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**“Azerbaijan`s bank market: condition, acute problems and perspectives  
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## INTRODUCTION

**Topicality of the topic** - One of the active issues of civil society is a credit market. Credit in Latin translation - I know, trust, and bear the meanings. The bank market is a combination of the relationships between the lender and the borrower on the issuance, use and repayment of the loan. The bank market is the most important mechanism that accelerates and stimulates the market economy.

Credit relationships occur when creditor and borrower have a loan. Bank market is a form of mutual relations between individual and independent decision-makers. The feature of the product in the bank market is its distinctive feature. It can be said that the bank market depends on the definition of the market capital market. With the advent of World War II and technology, the concept of the bank market in the world has grown wide. The bank market in Azerbaijan has an ancient history. However, it would be better to say that the main development period of the bank market of Azerbaijan was after independence. This area has been selected by the state as a priority area, and a number of state programs have been launched to promote it. Thanks to all this, we can see the flow of local and foreign investments into the bank market of our state.

**Purpose and Objectives of the Research** - The purpose of the research is to study the current state of the banking market in Azerbaijan and to explore the way economic analysis of development potentials.

To achieve this goal, the following tasks have been set:

- Theoretical methodological issues of bank market development
- Analyzing and evaluating the current state of the banking market in Azerbaijan
- improvement of the banking market performance and adaptation to international standards.

**Subject of the research** - The subject of the research is the selection of the bank market as a key priority area of Azerbaijan's economic development, its

current status, problems and methods of investigation of future development, analysis of used instruments and normative documents.

Object of research - The subject of the research is the development prospects of the bank market in modern times.

Scientific novelty of the research - The Azerbaijan banking system was researched in detail in areas and regions under existing conditions and analyzed development potential. For this purpose, trend analysis, correlation analysis has been applied.

- Issues related to improvement of the bank market activity and compliance with international standards are of great importance in chapter III.

Research Information Database - Various domestic and foreign articles and literature on the development of the bank market in Azerbaijan were used.

The practical significance of the research - The choice of the bank market as a priority area for the development of the state's non-oil sector, research and analysis of this issue, prospects of Azerbaijan's transformation into a regional and international bank market can be used to participate in scientific conferences in the future, as well as to study and improve the bank market.

## **CHAPTER 1. STRUCTURE OF THE BANKING MARKET**

### **1.1. The essence and participants of the banking market**

With the development of a market economy, there is a need to create an adequate financial infrastructure that includes financial markets. With the development of industry and trade, the financial system is developing the banking system of society, which carries out its operations in the banking market (primarily trade in credit resources).

The term "system" is used to determine credit relations, banks and the organization of their activities. Most often, the word "system" means the composition of something. In terms of content, the term "system" determines not only the composition of elements, but also [1]:

- a collection of elements;

- sufficiency of elements forming a certain integrity;

- interaction of elements.

The banking system is a holistic education that ensures its sustainable development.

As a set of elements it can be defined as: [2]

Fundamental unit:

- the bank as a monetary institution;

- rules of banking.

Organizational unit:

- types of banks and non-bank credit institutions;

- bases of banking;

- organizational basis of banking activities;

- banking infrastructure.

Regulating unit:

state regulation of banking activities;

banking legislation;

regulations of the central bank;

instructive materials of commercial banks.

The banking system is also defined as a set of participants in the monetary market - commercial and specialized banks, non-banking institutions that perform deposit, loan and settlement operations and operate within the framework of a common monetary and credit mechanism.

Blocks and elements form a unity, reflecting the specifics of the whole and acting as carriers of its properties. The banking system has a number of features:[3]

has specific properties;

acts as a unit;

is dynamic;

acts as a closed system;

possesses the character of a self-regulating system;

is a managed system.

The system can not include other entities that work in the market and are subject to other goals. The specificity of the banking system is determined by its elements and the relationships that develop between them. The essence of the banking system affects the composition and essence of its elements.

Types of banking systems: [4]

centralized centralized banking system;

market banking system;

transition system.

Until 1999, Japan, Germany, France, England, Italy and other countries had a banking system with an independent central bank. The federal reserve system

was used only in the USA. However, when trying to make its national currency, the reserve system of the federal reserve is more competitive, operational and sustainable. Banking systems of developed countries are of a two-tier nature (some authors define a three-tier banking system). The first level is the central bank or similar body regulating the monetary sphere and banking supervision, the second level - credit and financial institutions that meet the needs of economic entities in banking services (financial intermediaries). The banking supervision system also applies to a number of authors to the features of the banking system. We can distinguish three groups of countries that differ in how they build supervisory structures:

The supervision is exercised by the central bank;

supervision is exercised by other bodies to which the state delegated these powers;

supervision is exercised by the central bank in conjunction with other bodies.

The banking system is a variety of parts subordinated to a single whole. This means that individual banks are connected in such a way that they can replace each other if necessary. The system is in motion, supplemented with new components, is being improved. New connections are constantly arising within the system. The banking system is closed to the extent that it must comply with banking secrecy. Self-regulation of the system means that it is influenced by changes in the economic conjuncture, political situation. The system is manageable, since the central bank conducts an independent monetary policy, in various forms is accountable only to the parliament or the executive branch. The activities of commercial banks (business banks) are governed by general and special banking legislation, economic regulations. The supervision of the activities of commercial banks by the central bank or other specialized state bodies is functioning.

The banking system directs funds from creditors to borrowers, financial intermediaries issue their own debt obligations (banks - deposits, insurance companies - annuities), sell them in the money market, and the proceeds are purchased by foreign debt obligations. This process of creating obligations and exchanging them for obligations of other counterparties, i.e. double exchange, is the essence of financial intermediation. The most important function of financial intermediaries is that they bring their assets and liabilities in line with the demands of consumers, regulating the coincidence of the interests of savers and borrowers (liabilities are formed taking into account the wishes of investors to invest their money in a particular financial instrument, and placement in assets is carried out based on the needs of borrowers to receive loans). Bank intermediaries receive economies of scale as lenders and borrowers, reduce their risks and unit costs due to the size of their portfolios and the use of techniques for their diversification.[4]

From a macroeconomic point of view, intermediation is the mechanism by which money is most effectively redistributed between creditors and borrowers. Banks can help increase money in circulation, create money as a by-product in customer service. The Company benefits from loan operations of banks, when the limited amounts of temporarily free money that is subject to loan transfer ensure achievement of the set goals.

In most countries with a market economy, there is a two-tier structure of the banking system. The first level is formed by the central bank, the most important function of which is the implementation of the government's monetary and monetary policy to achieve national economic goals. The Bank acts as an intermediary between the government and financial markets and performs the following functions: [5]

carries out the issue of national currency, organizes their circulation and withdrawal from circulation, determines the standards and procedures for settlements and payments;



conducts general supervision over the activities of the country's financial and credit institutions and the implementation of financial legislation;

provides loans to commercial banks;

issues and conducts repayment of government securities;

manages accounts of the government, carries out foreign financial transactions;

regulates banking liquidity using traditional methods for the central bank to influence commercial banks, pursues a policy of discount rate, open market operations with government securities and regulates the reserve requirements of commercial banks.

Among other things, he collects a large amount of statistics about all financial institutions relating to the size of their operations, the sectors of the economy that they are lending to, their depositors. Due to its influence and control over other banks, the central bank can limit or increase the money supply in the economy by regulating lending in this way.

In most countries with a market economy and a two-tier banking system, the functions of the central bank are basically the same, but there are differences as well. For example, at the head of the banking system of France, which is characterized by strict banking supervision and credit control, as well as the predominance of public credit institutions, is the French Ministry of Finance. The Central Bank of France, along with two other institutions (the National Credit Council and the Banking Control Commission), which monitor the activities of commercial banks, is under the leadership of the Ministry of Finance. The Bank of France has a monopoly on the issue of banknotes, but its tasks as a state bank are limited, as many banking operations are performed by the treasury itself of France.

In addition to the two-tier banking system, there is a decentralized Federal Reserve System (US Federal Reserve System). It is announced by 12 federal reserve banks in various regions of the country, whose task is to monitor the

activities of the banks-members of the FRS and determine the cardinal directions of US monetary policy. Members of the Federal Reserve are 40% of all commercial banks, the rest of the banks work at their own peril and risk.

As a centralized mono-banking system, the banking system of the USSR and many other socialist countries was built. It was formed in the USSR from three state-owned banks (State Bank, Stroibank, Vneshtorgbank) and a system of savings banks. In addition to issuing and settlement-cash activities, the State Bank of the USSR performed the functions of lending to various branches of the national economy (providing short-term loans to industry, transport, communications, and long-term loans to agriculture). Stroibank carried out long-term crediting and financing of capital investments in various branches of a national economy (except for agriculture). Vneshtorgbank conducted foreign trade lending, was engaged in international settlements, operations with foreign currency, gold and precious metals. Savings banks attracted money deposits of the population, paid for communal and other services. The monopoly of the three state-owned banks led to the fact that loans often performed the role of the second budget. In these conditions, the effective potential of the credit mechanism was not used, nor was it possible to pursue an active monetary policy with those instruments that are known in the market economy countries.

The course on the development of market relations required the creation of a qualitatively new system of banks. In the mid-80s of the XX century. Banking reform began, as a result of which, at that time, large specialized specialized banks were organized: State Bank of the USSR, Promstroybank, Agroprombank, Zhilsotsbank, Sberbank and Vnesheconombank. However, in fact, this form led to the monopoly of the three state-owned banks being replaced by the monopoly of the reorganized specialized banks.[7]

The first commercial banks were established in August 1988 after the adoption of the Law of the USSR "On Cooperation", according to which associations of cooperatives were given the right to create cooperative banks. At

the end of 1988, 25 cooperative banks were created, in April 1989, the creation of joint-stock commercial banks on a share basis was permitted. The main advantages of the commercial banks being created in comparison with the state specialized banks were the freedom to choose methods of conducting banking operations and direct dependence on attracting clients on a contractual basis. In the late nineties the laws of the USSR "On the State Bank of the USSR" and "On Banks and Banking Activities" were adopted, and laws were soon enacted in the Azerbaijann Republic. In accordance with the Law of the Azerbaijann Republic "On Banks and Banking Activities," founders of commercial banks can be not only legal, but also individuals, as well as foreign participants. With the adoption of these laws, a more intensive process of organizing new commercial banks began.

The restructuring of the banking system by creating a second level in the form of independent commercial banks was called the reform of the banking system of the early 1990s. And if about 200 commercial banks were created at the beginning of 1990, then in five years they already amounted to 2.5 thousand. For comparison: in the USA it took about 80 years (1781 - 1860) to create 1,000 banks.

The Federal Law "On Banks and Banking Activities" provides the following definition: "The banking system of the Azerbaijann Republic includes the Bank of Azerbaijan, credit institutions, as well as branches and representative offices of foreign banks. (8, p.234)" The possibility of the presence of banks representing foreign capital on the Azerbaijann credit market is provided, the conditions for licensing their activities and the powers of the Bank are determined.

The banking system as a financial intermediary is characterized by specific relations between its links: the CBR exercises control over the activities of other banks in order to protect depositors' funds and control the money supply in order to limit its growth. The system is constantly transformed, on the one hand, under the influence of market demands (merger, acquisition, penetration into other spheres of the economy, bank failures of banks), on the other hand, the conditions of its functioning change under the influence of government policy, i.e. a system that

adequately responds to the methods of managing it. The banking system is closed to the extent that it is necessary to observe bank secrecy. It operates on the basis of banking legislation, where the main banking laws are in force: Federal Law No. 86-FZ of July 10, 2002 On the Central Bank of the Azerbaijan Republic (Bank of Azerbaijan) and the Federal Law on Banks and Banking Activities (1996)[9].

