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**“Bank competition and a financial stability”**

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## **Abstract**

The essence of the stability of the banking system in the context of strengthening interbank competition is defined in the dissertation. The result of banking activities-the bank product expresses the totality of economic relations arising in the course of carrying out the bank's operations, as well as the technology and organization of banking business processes for customer service. The quality of a bank product depends on the organization of four main lines of business of a commercial bank: production activities, marketing, financial management and personnel management. At the same time, foreign factors, as well as the conditions of interbank competition, should be favorable for the activities of banks. The characteristic of the methodological bases of stability assessment of the banking system is given, which allowed to substantiate the methodology for performing all operations for the creation and sale of banking products and a general approach to obtaining quantitative quality estimates.

Evaluation of the stability of the banking system allows to solve the following tasks: to optimize the design of the banking product; improve the technology of its creation; improve quality and competitiveness; To increase the efficiency of implementation due to qualimetric methods of forming a set of requirements for a banking product.

## INTRODUCTION

**Actuality of the study.** Bank competition is a dynamic process of competition between commercial banks and other lending institutions, within which they seek to secure a firm position in the banking services market.

Competition in the banking services sphere is a key factor in the effective implementation of the constitutional principle of the unity of the economic space and the free movement of financial services.

There are two types of competition: perfect and imperfect. With perfect competition, market participants can't influence prices, but are only able to adjust their volumes to market prices, maximizing profits. With imperfect competition in the industry that takes the form of monopoly, different types of oligopoly, firms are able to influence the prices set in the industry, offering a different volume of products and services.

If we consider world practice, we can see that interbank competition and its relationship to financial stability have been studied by many researchers. There have been no investigations on this subject in the reality of Azerbaijan. Everyone knows today that the situation in banks in Azerbaijan is so intense. The devaluation wave facing our country over the last two years has had a major impact on the Commercial Banks. The objective of this dissertation work is to investigate the competitiveness of the state and private banks (how they use financial or marketing tools to compete with each other) operating in our country and its impact on their financial stability.

Among measures aimed at increasing competition in the banking industry, an important place should be taken to reduce the gap between different categories of consumers of banking services. This can happen, firstly, by expanding the class of customers for which banks are ready to compete. Secondly, by increasing the capacity of medium-sized banks to provide "good" customers with adequate service requests.

Any measures aimed at increasing the exchange of information between banks and increasing the transparency of borrowers can smooth out the gap between different categories of banking customers. Among such measures are, for example, improving the quality of information exchange of credit bureaus, raising standards of corporate reporting, liquidating the institution of one-day firms, etc.

The limited ability of medium and small banks to compete for the best customers is largely due to the shortage of the resource base. In addition to long-term measures aimed at increasing the confidence of depositors and increasing the requirements for the size of capital, an important role here can be played by simplifying the procedure for refinancing banks, including medium ones, in the Central Bank and developing such an institution as syndicated lending. Another step in this direction may be simplification of the procedure for issuing debt securities by banks.

**Purpose of the study.** The purpose of the dissertation is to identify and theoretically substantiate the interdependence between financial stability and the competitiveness of banks, to develop recommendations for increasing the competitiveness of banks by improving its financial stability.

The purpose defines the objectives of the study: to define the concept of financial stability of banks and its components; to define the concept of the competitiveness of banks and their components; theoretically substantiate the relationship between financial stability and the competitiveness of banks; to analyze some of the existing methods for determining the financial soundness of banks;

- develop a methodology for determining the financial stability of banks on the basis of published reports;

- identify the internal factors of increasing financial stability and competitiveness of banks;

- determine the role of banking supervision in maintaining and strengthening the financial stability and competitiveness of banks.

**The object of the study** is banks competing in the banking services market.

**The subject of the study** is the stability and competitiveness of banks.

**The methodological basis** of the research is general scientific and private scientific methods: economic-statistical, monographic, computational-constructive.

**Theoretical significance of the research** results consists in determining the concept of financial stability of banks, the development of the theory of banking risks, the theory of banking competition and banking marketing.

**The practical importance of the study is based:** on the developed methodology for determining the financial stability of banks on the basis of published reports, which is easy to apply and can be used by bank customers to choose the most reliable and beneficial for cooperation; on the proposed methods of increasing financial stability and competitiveness of banks.

## **SECTION 1. THEORETICAL ANALYSIS OF BANK COMPETITION**

### **1.1. Literature Review**

Competition is a difficult process, for which there is no single generally accepted or best indicator. Therefore, in the literature on banks, various approaches were developed to assess its level: direct and indirect.

One of the first to address the relationship between competition in the banking sector and financial stability was Keeley (1990). He argues that competition in the banking sector reduces financial stability. The channel which explains this negative relationship between competition and financial stability is often described as the ‘charter value channel’. Conversely, the modern competition-stability view of Boyd and Nicolo claims that excessive competition in the banking market drives the banks to lower the loan interest rate which reduces moral hazard and adverse selection problem of the banks, reduces their default risk, and enhances financial stability. On the other hand, Martinez-Miera and Repullo claim that both the competition-fragility view and competition-stability view can coexist, and the relationship between competition and financial stability is non-linear or inverted U-shaped. The probability of a bank receiving a shock will depend in part on its risk-taking behavior. The literature on classic financial structure maintains that highly leveraged firms have an incentive to engage in risky behavior. If the gamble works, shareholders benefit; if it does not work, the lenders bear the cost (Jensen and Meckling 1976). This agency problem is particularly strong for banks, since they tend to be very highly leveraged. Many of the debt-holders are depositors who are small, widely dispersed, and tend not to be well-informed of a bank’s activities and potential risks; the existence of deposit insurance further lessens depositors’ incentives to monitor the risk taking behavior of the bank.

Shaffer (1998) describes a market where banks lend only to those borrowers that its screening technology designates as “good,” although each bank’s technology

is imperfect. Borrowers rejected by a bank can reapply to each of the other banks in the market, but the banks do not know whether a borrower has already been rejected. When there is a fixed pool of borrowers where the probability of being seen as a good borrower when true is greater than being seen as a good borrower when false, each successive pool of rejected applicants has a higher proportion of bad borrowers.

A number of recent research contributions has analyzed important aspects of the relationship between lending market structure and various aspects of performance. Broecker (1990), Nakamura (1993) and Riordan (1993) have studied the consequences of adverse selection resulting from the unobserved characteristics of borrowers. They argue that increased competition may make adverse selection problems more severe when borrowers that have been rejected at one bank can apply for loans at other banks so that the pool of funded projects will exhibit lower average quality as the number of banks increases.

Direct measurement is based on the market power index, reflecting the the share of the market premium that the bank sets product (Lerner A.). The market surcharge is measured as the difference between the product and its marginal costs (Berger A.N., Beck T., Delis M., Maudos J., de Guevara J., Fungáčová Z., and others). Direct estimation is difficult need to have data on prices of banking services and their marginal costs.

All developed competition indicators can be divided into two blocks: microeconomic and industry-wide. The former are measured by the level of individual banks, the second - either for the market segment, or for the as a whole. At the micro-level, the market power of banks - their ability to determine prices for their services (loans, deposits) on the market and thus influence the pricing policy of banks- competitors. The more such an ability, the lower the competition in the system. In fact, initially the microeconomic was only the Lerner Index, while all the others are purely industry-wide. Obviously, this is opportunities for panel analysis of



competition, which is more opportunities and more informative than analysis of macro-trends.

In the works of Delis M. using the technique of local optics, for the micro-level are given the H-statistics of Pansar-Ross, Buna and the Breshnahan Indicator. The next stage of the study is analysis of the impact of competition on the stability of banks. In the fundamental work of Keeley M. 1990- the concept of negative impact was formulated, the competition on the stability of banks, "Competition-vulnerability." In it, the emphasis was on worsening the banks with increasing competitive pressure, while the position of borrowers of banks was not taken into account.

The author Koetter et al proposed an alternative concept - "competition-sustainability", at which focused on improving the financial position of borrowers with the growth of competition between banks. Most modern empirical studies of competition and its impact on the stability of banks use the device of panel equations. Part of the work explores both processes competition (market power) and sustainability - based on the behavior of microeconomic indicators (Berger A., Turk Ariss R., etc.).

Results of the study by Bolt and Humphrey (2015) with the sample of total 2655 banks and 382 financial institutions reported weak relationship among three measures of competition in relation to each other, stating that banks with the highest loan rates are the least competitive.

A number of recent research contributions has analyzed different aspects of the relationship between lending market structure and various aspects of performance. Some of them argued that increased competition may make adverse selection problems more severe when borrowers that have been rejected at one bank can apply for loans at other banks so that the pool of funded projects will exhibit lower average quality as the number of banks increases. K. Booker (2007) has extended the analysis of winner`s curse problems in lending in several directions.

In particular, K. Booker has investigated the impact of banks use of common information filters (like shared databases and uniform screening criteria) on the winner's curse problems in lending and he has characterized the factors affecting the incentives of banks for using such common filters.

In their research, Allen and Gale (2003a) show that competition is compatible with the efficient level of financial stability. In this case, there is no "tradeoff" between competition and stability. Keeley (1990) developed a simple model of risk taking by banks with two dates and two states when there is deposit insurance. He showed that as competition increased risk taking by banks also increased. Additionally, Keeley (1990) explained that in 1990s (in the US) while competition and deregulation increased in banking sector that leads to decreasing monopoly rents and bank failures. In fact, deposit insurance is not necessary for this effect to be present although it does exacerbate it. There is debate in different stages of the literature describing effects of the degree of bank competition on the overall stability of the financial system. The banking industry is the main which's instability may be shifted to the whole economy. The main mechanisms of transmission are through the disruption of the interbank lending markets and payment mechanisms, the reduction of the supply of credit, and the freezing of deposits (Berger *et al.* 2008). One can consider wide range of views and literature which suggests that increasing bank competition leads to financial instability by reducing the level of market power in the sector, which consequently deteriorates profits supporting the competition-fragility view. Therefore, many banks are inspired to take on more risks to increase returns, eroding the quality of their portfolios (Marcus, 1984; Keeley, 1990 and Carletti and Hartmaan, 2002). There are different empirical studies supporting this relationship. For Hellmann, Murdock and Stiglitz (2000) opinion, the removal of interest rate ceilings, and thus generating more competitive prices, decreases franchise value and encourages moral hazard behavior in banks. Additionally, Vives (2010) observed the theoretical and empirical literature on the competition-stability relationship and

claims that although competition is not a determinant of instability, it may lead to instability problems.

