Project conducted a national public awareness campaign on the importance of corporate governance.

THE CHALLENGE

In 2005 few people understood the importance of good governance in companies or the benefits that it could bring. Shareholder protection in Azerbaijan was among the weakest of the transitional economies. Legislation governing corporate governance and shareholder rights did not form a coherent system to regulate the private sector and the activities of joint stock companies. To compete in a market economy Azerbaijani companies and banks needed to improve management and corporate governance practices to become more attractive to creditors and potential partners, including foreign and domestic investors.

THE IFC APPROACH AND RESULTS

Public Awareness

To raise public awareness on corporate governance, the Project conducted public awareness events, held roundtable discussions with journalists, published a periodic bulletin, a series of newspaper inserts and a total of 12 other publications, and maintained the project website.

- 11 events held for media representatives, 158 participants, over 950 media mentions;
- 13 bulletins, four newspaper inserts and 12 other publications.

Of note, one of the first things the Project did was to translate OECD Principles of Corporate Governance into Azerbaijani, to promote awareness, help companies implement the Principles, and to better facilitate the development of the corporate governance legislative framework.

Policy Work

In cooperation with the government authorities, the Project worked to strengthen the regulatory framework for corporate governance, working or advising on 12 individual items of legal reform and policy documents. Seven have been adopted:

- Related-party transaction regulation;
- Introduced director fiduciary duties;
- Central Bank corporate governance regulations;
- Central Bank external audit regulation;
- Listing Rules for Baku Stock Exchange;
- Law on Investment Funds;
- National corporate governance Standards (Code).
AZERBAIJAN CORPORATE GOVERNANCE PROJECT

Highlights of the above are the provisions on related-party transactions and directors’ fiduciary duties, which were instrumental in improving Azerbaijan’s ranking in the investor protection section of the IFC World Bank Doing Business Report, where Azerbaijan moved from rank 110 to rank 18 in 2009. The cooperation with the Azerbaijani Corporate Governance Task Force which developed the National Corporate Governance Standards (Code) was a large step toward promoting best practices among Azerbaijani companies, and is now being followed up by the development of a scorecard to encourage companies to adhere to the Standards.

Educational Institutions

The Project worked with educational institutions to introduce corporate governance courses and thus train the next generation of managers and policymakers on international best practices.

- 46 training events attended by 18 institutions and 52 lecturers trained;
- 14 courses and 463 students taught;

The university corporate governance course materials developed by the Project have been adopted and are continuing to be used by five Azerbaijani educational institutions.

Promoting Corporate Governance in Investment Decisions

The Project provided training and methodology to help investors and banks assess the governance of their client companies and thus strengthen investment decisions and reduce portfolio risk. The Project developed screening tools, tailored for investors and a standard Azerbaijan Screening Tool for Banking Organizations.

- Over 120 individuals trained at over 20 training events;
- Joint assessments / advice on corporate governance assessment to 20 banks.

10 banks and investors have introduced or strengthened corporate governance assessment into their decision-making processes.

Work with Companies and Banks

The project trained and consulted banks and companies on corporate governance best practices and helped them adopt internal documents, including charter and by-laws that stress better corporate governance practices.

- Conducted over 150 seminars, workshops and training events and advised over 600 companies and banks on improving corporate governance practices;
- Facilitated clients to attract US$132 million in investment and supported another US$ 550 million;
- 32 companies and banks reported benefits, such as clarified roles and better operations;

The Project conducted an assessment and program to implement better corporate governance practices in 13 pilot companies, which has facilitated $126 million in investment.

Exit Strategy

Corporate Governance practices in Azerbaijan have improved dramatically, but corporate governance is an ongoing journey, and therefore the Project’s exit strategy was included into the original Project design. All four elements have been successful, as going forward:

- investors and bankers continue to demand good corporate governance from clients;
- educational institutions continue to provide corporate governance training;
- authorities continue their promotion of good practices via regulations and standards;
- associations, law and consulting firms continue to provide advisory services.

IFC will continue to provide support to its local partners as they build their capacity to provide corporate governance services to Azerbaijani banks and companies.
Public Awareness

In 2005 the general awareness and understanding of corporate governance was very low in Azerbaijan, often confused with the idea of day-to-day management. In fact, when the Project started operations it was not clear how to translate the concept without it being confused with the terminology for management. In more developed economies, corporate governance is an extensively researched topic, producing a wealth of opinions and debate on the issue. The general lack of academic research and writing on corporate issues contributed to a shortage of informed people on the subject in Azerbaijan. To address this, the Project undertook a number of different activities to promote awareness and discussion.

Media Roundtables

Over the duration of the Project one of its highly popular activities was the series of roundtables for media representatives to raise their awareness about corporate governance and encourage greater coverage of corporate governance in the local media, newspapers and television coverage. A total of 11 media roundtables were held and covered topics ranging from introduction to corporate governance, the role of corporate governance in the crisis, to the benefits and purpose of a corporate governance code or voluntary standards. A total of 158 journalists and reporters attended the roundtables.

National Article Competition

In 2006 in cooperation with the Baku Stock Exchange, the Project organized a National Article Competition in Azerbaijan. The competition hoped to create a pool of well-written articles about the current situation in corporate governance, and attract interest from academics to research the topic. The competition succeeded in doing just that. It was widely covered in the media, due to its unique focus, and resulted in a greater awareness of corporate governance among scholars and academics as intended. At the request of professors and lecturers, the IFC project then delivered 14 additional roundtables and seminars on corporate governance at four Azerbaijani universities.

The greatest impact of the competition, however, is how the winners contribute to promoting corporate governance in Azerbaijan. Rashad Rasullu worked as a secretary at Ata-Holding when he submitted his article, “The Role of the Corporate Secretary in the Corporate Governance System,” to the competition. Upon winning third prize, the Holding management expanded his position and appointed Rashad to the newly created position of corporate secretary. Rashad has been able to implement all the recommendations that he described in his academic paper.
to daily practice at the company, one of Azerbaijan’s largest financial and retail corporations. He has helped restructure departments and introduce new by-laws, such as the “By-law on Corporate Secretary.” He has also helped to put into place meetings procedures in line with International Organisation for Standardization (ISO) standards, which halved the preparation time for Ata’s corporate meetings. And, in his promotion to Adviser to the Chairman of the Board, he coordinated the activities of AtaHolding’s Supervisory Board, Management Board and other committees. The second-prize winner was subsequently offered the position of Executive Assistant to the Head of the State Committee on Securities, and the fourth prize winner has been hired as a lecturer by the Azerbaijan Bank Training Center.

“The competition gave me a great chance to present my research and knowledge on corporate governance to the business sector, and in fact, played a considerable role in promoting my career.” Said Rashad Rasullu, Corporate Secretary, AtaHolding

Media Article Competition and Training on “The Role of Corporate Governance and Capital Market Development”

In 2009, together with the State Committee for Securities (SCS), the project organized a competition for journalists to encourage them to write about corporate governance and capital market development. The authors of the winning articles received monetary prizes and certificates at a ceremony hosted by the SCS. The aim of the workshop and competition was to foster interest in Azerbaijani journalists to write on corporate governance and capital market development issues.