## **1.2. Influence of world-wide processes on banking services market**

The globalization of the economic life of the society is becoming more and more vivid, all the more dynamic, its impact on various spheres of economic activity is very tangible and not always positive. That is why it is actively studied by scientists and practitioners from all directions. The proposed article highlights the impact of globalization on banking.

In the economic science the concept of "globalization" was introduced by sociologists. By the end of the twentieth century, a whole branch of knowledge was formed, called "globalists".[10] As many authors note, globalization and the growth of instability, which characterize the development of the world economy in recent decades, are especially clearly manifested in the banking sector of the economy, the most sensitive to external factors. Indeed, a modern bank is a high-tech financial institution capable of servicing any complex commercial transactions and projects.

The essence of globalization is the increase in the volume of international trade, financial and investment flows, with their growing interconnection, when the development of all spheres of economic life is increasingly determined by the action of non-national and regional rather than global factors.

Globalization is accompanied by deregulation of banking activities and liberalization of financial markets. At the same time, institutional distinctions between various types of banking and financial activities are erased: commercial, investment, insurance, etc. As a result, the nature and forms of competition in financial markets change significantly. Banks are compelled to compete

simultaneously in many segments of the financial market, and not only with each other, but also with other financial institutions - insurance and investment funds, financial companies, etc. And in conditions of liberalization - not only with residents, but also with non-residents [11].

Liberalization, on the one hand, creates conditions for the development of the foreign branch network of banks and the formation of an international banking business, which, naturally, intensifies the competition, but, on the other hand, simultaneously activates the consolidation of bank capital. This leads to an increase in the number of mergers and acquisitions in the banking sector, the expansion and increase in the variety of forms of cooperation between banks and non-bank credit and financial institutions, and the growth of banking alliances of various kinds.

Information technology plays a special role in global changes in the banking business. More recently, information systems and technologies have been used primarily to automate the collection and processing of banking information, less often for planning and control in banks and were seen as a means of reducing manual labor and reducing bank costs. Today, information technology has become the driving force behind radical structural changes in the banking business. They overcome space and time, opening to banks a round-the-clock exit on any geographically remote markets.

At the same time, the traditional competitive advantages of banks - multifaceted, long-term contacts with customers and a developed branch network - partially lose their significance. There is a new layer of customers who are willing to use Internet banking services. The nature of the bank's communication with these clients is very different from the traditional one. Modern multimedia tools provide a virtual interactive communication of the bank with the client, which gradually replaces personal communication with him.[12, p.10]

Technologies in the on-line mode, providing transparency of the market, allow customers to select the most profitable services for them without much effort and time, which reduces the opportunities for banks to "price maneuver".

On the basis of new technologies, services that are similar to banking ones, or even directly bank ones (for example, on the transfer of payments) can be rendered by organizations that are not banks, including telecommunications firms. The latter, as a rule, are not guided by individual operations, but offer an individual package of services for each client.

In these conditions, banks, for the sake of maintaining competitive prices for services, are constantly struggling to reduce costs, introducing cost control and efficiency analysis schemes. At the same time, the desire to meet the requirements of the time forces them to increase the cost of implementing new information and telecommunication technologies, to develop, in addition to the existing branch network, electronic distribution channels. There was a contradiction between the desire for economy and the need for large expenditures.

We gave only a few arguments in favor of the view that banking activity in the era of globalization is substantially modified. If we try to identify the reasons that caused these changes, then first of all we should name the following : [13, p.392]

1. The development of transnational corporations and their branch network in all countries of the world led to an increase in their need for adequate banking services and provoked the emergence of new non-traditional banking services.

2. The non-financial sector of the economy, the financial and banking systems of national economies are becoming more uniform when working in the domestic and world markets. This leads to a convergence of rules governing internal and external economic transactions.

3. National banking systems that are called upon to accumulate and redistribute financial resources within the national economic system are increasingly dependent on the international capital market, which in the era of

globalization has become an independent factor in the development of the world economy.

4. The national monetary and credit policy (that is, the banking activities of the Central Bank) is exacerbated by the growing expansion of corporations, banks, and other financial institutions on the world capital market, including in the direct investment sector.

5. The above-mentioned reasons 1 and 4, as well as the whole complex of reasons and circumstances pointed out by M. Delyagin, break the framework of the national economy and make it more open (for weak economic systems this has very unfavorable consequences, while strong economies benefit) .

6. A consequence of the fifth of the reasons mentioned is the change in the nature and main competitors in the banking market. It is very intense competition with non-resident banks in developed economies.

7. Increase in the share of international transactions in the total volume of banking operations.

8. The consequence of the seventh cause is a change in the structure of incomes, and, consequently, of the "geography of economic interests" of banks.

9. Standardization of banking supervision.

The banking business under the influence of the processes of globalization acquires new features, namely [14, p.608]:

reduction of the share of traditional banking operations in favor of increasing new ones that meet the qualitatively changed demands of customers. Rapid and continuous improvement of banking products and services, as well as channels for their promotion on the basis of modern information and communication technologies, give the banking business an innovative character;

consolidation of bank capital on a national and international scale. Increasing the size of banks on the basis of mergers and acquisitions, as well as their cooperation with other financial institutions, are aimed at strengthening

competitive positions at the national level and gaining new spheres of influence at the international level;

the main goal of bank management is to increase the market value (capitalization) of the bank as an enterprise. In the US, in European and in many Asian countries, the view has been established that the increase in the market value of the bank and the growth of the capitalization of the banking industry as a whole ensure that the banks fulfill their public functions and keep their jobs, which meets the needs of economic growth.

The process of financial globalization and the formation of the "global banking industry", according to some economists, contribute to the standardization of national banking systems and the emergence of a single, dominant model of the bank.

So, the French banker A. de Carmoy (H. De Carmoy) believes that such a model will be a bank that focuses exclusively on maximizing the income of shareholders, or "banquet - dividend". Such banks appeared in the United States in the 80s, in Great Britain in the 90s, after the restructuring of the banking system, their main strategic task was to seize the most profitable segments of the banking market. Priority tasks included the careful monitoring of costs and profitability of operations, the establishment of extremely accurate tariffs for services, "transparency" of financial statements, and the search for optimal bank sizes during the concentration process. All this makes it possible to expect in the long term a high level of return on equity (15-20%).[14, p.543]

This point of view is not shared by all the authors. Thus, for example, Pilon D., considers the concept of A. de Carmi's not sufficiently substantiated, indicating the "shakiness" of the theses on optimizing the size of the bank on the basis of the concentration process, the level of profitability and the inevitability of the dominant model of the bank in the future.

The rapid process of forming "mega-banks" in recent decades creates the illusion of optimizing the size of banks. Practice provides a lot of evidence that the



size of the bank and its profitability are not as tightly connected as it sometimes seems. Therefore, in the structure of the banking sector, banks of different sizes will continue to be present. But it is also obvious that globalization will help to accelerate the development of the process of involving medium-sized banks in the sphere of influence of large banking groups that will become the main structure-forming elements of the banking sector.

The profitability of the banking business at the declared level of 15-20% with an average annual GDP growth rate of most of the western in 2-3, from the strength of 4%, seems unlikely. As you know, an overestimation of the bank's profitability rate can lead to a reduction in the supply of loans, which will negatively affect the economy as a whole. The level of profitability of 15-20% may be achievable only for a relatively small group of the largest, transnational banks.

The institutional structure of modern banking systems is very diverse and it is premature to talk about the dominance of any model of the bank or any other monetary institution, but the indication of the tendency provoked by globalization is perfectly justified.

So, globalization generates a tendency to leveling the diversity of monetary institutions, making highly profitable only a large transnational banking business. What is the danger of this trend? [15, p.96] It can be assumed that a decrease in the degree of diversification of the institutions of the banking sector can complicate the course and, especially, the way out of the financial crises of the national banking system.

A proof of the stability of this trend can be the fact that banking legislation in most countries with a traditional "Western" banking business model is set to abolish the differentiation of types of credit and financial institutions depending on their functions and the universalization of their activities.[15, p.287]

Simultaneously with this trend, the specialization of banking institutions deepens, and this process is also quite stable and ubiquitous and is based on the "disintegration" of the intermediary function of banks under the influence of three

main factors: issuance of debt securities (securitization); deregulation of the credit and financial sector and industrialization of the banking sector.

It is obvious that the development of operations with securities has had a huge impact on banking activity lately. The process of lending using securities is divided into several consecutive operations that can be performed by different institutions. This circumstance and a certain share of deregulation lead to the fact that "alien institutions" penetrate into the traditional banking sphere, which previously had other branches of the economy as their business area. At the end of the twentieth century, the largest trading companies of France and the UK created their own financial units, providing various banking services, in stores and supermarkets. Today this is a common practice.

In practice, it turns out that certain types of activities (concept development, production, distribution, product improvement, etc.) are implemented not by the bank, but by other economic entities, which in this way formulate fairly rigidly formulated requirements for the banking service and bank, giving him the opportunity to act as a "collector", "designer", "door closer".[17, p.396]

Such changes in banking pushed Western economists to rethink the classical understanding of the intermediary function of banks in the economic system.

In recent years, the concept of "breaking up the bank" developed by the American economist L. Bryan, which justifies the need for a complete separation of the bank's deposit and credit functions, has received some support among specialists and practitioners of banking.

It was this concept that served as the theoretical basis for the process of vertical disintegration of "banking production" in Western countries. Today, banks, while retaining the final distribution of financial services, increasingly transfer other functions to independent firms on contract terms, for example, managing

customer risks, maintaining accounts of individuals, automated cash settlements, and so on.

All of this entails fundamental changes in the organizational structure of banks, while maintaining the principle of universalization of their activities. The facts show that organizational changes are moving towards the formation of large-scale diversified banking associations.

The position of those authors who believe that the main reason for the diversification of "banking production" is due to factors that lie not on the supply side but on the demand side is fair: banks are forced to diversify their products and services in order to better meet the needs of customers, thereby winning the market.

Simultaneously with diversification, in order to increase efficiency, banks are trying to cultivate those features of their activities that could take a competitive advantage over others, and, as a consequence, pursue a strategy of specialization.

These seemingly contradictory strategies banks are implemented through the reorganization of the structure of units, in particular, through the formation of a two-tier structure.[18,p.148] In such banks, the lower level includes specialized production units that have autonomous management and their own profit strategy and, as a rule, the legal status of the branches; The upper level consists of larger units, uniting specialized production units of the lower level.

In the organizational structure of large banks, as a rule, there are three main divisions that deal with the functions of a retail bank (services to individuals and enterprises), a wholesale bank (investment and business), and asset management.[19,p.857]

A kind of apogee in the implementation of the diversification strategy is the creation of financial conglomerates that develop three main areas of activity: classical banking intermediation, securities transactions and insurance. And in this field, banks compete with insurance companies, which are striving to increase their size and thus obtain the opportunity to diversify their activities.

It is obvious that today the creation of financial conglomerates, among other things, is also a consequence of deregulation of the financial and credit sector, and a new form of competition that is becoming more acute. In recent years, the majority of metallization's in the banking sector have led to the creation of financial conglomerates - kind of "supermarkets" engaged in providing a variety of services.

An important factor affecting banking activity is information and communication technologies. In connection with the use of new banking technologies, experts expect dramatic changes in the relationships between banks and customers in the coming decades. In some Western countries, these changes have already begun, in particular, with the emergence of so-called remote banks.

### **1.3. Current state of Azerbaijan's banking market and development trends**

The national banking system today is one of the most important and inalienable structures of Azerbaijan's market economy. A two-level banking system of market type has been developed in the republic, which is represented primarily by the National Bank and a number of credit organizations. They virtually uninterruptedly provide calculations between all segments of the economy, redistribute temporarily free cash, perform other banking functions, constantly and closely interacting in the market with each other and with the external environment.[20, p.216] These components form a single system designed for servicing monetary circulation and united by common functions and objectives. This is also confirmed by the existence of a general regulatory framework - banking legislation that defines the legal status and order of interaction of the main links of the banking system and regulates the most stable types of links between them.