There are also many studies which support a positive relationship between bank competition and financial stability. Saez and Shi (2004) claim that in the loan markets high market power rises bank risks therefore high interest rates which leads clients difficulties in paying their credits.

There are several recent studies which have disprove this hypothesis. Boyd, De Nicolo and Jalal (2006) and De Nicolo and Loukoianova (2006) both support the idea of inverse trade off between bank competition and financial stability. In their research they used Z-index and Rosse Panzar H-statistics. Schaeck, Cihak and Wolfe (2006) used Logit model and duration analysis for studying competition and financial stability. As a measure of competition they estimate the Rosse-Panzar H-statistic. The results of their measurements claim adverse relationship between competitive banking sectors likelihood of bank failure .

## **1.2. Theory Background**

Unlike other sectors, the competition and stability issues in the banking sector is unique (Claessens, Leaven, 2004: 563). Competition and the understanding of the relationship between the stability of banks is extremely important for designing and it is not possible to mitigate the risk of financial crises.

Negative relationship between competition and stability defines the basic approach of policy makers towards banks.

A general view that excessive competition will increase fragility and the relationship between competition and stability is theoretically and empirically not linked yet. (Beck: 2008: 1).

Another effect that has been shown theoretically as far as empiric is financial the degree of competition in the sector, the financial services of firms and households, introduction of external financing and then all economic development (Claessens, Leaven, 2004: 563-564).

The success of any commercial bank depends on the composition and number of clients of the bank, their position in the field of entrepreneurship, the ability to conduct banking operations, the level of qualifications and professionalism of the bank's staff and its equipping with modern technical means and applied information technologies.

The subject of competition in the financial market is a service through which financial organizations seek to gain recognition and money from customers. In a broad sense, this is a satisfying need. A narrow understanding of the subject of competition leads to the identification of competitors who provide analogue services or substitute services. A broad understanding leads to a wider set of competitors. All those who can satisfy the need for this service one way or the other, or "translate" it into some "other" need, or altogether exclude it from the life of the consumer. The object of competition in the financial market is the consumer of financial services - the client, and in this capacity he has the opportunity to choose. According to Barkan DI, the division of the "object" and the "object" characterizes not one but two spheres of competition: the service on the one hand, and the consumer on the other . The competitor is a competitor, that is, a financial and other organization that provides products and services marketed by the consumer as substitutes for original products / services . Proceeding from what has been said, the banking competition of Korobov GG, Semenyuta OG, Samoilov G.O. is defined as the process of competition of the subjects of the banking market taking place in the dynamics, during which they seek to secure a firm position in this market .

Competitiveness of a banking service is a relative dynamic indicator of its quality and cost characteristics, the optimal ratio of which ensures, first, the

satisfaction of the specific needs of customers, and, secondly, the beneficial difference from similar services of competitors. From my definition it follows that the level of competitiveness of a banking service with a consumer value is revealed in the process of comparison with analogues offered by other participants of the financial market. In this regard, the bank needs to constantly work to maintain the value of its services in the eyes of consumers, so that, as the life cycle goes through, it does not lose its properties and as long as possible competes. Yudanov A.Yu., competitiveness of banking services, calls the degree of its attractiveness for the consumer making a real purchase, which also, in my opinion, unilaterally reflects the essence of competitiveness.

(Shelkunova TG, Gagloeva K. A. Banking competition and competitiveness: essence, concept, // Problems and prospects of economics and management: materials III Intern. sci. Conf. (St. Petersburg, December 2014). - St. Petersburg: Zanevskaya Square, 2014. - P. 141-145. – URL.

Competition in the banking market acts as a stimulating factor that encourages competitors:

- expand the range of banking services;
- improve the quality of banking products;
- promptly adjust prices for these products.

Competition encourages banks to move to more efficient ways of functioning.

One of the most important characteristics of a banking service is its competitiveness. It most clearly reflects the essence of banking competition.

The sphere of activity of modern commercial banks is practically all market sectors. Consequently, the sphere of banking competition is also very extensive, and the competitive environment is diverse and heterogeneous.

Depending on the nature of the participants involved, the following types of banking competition can be distinguished:

- Intra-industry competition is competition between banks within the banking system, as well as competition between banks and other financial and credit organizations that provide financial services. This type of competition exists on the financial market and is characterized by sharpness and development of forms;

- intersectoral competition - competition of banks with various non-financial institutions: mail, trade companies, enterprises and organizations. At first glance, the activities of these companies have nothing to do with banking, but their interests may overlap. For example, post offices provide services but money transfers, in some countries can take funds into deposits. Trading companies can sell goods and services on their behalf on deferred payment terms;

- market competition - the competition of banks with all market actors for limited resources, not only money, but also labor, intellectual, material, organizational, technical, natural, etc.

In the practice of their activities, commercial banks can use both price and non-price forms of competition.

Price competition is carried out by manipulating prices, tariffs, interest rates. This is the simplest form of competition, it appears from the moment of the formation of a two-tier banking system and is constantly developing, gradually turning into non-price banking system. Price competition allows "to leave behind" the weakest competitors. At the same time, it has certain limitations. First of all, these restrictions are related to the specifics of the banking activity itself. Banks can not constantly reduce interest rates on active operations and increase them by passive. Sooner or later, this will lead to the fact that the bank will cease to make a profit. There is another risk: reducing prices is easy, much more difficult if you need to raise them again. An example is the tariffs of banks for acquiring services in Russia or fees for servicing card payroll projects. In addition, the decline in prices for banking services does not always ensure an adequate increase in demand, as this can cause mistrust of the bank, making it doubt its reliability.

Non-price competition is aimed at forming stable consumer preferences and strengthening the bank's position in the market. Banks use a wide range of methods and tools of non-price competition that are associated with improving the quality of service, implementing effective management practices, conducting advertising campaigns, developing new products and modifying existing ones, etc.

Features of banking competition are as follows:

- ✓ bank competition is characterized by the development of forms and high intensity;
- ✓ competitors of commercial banks are many other categories of competitors. Specialized banks compete with universal banks (savings, mortgage, investment banks, servicing small and medium businesses, clearing and innovation banks), non-bank credit institutions, non-financial organizations and (credit unions, pawnshops, leasing companies, clearing houses, financial brokers , investment companies, pension funds, mail, trading houses);
- ✓ Competitive space is represented by numerous banking markets, on one of which banks act as sellers, on others as buyers;
- ✓ Intra-industry competition is mainly of a species nature, which is associated with differentiation of the banking product and services;
- ✓ Bank products and services can interchange each other, but do not have competitive "external" (non-bank) substitutes, and therefore inter-sectoral competition is carried out primarily through the flow of capital;
- ✓ Bank sector have a number of entry barriers that are characteristic of many industries, which leads to a relatively higher intensity of competition in this area;
- ✓ Limitations of price competition put forward problems of quality management of the banking product, advertising services;

Most often, banks classify competitors in the following groups:

- direct competitors (traditionally among the main competitors): banks that have high growth rates and have (or can have) a significant impact on core business;
- new banks, mainly foreign banks or banks, expanding the geographical scope of activities;
- potential "newcomers" are new non-bank competitors.

To analyze the degree of influence of competitors, information about competitors is needed.

Having information about competitors, it is advisable to conduct a comparative analysis of the bank's own activity relative to its competitors. It allows you to identify the strengths and weaknesses in the activities of both the bank itself and competitors.

We can see that the sphere of banking competition is very extensive, and the competitive environment is diverse and heterogeneous.

The bank competition is affected by a number of objective circumstances:

- ✓ Liberalization of state regulation of banking activities.
- ✓ Universalization of banking activities.
- ✓ Expanding the regional scope of credit institutions.
- ✓ Penetration of non-banks and other credit institutions into the banking market.
- ✓ Increase in the value of non-price competition.
- ✓ Globalization of banking competition.

### *Competitiveness Theory*

The theory of Industrial Organization that has existed for a long time suggests that the competitiveness of the sector (market) can not be measured by market structure indicators (concentration indexes, number of institutions) solely. (Besanko and Thakor, 1992, Claessens, Leaven, 2004).



Economic research is an important factor of the competitive process of entry into the market. Dynamic models, inputs and expansions competitive process that tries to reduce the normal profits are caused by incomplete competition.

Looking at the dynamics in the market concentration it is obvious that many of the empirical studies are not based on direct inputs (Proxy) (Amel, Liang: 1997: 59).

The level of competition in the banking system can be measured taking into account the real action of the banks like in the other sectors.

From the view of structural approaches, intensive markets are not competitive because competitiveness depends on the degree of potential competition.

Non-structural competition measures are generally based on Lerner's (1984) market power measure. In particular, it includes competition measures between oligopolists (Iwata 1974) and tests competitive conditions in competing markets (Bresnahan 1982, Lau 1982, Panzar and Rosse 1987).

## **SECTION 2. BANKING SYSTEM OF AZERBAIJAN AND ITS STABILITY**

### **2.1. Banking system and main economic indicators.**

The development of market relations and the growing competition of commercial banks for temporarily free financial resources of AR state organizations and enterprises, off-budget funds, legal entities and individuals, especially in the conditions of imposing sanctions by Western financial institutions, led to a sharp decline in commercial banks. The year 2015 was not an easy financial year for the Azerbaijani economy, corporate and banking sectors and the country's population as a whole. In connection with political events and the current crisis situation in the country, banks are undergoing major changes in their livelihoods. At the end of 2015, the net profit of domestic banks declined 3 times. For January 1 2017, some of banks of Azerbaijan, namely 46% were profitable, and others (or 54%) - unprofitable . In general, the banking sector saw improvement in the profitability of 14 banks and a decline in 16 banks. Although some banks have been in loss by the beginning of 2016, they have been profitable at the end of 2017. Those years beginning from 2015 a record number of licenses for conducting banking operations was revoked. The main problems of the banking sector in the area of license revocation are not the crisis, but "skeletons in the closet". In most cases, the problems of banks began long before the current crisis, and the fluctuations in the manat exchange rate, the growth in arrears and other negative manifestations of the past year only increased the problems of the past. The Central Bank of Azerbaijan began to revoke licenses of banks that could previously be classified as "untouchables". For example, in 2015-2017 some banks with large balances of funds of state organizations were deprived of licenses, although before that their financial resources in deposit accounts acted as a certain insurance against the sanctions of the Central Bank of Azerbaijan. On an economic scale, this event is not so important, but for the banking sector it is a landmark. Thus, the Central Bank of Azerbaijan shows a really high degree of

