

IMPROVING AZERBAIJAN CORPORATE GOVERNANCE

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Abstract. The article discusses the role and importance of corporate governance in increasing the efficiency of companies, as well as the entire national economy as a whole and the results achieved in this direction. The current state of application of corporate governance at enterprises of the republic, as well as the prospects for its application in state-owned enterprises, have been studied. In conclusion, specific measures are proposed to improve corporate management in the republic.

Keywords: Corporate governance, efficiency, national economy, companies.

AZƏRBAYCANDA KÖRPORATİV İDARƏ- ETMƏNİN TƏKMİLLƏŞDİRİLMƏSİ

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Xülasə. Məqalədə şirkətlərin, eləcə də bütövlükdə milli iqtisadiyyatın səmərəliliyinin artırılmasında korporativ idarəetmənin rolu və əhəmiyyətindən, bu istiqamətdə əldə olunan nəticələrdən bəhs edilir. Respublikanın müəssisələrində korporativ idarəetmənin tətbiqinin mövcud vəziyyəti, eləcə də dövlət müəssisələrində tətbiqi perspektivləri öyrənilmişdir. Sonda respublikada korporativ idarəetmənin təkmilləşdirilməsi üçün konkret tədbirlər təklif olunur.

Açar sözlər: Korporativ idarəetmə, səmərəlilik, milli iqtisadiyyat, şirkətlər.

СОВЕРШЕНСТВОВАНИЕ КОРПОРАТИВ- НОГО УПРАВЛЕНИЯ В АЗЕРБАЙДЖАНЕ

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Резюме. В статье рассматриваются роль и значение корпоративного управления в повышении эффективности компаний, а также всей национальной экономики в целом, а также результаты, достигнутые в этом направлении. Изучено современное состояние применения корпоративного управления на предприятиях республики, а также перспективы его применения на государственных предприятиях. В заключение предлагаются конкретные меры по совершенствованию корпоративного управления в республике.

Ключевые слова: Корпоративное управление, эффективность, национальная экономика, компании.

1. Introduction

A feature of the current stage of development of the national economy is the need for its deep restructuring in organizational and structural aspects. The effectiveness of the Azerbaijani economy largely depends on its ongoing structural restructuring, the development of the non-oil economy, as well as the introduction of effective forms of management, which should be based on advanced foreign experience. The decisive role in this chain of reforms belongs to corporate governance. Over the past 40 years, corporate management methods have established themselves as the most effective tool for the development of the national economy in a market economy. One of the most controversial issues in a market economy, which is of great practical importance, is the problem of the relationship between the functions of the owner and the functions of company management. The most effective solution to this conflict is the

introduction of corporate governance in companies, which provides for the creation of such a set of management bodies and mechanisms that makes it possible to differentiate the functions of owners and managers, monitor the activities of management structures and protect the interests of shareholders, especially minority ones. This management system provides managers with broad freedom to develop and apply effective management tools and mechanisms, gain unlimited access to the financial resources market, create new jobs and increase the profitability of the enterprise. Corporate governance plays an important role in improving the efficiency of firms and companies operating in countries with developing market economies. As a rule, they especially need an influx of financial resources and economic restructuring. Corporate governance carries out an open exchange of information, based on its full transparency, protects the interests of all stakeholders, which creates favorable conditions for attracting third-party investors. In developing countries, a significant proportion of enterprises are state-owned, which is a factor in their low efficiency. These enterprises also need to introduce corporate management methods as a means of improving the health of these enterprises and increasing confidence in them from civil society and foreign investors. Thus, the corporate management method can be considered as a driver for the development of the national economy of developing countries.

2. Fundamentals and features of corporate governance in Azerbaijan

In Azerbaijan, in 2003-2012, the Ministry of Economic Development of Azerbaijan did a lot of work to prepare and adopt the necessary regulatory materials for the introduction of corporate management methods in domestic firms and companies. Features of corporate standards are:

A. They can be applied to all enterprises regardless of their form of ownership. This makes it possible to use them in both public and private enterprises;

B. The application of these standards is completely voluntary.

B they reflect the wealth of corporate governance experience accumulated in advanced economies.

The main goal of developing the entire set of documents on corporate governance was the desire of the state to provide legal support to domestic business. More than 10 years of experience in their use has shown that they are most widespread in the banking and insurance sectors of the economy. It is these sectors of the economy that showed the greatest stability during periods of economic crises of 2015-2017 and during the pandemic of 2019-2021. During the above periods of critical development, thanks to significant sums of money from investor-shareholders, they managed to maintain their stability and finance the business in the post-crisis years.