The winning article of the media competition was a television news broadcast on corporate governance and the role of the securities market. This article highlighted the importance of corporate governance internationally and in Azerbaijan and included interviews with project staff and pilot clients. The broadcast has now been dubbed into English and can be accessed on the project website (www.ifc.org/acgp) or via the following link:

Winning Television Broadcast Article on Corporate Governance


Project Bulletin

Between 2005 and 2009 the Project produced a series of bulletins on corporate governance which covered key elements of corporate governance and was distributed to a wide ranging audience of companies, banks, educational institutions and other parties interested in improving their knowledge on corporate governance-related matters. A total of 13 bulletins were published and are available from the Project website (www.ifc.org/acgp).
Newspaper Insert: “Business News”

In 2009-2010, four issues of the newspaper insert “Business News” were published in ‘Zerkalo’ and ‘Azerbaijan’ newspapers. This was a joint initiative of the project, the State Committee for Securities and other IFC Projects operating in Azerbaijan. The first topic was ‘Business Start-up’ and the Project contributed articles on the importance of corporate governance for start-up companies and how to establish a joint stock company. The topic of the second edition was ‘Capital Markets’ which had significant input from the State Committee for Securities and included articles highlighting the importance of good corporate governance to sustain efficiently functioning capital markets. The topic of the third edition was ‘Regulation’, and the fourth edition was ‘Risk Management’.

Other Publications

In total, the Project has published another 12 publications on corporate governance:

1. Azerbaijan Corporate Governance Project Booklet;
2. OECD Principles of Corporate Governance (translation into Azerbaijani);
3. Survey Results of Bank Corporate Governance in Azerbaijan 2006;
4. Survey Results of Company Corporate Governance in Azerbaijan 2006;
5. OECD Guidelines for State-Owned Enterprises (SOEs) (translated into Azerbaijani at the request of the Ministry of Economic Development);
6. IFC’s Family Business Governance Handbook in Azerbaijani;
7. Corporate Governance Brochure for Educational Institutions;
8. IFC’s Azerbaijan Corporate Governance Officer Handbook;
9. Survey on disclosure and transparency in the banking sector;
11. Corporate Governance Screening Tool for Banking Organizations;
12. Survey Results of Corporate Governance in Azerbaijan 2011.
Policy Work

There is significant research that acknowledges the importance of legal foundations, including the quality of corporate governance, for economic development and well-being. ¹ Great progress has been made in improving the legal and regulatory environment for corporate governance in Azerbaijan since 2005. At that time, no Corporate Governance Code existed in the country, and the lack of investor rights protection was highlighted in the World Bank’s Corporate Governance Report on Standards and Codes (ROSC) 2005. In particular, the report noted that there were “no specific duties of loyalty and care for supervisory board members of JSCs” and “related party transactions are rudimentary and incomplete.” The Project has provided advice, commentary and helped to draft a total of 12 pieces of legislation, regulations and codes related to corporate governance in Azerbaijan. Seven of these policy items have been adopted.

Corporate Governance Policy Items Adopted in Azerbaijan since 2005

<table>
<thead>
<tr>
<th>Item</th>
<th>Authority</th>
<th>Date Adopted</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Regulation of SCS on Related Party Transactions</td>
<td>State Committee for Securities</td>
<td>May 2008</td>
</tr>
<tr>
<td>4. Law &quot;On the Amendments to the Civil Code&quot; (Art. 49.3 and 99.4)</td>
<td>Parliament</td>
<td>May 2008</td>
</tr>
<tr>
<td>5. Listing Standards for Baku Stock Exchange</td>
<td>Baku Stock Exchange</td>
<td>June 2009</td>
</tr>
<tr>
<td>6. Law on Investment Funds</td>
<td>State Committee for Securities</td>
<td>October 2010</td>
</tr>
</tbody>
</table>

National Corporate Governance Standards

A major accomplishment was that in January 2011 the Ministry of Economic Development of the Republic of Azerbaijan (MED) adopted the Azerbaijan National Corporate Governance Standards.² These Standards are a set of nonbinding recommendations aimed at improving and guiding the governance practices of corporations, attempting to address the most evident corporate governance and confidence problems faced by Azerbaijani companies including shareholders’ right abuses, checks and balances between governance bodies, disclosures to shareholders and the general public. The Azerbaijani Standards adopt many principles and recommendations

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referred to in the OECD Principles of Corporate Governance. The Standards were drafted by the Corporate Governance Task Force established by MED, which includes representatives of MED, Ministry of Justice, State Committee for Securities, Azerbaijan Investment Company and IFC.

“For attracting investors, protecting shareholders rights and successfully mitigating impacts of the financial crisis, companies shall adhere to the principles of transparency, accountability and reporting which are essential components of good corporate governance practices,” said Anar Hadjizade, the head of corporate governance division at the Ministry of Economic Development. “These Standards are aimed at helping companies to adhere to sound corporate governance practices and thus reap the benefits that this brings.”

![Image of corporate governance event in Azerbaijan]

**Improving the Investment Climate**

Another example of the progress that has been made in corporate governance in Azerbaijan is the country’s improved ranking in the World Bank IFC Doing Business Report, specifically the section on investor protection where Azerbaijan moved from rank 110 in the 2008 report to rank 18 in 2009. Again, the task force convened by the Ministry of Economic Development and the reforms they promoted were instrumental in this improvement.

During 2007 and 2008, IFC assisted with the drafting of amendments to the civil code. These strengthened investor protection and shareholders’ rights by requiring that transactions between interested parties be approved by shareholders, and directors who are held liable must pay damages and disgorge profits. As a result, in 2008

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3 Organization for Economic Cooperation and Development. The Principles are available online in many languages including Azerbaijani, at: [http://www.oecd.org/document/49/0,3746,en_2649_37439_31530865_1_1_1_37439,00.html](http://www.oecd.org/document/49/0,3746,en_2649_37439_31530865_1_1_1_37439,00.html)
the government adopted two distinct reforms: amendments to the Civil Code and a regulation on related party translations. These legal amendments have introduced fiduciary duties of company directors and more strictly regulate the approval and disclosures of related party transactions.

These legal reforms contributed to improving Azerbaijan’s ranking in the Report in 2009, where Azerbaijan moved from rank 97 to 33 and was named top reformer.

IFC’s assistance in introducing amendments to strengthen investor rights protection has been highly appreciated by the government counterparts: “I would like to express my specific gratitude to the project for its tremendous support in the drafting and discussion of legal reforms in the country.” said Sanan Tapdigov, Director of the Corporate Governance Division at the Ministry of Economic Development at that time.

The 2009 Corporate Governance ROSC indicates how the outcomes of the project have assisted with improving the investment climate: “New laws and regulations have improved legal protection for investors and the broader business environment. These include … 2008 amendments to the Civil Code and regulations that introduce board member duties and regulate related party transaction. … Foreign donors, including the IFC’s Azerbaijan Corporate Governance Project, have been helpful in this area.”

Furthermore, local investors have also recognized the benefits that will come from the legal reforms. Anar Akhundov, then Director of the Azerbaijan Investment Company, stated:

“The recent reforms of Azerbaijani legislation on regulation of related party transactions and requirements related to fiduciary duties of the companies’ directors and top corporate officers will have crucial positive impact on local business environment. Implementation of these rules will contribute to better protection of investors’ rights and increase the role of minority shareholders in company’s governance. Doubtless, it is a big step towards introduction of best corporate governance practices in Azerbaijan.”

Two major factors contributed to this success: the commitment of the government of Azerbaijan and IFC’s efficiency in performing the work. IFC was able to leverage an existing project and staff to provide the assistance in the short timeframe given, using both global expertise and local knowledge.

Helping to build the Institutional Framework for developing Capital Markets in Azerbaijan

IFC helped the Baku Stock Exchange (BSE) develop listing rules to assist the exchange in its efforts to create a corporate securities market in Azerbaijan.

The Project worked with the BSE to draft new two-tier listing rules aimed at developing a secondary market for securities. These were adopted in 2009. The aim is to assist Azerbaijani companies in their efforts to raise external financing through share and bond issuances.
The advanced standards of corporate governance and disclosure will offer good incentives for Azerbaijani companies to improve their business practices in order to achieve tier-one listing on the exchange, which offers more attractive investment opportunities. Minority and institutional investors should benefit from minimized risk and the reassurance of investing in well-governed companies.