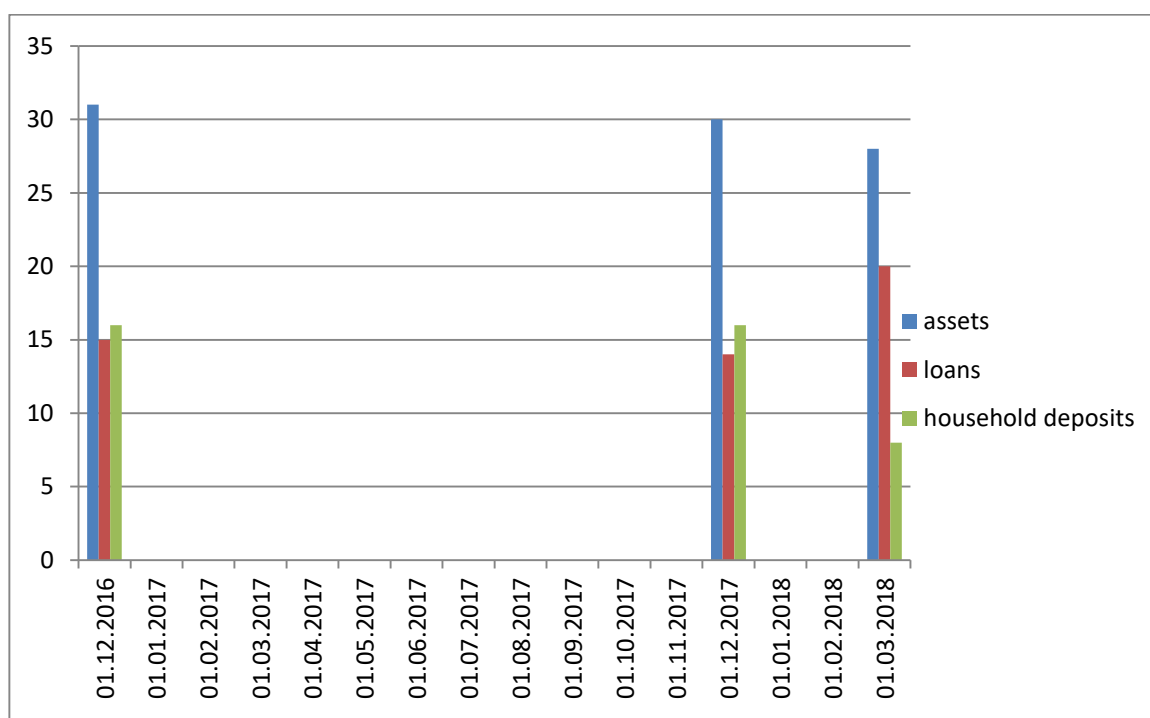
independence and recalls banking licenses without looking at the financial losses of other state institutions or state companies. In addition, given the fact of revocation of licenses from very large banks, we can say that there are practically no "untouchable" banks in Azerbaijan.

Figure 1. shows the dynamics of the main indicators of the banking sector of Azerbaijan - the assets of commercial banks, loans issued, household deposits. The main performance indicators of banks for the period from 31.12.2016 to 31.03.2018 mainly decreased : assets - by 10%; deposits - by 50%. Positive dynamics was demonstrated by loans to individuals: an increase of 33%.

*Figure 1.*

**Dynamics of the main indicators of the banking sector of Azerbaijan**

**Volumes of key indicators, bln. Manat**



Source: <https://www.fimsa.az/assets/upload/files/Bank%20icmali>, *Financial Markets Control Chamber of Azerbaijan*.

Over the past few years, the policy of the Central Bank of Azerbaijan has traced a trend aimed at cleansing the banking system from troubled banks. Table 1 shows the quantitative characteristics of the banking system of Azerbaijan for 30.12.2017.

*Table 1.*

**Quantitative characteristics of the banking system of Azerbaijan for  
December 2017**

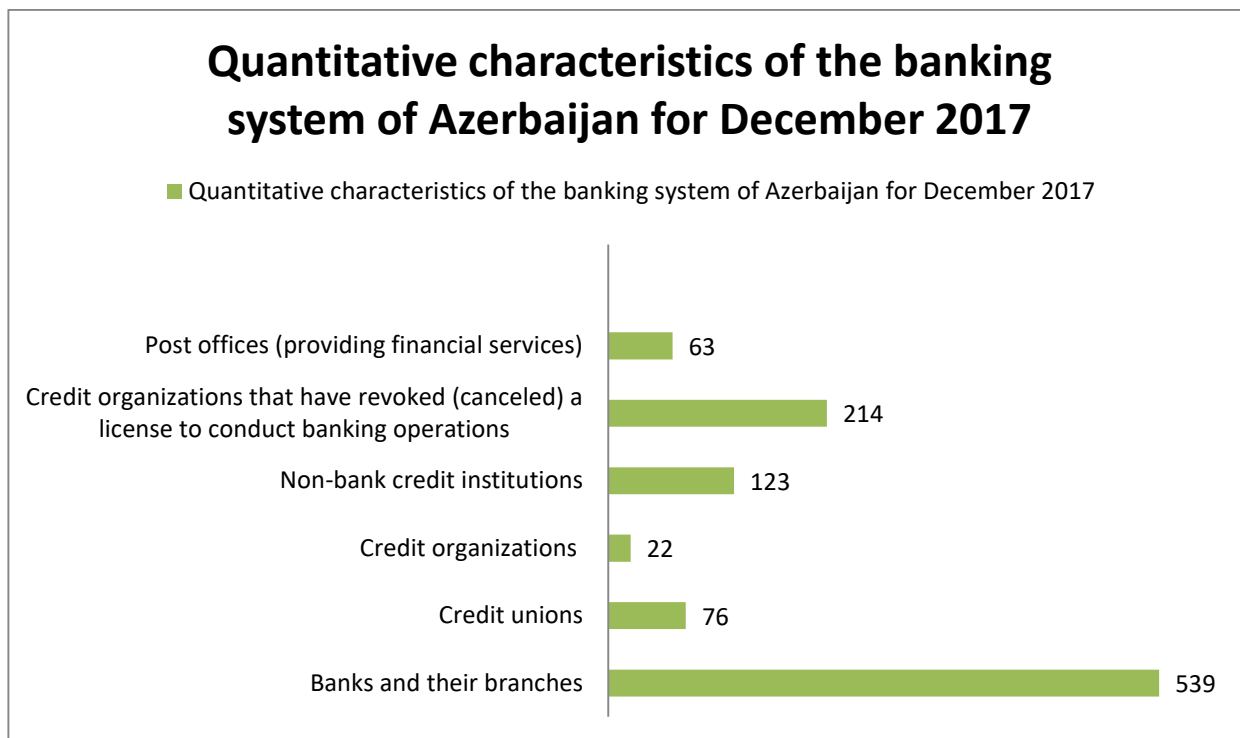
<b>Institution</b>	<b>30.12.2017</b>
Banks and their branches	539
Credit unions	76
Credit organizations	22
Non-bank credit institutions	123
Credit organizations that have revoked (canceled) a license to conduct banking operations	214
Post offices (providing financial services)	63

*Source: <https://www.fimsa.az/> , <http://esasodi.cbar.az:9704/obiee> *Financial Markets Control Chamber of Azerbaijan, CBAR.**

The crisis significantly shook the financial condition of banks. Therefore, the regulator, in order to stabilize the banking system, is forced to cancel licenses from organizations that have unsustainable financial condition and do not meet the liquidity standards of the Bank of Azerbaijan.

*Figure 2.*

**Dynamics of credit institutions that have a license revoked**



*Source: Table 1*

As a result, the list of participants in the banking market is steadily declining. Therefore, the question arises as this policy of the Central Bank of Azerbaijan influences the banking competition. Competitive analysis of the banking market as a procedure for its assignment to one of the competitive types is a multifaceted task. The special status of the banking market, which is an important part of the financial system, requires the use of the most capacious and accurate indicators on the basis of which market participants and supervisors can make decisions. To measure market concentration, many indicators are used, but within the framework of this article, we consider it expedient to use the concentration index as the main analysis tool.

With the help of this indicator, it is planned to carry out a retrospective analysis of the banking competition in Azerbaijan and assess how the current practice

Azerbaijani banks affects the sectoral competition. The coefficient of market concentration is determined by the formula:

$$CR_n = \sum_{i=1}^n S_i$$

where n is the number of participants in the market, Si is the market share of the i-th participant. In the framework of this study, the concentration ratio will be calculated for 5 banks (top 5 banks for a given period). IBAR, one of the country's main banks, did not participate in this analysis because it did not disclose its financial performance.

**Table 2.**

**Classification of the type of market by the level of competition, depending on the value of the concentration factor**

Type of market	CR-5 (%)
Highly concentrated	$70 \leq CR-5 \leq 100$
Medium Concentration	$40 \leq CR-5 \leq 70$
Low concentration	$0 \leq CR-5 \leq 40$

*Source: data from the website: [investopedia.com](http://investopedia.com)*

Table 2 presents the calculation of concentration indices for the banking sector for the period 2015-2017.

*Table 3.*

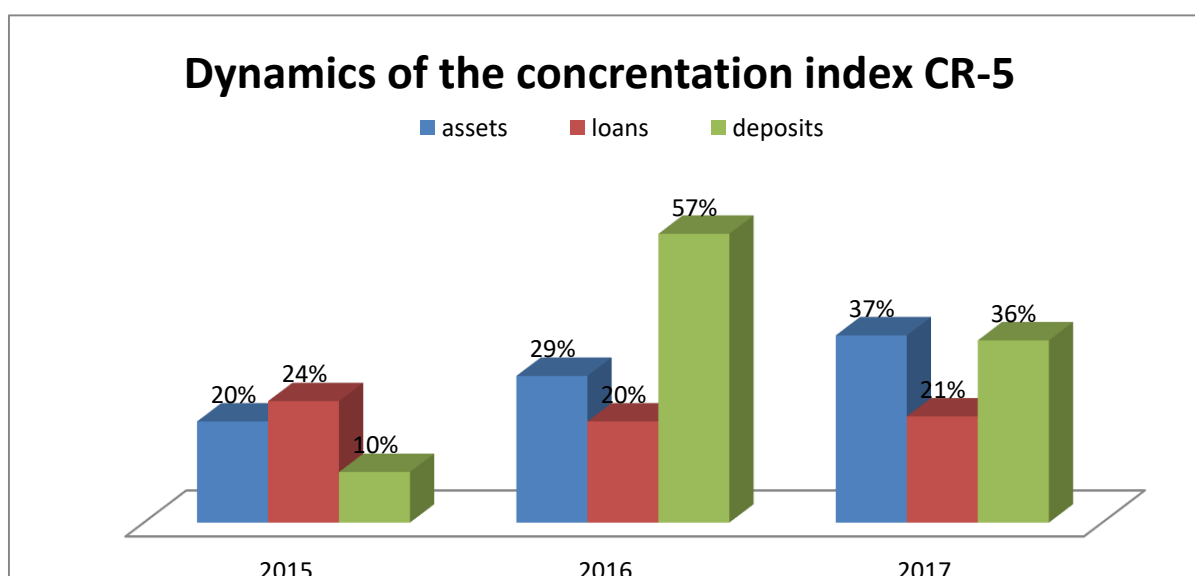
**Calculation of the concentration index CR-5**

Date	Assets, bln manat			Loans, bln manat			Deposits, bln manat		
	Five banks	Total	CR-5	Five banks	Total	CR-5	Five banks	Total	CR-5
31.12.15	5.7	29	20%	4.1	17	24%	1.6	7	10%
31.12.16	9	31.4	29%	4.8	24	20%	4.2	7.4	57%
31.06.17	10.1	27	37%	4.1	19.5	21%	7.1	19.5	36%

Source: the websites of relevant banks, <https://www.cbar.az/pages/financial-stability/banking-indicators/>

Let's illustrate the dynamics of the state of banking competition in Azerbaijan with the help of Figure 3.