The National Bank of Azerbaijan (NBA) has the necessary independence to perform the functions of the Central Bank. Its main task is to ensure the stability of prices within its authority. Among other tasks, it is also necessary to provide

stability and development of the banking and payment systems. Along with this, the NBA carries out licensing, regulation and control over the activities of commercial banks, and also has independence in determining and implementing monetary and foreign exchange policies of the state.

Among the country's credit institutions, the leading role belongs to commercial banks, the number of which at the end of 2007 was 46, of them 2 - state and 44 - private, among the last 21 - with the participation of foreign capital<sup>1</sup>. The prevailing model is a universal bank that provides a full range of banking services, including using electronic communication channels. Some of the domestic banks are specialized institutions (for example, the Azerbaijan Microfinance Bank) and captive credit organizations.[21]

During the transition period, the banking sphere of the republic underwent a structural and organizational transformation, the tendencies of which coincide with the general laws of the movement of transitive countries. The rules of the banking business were updated, the efficiency of its activities increased, the costs were rationalized, the incomes and net profit of banks systematically increased, and modern products and technologies were introduced. The result of these actions was the creation of a modern banking system that can function in market conditions and respond appropriately to customer needs and the changes that are taking place in the country.

It should be noted that the positive trend caused by the overall recovery of the economy of the AR and the growth of incomes of the population in recent years contributed to the strengthening of positive trends in the banking sector. The data of statistics allow to draw a conclusion that by the present moment, by the basic quantitative and qualitative parameters, there has been undeniable progress. The capital base of credit institutions has been increased, and the supply of innovative banking products and services has become more active. The total assets of banks have increased, their structure and quality have been improved. Thus, at the beginning of 2008, the actual capital of banks increased by 87.6% compared to

the same period of last year and reached \$ 1,297.9 million. Due to the growth of capitalization and liabilities, the total assets of banks increased during this period by 83, 5% - up to 7 949.1 million dollars. They accounted for 26.7% of GDP against 14.9% in 2003, credit investments - 18.1% and 8.3% respectively, attracted funds - 22.3% and 8, 5% 3.[22]

The total amount of deposits and deposits has increased, there has been a shift towards lengthening their terms. The volume of lending operations has significantly increased, the quality of the loan portfolio has improved (both in sectoral and currency terms, and in terms of terms), interest rates for loans have decreased, and their accessibility has increased. The network of bank branches has significantly expanded, the number of which has increased from 305 in 2003 to 485 in 2007, and their assistance to the development of regions and small and medium-sized businesses has increased. The total volume of commercial banks' credit investments in the real sector amounted to 5,382.0 million dollars, which is 8.9 times more than in 2003, and their ratio to total assets of the banking sector reached 67.7% (against 57.0% at the beginning of 2004).

These processes were accompanied by the improvement of the legislative and institutional base of this sector of the economy. Over the past four years, new laws have been passed: on banks, the National Bank, mortgages, insurance of bank deposits. Amendments have been made to the Law "On Currency Regulation" with a view to further liberalization, in particular, restrictions on the export of currency have been relaxed. Domestic banks began to implement international standards of corporate governance and reporting forms. The infrastructure of the banking system was strengthened at an accelerated pace: the Centralized Credit Register, the National Card Processing Center, the National Payment System, the Mortgage Fund and the Deposit Insurance Fund; the currency and stock exchanges function, the National Depository Center; the securities market is developing consistently. Increased attention was paid to the use of advanced technologies and application of the latest information and management systems.

However, despite the improvement of the situation and the successes achieved in the banking sector, its condition can not be overestimated. There are still many problem points. The conducted SWOT-analysis<sup>5</sup> - analysis of strengths and weaknesses of commercial banks, as well as an assessment of the opportunities for further development of their business and threats, which bear for it potential risks - gave the following results.[23]

**Fig.**

### SWOT analysis of the country's banking sector

| STRENGTHS   | WEAKNESSES   |
|---|--|
| <ul style="list-style-type: none"> <li>■ wide range of banking products and services;</li> <li>■ developed correspondent network;</li> <li>■ improving asset quality against the background of favorable credit conditions;</li> <li>■ opportunities to finance large projects;</li> <li>■ use of modern information technologies;</li> </ul> | <ul style="list-style-type: none"> <li>■ lack of a clearly formulated development strategy;</li> <li>■ low level of financial intermediation in the republic's economy;</li> <li>■ high lending rates;</li> <li>■ concentration of activity in limited market segments, inadequate loan portfolio diversification;</li> <li>■ low capitalization and, accordingly, limited opportunities for covering</li> </ul> |

Source: [https://www.ca-c.org/c-g/2008/journal\\_rus/c-g-2/08.shtml](https://www.ca-c.org/c-g/2008/journal_rus/c-g-2/08.shtml)

The presented assessment of the state of the domestic banking sector shows that at present, along with a number of positive sides contributing to its further development, there are a lot of factors that either have a negative impact, or in the long term may adversely affect the stability of financial and credit institutions. This is primarily high credit and currency risks, poor quality of management and protection of creditors' rights, relatively low level of liquidity and capitalization of banks, public confidence in them, shortage of long-term resources, high costs of banking business, its weak investment attractiveness and interaction with the production sphere, a limited number of sources for building up the resource base,

the slow incorporation of corporate governance mechanisms, the transparency of credit institutions, their weak participation in equity in modernization and technological re-equipment of enterprises, as well as in the securities market. Some obstacles to the development of the banking system are found in the plane of imperfection of the legislative and regulatory systems. However, on the whole, in the current situation, the strengths of the banking sector of the economy of the republic largely compensate for the threats that can be expected in the future, and the existing opportunities, together with the strengthening of the requirements of banking legislation, can lead to the leveling of weaknesses.



## **CHAPTER 2. THE MAIN FEATURES OF THE ANALYSIS AND DEVELOPMENT OF THE CURRENT STATE OF BANKING ACTIVITY IN AZERBAIJAN**

### **2.1. Analysis of the current state of banking activity**

For the more active functioning of the banking system with the real sector of the economy, long-term resource base is required. In this regard, one of the strategic tasks of the banking system is to activate the involvement of the population's savings.

Because the population's deposits are attracted to the banks as follows:[23]

- Increased confidence in financial intermediaries both by population and economic subjects;
- Real interest rate change;
- increasing population real incomes.

Even though there is a rapid increase in savings business in our country in recent years, there are still many things to do in the development of savings business.

**Table 2.1.**

#### **Information on Time Structure of Time Deposits and Deposits with Manat (%) (Annual Statistical Bulletin of the Central Bank of Azerbaijan)**

| <b>TERM OF DEPOSITS AND DEPOSITS</b> | <b>PERCENT</b> |
|--------------------------------------|----------------|
| Up to 1 month                        | 6.70           |
| From 1 month to 3 months             | 4.82           |
| From 3 to 6 months                   | 7.96           |
| From 6 to 9 months                   | 8.70           |
| From 9 months to 1 year              | 10.96          |
| From 1 to 5 years                    | 12.67          |

|                   |       |
|-------------------|-------|
| More than 5 years | 13.44 |
|-------------------|-------|

It should be noted that the volumes of deposits and deposits placed on private banks and individuals by banks in recent years are constantly increasing. This shows that the confidence in the banking system is growing with economic entities. Deposits of individuals in manat increased in manat compared to legal entities' deposits at higher rates. Total deposit base (excluding financial institutions), formed at the expense of internal sources of banks, was 794,6 mln. manat (17.1%) to the amount of 5448,8 mln. manat. During the year, the share of deposits and savings in the structure of total liabilities was 46.6% and total resource base was 38.6%. As of 01.01.11, the share of total deposits in the structure of the total liabilities amounted to 49% (01.01.10-48.2%). In 2010, deposits of individuals increased by 29.8% to 3029.8 mln. (growth rate was 22.5% in 2009), while deposits of legal entities (including state governance bodies) increased by 4.3% to 2419 million manat. As of 1 January 2011, the share of population's deposits in the liabilities of banks amounted to 27.2% (24.2% as of January 1, 2010).[24]

Along with the absolute increase in the deposit base, positive changes have taken place in its quality. The share of term deposits in the structure of population's savings has increased. In current accounts, deposits increased by 10.4%, while time deposits increased by 35.3%. In addition to improving the time structure of deposits, positive trends have also been observed in its currency structure. During the year, the level of dollarization has decreased in the conditions of stability of the manat. Thus, deposits of individuals in national currency increased by 46% during the year, and their share in total deposits increased by 46.5%. There were no significant changes in the depository structure, the share of resident individuals' deposits in total was 91%, and the share of non-resident depositors was 9%. The liabilities of the Central Bank against the banking system decreased from 15.2% to 13.9% during the year. In 2010, the amount of funds borrowed from financial

institutions (loans, deposits and other funds of other banks and other financial institutions) amounted to \$ 3.6 billion as of January 1, Manat (32% of bank liabilities). Net increase in non-residents 'expenditures (excluding individuals' deposits) amounted to 111.4 mln. manat (6.4%). The volume of term foreign debt amounted to 1.85 bn. The share of the total liabilities of the bank was 16.6%. [25]

Today, in Azerbaijan, people are considering a number of factors in the selection of banks before placing their funds on deposit. These factors can be summarized as follows: [26]

1. Reliability and firmness of the Bank.
2. Interest rate policy on attracted funds.
3. There is not a wide range of transactions offered by the Bank.

Today, the development of banking operations in our country has not reached the desired level, the quality and quantity of banking services are not yet up to international standards, and most banks are satisfied with building their business on loans, deposits and cash transactions. For comparison, today banks in developed countries offer about 300 banking services, operations and products to their customers.

Credit organizations, as well as banks, independently define the interest rates on deposits and commission fees. Nevertheless, certain factors influence commercial banks' interest rates on savings transactions. One of such factors is the classic instruments of monetary policy (in particular, the definition of mandatory reserve norms). From this point of view, the CBA should differentiate savings in order to attract more funds to the physical persons and the reserve requirements for term deposits must be eliminated.

As a result of such measures, the commercial banks' maneuvering capacities will increase in attracting term funds. It should be noted that at the beginning of the 90s, such differentiation of obligations was carried out in the local banking practice. That is, banks have been exempted from reserve requirements on term

liabilities. However, at that time commercial banks were permitted to commit certain unlawful actions (most of the liabilities were divested from reserve requirements under the term commitments) and the National Bank's control was insufficient. During the differentiation of savings, accounting for savings accounts on separate accounts of the bank ensured the elimination of this problem.

It should be differentiated from the population both in manat and in freely convertible currency in terms of maturity and term. It should be noted that the mandatory reserve rate for both manat and freely convertible currencies from natural persons was at the level of 10 percent at the end of 1999. For comparison, this rate was 0.15 percent in the UK, 3-10 percent in the United States, 1.5-2.0 percent in Germany, 0.5-1.0 percent in France, 0.05-1.5 percent in Japan , Canada, even at 0 percent. At present the Central Bank reserves the required reserve rate in national currency at 2% on 01 May 2011 and 3% in foreign currency as of July 1, 2011. In contemporary conditions, the process of attracting the population's funds for local commercial banks on the one hand is not easy, on the other hand, there are some differences between the demand of physical persons in banking operations and the possibilities for repayment of this demand in Azerbaijan today.[27]

This can be attributed primarily to the fact that the population is still in high demand for all banks, and banks have no confidence in their clients. Unsatisfactory mutual confidence strengthens the disintegration trend between the bank and the client. Finally, it loses its interest in reducing the interest of banks to individuals, and, on the other hand, the majority of the population still retaining their savings in the form of foreign currency and repayment.

We believe that the implementation of the deposit insurance system plays an important role in solving this problem. Thus, guaranteeing the repayment of funds placed by depositors in the bank is one of the main forms of strengthening the stability of the banking system and strengthening the deposit base of banks.