The two-tier system requires companies listed in the first tier to comply with higher financial reporting and disclosure standards, as well as good corporate governance practices such as transparent and fair nomination procedures to the Supervisory Board. It also includes guidelines for selecting independent directors, strict regulation of related party transactions, and strong shareholder protection mechanisms.

“IFC’s support in developing these rules is crucial, especially at this moment when we are building the institutional framework for developing capital markets in the country,” said Khayal Abdinov, then President of BSE. “We are happy to have new listing rules in conformity with international standards of corporate governance and disclosure.”

The public event organized with the support of IFC to present the newly adopted listing rules included keynote speakers from the Istanbul Stock Exchange and Jon Edwards, Senior Manager for Russian & CIS, of the London Stock Exchange.

“This is a momentous day – the adoption of listing rules is an historic occasion. These new listing rules will encourage investment, especially in those companies listed in the top tier. A tiered system has the benefit of meeting different needs, and the key is making sure investors are happy,” Edwards said.

**Reform Continues**

The government is now working to strengthen the legislation regulating corporate governance even further. IFC has continued to work with the government drafting legislative reform in the area of corporate governance, with additional draft amendments to the Civil Code. The State Committee for Securities (SCS) created a working group, with IFC as a key contributor, in order to draft amendments to Azerbaijan’s Civil Code as it relates to company law and investor protection. Key amendments include clarifying the authority of the General Meeting of Shareholders, the Supervisory Board, management and the Audit Committee. The amendments have been drafted and are currently under discussion by the Cabinet of Ministers.

Furthermore, IFC has continued to work with MED who are in the process of developing a Corporate Governance Scorecard with the aim of promoting compliance with the National Corporate Governance Standards. IFC is assisting by providing peer review by its panel of international experts in this field: members of the Global Corporate Governance Forum Private Sector Advisory Group. Results from this review will be included in discussions at a workshop being held with the MED and the task force in December 2011. IFC, with support from SECO, will continue to provide support in the development of the scorecard going forward.
Educational Institutions

Unlike most developed countries where courses on corporate governance are an essential part of curricula in business and law faculties, when the Project started the elements of corporate governance were not taught comprehensively at educational institutions of Azerbaijan. A lack of professional lecturers and instructors on corporate governance in the country was one of the main challenges in implementing courses on corporate governance in higher education and executive education curricula.

As a part of its educational component, the Project conducted a total of 46 training events for educational institutions via three separate deliveries of its Educational Program on Corporate Governance. This Program trained professors of business and law schools and other individuals interested in teaching corporate governance, so that they can teach corporate governance to their students and prepare the next generation of business people to be better equipped to run and control their organizations.

The Education Program covered the following topics:
1. The Corporation and Corporate Governance
2. Internal Institutions of Corporate Governance – The Supervisory Board
3. Internal Institutions of Corporate Governance – Management
4. Internal Institutions of Corporate Governance – Shareholders
5. The Control Environment: Risk Management
6. The Control Environment: Internal Controls and Internal Audit
7. Corporate Governance and Capital Market Development
8. Transparency and Disclosure
9. Corporate Governance and the Financial Crisis
10. Corporate Governance of Financial Institutions
11. The Demands of Investors
12. Corporate Governance and Islamic Finance
13. Corporate Governance and Strategic Planning
14. Corporate Governance and Corporate Social Responsibility
15. The Role and Functions of the Corporate Secretary

Presentation of Certificates to Participants of 2010 Education Program
“For the past five years, Corporate Governance has been taught in many Universities in Azerbaijan. In our University in particular, thanks to IFC, it started to be taught two years ago,” said Fuad Jabbarov, professor at Western University. “Using IFC materials, I was able to create a situation in which the students role-played the different committee heads in a company with good corporate governance.”

At the end of the academic year in 2011 a survey was conducted of all participating professors and lecturers to see which institutions were or had been teaching corporate governance related courses based on IFC materials. Educational institutions that included a course or series of courses on corporate governance included:

- Baku State University
- Khazar University
- Azerbaijan State Economic University
- Western University
- Baku Tourism Institute
- Azerbaijan State Oil Academy
- Center for Economic Research and Education
- Azerbaijan Bank Training Centre

Over the duration of the Project, the following results were achieved:

<table>
<thead>
<tr>
<th>Category</th>
<th>Achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of training events for educational institutions</td>
<td>46</td>
</tr>
<tr>
<td>Unique count of all Educational Institutions</td>
<td>18</td>
</tr>
<tr>
<td>Number of case studies written</td>
<td>14</td>
</tr>
<tr>
<td>Number of training modules developed</td>
<td>8</td>
</tr>
<tr>
<td>Unique count of all professors trained</td>
<td>52</td>
</tr>
<tr>
<td>Number of educational institutions that improve / introduce specialized courses</td>
<td>8</td>
</tr>
<tr>
<td>Number of improved/introduced corporate governance courses taught</td>
<td>14</td>
</tr>
<tr>
<td>Number of students taught with Project developed materials</td>
<td>463</td>
</tr>
</tbody>
</table>

The university corporate governance course materials developed by the Project have been adopted and are continuing to be used by five Azerbaijani educational institutions.
IFC Supports a Woman’s Professional Advancement and Educational Growth

In recent years, more and more women have been pursuing professional careers in Azerbaijan; they are still underrepresented at professional level in many professions such as law. For example, according to statistics provided by the Ministry of Justice of Azerbaijan, only thirty-seven out of 308 judges in Azerbaijan are women. This is why the IFC Azerbaijan Corporate Governance Project work with Naida Sadigova is especially noteworthy.

Naida Sadigova was in the final stage of completing her master’s degree in Law at Khazar University, which is a private university based in Baku with a reputable legal faculty. Naida applied for a lecturer’s position at Khazar and was interested in teaching a course on corporate governance. After she accepted Khazar’s offer to teach a joint law and MBA course on corporate governance, Naida approached the IFC for assistance in developing such a course. The Project experts had developed a model course on corporate governance and helped Naida adopt the course for the Khazar University. Notably, the first course on corporate governance to be taught at an Azerbaijani University was taught by a woman! Naida appreciated IFC’s assistance as:

“The initiative undertaken by me and the IFC at Khazar University has become the milestone of my educational experience. I was trained by the best experts in corporate governance in Azerbaijan. Also, it was a genuine luck for me as a future lawyer to receive in depth knowledge on corporate governance related issues.”

Naida taught two additional semesters of corporate governance courses at the university, during which she frequently applied to the IFC for advice on improving her course. Additionally, enriched with the project consultations and materials, she wrote her thesis paper on a corporate governance related subject and received her Master’s degree in Law with honors from Khazar University. IFC continued to involve Naida in its education work, including its train-the-trainer educational training for professors and lecturers designed to help Azerbaijani universities develop corporate governance courses. During the events, Naida shared her experience on delivering the corporate governance courses at Khazar University.

Naida has developed an affinity for legal scholarship and is pursuing her dream to obtain an advanced legal education as she was accepted to the Edmund S. Muskie Graduate Fellowship Program to further her legal education at Franklin Pierce Law Center in New Hampshire, USA.

“I am particularly grateful for the great experience with teaching a corporate governance course. I would like to thank the IFC both for knowledge and the teaching experience I gained. This work helped pave the way to my future professional growth.”