**Figure 3.**



**Source: Table 3.**

Thus, the Azerbaijani banking market can be attributed to the low concentrated markets. But if to take to the consideration that, one of the strongest banks of Azerbaijan CBAR did not participate in this ranking , with its figures market might be more concentrated. For the period 2015-2017 there is a slight increase in competition in the banking sector of Azerbaijan. So on 31.12.2015 compared with 31/12/2016 and 31/06/2017, the share of the 5 largest banks in the assets of the banking system increased by 46%. Loans to individuals decreased by 12.5%, in deposits - by 22.5%. For 31.06.2017, the share of the five largest banks in Azerbaijan in the assets of the banking system was 37%, in loans granted to individuals - 21%, in population deposits - 36%. According to the conducted studies, it is possible to say that sharp decline in the volume of loans and deposits in 2015-2017 can be attributed to the devaluation facing our country. Thus, the weakening of national currency against the dollar seriously prevented the population from borrowing from banks and depositing their money into banks.

## **2.2. Data analysis**

Despite the improvement of the situation and the successes achieved in the banking sector, its condition cannot be overestimated. There are still many problem points. The conducted SWOT-analysis - analysis of strengths and weaknesses of commercial banks, as well as an assessment of the possibilities for further development of their business and threats, which bear potential risks for it - gave the following results.

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

<b>STRENGTHS</b>	<b>WEAK SIDES</b>
a wide range of banking products and	lack of a well-defined development strategy;



services;	
developed network of correspondent relations;	low level of financial intermediation in the economy of the republic;
improving the quality of assets amid a favorable credit environment;	high interest rates on loans;
possibility of financing large projects;	concentration of activities in limited segments of the market, insufficient diversification of the loan portfolio;
use of modern information technologies	low level of capitalization and, accordingly, limited opportunities to cover banking risks, lack of sufficient
adoption of financial reporting standards generally consistent with their international counterpart;	effective system of their assessment and hedging;
current deposit insurance system;	resources and payment system;
low share of problem loans in the total loan portfolio;	shortcomings in corporate governance, internal control and audit systems;
maintenance of card projects, availability of ATM network;	weak transparency in the structure of the share capital;
financial capital of major shareholders;	lack of transparency in the recruitment process, their lack of professionalism;
the growing competitiveness of small banks with their greater mobility and the gradual seizure of some markets, in particular in the retail business;	underestimation of active marketing policy;
the growth of the qualifications of bank employees, especially the middle and lower levels, clearly demonstrated competence;	flaws in domestic regulatory and legal regulation;
a weak dependence on the resources of the world financial market, a high degree of protection against crisis phenomena of an international character.	low investment activity of commercial banks;
	insufficiently developed branch network, unequal access to banking services in the center and regions.
<b>CAPABILITIES</b>	<b>THREATS</b>

political and macroeconomic stability, positive changes in the social and economic environment, contributing to raising the credit rating as a country in general, and its banking system;	political risk of Armenia resuming war against Azerbaijan;
intentions of the government on the accelerated development of the non-oil sector of the economy;	monopolistic tendencies in the economy and, accordingly, certain difficulties for entrepreneurship;
adoption of new and improvement of existing legislation, directly or indirectly related to the banking system;	the disproportionate development of the economic sectors and, in general, its dependence on the oil sector;
improvement of the investment climate	inflationary expectations, high level of dollarization;
expansion of access to long-term resources by attracting foreign investments and free funds of the population;	instability of the world market of hydrocarbon raw materials;
a significant increase in the customer base, further expansion of the range of products and services provided, a sharp increase in demand for certain types of products;	high fragmentation among commercial banks, significant concentration by industry and debtors;
an increase in the income level of the population, a reduction in inflation and a tax burden on economic entities;	dependence of a significant part of the population, especially in the regions of the country, on cash receipts from outside;
development of retail lending, including consumer and mortgage lending;	complexity of the return of overdue loans;
increase in the equity capital of banks;	lack of real alternatives to lending;
improving the quality of the loan portfolio;	limited long-term resource base;
the spread of electronic payments, Internet and mobile banking, the increase in the level of computerization of banking operations;	lack of quality borrowers, their concealment of information about the real financial condition;
increase of professional level of the personnel.	changing customer preferences;
	access to the market for new foreign banks, the absorption by them of domestic banks;
	introduction of restrictive measures;
	Growth of competition in the banking sector in connection with Azerbaijan's accession to

The presented assessment of the state of the domestic banking sector testifies that at present, along with a number of positive sides contributing to its further development, there are a number of factors that either already have an adverse impact, or in the long term may negatively affect the stability of the financial credit organizations. This is primarily high credit and currency risks, unsatisfactory quality of management and protection of creditors' rights, relatively low level of liquidity and capitalization of banks, confidence in them from the population, 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, slow integration 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 the incompleteness of the legislative and regulatory systems. However, in general, given 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 development of weak spots. (<http://www.maliyye.gov.az>).

When we look at the international ratings of our banks, the result is that more and more refuses from foreign rating agencies.

One reason for this is to reduce the costs, and the other reason is to avoid negative news on the rating every time the media is down.

It should be noted that the presence of international ratings is very important for banks to attract foreign investors.

If the rating of any European country is considered a criterion for the investor, the fact that the bank's international rating in Azerbaijan is the sole indicator, at least the bank is evaluated by any neutral, impartial authority. However, it is important that the rating is high or low.

In August of the 2017 year, Fitch Ratings affirmed Azerbaijan's long-term foreign and local currency Issuer Default Rating (IDR) at BB +, with negative outlook. The rating of unsecured bonds of the country in national and foreign currency was also confirmed at "BB +" level. Short-term foreign and local currency IDRs, including short-term bonds, were set at level "B".

As a rule, the sovereign rating of the country affects the entities located on the territory of that country and the rating of any organization does not exceed the sovereign rating of the country in which it is located.

Ratings of Unibank, AgBank and DemirBank will no longer be out of the agency's analysis.

Kapital Bank is only continuing its cooperation with S & P.

Moody's Investors Service raised its bank rating following an agreement with the International Bank's lenders:

- ✓ Long-term national and foreign currency deposit rating: Raised from Caa2 to Caa1.
- ✓ Credit Rating Assessment (BCA): "ca" to "caa3"
- ✓ Long-term counterparty risk assessment (CRA) rises from Caa1 to B3
- ✓ Long-term deposit ratings are positive and debt ratings have a stable outlook
- ✓ Short-term national and foreign currency deposit rating was confirmed at NP (Not Prime) level.
- ✓ Evaluation of short-term counterparty risk capability has been confirmed in NP.

**Table 4.**

**Fitch Ratings: the default rating of commercial banks in Azerbaijan**

International Bank	BB+	Stable	BB+	B	D/E	3	06/09/2017
KapitalBank	BB-	RW** Negative	BB- RW**	B	D/E	3/RW** Negative	08/06/2017
Pasha Bank	B+	Stable	No level of	B	D/E	5	31/08/2017
AccessBank	BB+	Negative	No level of	B	D/E	5	01/02/2017
UniBank	CCC	Stable	No level of support	C	D/E	5	14/06/2016 (Cooperation has been suspended)

\* IDR - issuer default rating.

\*\* RW - Rating Watch list.

**Source:** <https://www.moodys.com/credit-ratings/>

The ratings are placed on this list to notify investors about the existing sufficient probability of rating change, as well as the possible direction of such a change. A placement marked "Negative" means the possibility of a downgrade.

As evidenced by the above credit ratings, the leading position in the domestic banking system belongs to the International Bank of Azerbaijan, which continues to collect year after year in its image assets such recognized trump cards as the leading

analytical structures of the global banking industry ("Euromoney" , " The Banker " , " Global Finance "). Over the past three years, the IBA, which accounts for more than 47% of total banking assets and credit investments in the country's economy, not only raised its rating from the international rating agency Fitch IBCA (from BB- to BB +), but, as noted above, received the second rating from Moody's Investors Service. In the traditional rating of 1,000 largest banks of the CIS in the first half of 2017 - Interfax-1000: CIS Banks, the IBA took the 51st place (by assets) and 61st place (by equity), significantly outperforming the leading Georgian banks and Armenia. (Rustamov E.S. (2010)).

The complexity of the tasks facing the banking sector of the republic during the period of the transformation of the economy is also conditioned by a number of other circumstances. Among them, in my opinion, we should note the underdevelopment of the market principles of the socioeconomic environment of its functioning, the low potential of national banks, their real differences in key positions (including the scale of capital and assets, and also the competitive environment).

On the formation of problems of the development of the banking system of the republic, the shortcomings and omissions directly influenced the work of banks. Among them, the most significant role was played by: a relatively low quality of management, focused on solving current problems to the detriment of the promising areas of the bank's development; inefficiency of internal control, lack of systematic work to prevent problem situations in the development of banks; non-transparent ownership structure; low level of banking technology. Comparison of the domestic banking sector with emerging markets indicates that it is less developed than the real sector of the economy. The size of the capital of the country's commercial banks does not allow them to meet the demand for credit from domestic companies. The existing structure and the tendency of the formation of raised funds do not yet allow to consider them as sources of long-term and medium-term investments.

However, in the near future, the banking system of the AR will not only

overcome existing difficulties, but also adequately respond to new demands and challenges related to the globalization of the world economy, which is rightfully recognized as the most adequate characteristic of the current stage of world development.