In recent years, the official deposit insurance system has been organized in most countries. At present, more than 40 countries are implementing the official deposit insurance project. In countries that have implemented this system, rapid population savings have been achieved in a short time.

Note that the Law of the Republic of Azerbaijan on Savings Deposit Insurance in Azerbaijan was adopted. This law was signed on December 29, 2006 by the President of the Republic and published on February 11, 2007 and came into force. The purpose of creating a deposit insurance system is to prevent the risk of losing money from individuals when the banks and local branches of foreign banks lose their ability to repay, to ensure the stability and development of the financial and banking system. With this law, the Deposit Insurance Fund has been established for deposit insurance purposes. Fund's insurance reserves are formed by the following sources:[28]

- membership fees of participant banks;
- Calendar fees of participant banks;
- additional fees of participant banks;
- funds attracted by the Fund's long-term debt commitments;
- stamp money paid by participant banks;
- income generated by the management of the Fund, net of current expenses;
- Grants, donations or other sources not prohibited by law;
- Debt funds received in the amount not sufficient for payment of compensation;
- Funds received from the bank or from the local branch of the foreign bank with a right of demand under regression procedure.

Participating banks pay 10 (ten) thousand manats (AZN) per one-day membership fee at the Fund's Lending Account within 10 calendar days after their entry into the Fund Register. In addition, banks pay a calendar fee in the background. Calendar fees are paid from the day the bank is included in the

register of participating banks until the date of cancellation of the banking license. The right of the participant bank to engage in deposits is suspended by the Central Bank until the bank fully executes its obligations under the Savings Deposit. The first reporting period for the calculation of calendar fees begins on the first day of the quarter, when the bank is included in the register of Participating Banks of the Fund and continues until the last day of that quarter. Calendar fees are paid at the rate of 0.15% of the amount of savings in the first year, and 0.125% in subsequent years, starting from the date of entry of the Participant Banks into the Fund Register. The Fund compensates for insured deposits in one participant bank at the following amounts (cash paid to protected depositors when an insurance event occurs):

The Fund shall pay compensation at the rate of 100% of the insured deposit, but not more than thirty (thirty) minimum wages in each participant bank. Repayments on deposits in the central currency are paid in manat, while deposits in foreign currency are repaid in foreign currency. When deposits are not in US dollars or Euro, the compensation is calculated and paid on the basis of the official exchange rate determined by the Central Bank on the day of the insurance event with one of these currencies.

The significance of determining their profitability in connection with the formation and application of new types of bank products is of great importance today. Various types of banking operations can be utilized for profitability, taking into account the characteristics of each transaction.[29]

In today's commercial banks of the Republic of Azerbaijan, offering such new banking transactions and services to their customers would allow their profits to grow. As a result, local banks will have the opportunity to increase their revenues, not just in international practice, but at the expense of operating income.

The feature of profitability in various markets of banking services is characterized as the price of banking services. The cost of banking services is

defined as TransAsia expenses after the consumer is provided with the services. These payments are calculated as expense to carry out transactions.

Banks, which manage the profitability of services in different markets and segments, are actively pursuing a competitive price competition with banks that attract customers' attention to these services and offer similar services. Additionally, the pricing factor of the services is the key element of the Bank's service reputation, which creates conditions for increased customer loyalty and, ultimately, increased intangible assets of the bank.

Traditionally, it was considered that customers should use the services of a large number of bank branches. Distributed branch network, operating conditions in operating rooms, working mode and so on. has long been regarded as bank attributes.

In modern times, the role of banks, operations and services are measured by the ability of banks to offer their products at a time when customers need it.

As known, in connection with membership in the World Trade Organization (WTO) and integration with the European Union (EU), the national standardization system of Azerbaijan is adapted to the requirements of these organizations. This will result in serious changes in the existing system. Thus, in contrast to the existing system, only security of the products in the market economy system is regulated by the state. The quality of products regulates the market itself. Accordingly, product safety requirements are referred to as technical regulations and are subject to mandatory application. The requirements for the quality of the products are reflected in the standard and the application is voluntary. Businesses that want to raise the quality of products and to come out in the competition voluntarily apply standards. At the same time, the state limits the control over the products to their safety.

The existing thousands of Azerbaijan's standards will be revised and harmonized with international standards in the said form. In general, the adaptation

of the national standardization system to international requirements will be implemented in the following aspects:

- adapting the system to the principles of market economy. Thus, standardization should be divided into two sections, namely, standardization, which defines voluntary requirements for technical regulation and quality of products that ensure and apply mandatory safety requirements for the market economy. This implies the limitation of state control over the economy in accordance with the safety of products and the regulation of quality in the market demand-submit law;

- bringing the products' requirements in line with the requirements of international standards. This means that existing standards are revised and adapted to international standards. This is the most difficult adaptive element of the standardization system. Because standards in the former Soviet republics have not been prepared on the basis of international requirements, the standard should be reconsidered with almost ten miles;

- Developing technical regulations for product safety requirements not on every product, but on product group and overall safety features. The former GOST standards cover safety and quality requirements for each product, requiring the preparation of a standard for each product. However, in international practice, safety requirements for products are determined not by product, but by safety features. Where there are safety features on which products are covered, the relevant technical regulations apply to those products;

- Defining the basic requirements for products in technical regulations and liberalizing the fulfillment of those requirements. In the former Soviet republics, the standard requirements for products were identified, as well as a single mechanism for how these requirements should be met. However, in international practice, technical requirements are set out in the security requirements, and how to ensure that they are provided in the reference standards or in the manner that the manufacturer specifically identifies. Manufacturers shall be deemed to have



satisfied the requirements of the technical regulation when applying any of the standards referred to above or the method that it has designated;

- Institutional reforms in the standardization system management. One of the main reasons for adaptation is the change in the structure and authority of the state bodies responsible for managing the national standardization system. It is required that the competence of the public authorities be limited to defining the requirements for the safety of products and liberalizing the powers of the standards preparation and implementation, conformity assessment by the private sector, and the necessary reforms to ensure unilateralism, transparency and public participation;

- Improving the product safety and quality assurance system. According to the former Soviet standardization system, almost all products are compulsory and certification is carried out by state bodies. In addition, both state-of-the-art compliance and market compliance are monitored. However, compliance with international requirements requires that only high-risk products are compulsory certified, the conformity assessment of low and mid-range products is carried out by the manufacturer themselves, and conformity assessment activities are carried out by accreditation bodies not accredited by the state but by international standards. Apparently, adaptation to international requirements makes essential changes in the existing system. Issues related to the private sector in the process of harmonizing the national standardization system with international requirements  
The following are relevant aspects of the private sector in the process of bringing the national standardization system to international standards:

- Granting of a transition period for the private sector to meet new requirements, providing technical support, making concessional loans and grants;

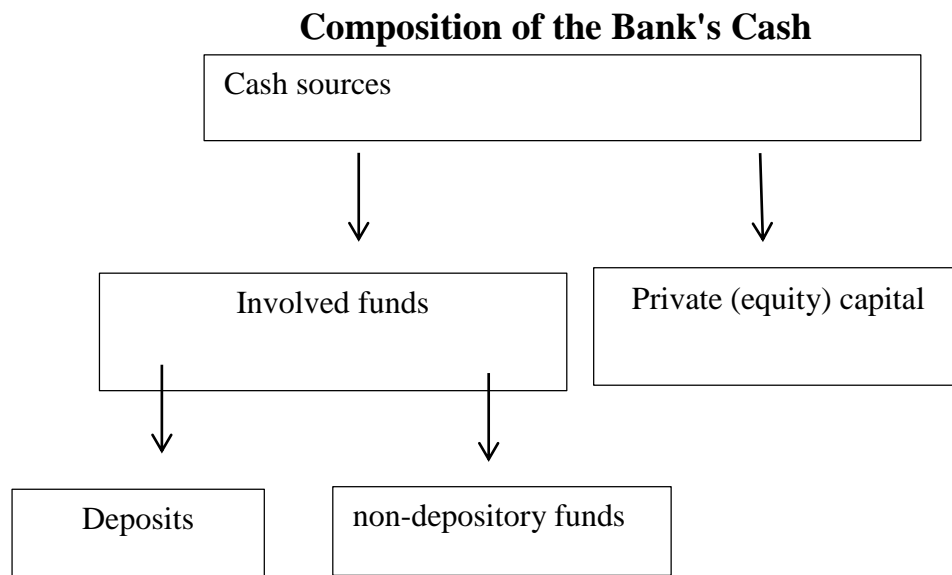
- Support for establishment of private enterprises that will carry out activities on the national standardization system;

- adaptation of the consumer market to new products.

## 2.2. Key features of the Bank's passive operations

The process of involving cash resources management is a necessary characteristic of the quality of banking business, while reducing the possible costs to a minimum. The scheme showing the major sources of cash resources is shown in general in Figure 1.

**Figure 2.1.**



It should be noted that the deposits (deposits) of legal entities and individuals take place in attracted funds (liabilities).

Deposits are the amount of money that a customer has to deposit to the bank so that it can be used or recycled in settlement.

The amount and range of deposit services offered by banks is constantly increasing. From this point of view, it is best to stand on the most widely spread services.

As a rule, the deposits are formed in two ways, i.e. as a result of the cash inflow of funds, as well as when making a cash deposit (checks, bond coupon, etc.) or as a result of the imaginary deposit in the customer lending process. It is important to take into account the tendency of the fraudulent delineation between various types of financial resources to identify the concept of deposit that gives rise

to the existence of counterparty accounts. Conventional accounts differ from ordinary deposits, which are considered to have a negative balance, that is, a debit balance.

In the classical literature on bank management, they allocate two main positions in the management of deposits:[30]

- Determine sources of deposits with lower costs;
- Determine the methods of deposit guaranteeing in order to provide sufficient amounts of credit and other financial services.

Transactional deposits are one of the oldest types of services offered by banks. First and foremost, they are usually non-interest-free deposits, do not generate revenue, make payments for the customer, guarantee the security of funds, and record any transaction on the checks. The main economic characteristic of this source of source is that the bank undertakes to repay the proceeds on the customer's request without delay. It is here that the share of a share that can be used to generate a profit from the total amount of deposits before, ie, is required, remains a priority. In other words, it is necessary to define the transformation ratio of short-term resources to long-term resources. In particular, in French banks, this is calculated by the following formula:[31]

- Paying interest on these deposits depends on the dynamics of prices in the stock and commodity markets, and allows the customers to gain high returns during the price increase of shares and commodities;
- brokerage deposits. These deposits are client funds deposited by brokers, placed in bank and deposit institutions. The maximum interest rates on these funds are offered;
- deposit certificates in foreign currency: This type of deposit allows customers to earn high interest income through operations in foreign markets;
- certificate of deposit insurance. This type of deposit allows the client to put as much money as possible until the sum of any amount;

- deposit certificates with postponed interest rates: The purpose of these deposits is to minimize interest rates on customers;

- Certificate of interest with increased interest rate: This type of deposit provides for the increase of interest income during the entire period of the deposit and allows withdrawal of funds at specified dates;

- Common Deposits: These deposits are intended for small savings groups combined for common signs. The main problem with innovation in the market of deposit resources is the reduction of the reliability of the promising companies, and the transfer of the already established customer market to more profitable collection forms.

The development trends of new types of deposits appear to indicate that banks prefer those forms of borrowed funds that interest expense is closely related to the proceeds from the use of funds.

In non-depository sources, we can show the following: Central Bank's Credit Resources Market - This market usually offers short-term (one-day) debts. This market acts as the Central Bank's monetary policy presenter and, in terms of debtors, its main drawback is the instability of the proposed interest rate, depending on the economic conjuncture, the barriers to the bank's business planning.

Interbank Bank market- This market is based on the freely available funds offered to others by banks.

Formal Deposit Sources - Transfer Certificates. One of the sources of formation of bank resources is the involvement of funds on the basis of debt receipts for a certain period of time.