4 Available at: www.un.org/News/Press/docs/2007/wom1598.doc.htm
Promoting Corporate Governance in Investment Decisions

IFC Azerbaijan Corporate Governance Project has also worked with the banking sector as a whole to encourage banks to look at the corporate governance of their clients when making loan decisions in order to strengthen the quality of lending and reduce the risk of default due to poor governance. Many banks have now included corporate governance into their lending appraisal process for larger borrowers.

The Project undertook the following activities with banks and institutional investors:

- Provided training on corporate governance to staff and leadership of banks and investors;
- Jointly developed corporate governance screening tools with Azerbaijan Investment Company and with Kazimir Partners for them to use in evaluating corporate governance in potential investees;
- For the banking sector the Project developed a user-friendly desk-top screening tool focusing on corporate governance risks in bank clients;
- Jointly undertook corporate governance assessments and reviews of selected client and investee companies; and
- Provided consultations to relevant bank/investor client/investee companies on issues related to corporate governance.

“We believe that implementation of the Corporate Governance Screening Tool for Banking Organizations will help the banks better assess and manage risks related to clients’ corporate governance practices, further enabling them to decrease credit and operational risks,” said Rauf Akhundov member of the Management Board in DemirBank. “At the same time, this tool will help Azerbaijani companies seeking financing to better understand issues that potential foreign partners are considering while dealing with them.”
Work with Companies and Banks

Seminars and Training on Corporate Governance

The Project has delivered over 150 seminars, workshops and training events for companies and banks, with over 1600 participants. A selection of these are highlighted below.

The Project’s seminars commenced in March 2005 with the first comprehensive training on corporate governance ever held in Azerbaijan, which brought together banks and other joint stock companies, government, officials, international NGOs, and limited liability companies to increase knowledge and promote corporate governance best practices. The seminars were planned with the assistance and cooperation of the Azerbaijan Republic State Committee for Securities (SCS) and the Baku Stock Exchange (BSE) and based seminar materials on their analysis that joint stock company leadership lacked basic knowledge in corporate governance and the functioning of corporate structures. Therefore, the seminar was entitled “Corporate Governance and Its Importance”. Participants appreciated the practical applicability of the materials to their work. As one respondent, Farid Akhundov, Head of the Management Board at Bank Standard remarked: “All topics are directly applicable to my company. We would like to implement the program in Bank Standard.”

In July 2007, the Project began a series of brown bag lunch roundtables for Azerbaijani corporate attorneys. These roundtables were organized to address the attorneys’ need to increase their capacity to advise companies on corporate governance matters. Since attorneys consult with client companies on a daily basis, enhancing their knowledge of corporate governance was a useful method to improve the corporate governance practices of more companies. Improving the attorneys’ ability to advise clients is a good way to indirectly help companies improve their corporate governance and increase the Project’s overall reach to include the participating attorneys’ clients. During the first roundtable, the participants discussed corporate structures and procedures for increasing companies’ charter capital. Another roundtable was devoted to the composition, authority and fiduciary duties of the supervisory board.

One of the roundtables featured Wisconsin Supreme Court Justice, Ann Walsh Bradley, where the Rule of Law and the American judicial system were discussed, and participants exchanged experience regarding judicial election procedures, judicial independence and ethical issues and highlighted a recent Wisconsin Supreme Court case on fiduciary duties of directors. “It was very exciting to meet Ms. Bradley and in fact, I learned many interesting things about the American judicial system,” commented Gunduz Mammadov, an Associate from the law firm of Baker and McKenzie and a roundtable participant.
In 2007 and again in 2009, the project delivered seminars on internal audit and internal control in cooperation with the Azerbaijan Bank Training Center (ABTC). During his opening remarks, ABTC Director, Javanshir Abdullayev, highly commended the project’s work: “We have been cooperating with various institutions to provide training events, and I would like to stress that IFC is the best institution to cooperate with. IFC demonstrates high professional level both in organizational matters and quality of presentations and materials.” Since the first delivery in 2007, ABTC took ownership of the materials and made a number of deliveries of the training course using its own instructors. In 2009 the course was upgraded with the Project to include advanced training materials on International Audit Standards.

The Project organized public seminars for specific market sectors, such as the one organized for microfinance institutions which took place in March 2009, and was delivered with the support of Azerbaijan MicroFinance Association (AMFA). This seminar covered key corporate governance issues, with especial focus on the specifics for smaller, less formal MFIs, and the importance of good corporate governance in attracting investment, developing strategy and managing risk. Other sector-focused seminars included a number of specific trainings for the banking sector, and seminars for insurance companies.

In 2009 the Project delivered a seminar on Corporate Governance and Enterprise Risk Management. This was delivered in cooperation with the BP supported Enterprise Development and Trade Programme, which helped develop potential suppliers of BP. There were 25 participants, who were limited liability companies working or hoping to work with BP. Although the profile of these companies was somewhat different to the project’s target clients, interest was high as the relevance of good corporate governance and risk management was gaining increasing focus at this time in Azerbaijan due to the global economic crisis.
In November 2009, Professor Ulrich Steger delivered a seminar entitled “Risk Governance Series: The Board’s Response to Crisis”. Professor Steger is a former professor at IMD International in Switzerland (International Institute for Management Development), and an experienced member of many boards. The seminar was delivered with the support of IFC’s corporate governance Unit and locally in conjunction with Azerbaijan Bank Training Centre. The 30 participants were directors or executives from local companies and banks. The topics covered were:

- Types and sources of crises and how to spot them early on;
- Possible consequences of crises in emerging countries;
- Responsibilities and responses of board members during a crisis;
- The role of the board in preventing crises.

A significant series of seminars organized by the Project was directed at Corporate Governance Officers, sometimes known as Corporate or Company Secretaries. The first of these seminars was delivered in December 2009 and was the first for this audience in Azerbaijan. It received excellent feedback from the 28 participants who all carry out some form of corporate secretary role in their respective firms. The seminar included the following topics:

- Preparation and conduct of Board meetings and General Meetings of Shareholders;
- Flow of information among the Board, management and company shareholders;
- Information disclosure and work with company documents.
- Compliance with legislation and informing Board of legal responsibilities;
- Advice on corporate governance and other business issues;
- Liaison with securities markets, compliance with listing requirements, etc.

In 2010 this was followed up with a seminar launching the Corporate Governance Officer Handbook and another follow-up seminar for CGOs attracting 35 participants from Azerbaijani companies and banks. The seminars included case study discussions to assist Azerbaijani CGOs to get better understanding of best practices and ways to improve their work.

In 2010 a seminar launching the Family Business Governance Handbook in Azerbaijani attracted 20 participants from private sector companies as well as academics and consulting companies. Additionally there was a large turnout from the media who took great interest and conducted a number of interviews of project staff on the topic as well as covering the event on TV and in the press.
Throughout the lifetime of the Project, seminars were also held in the regions of Azerbaijan, starting in 2005 with introductory seminars in Ganja, Lenkaran, Guba, Shamakha and Nakhichevan. In 2009, in cooperation with the State Committee for Securities, the project held regional seminars on corporate governance and capital markets in Sheki. The seminar attracted more than 50 participants from companies located in Sheki, Gabala, Oguz, Zagatala and other bordering regions. The seminar focused on the role of corporate governance in attracting investments and contributed to awareness-raising in corporate governance related issues among regional companies and entrepreneurs. In 2011, a series of seminars were held with the Ministry of Economic Development to publicize the newly adopted voluntary Corporate Governance Standards throughout the country.

In 2011 the Project organized a Bank Director training conducted with the support of the World Bank and the Central Bank of Azerbaijan. An experienced board director, Mr. Eric Rajendra, discussed practical ways to improve board performance, which highlighted the actual challenges faced by banks in the region, and proposed concrete, workable solutions. The chairmen of both the supervisory and management boards for almost all Azeri banks attended and the session was opened by the deputy governor of the central bank, Mr. Vadim Khubanov.