### **2.3. Structure of the Azerbaijani banking system**

The banking system is an important element of the Azerbaijani financial system. Today, banks overwhelmingly increase their assets and capital and other financial intermediaries for their regional coverage.

The activity of the banking system of the Republic of Azerbaijan is regulated by the Law "On Banks".

According to the legislation, the banking system of the country is a two-tier one - it consists of the Central Bank of Azerbaijan Republic and credit organizations.

The central bank, which is the main step, is the central bank of the state, and its activity is regulated by the Constitution of the Republic of Azerbaijan, the Law on the Central Bank of the Republic of Azerbaijan, the Civil Code and other regulatory acts. According to the legislation, the Central Bank licenses and regulates banking activities, in the manner specified by legislation, supervises banking activities.

The organizational structure of the Central Bank includes the Management Board, central office, territorial offices. The central office of the Central Bank consists of the internal audit division, as well as other structural units determined by the Management Board.

Central Bank is managed by Management Board. The Board of Directors of the Central Bank consists of seven members. The Management Board consists of four members and two external members, who are permanent members of the Central Bank.

The second stage of the banking system is made up of credit institutions. The activity of credit organizations is regulated by the Constitution of the Republic of Azerbaijan, the Law on Banks, the Civil Code, the Laws "On the Central Bank of the Republic of Azerbaijan", "On Credit Institutions that are not Banks" and "On Credit Unions" and other regulatory legal acts. (<http://www.cbar.az>)

Functions of a commercial bank are to attract funds in exchange for deposit interest rates and to place them on the credit market in exchange for lump-sum rates. But at the same time, there are other multilateral functions of the Commercial Bank (CBA).

Most of the success of the commercial bank depends on the design of its structure.

The following structure is typical for commercial banks of our country:

- ✓ Administrative-administrative bodies;
- ✓ Bank's functional services;
- ✓ deposits section;
- ✓ credit line;
- ✓ internal banking services;
- ✓ Information section.

Thus, the bilateral banking system based on market principles has been formulated.

1st stage - AR Central Bank (at that time it was called the National Bank)

2nd level - Commercial banks and other non-bank credit organizations.

Today, Central Banks plays one of the most important components of the financial system of any developed state, which acts as a direct intermediary in the official monetary policy of the country. Monetary policy can, of course, be the basis for the state regulation of the national economy as a whole, along with the budgetary



policy. That is why the effective aspects of the Central Bank's activity are a very important condition for the effective organization of the market economy as a whole.

Over the past year, the revocation of licenses, and, accordingly, the clearing of the banking sector, has significantly accelerated. From the high stands, earlier predictions were made about halving the number of banks, but until recently it sounded like a radical fantastic scenario.

The determination of the Central Bank of Azerbaijan, and then its follower - the Chamber for Supervision of Financial Markets, on the issue of license revocation allows us to say that the "fantastic" scenario of reducing the number of working banks takes on real shape. And in 2018, the IMF expects the regulator to continue the policy in the field of "clearing" the banking system.

In most cases, the problems of banks began long before the current world crisis, and fluctuations in the exchange rate of manat, the growth of delinquency and other negative manifestations only increased the problems of the past. In this sense, the "cleaning" of the banking system is indeed overdue, as the observed toxicity could have a tendency to grow.

Despite this, activity among private banks in the market of mergers and acquisitions has not been observed. Although AGBank's attempts, which first announced plans to merge with DemirBank, and then Bank Standard, were unsuccessful. In addition, the Caucasian Development Bank and Atrabank, after revoking their licenses, decided to merge their healthy assets, but this transaction also did not take place due to the fact that the legal proceedings were not completed in favor of these banks. The fact is that to begin the process of unification, they had to restore the license for banking activities before, but the court never canceled the decision of the Central Bank about their withdrawal from the market.

With regard to the revocation of banking licenses, the year 2016 was largely a record. Licenses lost 11 banks. Such a scale of license revocation in Azerbaijan for the period of formation of a modern banking system has never been. And banks are

closed at different levels.

Undoubtedly, the banking sector of Azerbaijan is in crisis - the profit has noticeably dropped, the delay is growing, and the dynamics of the main indicators are rather weak, and it is difficult to say when the situation will improve.

According to the world practice, experts consider it expedient to release banks' balances from toxic assets through the creation of a separate structure in Azerbaijan that could buy them back.

In particular, such an organization could help reduce the volume of problem assets in the banking sector of the country and optimize the management of such resources.

Such a structure can act both in the format of the Bank of Bad Assets and in another form. The non-bank credit organization "Agrarkredit" has a fairly good experience in managing problem assets. At different times, it was transferred to the "toxic" assets of banks and the last such case is connected with the International Bank of Azerbaijan (IBA). In this context, it is permissible to develop existing experience, as well as introduce a new format. These measures can be implemented within the framework of the financial rehabilitation program.

It should be noted that Agrarkredit has been operating since 2001, and at the same time it was for the first time in charge of managing bad assets. Subsequently, in 2015, as part of the IBA's recovery and preparation for privatization, the troubled assets of the bank were also transferred to the management of Agrarkredit. (Economic and Social Development Center, 2016)

Nevertheless, the government does not see the need to turn Agrarkredit into a debt management agency or troubled assets. Earlier, Finance Minister Samir Sharifov said that if a structure is created in Azerbaijan that manages problem assets, it will not be established on the basis of "Agrarkredit".

A similar structure can be created under the Azerbaijan Deposit Insurance

Fund (ADIF), a similar practice is applied in many countries of the world. Moreover, ADIF has sufficient experience managing problematic assets.

According to ADIF executive director Azad Javadov, the fund has a separate unit that deals with bad assets of banks, where he acts as a liquidator. In addition, the Deposit Insurance Fund acts as a liquidator in many countries of the world, but there is already such practice in Azerbaijan. When ADIF takes over the funds of a closed bank, along with good assets, bad ones are transferred to it. And to work with them in the fund operates a separate unit.

The Fund acted as the liquidator of nine banks (Texnikabank, Bank of Azerbaijan, Dekabank, Parabank, Kredobank, Zaminbank, Atrabank, Caucasian Development Bank, Bank Standard), whose licenses were withdrawn from the beginning of 2016.

Recently at his disposal was also transferred to Royalbank, whose license was withdrawn by the Central Bank in July 2012, in order to ensure the bank's repayment of loans. The role of the liquidator of one of the largest private commercial banks of the country - Bank Standard, is also entrusted to the fund.

Banks are not in a position to independently generate enough capital to absorb losses from impairment of assets. In some form they will need support from their shareholders or from the state.

One of the options for solving the problem experts believe is the repayment of troubled assets by the Bank of bad assets. Nevertheless, another solution may be the usual capitalization. A bank of bad assets is simply a support mechanism, it can also be provided by simply injecting new capital into the system.

In 2017, banks reduced the issuance of loans by 22.8%. However, after a prolonged decline in June, compared to May, lending slightly increased by 1.3% to 18.4 bln AZN., but in the following months the decline continued even more rapidly, as a result of which the portfolio shrank to 16.78 bln. AZN. (Central Bank of the Republic of Azerbaijan, 2018)

According to the report of the Central Bank, the June growth was provided mainly due to an increase in the issuance of loans in foreign currency - by 4.02%. As for manat loans, in spite of insignificant growth of short-term loans (by 0.8%), in general, due to the reduction in the volume of long-term loans, the issuance of loans in national currency decreased in June by 1.1% compared to May. This can be explained by the fact that in the current situation banks have become more cautious about issuing long-term loans. At the same time, due to the high level of dollarization of deposits, which are one of the main sources for granting loans, banks as a whole reduced the issuance of loans in manats.

The structure of bank deposits shows that both in the capital and in the regions of the country there is a similar situation: the population prefers dollar savings. This is one of the reasons for the increase in demand for foreign currency.

Despite this, banks restrict currency exchange operations, which is explained by the insufficient volume of their dollars. Weekly, the Central Bank in conjunction with the SOFAZ hold currency auctions, but currency purchased by banks mainly directed to service its own foreign obligations and liabilities to depositors, considering that over 80% of liabilities are concentrated in foreign currency.

## **SECTION 3. ASSESSMENT OF FINANCIAL STABILITY IN THE BANKING SYSTEM**

### **3.1. The trade-off between competition and stability in banking system**

The banking system of Azerbaijan has already gone through a rather complicated path since its formation and achieved significant positive results in its development. However, in the face of the growing challenges of globalization and the growing competition in the domestic banking sector, the key task is to ensure its maximum effective functioning. At the same time, the determining factor is the increase in the competitiveness of the country's banking institutions, whose low level, in my opinion, can lead to an actual loss of the banking system. And this, in turn, means the loss of levers of influence on the financial system of the state, without which the regulation of the economy becomes impossible.

Competitiveness of a commercial bank is an opportunity to carry out effective economic activity and achieve a profitable sale of banking products in a competitive market. The existence of a number of objective factors determined that it is difficult for Azerbaijani banks to achieve competitiveness, at least in the domestic market of banking services, not to mention competition with powerful foreign banks. One of the objective and determining reasons for this is the relatively short history of the functioning of commercial banks in Azerbaijan. The weakness of the country's banking system and, consequently, its low competitiveness in comparison with foreign financial and credit institutions is primarily due to the following factors: insufficient levels of capitalization, financial management and corporate governance in Azerbaijani commercial banks, lack of effective mechanisms and management tools risks, planning and development strategies, imperfect structure of the resource base with the predominance of expensive raised funds, low profitability on assets, weak efficiency of supervision and transparency of financial institutions. In addition, the range and volumes of credit services remain very limited, and the needs of the economy for credit support are unsatisfied.

If the 2016th year was a real test for banks, then 2017 became for them a year of reforms, adaptation to new economic realities and preparations for the resumption of growth.

The past few years in general have been very saturated for banking events. The past year was not an exception - the institution of the bank ombudsman, the Financial Literacy Council, established the Azerbaijan Credit Bureau. Not without revocation of licenses, though not in the same amount as in 2016.

In general, after a difficult 2015-2016 period, the banking sector began to recover gradually, it became clear more clearly by the end of 2017. First, the sector has restored its profitability - at the beginning of November 2017 net profit of banks amounted to 549.6 million manats against the loss of 1.7 billion manats in 2016. The number of bank employees also resumed. (Central Bank of the Republic of Azerbaijan, 2016)

One of the main problems of the banking sector is the continuing growth in overdue loans. Certain measures taken by banks gave only a point result. It was clear that a more comprehensive approach was needed. Such, as expected, will become the so-called "Baku approach." Created by analogy with the Istanbul and London approaches, it is called upon to unite the banks in the fight against the growth of credit delinquencies. The general principles of these approaches are that banks restructure problem loans and facilitate loan terms for debtors who are in a particularly difficult situation.