One of the key features of transfer deposit certificates is their active turnover on the second market. According to nature, this source is similar to bank debts. Bank loans are debt liabilities and are issued to individuals for a fixed period by bank institutions and are refunded after a certain period of time. It should be noted that the debt is not included in the secondary market. These types of sources also

refer to the Eurozone deposit market. The Euro-currency deposit market is created by the transnational financial institutions on the basis of liquidity funds to provide loans to large customers.[32]

Securities Recovery Agreement - This type of hedge deficit sources provides short-term loans with a relatively low interest rate (for example government securities), less risky assets.

Recognition of Bank Accounts - The Bank has a long-term tratta (a promissory note) and is settled by the exporter or importer to a bank that agrees to accept it and is intended to fund foreign trade transactions.

Capital Notes and Bonds - The issuance of commercial securities (bills) through branches, long-term sources, a group of non-depository and debt and long-term liabilities of long-term capital. The duration of their payment is usually wavered between 7-12 years.

Non-depository sources have not found their development in the Republic of Azerbaijan compared to depository sources. Traditionally, centralized credit resources and interbank bank marketsegments are used in our country for non-depository sources.

From the 60s of the 20th century, the development of a new doctrine of relationships with the client has become a dominant position in banking management. The main aspect of the doctrine is that the bank must give priority to all customers in making debts and should treat them all the same way. The expansion of this doctrine required paying attention to the development of the strategy in managing passives. The management of non-deposit liabilities allows the financial firm to manipulate independently from its own resource market, with a flexible response to the customer's credit needs, depending on the conjugation.

The main focus of research on banks' activities is their impact on government regulatory policies. Measures taken by central banks can be divided into three types:[33]

- effects of observation, control or morale;
- impacts on fixed capital;
- Implications for direct costs of resources and services.

The latter type impacts more in economic literature. For example, some economists consider the mandatory reserve requirements set by central banks as a tax on financial institutions. Freezing of some of the attracted funds does not bring any profit and, in general, causes a decrease in the profitability of the banks. Generally, this regulatory impact can be determined after a complex analysis of credit and deposit resources.

### **2.3. The role of internal control and audit in bank management**

The development of the banking system, including the cooperation of the real sector of the economy with banks, is impossible without continuous improvement of management methods. Controls, as one of the key elements in the management system, are controlled.

It is not an easy task to ensure that the profitability of banks at the same time protecting the interests of state-owned companies, private companies, lenders and depositors in the conditions of competition between credit institutions. Control is intended to ensure compliance with the objectives set for the Bank. Control over banks may be external (outside the bank) and internally.

It is possible to distinguish several forms of interactions that are interrelated:  
[34, p.200]

- 1) banking supervision by the central banks;
- 2) external audit carried out by a specialized organization;
- 3) an internal control system formed by owners (shareholders) and bank management;
- 4) an internal audit that forms an independent part of the internal control system;

However, various aspects of banking activities can be controlled:

- protect the interests of creditors and depositors by the bank and comply with legislative requirements;
- Accuracy, accuracy and validity of the bank's accounting (financial) reporting;
- efficiency of banking activity, profitability of the activity and risks;
- the state of corporate governance, management risk and internal control system in the bank;

Modern conditions require banks to closely interact with the real sector of the economy. One of the top priorities here is the loans given to customers with more risk and the other banking products they offer. Banks take the majority of risks that may occur in their clients' businesses. However, risk management in the banks does not always give the desired result. All of the above dictates the need for various forms of control over banking operations, first of all, for audits. It should be noted that the functions and roles of audit, in particular the internal audit, have not been studied at a satisfactory level in the commercial banks management system.

Study experience indicates the need to solve the following tasks [35]:

- Comparative analysis of forms of control over the activities of commercial banks, identification and discovery of differences;
- study of domestic and foreign experience in internal audit, defining direction of improvement of organization and methodology of internal audit;
- analysis of loan transactions and risks;
- identification of directions of improvement of internal and external (external) audit;
- Comparative analysis of the requirements of local and international standards for the recording of loose transactions, as well as the necessary adjustment of the audit objectives and methods.

The main purpose of control of the Central Bank of Azerbaijan is to ensure the stability of the banking system, protect the interests of creditors and depositors, and comply with the requirements of the legislation by banks. The Central Bank of the Republic of Azerbaijan carries out control over the activities of banks, in accordance with the norms of the laws of the Republic of Azerbaijan "On the Central Bank of the Republic of Azerbaijan" and "On Banks". The main element of control is licensing. A number of requirements must be met to obtain a license for banking operations.

One of the important tools of control is prudential norms (amount of charter capital, capital adequacy ratio, liquidity, aggregate credit risk, mandatory reserve, open currency position, etc.). The Central Bank of Azerbaijan (CBA) organizes a system of data collection and analysis for credit organizations to ensure the effectiveness of control. Credit organizations provide the Central Bank with financial statements, information on the actual status of mandatory reserves, information on customers' currency transactions, and so on. submit. Monitoring of banking activity on the basis of reporting data allows for timely identification of problems and their elimination. The accuracy and completeness of bank statements is confirmed during complex and thematic inspections and inspections carried out by employees of the Central Bank of Azerbaijan.

External (off-the-shelf) audit can be viewed as part of the banking system's infrastructure and performs the function of maintaining financial strength. The purpose of the audit is to provide an insight into the validity of accounting (financial) reporting and to determine whether the accounting records are properly complied with.

Wide range of audits, other audit services, including applying, restoring and maintaining accounting standards, compiling financial statements, tax advice, financial-economic analysis, management tips, etc. means.

According to the Law of the Republic of Azerbaijan "On Banks", annual financial statements of commercial banks must be approved by an independent



auditor's opinion and published in mass media. Undoubtedly, comprehensive audit of banks' activity would be not only economically inefficient, but even practically impossible. For this reason, auditors check the bank's performance by selecting and express their views and conclusions on the integrity of the reporting in all material respects. This means that reports may contain any errors, but these will not affect the users' results and decisions. This is the main methodological difference from external audits, ie, the final risk exposure and the efficient selection of the latter.[36]

Under the risk of auditor, it should be understood that if the report contains serious errors, the auditor will immediately express his or her inadequate opinion on this fact. In order to minimize risks, auditors will develop appropriate auditing procedures.

The auditor's risk consists of three components. Most of the time, the risk of improperly listed bank transactions is assessed in the accounting records, and then the risk that the accounting system and internal control can not get ahead of time can be avoided. Finally, the auditor's conclusion on the amount of risk that the error is not discovered by the auditor himself.

The key conditional control procedures of the authenticity, accuracy and completeness of financial and managerial information are considered to be the means to eliminate the following errors in a timely manner:[37]

- 1) the operation reflected in the record has not been executed in real terms;
- 2) the performed operation is not reflected in the accounting records;
- 3) the transaction was not reflected in the relevant period;
- 4) the operation has not been properly classified;
- 5) the outcomes on operating groups have not been calculated correctly;
- 6) Inaccurate returns are used in the record.

Auditors analyze and evaluate the quality of the bank's management and internal control system in a very limited area.

This will help them identify the amount of unexcused risk and plan audit procedures for the merits.

The internal control system and internal audit of credit institutions play a special role. An effective system of internal control is an important component of the bank's governance. In the process of internal control, the board of directors, the management and the staff of the bank are also involved.

The duties of the internal control include:[38]

- ensuring the efficiency of banking activity;
- compliance by the bank with the requirements of the legislative and regulatory authorities, as well as the expectation of domestic policies and strategies;
- Ensure transactions by authorized persons on behalf of the bank;
- ensuring asset protection and control of liabilities;
- ensuring accuracy, accuracy and completeness of financial and managerial information.
- The internal control system combines the following elements:
  - management oversight and control environment;
  - risk detection and evaluation;
  - control procedures;
  - information exchange;
  - monitoring and error correction;

Despite the importance of the internal control system and the need to maintain it, this system continues to be weak in banks. The analysis of modern practice enables the classification of the internal control system in five groups:[39]

- inadequacy of management oversight and the lack of control over the bank;

- The risk of separate banking operations has been detected and operative;

- lack of decisive control procedures, such as division of duties, obtaining permits, data reconciliation and review of action;

- the lack of adequate information exchange procedures between different management roles;

- inadequacy of internal audit and monitoring activities.

Despite the relatively insightful aspects of many aspects of internal audit, there are a number of methodological and organizational challenges that require scientific research in this area. These are [40]:

- The internal audit functions in normative documents and scientific literature have not been clearly defined. In many instances, the internal audit is identified by inspection and its functions end with the confirmation of completeness and accuracy of the transactions reflected in the accounting records. Special attention is paid to studying business processes and assessment of operational risks;

- It is necessary to formulate the principles of internal audit;

- the method of internal audit is poorly developed;

- no classification and procedures of internal audit have been performed;

- The advanced achievements of internal audit practice and theory are not summarized by independent associations;

- the structure of the internal audit department is not defined;

- the features of conducting internal audit in banks with a large branch network are not fully studied;

- Interaction between internal and external audit should be organized in order to avoid parallelism. For this purpose it is possible to reach the bank with the establishment and normal activity of the audit committee;

Most banks face objective difficulties in organizing the internal audit as a whole or its separate lines. In our opinion, outsourcing of internal audit will allow solving this problem.

Active involvement of financial institutions of Azerbaijan in world capital debts,

the growing interest of foreign investors to the economy of our republic

an increase in the existing internal audit system to meet international standards

the reform of accounting and internal audit control systems in our country

increases its necessity even further. So, in our republic financial and economic

Formation of transparency of control in management, corruption and finance

prevention of fraud, about each financial and economic activity

objective and impartial information and our foreign economic relations

there are real opportunities to expand. In modern conditions, it is crucial to further improve the accounting and financial and internal audit oversight of financial and economic activity in enterprises and organizations and their principles.

Undoubtedly, there may be serious difficulties in managing those operations without the regular and consistent accounting and economic control over the execution of financial and economic activities in enterprises and companies. It is no coincidence that at least two percent of the funds to be spent on all major capital investments in western enterprises and companies operating at a high level in a free market economy are spent on economic control issues.

The emergence of independent Azerbaijan's democratic development path, the formation of market relations in the country's economy, the purposeful

expansion of entrepreneurial activity, and the emergence of economic subjects related to the market economy necessitated re-establishment and modernization of the financial control system. In the world practice, audits as the most widely spread progressive form of financial control. The basics of the organization and regulation of the audit system in Azerbaijan are reflected in the Law of the Republic of Azerbaijan "On Audit Service". The process of formation of an audit system in Azerbaijan reflects the qualities inherent to the progressive controlling body, oriented towards the economic direction by bringing transparency to the country's financial life.

Thus, as part of the audit system, internal audit provides the protection of assets and accounting concepts as an integral part of the entity's internal control system, the accuracy, completeness and adequacy of the reflected financial and operational activities, as well as the preparation of a timely financial statement assessment of the effectiveness of the enterprise management system. Internal auditors operate both in the public sector and in the private sector.

## **CHAPTER 3. DIRECTIONS OF IMPROVEMENT OF BANKING ACTIVITY IN NEW ECONOMIC CONDITIONS**

### **3.1. Opportunities for Monitoring in Banking Activities**

The banking sector, being a part of the financial system, whose activity is related to market conditions of management, is inevitably at risk. Having information on the possible risk of the banking sector, the authorities can develop preventive measures aimed at creating a competitive banking system that is capable of efficient allocation of credit resources and possesses a high level of financial stability that would exclude the possibility of a systemic banking crisis.