Consultations and Standardized Corporate Governance Documentation

During the seven years the Project has been active its experts have delivered over 1250 individual consultations on corporate governance to over 130 companies and banks in Azerbaijan. Topics have covered all areas of corporate governance, with some of the most popular questions on corporate documentation and board practices.

Many consultations were regarding the appropriate internal documentation to formalize and embed good governance practices into the organization. In regard to this, the project developed standardized corporate documents based on international best practice and Azerbaijani legal requirements and these are available from our exit partners as well as on the project website. The documents are:

- Model Charter
- Model by-law on General Meeting of Shareholders
- Model by-law on Supervisory Board
- Model by-law on Management Board
- Model Risk Management by-law
- Model by-law on Audit Committee
- Model by-law on Internal Audit Department
Corporate Governance Pilot Program

The Project has worked with a total of 13 companies and banks as part of its pilot program. The pilot companies and banks were selected based on investment potential and financial promise, commitment to reform, likelihood for success and other criteria. The program covered the following aspects:

- An assessment of their corporate governance practices;
- Consultations and training on improving corporate governance, including structures and relationships between boards, management and shareholders;
- Assistance in revising corporate documents to bring them in line with best practices;
- Advice on preparing transparent and meaningful financial reports.
- Help in organizing shareholders meetings.
- Orientation sessions for Supervisory Boards.
- Developing the role of Corporate Governance Officer.
- Advice on how to approach investors and obtain sources of financing.

A number of examples of the pilot program follow.

SECO and IFC help Azeri banks improve corporate governance and expand access to finance for SMEs

Azerbaijan’s Turan Bank is a relatively small bank, but has ambitious growth plans, particularly for the underserved areas of the country. Launched in 2005, the bank’s vision is to become a universal bank that provides a comprehensive range of financial products and services to small and medium enterprises and individuals through a wide network of branches and regional centers. To strengthen its position in the market, the bank’s management knew that it needed to improve its internal systems and practices and to attract further investment.

In 2009, Turan Bank was chosen as a pilot in the IFC Azerbaijan Corporate Governance Advisory Services Project, which IFC is implementing in partnership with SECO. The IFC program provided in-depth advice to help banks align their corporate governance systems with best international practices.

“Our plans for growth were ambitious, and we knew that we would benefit from IFC’s expertise in this area,” said Fuad Musayev, Chairman of the Turan Bank’s Supervisory Board. “We felt IFC’s pilot program would help strengthen our systems in line with our strategic plan on institutional development.”

IFC experts helped Turan Bank to introduce numerous corporate governance improvements, including the development and adoption of new internal documents to govern and guide practices, the clarification of management and supervision responsibilities, the establishment of a Corporate Governance Officer position, and the adoption of a succession plan and a dividend policy.

“With IFC’s support, we achieved significant results. IFC’s methodology engaged not only top management, but all Turan Bank’s employees. IFC does a great job in increasing awareness and improving understanding through its tailored workshops and meetings. Personally, I see that employees are much more informed and willing to implement better practices,” said Nazim Sadigov, Chairman of Turan Bank’s Management Board.
Building on its successful collaboration with IFC, Turan Bank later joined IFC’s Risk Management Project, which IFC is also implementing with SECO’s support. The project is helping banks across Eastern Europe and Central Asia recover from the financial crisis by building their internal capacity and advising them on how to better manage risk. Currently, IFC is working with Turan Bank to better manage non-performing loans and credit risk.

In June 2011, IFC extended a $7 million loan to help Turan Bank increase lending to micro and small entrepreneurs across Azerbaijan. The loan will enable the bank to diversify services and expand operations, especially in underserved rural areas.

Ed Strawderman, IFC Senior Manager, said: “Turan Bank’s partnership with IFC to date and the bank’s commitment to strengthening its corporate governance and risk management practices are key factors that led IFC to provide this loan. This financing will help Turan Bank to increase outreach to micro and small businesses, which is part of IFC’s financial markets strategy in Azerbaijan.”

Nailya Safarova, National Coordinator at the Swiss Cooperation Office in Baku, said, “We are very proud to see that the impact of the cooperation with IFC was even higher that we expected. While Turan Bank received the IFC investment as a result of its improved corporate governance and risk management practices, this facility will help it to achieve other development goals which are priorities for SECO - to ease access to finance for the small and medium enterprises and for the agricultural sector through microfinance.”

The Project Assists a Poultry Producer Improve Shareholders Rights

One of the major corporate governance challenges in Azerbaijani companies is adequate protection of shareholders rights. In fact, one of the fundamental incentives for investing in shares – receipt of dividends – is a remote prospect in most of Azerbaijani companies. According to the Azerbaijan Corporate Governance Project Survey Results, only eighteen at of one hundred surveyed companies declared and paid dividends in previous years. To this extent, the Azerbaijan Corporate Governance Project pays a special attention to the topic of shareholders rights protection at its events and during its work with companies. A good result was achieved with Project Client, Davachi Broyler, which is a market leader in poultry production in Azerbaijan.

In January 2005, Davachi requested the Project’s assistance in improving corporate governance practices at Davachi. Since then, the Project has provided a series of consultations to the company. For example, the Project
prepared a new charter with heightened corporate governance standards that was subsequently approved by the company’s shareholders and further registered with the Ministry of Justice of Azerbaijan.

Davachi also applied to the Project pilot program. Following consultations with the Project and after being selected as a pilot, the company took a monumental step towards improving its governance, when the company decided at its 2006 annual general meeting of shareholders to declare its first ever dividend distribution.

“I possess shares in more than 400 companies and none of these companies has been paying dividends. That is why it was a pleasant surprise to receive dividends from Davachi, especially on New Year’s Eve. I wish that other companies would implement this practice,” noted minority shareholder, Ramiz Aliyev.

In 2007, Davachi adopted the Project developed a dividend policy in the form of by-laws. This document establishes the rule and procedures for dividend declaration and distribution.

“We see a direct link between the company’s profitability, quality of production and the company’s corporate governance practices. We plan to continue improving our corporate governance practices and improve the efficiency of the company. We are very grateful to the the Project for its work,” noted Zakir Azimov, Chairman of Davachi’s Management Board.
Exit Strategy

Times have changed since 2005 when IFC’s Azerbaijan Corporate Governance Project was launched. As noted, at that time almost no-one in the country knew what corporate governance was, and there were certainly no associations or consulting companies working on the topic in Azerbaijan. One of the Project’s aims was to ensure a sustainable exit strategy to ensure that, after the close of the project, corporate governance would continue to advance in the country.

The project’s exit strategy has been a multiple partner and multifaceted exit strategy:
1. to create a “pull effect” with investors and bankers so that they keep demanding good corporate governance from clients;
2. to help authorities promote good practices via regulations and standards;
3. to work with educational organizations so corporate governance training continues; and
4. to work with associations, law and consulting firms so they continue to provide advisory services.

Developing Local Partners, and Improving the Corporate Governance of IFC Investment Clients at the Same Time

The last component of the exit strategy is the work with official ‘Exit Partners’: building the capacity of local organizations to provide corporate governance training, consulting and expertise. This will meet the increasing demand from companies and banks for training for directors, which is indeed globally recognized as key in order to ensure they are adequately informed about the company and to improve their effectiveness as directors. To ensure that there are local organizations able to continue this work, including director training, consulting and working to advance the enabling environment, the Project has been working with a number of organizations to provide them with the necessary knowledge and skills. In this way, future companies in Azerbaijan will also be able to gain from the benefits of good governance, such as better financing prospects, clarified roles and responsibilities, improved risk and control, leading to better operational performance.