In Azerbaijan, the growth of problem loans, both for individuals and legal entities, has been observed since February 2015, when the first devaluation of the national currency occurred. At the end of October 2017, 15.55 percent of all loans issued in the country were overdue. This is almost 1.9 billion manat (an increase of 37.4 percent per year) from 12.15 billion manat (data of the Central Bank). (Ministry of Finance of the Republic of Azerbaijan, 2018)

The development of the "Baku approach" continues. But the fact that the government creates comprehensive measures to combat the growth of problem loans, gives a chance to improve the condition of banks and their customers in 2018-2019.

Since September 2017, the institution of the bank ombudsman has appeared in Azerbaijan. During this period, Ombudsman Ikram Karimov examined over 160 cases, some of which were settled in favor of bank customers. The appearance of the ombudsman is one of the landmark moments of 2017. Of course, it will be possible to speak about the effectiveness of this institute only on the basis, at least, of the first half of 2018. But a certain positive effect is already visible.

So far, the Ombudsman is considering appeals for disputes amounting to no more than two thousand dollars. At the same time, citizens who have disagreements with banks for up to two thousand manats, there are more than 100 thousand people.

All last year, both the Ministry of Taxes and the Chamber of Supervision of Financial Markets, and the banks themselves implemented various measures to stimulate non-cash settlements.

Since 2017, entrepreneurs have been restricted with cash. So, up to 30 thousand manat per month are limited to the operations of entrepreneurs operating in the areas of trade and public catering, which for 12 months had a monthly turnover of more than 200,000 manat. For other taxpayers, the limit is 15,000 manat per month.

At the same time, since last year, non-cash form has been transferred to lending, payment of administrative fines, financial sanctions, taxes, customs duties, insurance payments, loan issuance and payment of debts on leasing transactions, pension payments and others.

Thus businessmen for cashing of means should pay the tax from a source in the simplified order at a rate of one percent from the sum which they cash.

All these measures led to an increase in funds in bank accounts, primarily of entrepreneurs, and banks received additional funds for the issuance of loans.

Continuing long years of talk about the need to unite the banks, in 2017, finally, gave the result.

Although the number of merged banks could be more, given the active negotiations that took place between them last year, but in practice, it did not go further than talking.

Nevertheless, last year, there was only one merger - in the first half of the year, the merger of AtaBank and Caspian Development Bank was completed. As a result, the latter was liquidated and its assets transferred to AtaBank. This enabled AtaBank to significantly increase its financial performance.

One of the participants in the sector, which could also join with another bank, was DemirBank. These plans were not realized, because in December the Chamber of Financial Market Supervision revoked the license of the bank. As a result, after one consolidation and revocation of one license, there were 30 participants in the banking sector, and not so long ago there were 45 of them.

In March 2017, non-bank credit organization PARA appeared in Azerbaijan (instead of PARA bank). In appearance, the unremarkable news is in fact an important event of the past year - this is the first in the history of the Azerbaijani banking sector to turn the bank into a NBCO. Para Bank lost its license in 2016. However, unlike other banks, it decided to continue its activities. The charter capital of the Credit Organization will be PARA bank's authorized capital. Instead, the bank asked the regulator for a license to the NBCO. In Azerbaijan, this is the first such case, but perhaps not the last. (<http://www.maliyye.gov.az/node/1949>)

Since 2015, the International Bank of Azerbaijan is in the process of recovery. Last year, the country's largest bank completed a successful restructuring of foreign liabilities worth three billion dollars.

For the bank, last year became a preparatory stage before being put up for privatization. It is expected that this year the IBA, the majority of shares owned by the government represented by the Ministry of Finance, will be sold. Who will



become the buyer of the bank is, of course, unknown, but the European Bank for Reconstruction and Development (EBRD) has already shown interest in it. Earlier, EBRD President Suma Chakrabarty stated that his financial organization is ready to take part in privatization only in case of reforming the corporate governance system. In Azerbaijan, the EBRD is not a new player in the banking market, it already owns shares of a number of local banks. He also owned part of the shares of DemirBank, which closed late last year.

The banking sector of Azerbaijan still has problems - banks have to take measures to resume growth in lending, attracting savings to the deposit. Of course, great work is waiting for banks and the regulator in terms of restoring public confidence in banks. Over the past few years, much has been done to improve the situation in the sector: new laws have been adopted, old ones have been modernized and supplemented. Much has been done, but more needs to be done. However, the initiatives and measures implemented over the past year give hope that in 2018, the banking sector and the economy as a whole will begin the stage of reconstruction and development.

According to the Central Bank of Azerbaijan, in the republic as of early 2017, 165 financial organizations have a license of the CBA for conducting banking operations, and the number of banks is 30 (Table 5).

**Table 5.**

**Indicators of the development of the banking sector of Azerbaijan in 2015-2017, as of the beginning of the period**

<b>Indicators</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Number of financial institutions licensed to conduct banking operations	176	167	165
Number of banks - total:	43	32	30
Including: public	2	2	2

of private	41	30	28
Number of banks with foreign capital:	22	20	16
including those with an authorized capital of 50% to 100%	7	7	7

**Source:**

[https://www.fimsa.az/assets/upload/files/Bank%20icmal%C4%B1\\_30%20sentyabr%202017.pdf](https://www.fimsa.az/assets/upload/files/Bank%20icmal%C4%B1_30%20sentyabr%202017.pdf)

The data in Table 5 indicate a slight change in the number of banks operating in Azerbaijan over the past nine years. So, if in early 2015 their total number was 43, then at the beginning of 2017 - 30. A negative trend is an decrease in the number of financial institutions that have a CBA license to conduct banking operations: from 176 in 2015 to 165 in 2017. The number of banks with foreign capital was 22 as it was in 2015.

In practice, a significant number of banks within the banking system does not mean that this system is effective, financially strong, reliable, and, accordingly, competitive. After all, not the number of banks, but such characteristics as the solvency of banks, their ability to use their capital, and quality management determine the effective functioning of the banking system. Thus, in modern conditions, it is the qualitative aspects of the activity of banking institutions, in contrast to quantitative ones, that become the main criteria for assessing their competitiveness. One of the most important indicators characterizing the level of development of any banking system is the volume of capital and its quality, i.e. capitalization of the banking sector.

The capital of commercial banks is the basis of their functioning and development of the entire banking system. The total capital of the banking system is defined as the amount of money and is expressed in monetary form: part of the property at the disposal of all commercial banks that make up the system. The formation of the resource base of commercial banks is one of the main prerequisites

for the stable functioning of the banking system of any country. The inadequacy of the capital of the domestic banking system is one of the main factors that constrains the development of the financial and credit sector in the process of fulfilling the function of financial intermediation in the conditions of global financial globalization. This is a serious obstacle to the development of banks, minimizing their chances for attracting investments, participating in financing of large economic projects and long-term needs of their clients.

At the same time, capitalization of the banking system is under strong pressure due to the rapid growth of balances, and banks need support in the form of regular contributions to capital.

An important point, in my opinion, is not only the level of capitalization of the banking system, but also the quality of capital of domestic banks. After all, the capitalization of many domestic banks consists of means of revaluation of fixed assets, unpaid interest, subordinated debt. The growth of such components is considered an artificial increase in capital. The solution of this problem, may be possible not only due to the profits of banks and additional contributions from shareholders, but on the condition of public confidence in domestic banks as reliable monetary institutions. In addition, the functioning of a large number of banking institutions with a small amount of capital in the banking system can cause problems with supporting the liquidity and stability of the financial sector of the country, since bankruptcies even of individual banks can undermine confidence in the credit system as a whole. Thus, for the effective development of the banking system, it is necessary to consolidate it around financially strong and efficient banks. This will contribute to the concentration and increase of the aggregate capital of the banking system of Azerbaijan.

The main ways to increase the capitalization of Azerbaijani banking institutions, as it seems to us, are: an increase in capital through the placement of

shares of its own issue, an increase in capital due to profits, as well as consolidation of the country's banking system.

The stability of the banking system can be defined as its ability to overcome crisis phenomena at the expense of internal forces and continue to function, avoiding the massive bankruptcy of financial institutions, in order to fulfill its functions of redistributing resources in the economy in the amount not less than before the impact of these factors. It is clear that the stability of the entire banking system is impossible without its achievement in individual banking institutions. The stability of a commercial bank is seen as its ability to function, to realize its goals and objectives even under the conditions of destabilizing factors. Thus, to ensure the stability of the domestic banking system, it is necessary to ensure the reliability and sustainability of commercial banks.

Among the factors affecting the stability of the banking system of Azerbaijan and making it vulnerable to risks, we can distinguish the following: the state of regulatory and legal support for banking activities, the degree of asymmetry in the system, and the profitability of banks and the level of capitalization of the banking system and the stability of general macroeconomic conditions in the country. The stability of the domestic banking system can also be adversely affected by the entry of weak and unreliable foreign banks, the spread of crisis phenomena from countries with banking institutions whose domestic financial institutions and companies have economic ties, and the weakening of the possibility of state regulation of the functioning of the banking system, the functioning of problem banks, presence of problem assets in total banking assets. Thus, the functioning of troubled banks within the banking system of Azerbaijan can lead to such consequences as a decrease in confidence in the domestic banking system and the national monetary unit and, as a result, an increase in the level of dollarization and cash foreign exchange savings. As is known, the main prerequisites for the existence of these problems are the low level of bank management and the low efficiency of the banking supervision system, a high concentration of the loan portfolio and poor monitoring of the state of the

portfolio of assets. Among the most important measures aimed at preventing this problem, in my opinion, can be called the increase in the effectiveness of supervision within individual banks (first of all, the early response units), as well as the strengthening of supervision by the CBA in the areas of reporting, disclosure, affiliated persons, the quality of assets and equity capital at the level of the entire banking system.