The most intensive work on the introduction of a corporate management model in the banking sector of the economy, based on the principles of transparency and parity of

management, was carried out with the support of the International Finance Corporation (IFC) and the Swiss State Secretariat for Economic Affairs (SECO). The successful implementation of this project with the support of companies from Switzerland made it possible to attract foreign direct investment in the amount of 132 million US dollars. In total, 32 companies and banks of the republic participated in this project. The introduction of a corporate management system based on transparency of economic activities in these organizations allowed them to attract investments in the amount of more than 500 million US dollars. Considering the significant share of state-owned companies in the economic development of the republic, it is planned to introduce the principles and mechanisms of corporate governance at all large state-owned enterprises by 2026. It is assumed that the introduction of this management system in them will improve their efficiency, reduce costs and make them more competitive.

A special feature of the Azerbaijani economy is the presence of a significant share of state-owned enterprises in it. Which produce up to 25% of the republic's gross domestic product. Moreover, these enterprises are systemic in a number of areas of economic activity. These are, first of all, enterprises in such areas of the economy as oil production, the chemical industry, the production of petroleum products for various purposes, gas production and electricity, most of the transport transportation, water production and its distribution. The state also owns one of the largest commercial banks in the republic, as well as the Central Bank. Increasing the efficiency of their work is closely related to improving the management system, including the development of corporate governance in them. The implementation of this management system here is still at the initial stage of its development.

The purpose of introducing corporate governance, in accordance with the principles adopted by the Organization for Economic Cooperation and Development, is to harmonize relations between the administration and employees, the administration and shareholders of the company, as well as other interested parties. In this regard, it is important to understand the peculiarities of the functioning of the state form of ownership in a market economy. According to one of the leading experts in the field of doing business and increasing efficiency in state-owned enterprises, Isaac Adizes, all such enterprises are at the stage of their bureaucratic development [1].

The vast majority of state-owned enterprises are unprofitable, however, they continue to exist due to subsidies from their state budget. In recent years, many foreign and domestic experts have proposed measures to improve the health of state-owned enterprises while maintaining their status. One of the most important of these methods is the introduction of a corporate management method in state-owned enterprises, using the principles applied to enterprises in the private sector of the economy. Among these principles are:

1. Creation of a limited apparatus of independent directors. These directors should not report to the owners of the largest shares, but only to the general meeting of shareholders;
2. Reduce the number of centrally regulated standards;
3. Expand the powers and rights of the group of directors;

4. Ensure complete transparency of all information within the enterprise.

State-owned enterprises are characterized by the following features:

A. Each enterprise has its own institutional specifics, determined by the ministry in which it operates. The technical and technological specifics of the enterprise are determined by the characteristics of the products manufactured;

B. State-owned enterprises are exempt from liability for their ineffective actions. If in the former USSR the managers of such enterprises faced serious administrative and criminal punishment, then in a market economy the responsibility is reduced only to administrative punishment;

C. Directors of state-owned enterprises have limited discretion. They are forced to constantly coordinate their actions with higher management.

Research conducted by the World Bank in 2014 and 2020 suggests that state-owned enterprises in developing countries, especially in the Eastern Europe and Central Asia region, still play a significant role in the economies of these countries. They operate primarily in such areas of economic activity as the mining and oil and gas industries, transport, finance and water supply.

3. Divergence of interests of owners and managers

According to Fortune magazine in 2017, out of the 500 leading companies in the world, 125 companies were state-owned [2]. The total revenue of state-owned companies in 2017 amounted to 8 trillion US dollars, which is equal to 10% of the gross domestic product of the whole world [9]. According to World Bank research, the total value of public administration enterprises in the world as a whole was estimated at 3.4 trillion US dollars [9].

Below, Figure 1 shows data on the rate of revenue growth in the group of countries of Eastern Europe and Central Asia for 2016-2018 as a percentage of the previous period. From this figure it follows that the most significant share of state-owned enterprises is in Azerbaijan, Belarus and Kyrgyzstan. The fewest state-owned enterprises are in the Baltic countries, Georgia and Serbia. This is confirmed by the growth rates of revenue in these countries for 2016-2018, as a percentage of Gross Domestic Product: in Azerbaijan they amounted to 146% and in Belarus - 112%.

According to classical theories, there is a certain divergence of interests between the owners of the enterprise (in this case, a state-owned enterprise) and managers. Practice shows that very often when making decisions, managers proceed primarily from their own interests and not from the interests of the enterprise for which they work. Thus, it can be considered that there is a conflict of interests between the owners of the enterprise and its managers. In most cases, wages and performance indicators of managers are determined by the amount of revenue received by the enterprise. Hence the interest of managers not in increasing the capitalization

of the value of the enterprise they manage, but in increasing revenue and accordingly, remuneration for their labor.