Sustainability of the development and functioning of the banking system is now becoming one of its main characteristics. Only a stable banking system in the long term can fulfill its tasks, on the one hand, and on the other, serve as a certain guarantee of the overall stability of the economy. Crisis phenomena in the world and domestic financial markets confirmed the need to improve the risk management system in the banking sector. The urgency of developing institutions for monitoring banking risks is due to the fact that various spheres of the economy, such as the banking system and the real sector, interact with each other. This sometimes leads to the spread of negative phenomena from other spheres to the banking system.[41] Therefore, it is important that approaches to monitoring and forecasting risks be coordinated with consideration of external factors and aimed at reducing the likelihood of negative consequences

Increasing the effectiveness of supervision over the banking system highlights the task of finding new methods for determining the reliability of credit institutions. At the same time, it is important for supervisors to have an idea not only of the current financial situation of the bank, but also the likelihood of its sustainable preservation in the long term. Therefore, forecasting its future financial situation using data that can be obtained in the process of functioning of a centralized sb system pa, processing and analysis. As the basis for the formation of a system for monitoring and forecasting banking risks, the current network of

credit history bureaus can be used. However, in practice, it was not possible to form a single system of credit bureaus. Thus, the study of the problems of the stability of the banking system and the creation of a system for monitoring and forecasting banking risks is currently very relevant.

With a view to sustainable development of the banking sector, the state should contribute to the formation of regulatory infrastructure and supervision over the activities of banks. Therefore, the Government of the Azerbaijan Republic and the Central Bank of the Azerbaijan Republic also pay great attention to ensuring the stability of the banking system, which manifests itself in determining the main goals and objectives of the "Strategies for the Development of the Banking Sector of the Azerbaijan Republic".[42, p.455]

1. Within the framework of the "Strategy for the Development of the Banking Sector of the Azerbaijan Republic for the Period 2001-2005", adopted in December 2001, measures were developed that helped to consolidate the positive trends in the dynamics of the formation and development of the banking system, Azerbaijan Republic.

2. The Azerbaijan banking sector development strategy for the period to 2008 was adopted by the Government of the Azerbaijan Republic in conjunction with the Bank of Azerbaijan in 2005. Its main objectives were to increase the competitiveness of Azerbaijan credit institutions, improve banking regulation and supervision, strengthen the protection of interests of creditors and depositors, ensuring the stability of the banking sector.

3. The main objective of the development of the banking sector of the Azerbaijan Republic until 2015 is to actively participate in the modernization of the economy on the basis of a significant increase in the level and quality of banking services provided to organizations and the population and to ensure its systemic stability. This is enshrined in the "Strategy for the Development of the Banking Sector of the Azerbaijan Republic for the period until 2015 ". In this document, the Government of the Azerbaijan Republic and the Central Bank of

the Azerbaijann Republic, taking into account the lessons of the crisis, intensify efforts to increase the stability of the banking sector and ensure a stable growth of the basic indicators of its functioning.

The Central Bank of the Azerbaijann Republic on the transition to a model for the development of the banking sector, focused on long-term efficiency. This fully meets the long-term development priorities of the economy, including those envisaged by the "Concept of Long-Term Social and Economic Development of the Azerbaijann Republic for the Period to 2020", approved by the Government of the Azerbaijann Republic on November 17, 2008, No. 1662-p. Achieving such a model of banking sector development is possible with further increase in the level of competition, market discipline and transparency in the banking sector. At the same time, the formation of a more effective system of banking monitoring, regulation and supervision, capable of resisting crises, becomes especially important in the near future.[46]

At present, the Azerbaijann banking system is one of the most important sectors of the economy, which is not inferior to the real sector. Based on the special role of the banking system in the economic life of the state, it can be definitely argued that crisis phenomena in the banking sector can lead to a breakdown in economic life and the emergence of a financial crisis.

The special influence on the stability of the financial market and the emergence of risks is provided by information. As a result of the development of science and technology, information asymmetry arises and increases. From the point of view of risk, information asymmetry means uncertainty. Asymmetry of information is defined in the economic literature as a lack of information about a partner available for a deal, which leads to inefficient distribution of credit resources. For the first time, scientists began talking about information asymmetry in the consumer market in the late 1960s, when J. Akerlof suggested that in some markets the quality of the product is known only to the seller. Therefore, one can not understand how much such goods are quality without trying them. Later, the



universality of the phenomenon of asymmetry of market information was proved; presence in many markets. Asymmetry of information characterizes the situation when some market participants are more informed than others.

As a result of financial globalization, as well as the growth of general instability in modern conditions, information uncertainty in the financial markets has significantly increased. In our opinion, one of the possible solutions to this problem is the creation of a comprehensive model for monitoring banking risks, which will allow the formation and accumulation of information on the state of the regions' industries, national economies, the risks of the real sector of the economy, and risks in the banking sector itself.[47]

Based on the close relationship of the crisis phenomena of different sectors of the economy, it is necessary to take into account the probability of destabilization of the banking segment, which can lead to destabilization of the financial sector and the economy as a whole.

Thus, the banking system as part of a single economic mechanism, as well as the source of development of the economy and society should have reliability, stability and stability. In this regard, it is necessary to create a stable and reliable model of the banking system in general and a commercial bank in particular, which will be able to withstand the negative phenomena in the modern financial world.

It is important to determine the causes of instability in the banking system in general and in the bank, which should be supported by a set of measures that the bank can use to ensure its stability, stability and reliability.

Currently, the most well-known areas are the risk management policy associated with its cause, and the risk management policy associated with its operation. According to these areas, there are two forms of risk management. The first form includes such methods and forms that affect the causes of the risk, i.e. reduce the likelihood of risk and reduce the degree of uncertainty. The second form of management is aimed at the results of the manifestation of risk.

Managing the causes of risks, the bank can significantly reduce the level of threats. In our opinion, the only adequate way to reduce the degree of uncertainty is the method of forecasting, while observing and evaluating the results of the bank's activities, that is, risk monitoring. In this regard, there is a need for the existence of such a system of monitoring and assessing banking risks, which would allow us to see the impact of private indicators on the comprehensive assessment and overall performance of the bank and the entire banking sector at the current time and in the future, ie. monitoring systems. After all, for any country's economy, important is not only the current state, but also the prospects for the development of the banking system, which is explained by its key position in the economy.[48]

The need for carrying out and increasing the role of monitoring bank risks in modern post-crisis conditions is caused by internal and external factors. The most significant external factors include: the special role of the banking system in the country's economy; the peculiarity of the development of the country's banking system in the context of the impact and consequences of the global financial crisis; interest of a wide range of economic entities in the uninterrupted functioning of the banking system; the need to increase the capitalization of credit institutions in order to meet the growing demand of the country's economy for credit resources; the growth of the presence of foreign capital in the Azerbaijann banking system; Inclusion of the banking system in the processes of globalization and informatization of banking; the emergence of imbalances in the financial sector of the economy; expansion of the scale of banking activities; general deficit of investment opportunities of the economy; short-term nature and limited credit resources, etc ..

Internal factors include: low quality of bank audit; underdevelopment of internal banking control systems; lack of consolidated supervision; inadequate performance of banking systems of risk management of their functions; the

implementation of Basel Agreements (Basel-2 and Basel-3) in the Azerbaijann banking sector, etc.

The above internal and external factors that determine the need to monitor banking risks show that the competitiveness of Azerbaijann lending institutions and the banking sector as a whole remains insufficient. These shortcomings reduce the credibility of the Azerbaijann banking community and the level of confidence in the banking sector, worsen the opportunities for banks to attract investments, etc. Therefore, there is a need to change the regulatory impact on the activities of banks, which should be aimed at actively countering the emergence of crisis phenomena, rather than the subsequent infusion of budgetary funds into banks to keep the entire financial system afloat.

The implementation of monitoring of banking risks provides:[49]

1) for the state as a whole, monitoring allows to increase the transparency of the banking sector, increases the possibility of operative control of banking risks and regulation of the banking sector;

2) for the Bank of Azerbaijan, monitoring helps identify market-based risky trends, provides an adequate analysis of market development and the opportunity to develop a further strategy for the development of the banking sector;

3) for a commercial bank, monitoring allows you to identify bank risks at the earliest stages, and can also be a specific tool that affects the reduction of banking risks.

Thus, monitoring of banking risks is important for both practice and theory, as it allows not only promptly to receive current information about risks, but also to identify market trends and patterns, and draw conclusions about the prospects for the development of the banking sector.

The history of the development of banking systems is indicative of recessions, ups and crises. At any stage of their development, tracking and forecasting are equally important: the financial condition of banks; the level of

risks taken by banks; influence of external and internal factors on the reliability of banks and the stability of the banking system as a whole. This is due to the special significance and influence of the activities of banks on the development of the economy of the country and its regions.

Monitoring of the activities of commercial banks within the framework of the current system of banking regulation and supervision of the Bank of Azerbaijan is designed to solve in the complex the following tasks:[50]

- collection and accumulation of information reflecting the main indicators of the country's economic development and the operation of the commercial banks system;

- analysis and forecast of stability indicators of the banking system, assessment of systemic risks of the banking system;

- Identification and assessment of the degree of influence of various factors that determine the reliability of banks, the stability of the banking system;

- Evaluation of the effectiveness of activities carried out within the framework of state regulation of the banking system.

The following directions can be distinguished [51]:

monitoring of coefficients;

regular monitoring of bank risks

monitoring based on stress testing data;

monitoring of indicators of financial stability of the banking sector;

monitoring of information on the results of curators;

monitoring of enterprises in the non-financial sector.

Each of the monitoring directions has a corresponding functional significance. [52]

1. Monitoring of coefficients - an analysis of the coefficient system based on the Instruction of the Central Bank of the Azerbaijan Republic No. 110-I of

16.01.2004 "On Mandatory Banking Standards", which sets general principles for protecting banks from financial risks. However, the reliability of the established system of standards is not too high, since the reliability of official bank reporting is at a rather low level, and the results obtained with the help of coefficient systems do not always reflect the real situation in the bank. They can be used only to identify individual alarm signals in the activities of banks.

For example, a low level of transparency in Azerbaijann banks' reporting is provided by the data of the transparency survey conducted by the Standard and Poor's Corporate Governance Rating Service in 2005 among the 30 largest Azerbaijann banks. This study showed a low level of transparency of these banks - 36%. While the average disclosure rate in the 10 largest international banks used in the comparison is about 85% .. As the Director General of the ASV Turbanov AV notes, the situation with the reliability of the reporting is of concern. When executing the liquidation procedures of some banks, it was revealed that the real assets of these banks are 5% -7% of the figures reported. In fact, many of these banks were bankrupt already before there were violations of transactions with "cashing".

The main ways to solve the problem of reliability of banks' reporting offered by various specialists are to create conditions for the transition of the Azerbaijann banking system to international business standards and IFRS, to reduce excessive amounts of mandatory economic standards, to improve the regulations of the Central Bank of the Azerbaijann Republic, to introduce elements of Basel II, Azerbaijan over the course of audits of bank reporting by audit companies, etc.

As part of the solution to this problem, we also propose to establish increased requirements for managers, chief accountants, to organize the accounting and operational work of banks, and to the internal control system. In this regard, close cooperation between the Bank of Azerbaijan and audit firms is needed on the basis of the creation of a single methodological center for working with banks and

audit organizations. The appearance of such a center will help improve the interaction of supervisory and supervisory authorities with banks and auditors, reduce tax and accounting risks, reduce the number of inspections of banks and accelerate the time of their conduct. The formation of such a center should be accompanied by the creation of certification systems for key positions of banks, which can be implemented as part of the introduction of banking quality standards.[53, p.360]

The system of traditional coefficients should be supplemented by a new comprehensive risk analysis scheme, which banks face in their activities. This will contribute to the development of all areas of monitoring of banking activities.

2. Regular monitoring of risks includes at present the following areas:[54,p.25]

- monitoring of credit risks (the risk of lending to non-financial enterprises and the risk of consumer lending);
- Monitoring of liquidity risk;
- monitoring of market risk;
- Monitoring of capital adequacy.