The reliability of the banking system is closely linked to its stability. Reliability, expresses the qualitative state of the banking system in its acceptance by society. A reliable banking system evokes public confidence, ensures the interests of clients and investors, is guided by the principles of partnership, mutually beneficial relations, pursues a policy for the development of the whole society. With dynamic changes in modern socio-economic systems, it is the stability and reliability of the banking system that can ensure the financial security of the state. (www.worldbank.org)

The leading role in ensuring the reliability of the banking system belongs to the central bank of the country. After the appearance of banking, the instability caused by the bankruptcies of individual banks, the massive withdrawal of deposits, various types of banking risks objectively pushed the state to introduce and expand the practice of regulating the activities of commercial banks. With the help of regulation, the state is trying to protect depositors from financial losses and avoid destructive for the economy consequences of bank failures. The most important directions by which the government tries to ensure the reliability and stability of the banking system include: conducting bank audits, centralized banking operations and creating a deposit insurance system. It should be noted that the creation of a special fund that guarantees deposits is one of the most important factors for ensuring the reliability of the banking system and increasing the confidence of depositors in it.

It was revealed that in almost all countries there is one or another form of deposit insurance, through which depositors are guaranteed return of their invested

funds. Deposit insurance is a set of measures aimed at protecting deposits and ensuring their guaranteed return in full or in part in case of bankruptcy of a banking institution. This system increases the effectiveness of control over the activities of banking institutions, protects depositors from possible losses, and, consequently, ensures the population's confidence in the domestic banking system. So, in the USA, the Federal Deposit Insurance Corporation enjoys unquestioned authority among the population. Investors are convinced that the corporation keeps under control the state of affairs in each and every financial and credit institution and, if necessary, applies appropriate measures. In Azerbaijan, an important role in ensuring the reliability of the banking system is played by the Deposit Insurance Fund, which was created under the Presidential Decree of February 9, 2007 "On Approval and Enactment of the Law on Deposit Insurance" adopted by the Parliament of the country.(Rustamov E.S.,2010)

Increase of population confidence in banking institutions was facilitated by an increase in the amount of guaranteed amount of reimbursement of funds from individuals' deposits from 8,000 manats to 30,000 manats. Since the creation of the Deposit Insurance Fund, the amount of compensation to individuals has been increased by 7.5 times. Particularly dynamic growth began in 2006, which was largely due to the growth of household incomes and, accordingly, the government's desire to stimulate the investment of free funds of citizens to deposit accounts in commercial banks. However, despite such significant changes in the amount of the maximum compensation amount, in my opinion, the deposit guarantee system requires further improvement. In particular, it is necessary to create a system of reimbursement of deposits of legal entities, which would facilitate the inflow of new capital and expand the opportunities for the formation of an appropriate resource base for commercial banks. The banking system plays a crucial role in the economic system of any country. Today in Azerbaijan the greatest development has been achieved by banking institutions, whose role in the domestic financial market is significant (Table 6). This is due to the fact that the reform of the banking system was

launched earlier than other sectors, in the future it determined the key role of banks in solving the problems of transition to a market economy. It is the banking institutions that play the main role today in the formation of an optimal environment for the mobilization and free flow of capital, the accumulation of funds for structural adjustment of the economy, privatization and development of entrepreneurship, ensuring effective demand and better meeting the needs of the population.

**Table 6.**

**Assets of financial and credit institutions of Azerbaijan for 31.12.2017**

<b>Financial and credit institution</b>	<b>Total assets, million manat</b>	<b>Specific gravity, %</b>
Banking institutions	27921,0	74.5
Insurance companies	5102,0	13.6
Credit Unions	589,8	1.6
Credit organizations	3539,0	9.4
Other lending institutions	295,7	0.9
Total	37447,5	100

**Source:** <https://www.fimsa.az/az/statistics-statistics>

As can be seen from Table 6, a characteristic feature of the current stage of development of the financial system in Azerbaijan is the dominance of its banking segment, which occupies nearly 75 % of the total assets of financial and credit institutions. One the main elements of the financial system is the banking system, the degree of development of which has a decisive influence not only on the financial sector but also on the entire economy of the country.

Thus, in the current conditions of the development of the market mechanism of economic management in Azerbaijan, the importance of a stable and efficient banking system is substantially growing, and it is becoming one of the most important components of the successful functioning of the entire economy of the state.

It is known that an increase in the volume of bank lending indicates an increase in the scope of financial intermediation, and this contributes to a more efficient allocation of resources and an increase in the rate of economic growth in the country. However, it is important not to forget that a significant expansion of lending creates significant risks to the stability of the banking system and the economic system as a whole. IMF experts came to the conclusion that in 70% of cases the credit boom is accompanied by a consumer or investment boom and, with a probability of 20%, ends with a banking or currency crisis.

Taking into account all of the above, we believe that the main prerequisites for the effective functioning of the banking system of Azerbaijan today are to strengthen and improve the resource base, maintain a balanced growth in the loan portfolio with the rate of capitalization, provide economic conditions for increasing the share of long-term investment lending in the banks' assets, reduce vulnerability banking system to external and internal factors of destabilization, ensuring its reliability, and increasing its role in the process of economic transformation. The above factors directly affect the competitiveness of the national banking system. Therefore, they should be taken into account when developing and implementing domestic monetary and financial policies in Azerbaijan with the aim of strengthening its competitive positions in the global economic space.

### **3.2. Evolution of the Azerbaijani Banking System**

The national banking system today is one of the most important and inalienable structures of Azerbaijan's market economy. National Bank and a number of credit



organizations instantly 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. 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 determines the legal status and order of interaction of the main links of the banking system and regulates the most stable types of ties between them.

In order to achieve defined targets, specific tasks have been identified such as improving the legislative framework of the banking activity and bringing it in line with international standards, expanding access to banking services, enhancing transparency in the banking system and strengthening market discipline, and effective banking supervision.

The main issue facing the Azerbaijani banks is to finance the modernization of the country's economy. For this purpose, banks should first of all be modernized, increase their assets, and improve corporate governance. Certain steps are taken by the regulatory body in this direction, and this process has been started before the economic crisis. Thus, the Central Bank of Azerbaijan (CBA) has decided to increase the total capital requirements of banks by 5 times, which should stimulate the creation of strong players in the market.

The main purpose of the strategy is to increase the profitability of the oil revenues to the non-oil sector, increase access to banking services for the population and the regions and, on this basis, improve the financial intermediation function of the banking system for poverty reduction, strengthening the sustainability and reliability of the banking system, free and healthy competition in the banking services market. environment. The financial and banking sector plays an exceptional role in building a diversified economy on the basis of the great economic power and

financial capacities of the country and focusing resources on the non-oil sector's capitalization.

Its good fact that, banks` services are rapidly developing. Customers are now offered the most up-to-date technological tools such as internet banking, mobile banking, automated bank booths.

At the moment, country try to build a new concept for the development and further modernization of the banking business.

The banking system's regional network and access to financial services are rapidly expanding, and banks are active in international financial markets.

The flow of foreign capital to Azerbaijan has several positive sides. This ensures the strengthening of the banking sector due to the arrival of strong players in line with international standards, the level of management in this area to a new level, and, ultimately, the access of Azerbaijani banks to foreign funding sources. The main advantage of working with foreign banks for the population is that these banks have more financial resources. Such banks are able to offer their relatively low interest rate loan products, since their financial resources are not derived from high interest rates through savings from the population. Thus, foreign banks become a serious rival for local banks, which is a boost to rapid growth and growth. (The official website of the Association of Insurers of Azerbaijan)

The operation of foreign banks is also important for the development of new products in the banking market. For example, asset management, placement of securities, or investment services have not been developed in Azerbaijan.

Total assets of 31 banks operating in Azerbaijan totaled 29,491.7 and total liabilities at 26,568.2 million manat as of 31 August 2017. The balance capital of the sector was 2,923.6 and the population's deposits were 6,871.7 million manat.

Total assets of banks in December 2017 constituted 27,921.0 mln manats. Liabilities totaled to 24,211.8 mln manats.

As it mentioned, in order to promote depositing in the banking sector and increase people`s reliance in the sector, the deposit insurance system was created in 2007, the sum of deposits protected by the Deposits Insurance Fund reached 30000 AZN.

To provide financial services to the population in the regions of the country Azerpocht LLC was reconstructed and licensed, which includes over 1200 regional mail branches and sections.

Number of banks in Azerbaijan to 30 November 2017 is 31 ( 2 of them State banks 29 of them are private).Number of banks with foreign capital are 16.

As its known our county faced devaluation of currency in recent years. 1st The official exchange rate of 1 US dollar at 21 February 2015 was set at 1.05 AZN (1<sup>st</sup> devaluation). The national currency has fallen by 30% against the US dollar. February 21, devaluation has been shocking for the Azerbaijanis who have been accustomed to the stable exchange rate of the national currency or minor changes in exchange rates since 1999.

High deposits in USD currency restricted domestic-currency lending, and banks were unwilling to lend in foreign currency owing to enduring concerns over further devaluation of the manat.

The pressure on the national currency "manat" has been exacerbated since the second half of 2014 due to fallings in oil prices in the world markets.

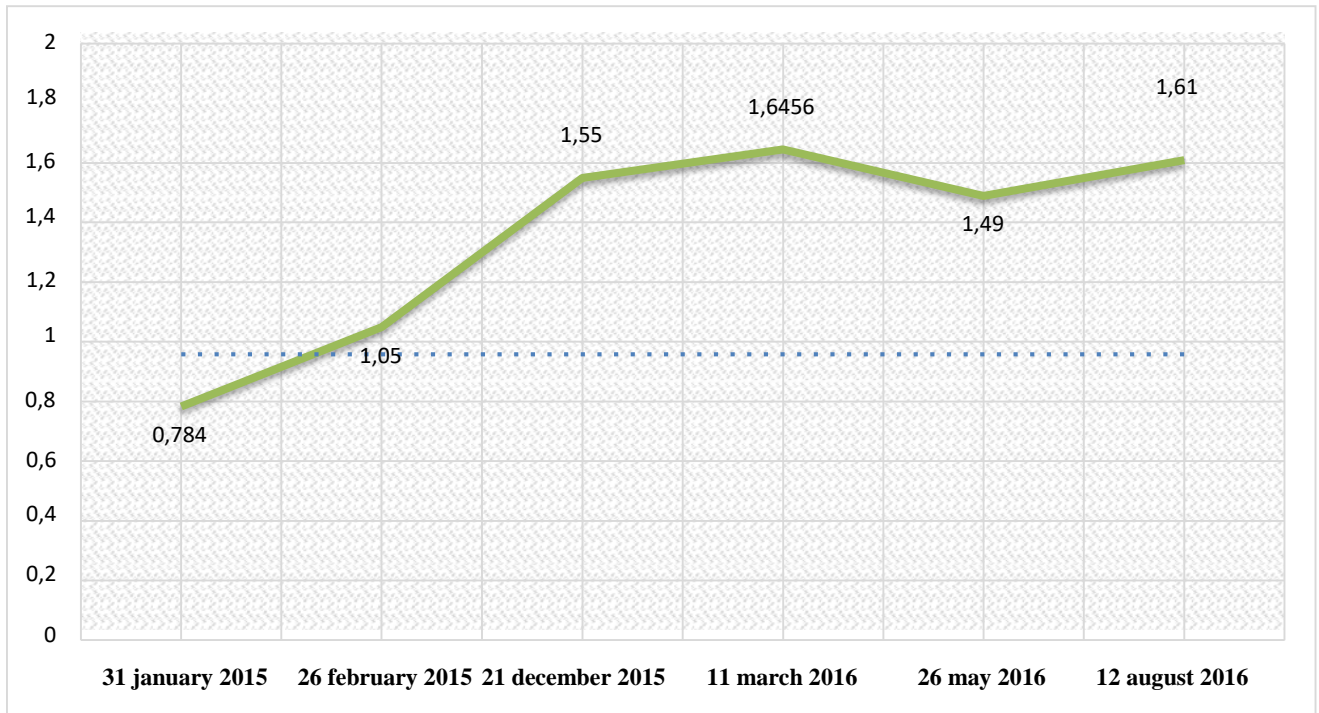
The Central Bank of Azerbaijan has switched to floating exchange rate. Thus, the official exchange rate of manat at present has increased by 47.63% or AZN 0.501 to AZN 1.5500.(December 2015).