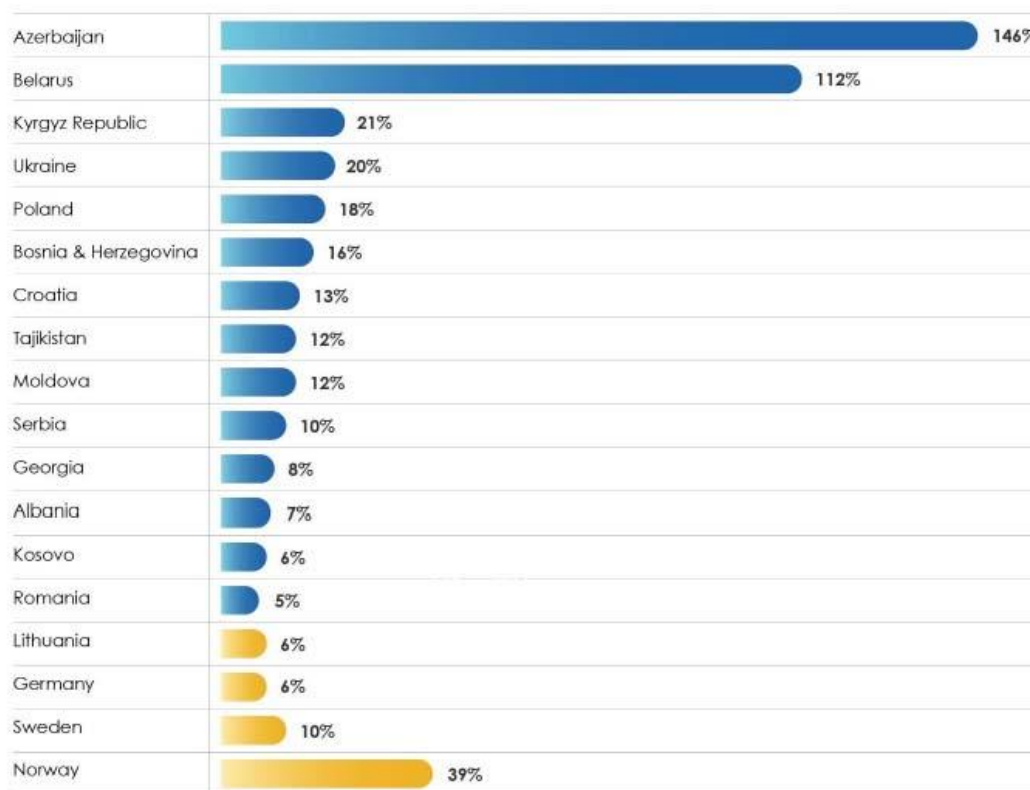


Figure 1. Revenue Generated by SOEs as Compared to GDP

Source: Individual countries' SOE ownership reports, individual SOEs' financial statements (2016-2018) [7].

In our opinion, it is necessary to clearly define the fundamentals of the functioning of state-owned enterprises. In most Organization for Economic Co-operation and Development (OECD) countries, state-owned enterprises do not have immunity from bankruptcy. The same general rules apply to them as to private enterprises. This principle is used for state-owned enterprises operating in such developed countries of the European Union as Germany and the UK. Sweden, Italy [9].

4. Foreign experience in applying corporate governance

Numerous studies indicate that there is a direct relationship between the effectiveness of corporate governance at state-owned enterprises and the effectiveness of the Board of Directors appointed to them and the improvement of their professional level. In this context, the study of advanced foreign experience and its application at the enterprises of our republic is important. A fundamental issue is the presence of state representatives on the Board of Directors. For example, in countries such as Great Britain, Denmark and Finland, Germany, their number ranges from 0 to 2 people on the Board of Directors.

A fundamental issue in advanced foreign practice is also the presence on the Board of Directors of representatives of the enterprise's workforce. Their number in countries such as

Austria, the Czech Republic, Germany, Norway is regulated by the practice of the current legislation on joint-stock (corporate) entities in force in these countries.

Another important issue is the inclusion of independent managers on the Board of Directors. Factors of managerial independence are also determined by the legislation in force in a given country. Thus, in France and Greece, up to 30% of the members of the Board of Directors are persons independent of the state and not members of the managers of the company. In a number of other countries, for example in Slovakia, at least 51% of the members of the Board of Directors must be independent persons. A slightly different practice is used in a group of countries such as Austria, Germany and the Netherlands. In these countries, specialist managers from the private sector of the economy are attracted to the Board of Directors [9].