For further development of monitoring of risks (especially credit) and their management, an important role can be played by information accumulated within the framework of a developed system of credit information (credit history bureau). World experience of their creation showed that, firstly, the credit history bureaus provide better awareness of banks about potential borrowers and allow more accurate forecasting of loan repayments, which reduces the risk of a negative selection problem.

Secondly, thanks to the credit history bureau, the cost of finding information about customers is reduced. This facilitates the alignment of the information field within the credit market and forces lenders to establish competitive prices for their resources. Thirdly, the activity of the credit history

bureau disciplines borrowers because of the real threat of causing significant damage to their reputation in the eyes of potential creditors.

The system of the credit history bureau in Azerbaijan is now at the stage of formation and accumulation of information. As of April 8, 2010, there were 33 credit history bureaus in Azerbaijan. The bulk of credit histories is kept by the five market leaders - Equifax Credit Services LLC (formerly called Global Payments Credit Services LLC); OJSC "National Bureau of Credit Histories", CJSC "Bureau of Credit Histories" Infocredit "; CJSC Bureau of Credit Histories Experian-Interfax; LLC "Azerbaijann Standard Credit Bureau". They collectively account for about 95.5% of credit histories of individuals and legal entities accumulated in the credit history bureau in the country. According to the Central Bank of Azerbaijan on October 6, 2008, the number of titles of subjects of credit histories reached 50 million.

Despite the fact that the credit history market is very young, in practice there are already several objective obstacles that complicate the development of an effective system of credit histories in Azerbaijan.

In the opinion of the representatives of the banking community, in practice it was not possible to form a unified system of credit history bureaus. It turned out that many banks are simply not interested in cooperation with the credit bureau for a number of reasons, and the bureaus themselves can not agree on joint work among themselves. The negative aspects are also noted: inadequate legal protection of banks, lack of a clearly prescribed order of horizontal interaction between various bureaus, the problem of "pocket" bureaus (hence the danger of monopolization of the market, the establishment of unreasonably high prices for credit histories), the potential risk of losing confidentiality for borrowers. [55, p.611]

Therefore, it is necessary to find ways of more efficient functioning of the CRC, while an important role in this is assigned to the Central Bank of the Azerbaijann Republic. Improving the functioning mechanism of the BCH will play

a significant role in enhancing the transparency of the banking sector. But in order for supervisors to be able to control the quality of investments made by banks and promptly intervene in their activities in violation of established parameters, state BCH should be created. Moreover, the Central Bank has a practically streamlined system of information flows from banks (financial and accounting reporting, including information on large loans, interest rates, various banking risks). In such a system, it is easiest to integrate information flows related to the activity of the credit history bureau.

### **3.2. Main directions of Bank's improvement**

Recent years in Azerbaijan have been marked by stabilization of the economic, political and social situation, legislative reforms, as well as by the improvement of the macroeconomic climate characterized by the overall economic growth, including the production sector, the growth of retail turnover and real incomes.

All this is a significant prerequisite for the development of the retail financial services market.

The last six years have been marked by the intensive development of the Azerbaijann banking system. The analysis of the dynamics of the main indicators of the activity of banks makes it possible to characterize the year 2006. As extremely successful for our banking sector in terms of development of banking services. The assets of the banking sector increased more than 8 times from \$ 1,586.4 billion as of 01.01.2000 to 14,045.6 billion as of December 31, 2006. for the year they increased by 44, 1% (in 2005 the growth was 36.6%) (Appendix 6).

At the same time, the growth rates of the assets of the banking sector are now somewhat ahead of GDP growth rates.

Own funds (capital) of credit institutions increased by 36.3% (in 2005 - by 31.2%) - to 1692.7 billion manat. [56]



The number of credit institutions with capital over 5 million euros increased by 74 per year and reached almost 57% of the number of credit institutions operating at the beginning of this year (48.0% as of January 1, 2006).

At the same time, post-crisis rates of development of the whole banking system are much inferior to the rates of development of other sectors of the economy. The domestic banking system is only in the initial stage of its formation. A striking testimony to this is the fact that there are constantly changes in the composition of the twenty Azerbaijann banks-leaders. Thus, the Azerbaijann banking system is far from the situation of a relative equilibrium state. [16, p. 26]

The shortcomings of the modern banking system of Azerbaijan in many ways duplicate the shortcomings of the country's economic development, but at the same time have a certain specificity.

The lack of an adequate development strategy is a general drawback of the Azerbaijann economic model of development. The Central Bank of Azerbaijan, as a priority goal, chose to fight inflation, which is due to economic growth. Currently, according to a number of prominent economists, in Azerbaijan there is a situation where not the banking sector exists for the economy of the country, and the economy for the banking sector. Most of the assets of the banking sector (over 60%) remain located outside the real economy lending.

The absence of specialized banks does not contribute to the implementation of economic development programs, accelerated progress in priority sectors and spheres of the economy, the production of high technology and venture entrepreneurship, a mortgage loan, and small and medium-sized businesses.

As a result of the collapse of the USSR and the Soviet banking system, the country's largest banks were destroyed. Currently, the country's largest bank, Sberbank, ranks only 138 among the world's 1000 largest banks. In total, 22 Azerbaijann banks entered this list, but most of them are in the last third of this list. For comparison, the largest banks in China are in the second ten of the list.

In the Azerbaijann banking sector, there is a structural imbalance - when small banks predominate, which could not be registered in any EU country due to the insignificant amount of capital. At the same time, about ten of the largest banks, in fact, control the entire banking market. [57]

Regional imbalances are also present in Azerbaijan. 85% of financial capital is concentrated in Moscow. More than 80% of credit institutions are located in the capital. Characteristic for most of the regions was the growing uneven regional distribution of the money supply: the money supply deficit in most of the regions with surpluses in others, especially in Moscow and the so-called offshore zones. At the same time, in terms of the level of provision of the population with commercial banks with branches (3.4 banks per 100 inhabitants), Azerbaijan lags far behind most developed countries.

There is also an insecurity. The default of 1998 for a long time remained in the memory of the Azerbaijanns. According to opinion polls, 52% of the country's residents consider it possible to repeat the default, 36% are sure that it is more profitable to invest in real estate, 24% are ready to put free cash in Sberbank, 14% do not trust anyone and prefer to keep money in cash, 8% in gold and jewelry.

Opacity is still a significant obstacle to an effective banking vector.

Unlike most of the banking systems of developed countries in the Azerbaijann system, weak coordination of links, as in the banking system there is no department for control over banks, similar to the former ARCO. This significantly impedes the consolidation of the banking sector in the development of a national development strategy.[58]

The absence of a single data warehouse prevents the development of credit. Azerbaijann banks are slow to implement the Law on the Bureau of Credit Histories, which came into force in June 2005. and according to which banks are obliged to provide these stories in a single National Bureau of Credit Histories, created under the auspices of the Association of Azerbaijann Banks. Even the state-owned Sberbank, which accounts for half of the loans issued, as well as the

Azerbaijann Standard (about 7% of consumer loans) intend to create their own bureau of credit histories. However, without Sberbank, the system of credit bureaus in Azerbaijan is not able to develop effectively, since the existence of its own office with Sberbank can lead to the fact that a large amount of information will be inaccessible to other banks.

In 2005 The Central Bank withdrew the license from 15 banks, for participating in the shadow business, having caught them in large-scale cashing of money of dubious origin. The fight against the shadow banking business in Azerbaijan is also being carried out in other countries. Thus, the US banks began a mass closure of correspondent accounts of Azerbaijann banks because of the need to monitor payments in the fight against money laundering. For the year 2005. in cooperation with the United States, about 300 Azerbaijann banks were denied.

In this regard, at this stage, the banking system of Azerbaijan is not able to fully meet the objectives of lending to current operations of the real sector and practically does not participate in lending to long-term investment projects.

In April 2005 The Government and the Central Bank adopted the "Strategy for the Development of the Banking Sector of the Azerbaijann Republic for the Period Until 2008". In accordance with this document, the main goal of the development of the banking sector in the medium term is to increase its sustainability and efficiency of operation.

The main objectives of the development of the banking sector are: strengthening the protection of the interests of depositors and other creditors of banks; increasing the effectiveness of the banking sector's activities to accumulate funds of the population and organizations and their transformation into loans and investments; increasing the competitiveness of Azerbaijann credit institutions; prevention of the use of credit institutions for the implementation of unfair commercial activities and for unlawful purposes (primarily such as financing of terrorism and legalization of proceeds from crime); development of a competitive

environment in the activities of credit institutions; strengthening confidence in the Azerbaijann banking sector by investors, creditors and investors.

Reforming the banking sector will facilitate the implementation of the program of social and economic development of the Azerbaijann Republic for the medium term, first of all, overcoming the raw material orientation of the Azerbaijann economy due to its accelerated diversification and realization of competitive advantages. At the next stage (2009-2015), the Government of the Azerbaijann Republic and the Bank of Azerbaijan will consider the priority task of effective positioning of the Azerbaijann banking sector on international financial markets.

The main areas of activity of the Government of the Azerbaijann Republic and the Bank of Azerbaijan are: improvement of legal support for banking activities; formation of favorable conditions for the participation of banks in financial intermediation; increasing the effectiveness of banking regulation and banking supervision; strengthening market discipline in the banking sector and ensuring equal competition conditions for all credit institutions, including state-controlled banks; increasing the requirements for the quality of corporate governance in credit institutions; development of the banking business infrastructure.[59]

In the field of legal support of banking activities, it is necessary first of all to create legal conditions for the functioning of credit institutions in accordance with international standards, defined in particular in the document of the Basel Committee on Banking Supervision "Fundamental Principles for Effective Banking Supervision", including: first of all, their claim rights secured by a pledge; to ensure the improvement of legal mechanisms for the liquidation of credit institutions that have their licenses revoked for banking operations; to strengthen legal mechanisms of competition and prevention of actions to restrict the freedom of commercial activities in the banking sector; simplify procedures for mergers and acquisitions of credit institutions; create conditions for the formation of an

effective system for storing and using credit histories; create legal conditions for wider application of modern electronic technologies in banking; to create legal mechanisms to counteract the establishment of control over credit institutions by unscrupulous persons; continue work on improving the system of taxation of banking activities.

Given the expected growth in real incomes of the population, creating the conditions necessary for economic growth and business development of banks, lending to small businesses and the population, including mortgage lending, should increase substantially. The implementation of measures to reform other segments of the financial sector of the economy, including the pension system, the health insurance system, etc., will also facilitate the activation of credit institutions' operations.

The strategic perspective of the development of the banking sector structure is the optimal combination of large multi-branch banks, regional banks of medium and small size, banks specializing in individual services (consumer lending, mortgages, lending to small and medium-sized businesses), the goal of the Government of the Azerbaijan Republic and the Bank of Azerbaijan is to form medium-term perspective of the banking sector, capable of ensuring the provision of all categories of customers both in the territory of the subjects of Azerbaijan Coy Republic and in the markets of the "near abroad" universal range of banking services, and banking services to Azerbaijann economic interests in the global economy. Optimal in its structure and built on the principles of fair competition, the banking sector will become an effective tool for accumulating investment resources to ensure accelerated economic growth based on the diversification of the housekeeper, leveling the levels of regional development, improving the quality and living standards of Azerbaijann citizens.

However, the development of the banking sector is constrained by a number of circumstances, both internal and external.

Internal obstacles include undeveloped management systems, weak level of business planning, unsatisfactory level of management in some banks, their orientation to rendering doubtful services and conducting unfair commercial practices, fictitious nature of a significant part of the capital of individual banks.

Among the external deterrents are high credit risks, unresolved number of key issues of collateral legislation, limited resource opportunities of banks, first of all, short-term medium and long-term liabilities, insufficient level of confidence in banks by the population.