Training

IFC worked with a number of local associations and companies that could be suitable to provide these services on the market. Many of these partners attended the train the trainer courses the Project was providing to local educational institutions, which covered the basic tenets of corporate governance: good board practices, strong control environment, transparent disclosure and reporting, and protection of shareholders’ rights. These regular trainings, that started in 2006, covered in detail the various elements of corporate governance, giving the partners a solid background in the subject.

An important element most of the partners lacked, however, were the skills and techniques needed to successfully train adult learners - a very different skill to lecturing at university – and essential when the target potential trainees
are directors and top management of Azerbaijani companies. Together with the Global Corporate Governance Forum, IFC’s internationally recognized centre of expertise in corporate governance, the Project delivered the Board Leadership train the trainer to local partners to enhance their skills in training directors.

“I was impressed by the level of commitment from the local trainees and by the level of interaction at the workshop,” said Miroslav Veprek, Program Manager at the Swiss State Secretariat for Economic Affairs (SECO), which is co-sponsoring this initiative together with the Development Bank of Austria. “Building local capacity is a priority for us as donors and I am pleased to see that our efforts are well on track.”

IFC’s corporate governance Unit, who assess the corporate governance of larger IFC deals, also provided training to the local partners on how to conduct a corporate governance assessment. This gave partners an understanding of what questions they need to ask, and how to ask them, in order to understand the actual governance practices of the companies they assess, and how to present this to clients to encourage them to reform and improve their practices.

“I believe that the nature of the training was very valuable to all participants as the real subject related conditions showed us the benefit of applying IFC methodology and made us familiar with the specific ways of implementing assessments,” said Puste Babayeva, a participant at the IFC corporate governance methodology training. “I loved the dedicated environment, professional case studies and open dialogue with the trainers. It encouraged us to proceed further with our corporate governance activities.”

**Hands-on Experience**

Classroom-based training, however, is simply not enough to really ensure the partners are able to do this in practice. There is no substitute for hands-on, practical experience. In order to give our partners this experience, as part of a documented and clearly defined exit partner development program, three exit partners were selected who were committed to improving their skills in this area and continuing to provide corporate governance services after the close of the project. These selected partners were then given the opportunity to work side-by-side with IFC staff on corporate governance assessments and improvement plans, also helping the client to implement the recommendations made.

**Case 1: Isgandarov & Partners and Demir Bank**

Demir Bank has been an IFC investment client for a number of years, and the bank has also received advisory services on risk management from IFC. The Bank took active part in many of the trainings offered by IFC on corporate governance, and became an active client of the Project in September 2009, which meant that it was regularly approaching the Project for advice and demonstrated its commitment and interest in improving its corporate governance.

In March 2011 Demir Bank become a pilot company of the Project. This included conducting, in cooperation with Isgandarov & Partners, a full corporate governance assessment and improvement plan. Staff from Isgandarov & Partners worked with IFC staff to conduct the interviews, document reviews and to draft the assessment, discussing
the issues and jointly deciding on the appropriate recommendations every step of the way. After completing the assessment, Isgandarov & Partners provided many workshops and consultations to the Bank, including helping the bank to improve its internal audit and control practices, and financial disclosure and reporting.

“The recommendations provided in the assessment are most useful for the Bank, and with the help of IFC and its consultants we are in the process of implementing them” said Roman Amirjanov, Head of the Management Board.

**Case 2: Azerbaijan Risk Professionals Association and Rabita Bank**

IFC is now considering taking an equity stake in Rabita Bank, which has been an active client of the corporate governance project since 2007. As part of the equity investment, which is being considered in conjunction with EBRD, both investors are working with the bank to implement an institution building plan which includes strengthening its governance. Drafted in conjunction with Azerbaijan Risk Professionals Association (ARPA), the Project’s corporate governance assessment and improvement plan covered the key areas noted by the investment teams, including the relationships, authorities and reporting between the supervisory and management boards.

“Improvement of corporate governance will help the Bank to improve decision making processes. Good corporate governance practices are also one of the major parameters that is considered by investors” said Elchin Gadimov, Deputy Chairman of the Management Board.

**Case 3: Azerbaijan Corporate Managers & Directors Association and Bank Respublika**

Bank Respublika is one of the largest private banks in Azerbaijan has also been a long-time supporter of introducing good practices, and became an active client of the Project in March 2009. The Bank requested assistance from IFC and Azerbaijan Corporate Managers & Directors Association (AKDMA) to help ensure it had comprehensive and clear reporting and communication between its management board, supervisory board and shareholders.

“The project to deepen further corporate governance improvement in Bank Respublika with IFC support is an important and valuable one as it is one more way to establish better management in the Bank,” said Aslan Abasov, Deputy Chairman of the Executive Board. “We appreciate the fact that IFC has attracted the local consultant (AKDMA) to work jointly on the subject. The level of professionalism of AKDMA experts is very high and I am sure we, as the Bank, will continue our cooperation with them on further promotion of the corporate governance related issues in the Bank.”
2011 Survey Results

Introduction

This section presents the results of a survey of the corporate governance practices of key Azerbaijani companies and banks, conducted between July and November 2011. The organizations surveyed included both active clients of the Project, those who have taken five or more consultations from the Project, and those attending several trainings and seminars. In total, over 100 of Azerbaijan’s major companies and banks were targeted, and responses were received from 37 organizations. These final results show significant changes compared to the baseline survey conducted at the beginning of the Project, 2005-2007, and indeed compared to the individual companies’ accounts of their corporate governance in 2005.

Results are self-reported based on interviews with key persons in the respective organizations, and these include banks, joint-stock companies, limited liability companies and a non-governmental organization.

Corporate Governance Practices in Azerbaijani Companies 2011

Figure 2 shows the percentage breakdown of different elements of good corporate governance that are currently practiced by the respondent organizations. Overall it shows that the majority of respondents have certain key good practices in place. It is a highly positive sign that over 80% of respondents all noted that strong internal control and functioning of their supervisory board were priorities. Similarly, 76% of respondents use International Financial Reporting Standards and have an independent internal audit function, and 73% have an independent external audit. These are all vital to good governance and help companies be transparent, and ensure competent control over their operations.

A majority of respondents have key corporate governance documentation (65%), an audit committee (62%), procedures on General Meetings of Shareholders (59%) and an annual report (54%). Just under 50% of respondents have independent directors on their supervisory boards (49%) and documented policy on related-party transactions (46%). A good sign is that now 43% have corporate governance codes, and 41% have corporate governance...
officers and supervisory board committees, all more advanced practices and illustrative of strong commitment to good corporate governance.

35% have a policy on paying dividends, and 16% have preemptive rights for existing shareholders to acquire new shares in a rights issue. These practices tend to be found in more advanced markets and help better protect shareholders rights. Other more advanced practices include a remuneration system for supervisory board members, which 30% of respondents reported. Remunerating directors helps to promote professionalization of supervisory boards and improves their functioning and oversight. Additionally, 19% of respondents have a documented succession plan, which help companies ensure their long-term sustainability and business continuity in emergency situations.

Figure 2: Elements of Good Corporate Governance Practices among Azerbaijani Companies 2011
Corporate Governance Improvements Since 2005

97% of firms reported that their corporate governance practices had improved since 2005. Figure 3 shows that the areas where most reform has been made include introducing or strengthening internal control, the functioning of the supervisory board, but also much progress has been made in transparency and disclosure, with many companies introducing and improving their annual reporting and the disclosure of related-party transactions. It is also highly positive that many organizations have introduced independent directors to their supervisory boards and established the position of corporate governance officer, both of which show significant commitment to good governance practices and can help better protect shareholder rights.