The experience of developed countries in establishing criteria for management efficiency and qualification requirements for potential candidates to the Board of Independent Directors deserves great attention. Many OECD member countries have defined very specific qualification criteria for future directors, such as their level of higher education, work experience in senior management positions (Israel, Finland, Denmark). In other countries, the main emphasis is placed on qualitative criteria, such as innovativeness, specific results achieved in previous work positions, as is the case in Spain, Sweden and Denmark). According to the recommendations for the implementation of corporate governance in enterprises with state participation, prepared by the OECD, the same conditions should be created for their activities as for the private sector of the economy. The establishment of an equal competitive environment for everyone in each specific country will most stimulate the increase in the efficiency of their activities [8]. The state must clearly indicate the goals of its participation in such enterprises, since it, as a rule, comes down to solving certain problems related to protecting the interests of the entire society and not maximizing profits for the sake of a narrow circle of owners.

The need to solve global problems to improve public welfare and strengthen the defense capability of the republic requires further increasing the efficiency of existing state-owned enterprises, by improving the efficiency of their activities, including through the introduction of a corporate management system at state-owned enterprises. To this end, on August 31, 2023, the President of the Republic of Azerbaijan issued the Order “On measures in connection with attracting private investment in state-owned enterprises of the Republic of Azerbaijan” [4].

In fact, this order of the President of the Republic lays the foundations for a new reform of the management system of state-owned enterprises. It provides for greater involvement of citizens of the republic in the management of state-owned enterprises. In addition, it is planned to attract additional investments in such largest state-owned enterprises as the International Bank of Azerbaijan, Baku Telephone Communications and “Aztelekom”, “Azerbaijan Caspian Shipping Company CJSC” and “AzerGold”, “Azerikimya Production Association” (ethylene-polyethylene plant) and also to urea and methanol plants [3]. The implementation of this decision is aimed at reducing the state’s share in these companies by deepening the corporate

governance mechanism in them. All listed companies are enterprises with a high level of profitability. Attracting private investors here by expanding corporate governance is undoubtedly evidence of the government's serious intentions to further develop and deepen corporate governance mechanisms in the public sector of the economy. This order provides for the assessment of state-owned enterprises, identification of potential investors and demonopolization of certain sectors of the national economy. There is also a partial sale of state shares in the above-mentioned enterprises, which will free up a significant part of state funds for other purposes. The implementation of these measures will also revive the capital market in the republic. It is expected that the ongoing reforms will strengthen the interaction of public and private enterprises, accelerate the process of diversification of the national economy and give impetus to the development of the non-oil economy. In order to accelerate the implementation of corporate governance in the system of state-owned enterprises in Azerbaijan, the Azerbaijan Investment Holding was created in 2020. It is planned to create Supervisory Boards at state enterprises, which will allow for the separation of the functions of the owner and operational management. The goal of reforming the management of state-owned enterprises, through the introduction of corporate governance, is to overcome the unprofitability of the absolute majority of them, reduce annual government subsidies for the activities of these enterprises, increase their responsibility and bring them to the level of profitable operation.

Conclusion. A developed corporate management system makes it possible to increase the social and environmental responsibility of a business and determine an effective strategy for the long-term development of the company. The practice of companies that apply corporate management methods allows them to achieve greater efficiency. In 2023, additional measures were taken in the republic to introduce the corporate management method in state-owned enterprises.

To overcome the above-mentioned shortcomings and increase the efficiency of corporate governance at state and private enterprises of the republic, it is proposed:

A. The Board of Directors shall be appointed for a period of 3 to 5 years. The duration of this assignment should be determined by the complexity of the technologies used and the products manufactured. Thus, the extraction of raw materials has a long technological production cycle and requires more time to determine the efficiency of its production than, for example, organizing the production of shoes or shirts. Western experts, for example, suggest appointing a board of directors for 3 years [7].

B. Members of the Board of Directors must receive a full amount of information about the activities of their enterprise. This is necessary to justify the objectivity of decisions made.

C. Members of the Board of Directors should be given broad rights to hire and fire employees.

D. Strategic decisions and development plans of a state-owned enterprise must be approved by the government of the country.

E. It is necessary to establish the financial responsibility of members of the Board of Directors for making erroneous decisions.

F. At least 2 representatives of the company's employees must be present on the Board of Directors.

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