In addition, the Azerbaijann economy as a whole and the banking sector in particular have a relatively low investment attractiveness, as evidenced by the dynamics of investment, and with respect to the banking sector - and the declining share of foreign capital. In the period from January 1, 2000. to January 1, 2007. the share of non-residents in the total authorized capital of operating credit institutions of the Azerbaijann Republic decreased from 10.7 percent to 6.2 percent.[60]

Increasing confidence in Azerbaijann banks is impossible without the unification and standardization of the activities of commercial banks and methods for regulating their activities. For example, the standardization of approaches to the evaluation of the activities of credit institutions, in particular, the development and implementation by the Bank of Azerbaijan of national standards for the quality of banking activities, and the bringing to the attention of the public of compliance with these standards by specific credit institutions, can have a positive impact on the level of confidence in the national banking system.

Particular attention should be paid to the level of provision of credit institutions with information on the development and current status of the retail banking business, the main parameters of the market, the situation in the regional retail banking markets, and the level of providing individuals with information on the activities of a commercial bank in this market, its product range, target client segment.

But the most important thing is the creation of a system of effective internal management of the retail business sector in a bank that originally specializes in servicing corporate clients, embedding this block in its structure.

### **3.3. Bank's development strategy**

In general, under the strategy of the bank as a working management tool, it is advisable to understand the answers to the basic, fundamental questions of the organization's development (calculated not necessarily for long periods of time), consistent with its development concept (mission), formulated on the basis of an analysis of the totality of external and internal factors that affect or are able to affect the conditions and results of its activities in a foreseeable (affordable forecasting and planning) perspective. Such responses should be embodied in a single completed working paper, which may contain the following sections or parts: [61, p.455]

- the bank's objectives system;
- Bank management strategy:
  - the bank's policy in the main areas of its activities;
  - a system of practical measures that can implement these policies (Figure 2).

**Fig. 2.**

**Hierarchy of the bank's goals in strategic management [62]**

Executives rely on vertical and horizontal linkages to create a structure that they hope will match the firm's needs. While no two organizational structures are exactly alike, four general types of structures are available to executives: simple, functional, multidivisional, and matrix.

|   |   |
|---|---|
| <p><b>Simple Structure</b></p>          | <p>Simple structures do not rely on formal systems of division of labor, and organizational charts are not generally needed. If the firm is a sole proprietorship, one person performs all of the tasks that the organization needs to accomplish. Consequently, this structure is common for many small businesses.</p>  |
| <p><b>Functional Structure</b></p>      | <p>Within a functional structure, employees are divided into departments that each handles activities related to a functional area of the business, such as marketing, production, human resources, information technology, and customer service.</p>   |
| <p><b>Multidivisional Structure</b></p> | <p>In this type of structure, employees are divided into departments based on product areas and/or geographic regions. Jim Pattison Group, for example, has nine product divisions; Food and Beverage, Media, Entertainment, Automotive and Agriculture, Periodical Distribution and Marketing, Signs, Packaging, Forest Products and Port Service, and Investments and Partnerships.</p> |
| <p><b>Matrix Structure</b></p>          | <p>Firms that engage in projects of limited duration often use a matrix structure where employees can be put on different teams to maximize creativity and idea flow. As parodied in the movie <i>Office Space</i>, this structure is common in high tech and engineering firms.</p>  |

1. The bank should begin with a strategy for its development (emergence, formation, functioning, survival) - a well-considered, high-quality (adequate conditions for its activities), individual, flexible.

The development of a quality strategy and its consistent implementation is a central problem of the formation and sustainable development (survival) of each commercial bank.

The lack of a bank's own development strategy or its formal availability means the absence of planning in it (bearing in mind that management of the bank should include the following consecutive links: analysis ... planning ... operational management ... control) and, therefore, full-fledged on formal signs of management.



2. The presence of even a qualitative development strategy in itself does not guarantee the bank success. At the same time, its absence dooms the bank to failure, especially in the medium and long term.

3. Qualitative development strategy of the bank, if it is really used by it:

- facilitates strict, meaningful coordination of its efforts; [62]
- ensures the unity of the bank's overall priorities and means of achieving them, equips the bank's activities with the necessary "core";
- significantly reduces the risk of the management of the bank misconduct or uncoordinated management decisions;
- serves as a clear reference for subsequent decision-making, monitoring and evaluation of the organization's successful progress;
- is a criterion for the quality of management in the bank and the final results of its activities.

4. It should avoid those gross deficiencies in relation to the problem of development strategy and its development, which have already been revealed in the practice of domestic banks. The main of these drawbacks are the following:

- the lack of a strategy as such, including the neglect of the need to develop it;
- fragmented, incomplete nature of the announced strategy;
- Lack of proper coordination, internal consistency between the various components of the strategy;
- inclusion in a single document, claiming the status of a development strategy of the bank, on equal rights of the most diverse, diverse and logically different levels.

5. The need for the development of one's own qualitative development strategy (survival) of the bank is higher the worse it is for him (while there are still chances to survive, to remain functioning as an independent bank).

6. Our own strategy (meaningfully different) is also needed for a steadily developing, strong bank.

The definition of a clear strategy (its clarification) is especially important if the bank:

- growing, expanding;
- penetrates into new areas of activity;

7. The bank's development strategy must take into account and be internally coordinated with the country's economic development strategy and (or) the region's economic development strategy, if any, and if not, the bank should still have its own strategy.

8. For each planning period, a bank can have only one strategy. At the initial stage of strategy formation, it is possible to consider several alternative versions of the draft strategy, which, however, should be based on the same key ideas.

9. Initiate the development (clarification, updating) of the development strategy of the bank should necessarily be the top management of the bank in the person (options): [63]

- chairman of the board;
- government;
- Board;
- council and board.

Such an initiative should include:

- formulation of key ideas of the strategy (its updated version);
- organization of work on the development of the strategy (its updated version).

10. The formation of the bank's development strategy takes a certain place in the overall process of its management (ie in the chain analysis-planning-

operational management-control): it begins at the analysis stage, based on its results, and directly constitutes the core of planning.

11. Development of the bank's development strategy is suitable for all banking management objects (all processes characterizing the bank's activities, or their components, all of its internal and external relations) in general or in various combinations.

Each bank, taking into account its own assessments of the situation, including within the bank, its strengths and weaknesses, interests and opportunities, can distinguish from the whole variety of bank management objects those of them for which the development (clarification) of the strategy at a given moment of time is represented by its management and specialists more relevant. It is also necessary to bear in mind the financial and other costs associated with the proposed changes.

12. Strategies for the development of domestic commercial banks, taking into account Azerbaijani realities, can be developed for different periods, but not less than a year (that is, the strategy may not be long-term by world standards).

The length of time for which the bank formulates its strategy depends on the reasonable forecasting of the situation in the economy of the country and (or) the region, on the markets of banking services and the position of the bank itself, accessible to its analysts and managers of the horizon.

13. A draft strategy for the development of the bank based on key ideas formulated by the bank's management can be prepared (options in order of increasing preference):

- invited by a group of independent experts (in the absence of the bank's own specialists of the required profile and level);
- Bank experts together with external experts invited;
- Specialists of the bank as part of a special structural unit of the bank (possible subdivision names: management (department) of development;

management (department) of planning; management (department) of development strategy; management (department) of strategic (prospective) planning, etc.).

14. Preparation of the draft strategy for the development of the bank should consist in successive (if necessary - iterative) enrichment and clarification of key ideas formulated by the bank's management, detailing them in terms of opportunities and implementation mechanisms, internal harmonization. At the same time, it is highly desirable to fully take into account all the opinions and proposals of the structural divisions of the bank and its employees. This involves familiarizing the bank's staff with the initial version of the strategy, prepared by the experts invited by the specialists or by its own Department (department) of development. [64]

15. The strategy for the development of the bank should be formalized in the form of a single document and approved in accordance with the specific rules of the decision (options): a) the board; b) the council; c) council and board.

Responsibility for the content and implementation of the development strategy is borne by the bank's governing body that approved it.

## CONCLUSION

Thus, the above analysis allows us to conclude that the Azerbaijani model of social and economic development has justified itself, that is, it is successful. Successful models are when the country's leadership is well aware of the essence of public administration and its country, acts in the interests of the absolute majority of the population, taking tactical decisions to meet the daily needs of people and, at the same time, concentrating organizational efforts and public resources at strategically important "growth points" economy taking into account own possibilities and external conjuncture.

In accordance with the "Azerbaijan 2020: Looking to the Future" Concept, Azerbaijan has set itself the goal of becoming a "high-income" country according to the World Bank's classification of GDP per capita, eliminating the dependence that the main source of this achievement is the availability in the country of hydrocarbon resources, and also to enter the list of countries with a high "human development index" according to the classification of the United Nations Development Program. As a result of the measures taken within the framework of this concept, by the end of the period it is planned to increase GDP per capita almost twice - to 13 thousand US dollars, and to increase the volume of export of non-oil products to the level of 1 thousand dollars per capita.

The concept also indicates the desire to make the non-oil industry multi-vector and develop it, to expand the use of alternative and renewable energy sources, etc. During the period covered by the concept, the rate of the annual average real growth in the GDP of the non-oil sector should be above 7%. The concept also envisages, along with the development of the non-oil industry, the creation of favorable conditions for the formation of a knowledge-based economy, stimulation and expansion of innovation activity.

On the whole, it can be noted that, despite the ambiguity and, in some cases, the inconsistency of the situation developing in the AR, the process of financial globalization and liberalization has had a certain stimulating effect on the

development of the national banking system. A generalized reflection of progressive shifts is the progressive strengthening of confidence in banking structures on the part of both corporate clients and the public. The positive aspect is that the country's banking sector (primarily its leading lending institutions) is beginning to enter a different, higher level, consistently approaching international standards, which ultimately will contribute to the formation of the capital of the republic as a financial and investment center Caucasus. The effectiveness of the functioning of this segment of the economy largely depends on the optimal combination of the line for spreading the processes of financial globalization and measures for their regulation. Thus, we are talking about the formation of conditions under which the banking system of Azerbaijan would act as an effective factor in enhancing the activity of local business and improving the investment climate by developing both quantitative and qualitative indicators of the country's monetary and financial-credit systems.

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## SUMMARY

One of the active issues of civil society is a credit market. Credit in Latin translation - I know, trust, and bear the meanings. The bank market is a combination of the relationships between the lender and the borrower on the issuance, use and repayment of the loan. The bank market is the most important mechanism that accelerates and stimulates the market economy. Purpose and Objectives of the Research - The purpose of the research is to study the current state of the banking market in Azerbaijan and to explore the way economic analysis of development potentials.

Key words: Bank Market, Globalization, Azerbaijan

## РЕЗЮМЕ

Одним из активных вопросов гражданского общества является кредитный рынок. Кредит на латинском переводе - я знаю, доверяю и несу значение. Банковский рынок представляет собой сочетание отношений между кредитором и заемщиком при выпуске, использовании и погашении кредита. Банковский рынок - это самый важный механизм, который ускоряет и стимулирует рыночную экономику. Целью исследования является изучение текущего состояния банковского рынка в Азербайджане и изучение способа экономического анализа потенциалов развития.

**Ключевые слова:** Банковский рынок, Глобализация, Азербайджан

## XÜLASƏ

Vətəndaş cəmiyyətinin aktual məsələlərindən biri kredit bazarıdır. Latın tərcüməsində kredit - Mən bilirəm, etibar edirəm mənalərini daşır. Bank bazarı borc verənlə borcalan arasında kreditin verilməsi, istifadəsi və geri qaytarılması ilə əlaqələrinin birləşməsidir. Bank bazarı bazar iqtisadiyyatını sürətləndirən və stimullaşdırıcı olan ən mühüm mexanizmdir. Tədqiqatın məqsədi Azərbaycanda bank bazarının mövcud vəziyyətini öyrənmək və inkişaf potensialının iqtisadi təhlili yolunu araşdırmaqdır.

**Açar sözlər: Bank Bazarı, Qloballaşma, Azərbaycan**