Figure 3: Corporate Governance Improvements in Azerbaijani Organizations since 2005
Analysis of Results

The following analysis shows the breakdown by the five elements of good corporate governance following IFC methodology.

**Commitment to Good Corporate Governance Practices**

The results show that solid improvements have been made in overall commitment to good corporate governance practices over the past six years. The majority of respondents have updated or introduced key corporate governance documentation, such as charter, by-laws and policies, including 43% improving or introducing a documented policy on related-party transactions, up from only 3% in 2005. 35% have introduced a corporate governance code for the organization. Success in implementing good corporate governance practices in an organization largely depends on the commitment and understanding of the concept by senior officials and the importance they attach to introducing and enforcing good practices throughout the company. This sets the ‘tone at the top’ and starts the process of it trickling down to all levels of the organization.

Significantly, 41% have introduced the position of corporate governance officer, from a base of zero in 2005. Under the best practices of corporate governance, a corporate governance officer (CGO) or corporate secretary is of key importance in an organization’s corporate governance, responsible for ensuring that adequate corporate governance principles are observed and acting as an interface between shareholders, supervisory board and management, as well as liaison with other stakeholders such as regulators. As well as demonstrating commitment to good corporate governance principles, this indicates that shareholder rights would be better protected at such organizations.

**Awareness of Azerbaijani Corporate Governance Standards**

Another indicator of commitment to good governance is the fact that 86% of respondents are aware of the Azerbaijani National Corporate Governance Standards, and of those 84% intend to comply or believe that they already comply with all or most of the Standards. This is a significant result considering that the Standards were only introduced in February 2011, less than one year before this survey was conducted.
Supervisory and Management Board Practices

Closely linked to heightened levels of awareness and commitment, practices at the top levels of organizations are improving, with better board oversight and control. 70% of respondents note they have improved the functioning of their supervisory boards, and 46% have introduced independent directors since 2005. A company’s supervisory board is the link between shareholders and management and provides strategic guidance and effective monitoring of management. It ensures that the right management is in place, pursuing the right strategy, and independent directors can help ensure a balance of power on the board, who can challenge and bring experience. This must be coupled with a strong management board, with a good mix of skills and experience, which is responsible for day-to-day operations and has effective reporting to and working relationship with the supervisory board.

97% of joint-stock companies responding now have functioning supervisory boards, and these results show that members of boards are becoming more professional and better understand their duties thanks to clearly documented roles and responsibilities. This is reinforced by the Azerbaijani Corporate Governance Standards which stress the need for strong supervisory boards and recommend that supervisory boards should include independent members.

Azerbaijani organizations should continue to work on practices in this area, especially ensuring their supervisory and management boards are active and have clearly delineated roles and responsibilities. It is a highly positive trend that in the past six years 24% of respondents have introduced a remuneration system for supervisory board members, but the total still remains low, at 30%, relative to best international practices. Remunerating directors helps to promote professionalization of supervisory boards and improves their functioning and oversight.

The results show that succession planning is an area of weakness, with only 19% of organizations surveyed reporting

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that they have a documented succession plan in place. While it is positive that this has increased significantly from only 3% that reported having one in 2005, the lack of succession planning policies show potential fragility in cases of emergency situations and indicates limited forward planning, and can imply key person risk: the over-reliance on one person to lead the organization. It is especially noteworthy that the massive departure/replacement of key personnel is the second most noted issue that respondents have faced in the past six years, see Figure 9. A clear succession policy helps ensure business continuity and establishes a formal process of delegation of authority, strengthening the long-term sustainability of the organization.

Figure 7: Board Practices

![Bar chart showing board practices improvements over time.]

**Family-owned Enterprises**

38% of respondents reported that they were family-owned enterprises, meaning the company or bank is owned or controlled by one person or family. Of these, 64% had family members represented in the supervisory board and 14% in management. Significantly, a good sign is that 21% had no family members in either supervisory or management boards, which indicates that in these cases the family had fully delegated authority to professional managers and directors.

Figure 8: Family-owned Enterprises in Azerbaijan

![Bar chart showing representation of family members in supervisory boards and management.]

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The Control Environment

A significant result is the increased understanding by Azerbaijani organizations that having a strong control environment is essential, and this is illustrated by the fact that 84% of respondents have improved their internal control system in the past six years. Figure 10 also shows that 57% of respondents have introduced or strengthened their internal audit function since 2005, and in total 76% of respondents reported that they now have a functioning internal audit. Furthermore, 49% of respondents have strengthened their audit committee in the past six years and a total of 62% of respondents now have an audit committee. These results reflect the fact that the most common corporate governance issue reported to have been faced over the past six years has been around cases of internal fraud and misuse of authority, noted by 11% of respondents, as shown in Figure 9.

When IFC first started working on corporate governance in Azerbaijan the importance of the control environment was poorly understood and as a consequence insufficient attention was given to risk management, control and audit. According to COSO,\(^9\) enterprise risk management enables management to effectively deal with uncertainty and associated risk and opportunity, enhancing the capacity to build value. It is an essential element of good corporate governance as it helps align risk appetite with strategy, identify and manage cross-enterprise risks, enhance risk response and reduce losses.\(^10\) Internal control is defined as a process, effected by an entity’s board of

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\(^9\) Committee of Sponsoring Organizations of the Treadway Commission which provides guidance on risk and control

directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives. Control activities are the policies and procedures that help ensure that management directives are carried out.\textsuperscript{11} Under best practice, risk management and control activities are separate to the company’s internal audit function, which provides independent, objective assurance and consulting services to add value and improve an organization’s operations, bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.\textsuperscript{12} The audit committee should then provide oversight over these areas, including: (1) financial reporting and disclosure; (2) internal control and risk management; (3) compliance and ethics; (4) oversight of the internal audit function; and (5) the external audit process.\textsuperscript{13} Risk management, controls and audit are all much better understood by major Azerbaijani firms now and this is helping to strengthen the business environment as a whole.

\textbf{Figure 10: The Control Environment}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{control_environment_graph.png}
\caption{The Control Environment}
\end{figure}

\begin{itemize}
\item Introduced/strengthened internal control system
\item Introduced/strengthened internal audit function
\item Established/strengthened Audit Committee
\end{itemize}

\begin{tabular}{|c|c|c|c|c|c|c|c|c|c|}
\hline
 & 0\% & 10\% & 20\% & 30\% & 40\% & 50\% & 60\% & 70\% & 80\% & 90\% \\
\hline
In place before 2005 & & & & & & & & & & \\
CG improvements in past 6 years & & & & & & & & & & \\
\hline
\end{tabular}

\textsuperscript{11} COSO Internal Control – Integrated Framework. \url{www.coso.org}
\textsuperscript{13} For example, THE UK GUIDANCE ON AUDIT COMMITTEES (Oct. 2008) mandates audit committee should be mainly responsible for the oversight over: (1) financial reporting; (2) internal financial control and risk management; (3) whistleblowing; (4) internal audit process; and (5) external audit process, art.4.1-4.40.
**Transparency and Disclosure**

Azerbaijani companies are also improving their transparency and disclosure practices. 76% of respondents now adhere to International Financial Reporting Standards, while only 14% reported that they did so in 2005, and 65% have introduced or improved it over the past six years. A good sign is that 100% of banks responding now adhere to IFRS, compared to 40% of other joint-stock companies, and 57% of limited liability companies. Furthermore, for the banking sector this is a significant improvement on the 53% of banks that reported they disclosed financial statements according to IFRS in the survey conducted in 2005.\(^{14}\)

51% of respondents have improved or introduced the practice of producing an annual report, a significant improvement from 2005. A total of 73% of respondents now have their financial statements audited by an independent external auditing company, and 49% of respondents state that they have introduced this in the past six years.

Clear and transparent disclosure of material information is a key tenet of good corporate governance practices, which includes disclosure of ownership, financial information, material events, and related-party transactions, amongst other things, and ensures that all stakeholders can effectively monitor and hold management accountable. Best practice companies produce comprehensive annual reports including strategic plans for value creation, which are widely accessible to all shareholders and stakeholders via the internet. The OECD Principles (2004) recommend that disclosure should include: financial results; objectives; ownership; remuneration policy; related-party transactions; risk assessment; employee and stakeholder issues; governance structures and policy.\(^{15}\) The Azerbaijani Corporate Governance Standards also advocate more transparency in access to information through corporate websites and increased credibility of company financial statements and annual reports.

**Figure 11: Transparency and Disclosure**

![Bar chart showing improvements in transparency and disclosure](chart.png)

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Shareholders’ Rights

The trends in the area of shareholder rights protection are strong. 49% of respondents have improved their procedures on holding General Meetings of Shareholders, 30% have introduced a policy on paying dividends, and 11% have introduced preemptive rights, whereby existing shareholders can acquire new shares in a rights issue. While the absolute figures of respondents with these two latter practices remains relatively low compared to international standards, only 35% and 16% respectively, the trends show great improvement, and confirm that Azerbaijan is moving in the right direction. It is understandable that the absolute figures of these practices is relatively low as they tend to be found in more advanced markets.

Other items, such as the introduction of a corporate governance officer by 41% of respondents and the fact that 46% of respondents have a documented policy on related-party transactions are also key indicators that shareholders rights are increasingly better protected in Azerbaijan.

Good corporate governance practices ensure the protection of shareholders’ rights: that they are treated equitably, minority as well as controlling shareholders, they have equal access to all necessary information, the right to participate in the General Meeting of Shareholders and vote on key issues, and there is a fair and consistent dividend policy. As the Azerbaijani Corporate Governance Standards become more widely followed this will improve further as the Standards include these measures to protect the interests of minority shareholders.

Figure 12: Shareholders Rights

- Improved/introduced procedures on General Shareholders Meetings
- Introduced a policy on paying dividends
- Introduced preemptive rights

In place before 2005  CG improvements in past 6 years
**Benefits from Corporate Governance Practices**

97% of respondents noted that the corporate governance practices they have introduced have brought benefits to their organization. The greatest benefits noted were those related to helping an organization to grow and develop: 86% of respondents noted that corporate governance has provided clearer roles and responsibilities within the organization and 81% of respondents reported that it has improved decision-making.

Legal and regulatory compliance and the mitigation of risks were the next most cited benefits, with 70% and 59% respectively, and 35% also noted that it helped to prevent or resolve corporate conflicts. Reputational benefits were recognized to stem from good corporate governance practices, reported by 51% of respondents.

Financial benefits were also stated by respondents. 35% found they had better access to capital markets and 32% found it helped attract investment. A higher valuation (22%) and lower cost of equity and/or debt capital (11%) were also noted, and 22% of respondents reported that it led to improved productivity, sales or profits. All these results are analogous to other studies on corporate governance, and demonstrate the impact good corporate governance practices can bring to individual organizations, and ultimately to the economic development of a country. 16

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![Figure 13: Benefits from Corporate Governance Practices](image-url)
**Key Project Results**

82% of respondents that reported close cooperation with the Azerbaijan Corporate Governance Project noted improved performance, and the areas of improvement were mostly in the area of commitment (71%), controls and risk management (56%), activities of the executive bodies (56%) and supervisory board activity (53%), as shown in Figure 14.

**Figure 14: Improvements made in cooperation with IFC Project**

The overall results of the Project’s activities are significant, as shown in Figure 15 below. Especially of note is the total value of US$132 million in financing that eight client companies reported was facilitated by the corporate governance improvements that the Project helped them to make. Over the course of the Project, 45 organizations\(^{17}\) noted that they improved their corporate governance practices, and of these 32 reported improved performance resulting from these practices.

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\(^{17}\) Includes additional data taken from a previous survey conducted at the end of Phase 1 of the Project in 2007.
**Conclusion**

In conclusion, many Azerbaijani companies now recognize the importance of good corporate governance practices to add value by improving their performance through more efficient management, systems and structures, and that this is a key area that investors look at and thus can help facilitate investment. In emerging markets this becomes especially important for investors and there are numerous studies that show the importance of corporate governance in attracting financing. A recent article notes how well governed companies in emerging markets tend to be valued more highly, and indeed research shows that the majority of investors are prepared to pay a premium for good Corporate Governance – noted at over 30% in Eastern Europe.

The improvements in corporate governance that this survey documents will help those organizations make the right strategic decisions in an increasingly competitive market, and help protect themselves from the additional risks faced as they grow and internal operations become more complex.

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The Future for Corporate Governance in Azerbaijan

IFC Azerbaijan Corporate Governance Project is closing at the end of December 2011 in recognition of the fact that its objectives have been met and corporate governance practices in Azerbaijani companies and banks are much improved. Going forward, many banks and investors are now demanding good governance practices from their clients, the subject is taught in a number of educational institutions, and the legislative environment is stronger.

Corporate governance, however, is a journey not a destination, and as such work on improving practices and the enabling environment for corporate governance will need to continue in order that Azerbaijan maintains its progress and advances in this area. The keys things that are in progress and are being addressed in the near future are:

- Civil code amendments to clarify and strengthen further the legislative environment for joint stock companies;
- The promotion of the National Corporate Governance Standards and compliance with them by major Azerbaijani organizations;
- Continue progress in governance practices by strengthening the ability of Supervisory Board and Audit Committee members to carry out their duties diligently and effectively.

An essential element of the latter will be director training and consulting, and for this reason IFC has focused one part of its exit strategy on building capacity of local director training organizations as the Project’s official Exit Partners.

IFC is pleased to announce that the official Exit Partners of the Project are:

Better Governance – Stronger Business!

AKDMA aims to increase the knowledge of Azerbaijani directors and managers on best standards and foster better practices of corporate governance and business conduct through trainings and consulting services. Cooperate with appropriate state agencies, as well as with business and other civil society organizations, to contribute to the formulation and pursuit of a Corporate Governance reform agenda. Collaborate with international institutions and organizations in area of corporate governance related issues.

Murad Alizada, Chairman of the Management Board
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ARPA’s vision of Corporate Governance: “ARPA aims to contribute to stable development of Azerbaijan by becoming a provider for forming and improving culture of corporate governance, by informing and educating businesses, institutions, associations and other legal entities as well as private interested parties engaged in the applicable fields on corporate governance related issues and developments. We are honored to experience corporate governance practice by conducting researches, analyzes and events which are specially designed to expand and deepen knowledge on corporate governance culture in our dynamic region”.

Rufat Mahmud, Chairman of the Board of Directors
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Isgandarov & Partners’ mission is leading clients to the top of business by presenting top quality and tailor-made advisory services. Established in 2005, Isgandarov & Partners specializes in providing financial advisory services in Azerbaijan, focusing heavily on accounting, management capacity, and trainings. In 2008 Isgandarov & Partners obtained a correspondent membership with DFK International, an International Association of Independent Accounting Firms and Business Advisers. The Association has over 360 offices worldwide.

Kamran Isgandarov, General Director
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These organizations will continue to work with companies, banks and other organizations to promote good corporate governance practices in Azerbaijan. IFC will be closely following the progress of these organizations going forward and will provide support on qualitative issues on corporate governance. With continued support from SECO, IFC’s Global Corporate Governance Forum will work together with the local IFC team to provide training and advice to these organizations to help them become sustainable providers of corporate governance services in Azerbaijan.
IFC is a member of the World Bank Group