After the introduction of the new regime Central Bank's currency market interventions have decreased considerably.

The Azerbaijani manat was devalued by 98% in the last 2 years.

In general, the world's leading currencies have fallen by at least 15% compared to the dollar.

**Diagram 1: USD/AZN**



**Source: Central Bank of the Republic of Azerbaijan, <https://www.cbar.az/other/azn-rates/>, 2016.**

Since the end of 2014, the government has been trying to streamline foreign exchange demand by minimizing the circulation of manat in order to minimize the pressure on the national currency.

Currently the Central Bank's currency sales implemented through auctions. There is no quantitative goals of Central Bank related to the exchange rate. The operations of the Central Bank are directed only to prevent a sharp hesitation on the exchange rate.

Interbank transactions average weighted rate is taken as the official exchange rate.

The transition of the Central Bank to the floating exchange rate (December 2015) regime has caused the population of the country to become mass market participants of the currency markets. As a result, a new trend has emerged in the currency markets. That is, citizens and business entities are trying to take a profit position from the exchange rate change. In other words, during the period when the national currency strengthened, the foreign exchange gains from these instruments are observed in the sale of the foreign currency and the purchases during the period of impairment. This leads to volatility in the currency markets and the limitation of the Central Bank's regulatory capabilities.

Most casualties hit the banking sector. Prior to the first devaluation, banks had foreign debt of \$ 6.5 billion. After the decline in the value of the manat, the external debt service of the banks doubled. That's why there are big problems in the banking sector. Banks also increased their debts to the population in the currency. As a result, the quality of assets deteriorated, the volume of problem loans increased.

The list of banks whose license has been revoked after devaluations is as follows.

“Azərbaycan Kredit Bankı” OJSC – 10 July 2015

"Bank of Azerbaijan" OJSC - 18 January 2016

"Qafqaz İnkişaf Bankı" OJSC 27 January 2016

"Atrabank" OJSC

“Texnikabank” OJSC - 1 February 2016

"Bank Standard" - 1 October 2016

“Dekabank” OJSC, 21 July 2016

“Kredobank” OJSC,

“Parabank” OJSC

“Zaminbank” OJSC

"DəmirBank" OJSC 23 december 2017

The deterioration of the financial base of Azerbaijani banks has a long lasting unfavorable operating environment and a negative impact on the depreciation of the manat, in particular, deterioration in the quality of assets, high credit costs and exchange rates. in the background of the net loss of the cause.

There is a tendency of return of deposits and deposits placed in foreign currency in commercial banks, which are currently subject to state supervision and control, which in turn affects the formation of additional demand in the foreign exchange markets.

### **3.3. Assessment of stability and competition**

With the stabilization of the situation in our economy for the last year, the demand for banking services began to grow. As a result, competition intensifies.

Based on a sample of the top ten (by assets) banks, their market shares were analyzed for following indicators: assets, loans to individuals and legal entities, deposits of individuals and legal entities. In addition, the market shares of three, five and ten leading Azerbaijan banks.

**Table 7.**

The following table shows the top ten banks' annual dynamics of assets (TOP-10):

<b>Banks</b>	<b>Assets (thousand man.)</b>	<b>Date</b>
IBAR	8 695 106	31.12.2017
Pasha Bank	3 551 787	31.12.2017
Kapital Bank	3 184 537	31.12.2017
Xalq Bank	1 813 647	31.12.2017

ASB bank	945 189	31.12.2017
Access Bank	844 821	31.12.2017
Bank Respublika	702 114	31.12.2017
Ata bank	625 861	31.12.2017
Unibank	601 841	31.12.2017
Rabita Bank	510 851	31.12.2017

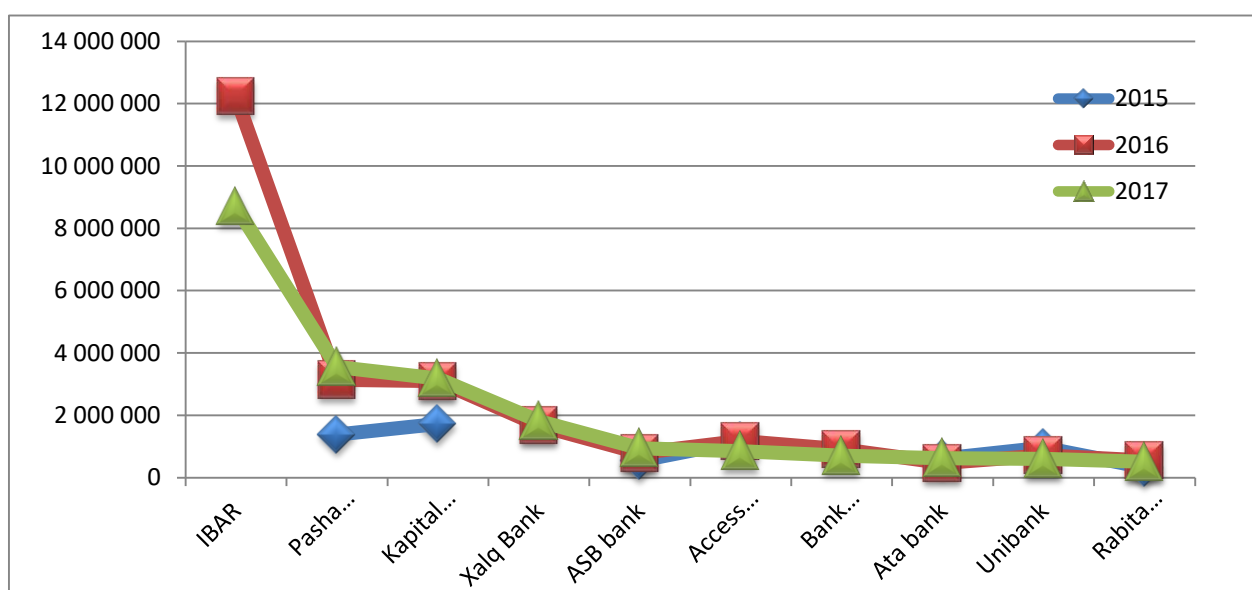
*Source: the websites of relevant banks.*

According to the total volume of assets, the first place was given to IBAR with 8.695 bln. Thus, the International Bank has begun to improve its financial situation after restructuring. In addition, the following four banks with the highest total assets are Pasha Bank (3.55 billion manat), Kapital Bank (3.19 billion manat), Xalq Bank (AZN 1.81 billion) and ASB Bank (945 million manats).

If to take into account that total assets of all banking institutions of Azerbaijan for 2017 constituted 27921.0 mln manats, the majority (55.2 %) of the shares fall to the top 3 banks.

**Diagram 2.**

**Total loans of 10 Banks for 2015-2017 years.**

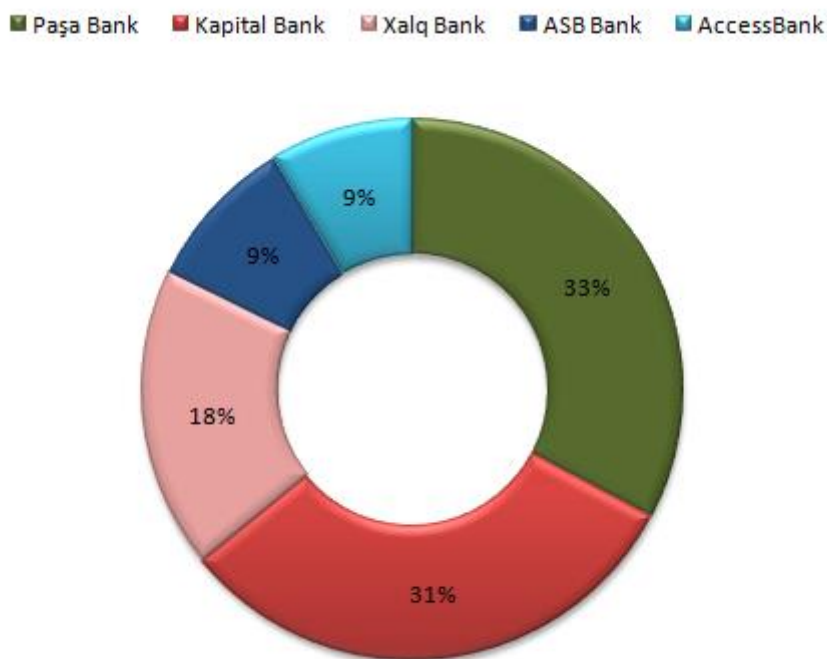


*Source: Table 7.*

In 2015, the International Bank of Azerbaijan and the Xalq Bank did not disclose the aggregate amounts of their assets, so they could not take part in the above diagram. For this reason, I can not compare their performance over these years. Let's look at other major banks, Pasha Bank and Kapital Bank have increased their assets by 2.5 times and 1.8 times respectively from 2015 to 2017. There is no sharp change in the indicators of other banks.

*Figure 4.*

*The strongest 5 banks in terms of assets for the year 2017*



*Source: Table 7.*

It is real that, interest revenues and additional funds from loans, constitute the majority of banks' revenues. Taking into account that non-interest income of most banks operating in Azerbaijan is less than non-interest expenses, it is not difficult to understand the importance of loans for future activities of banks.



**Table 8.**

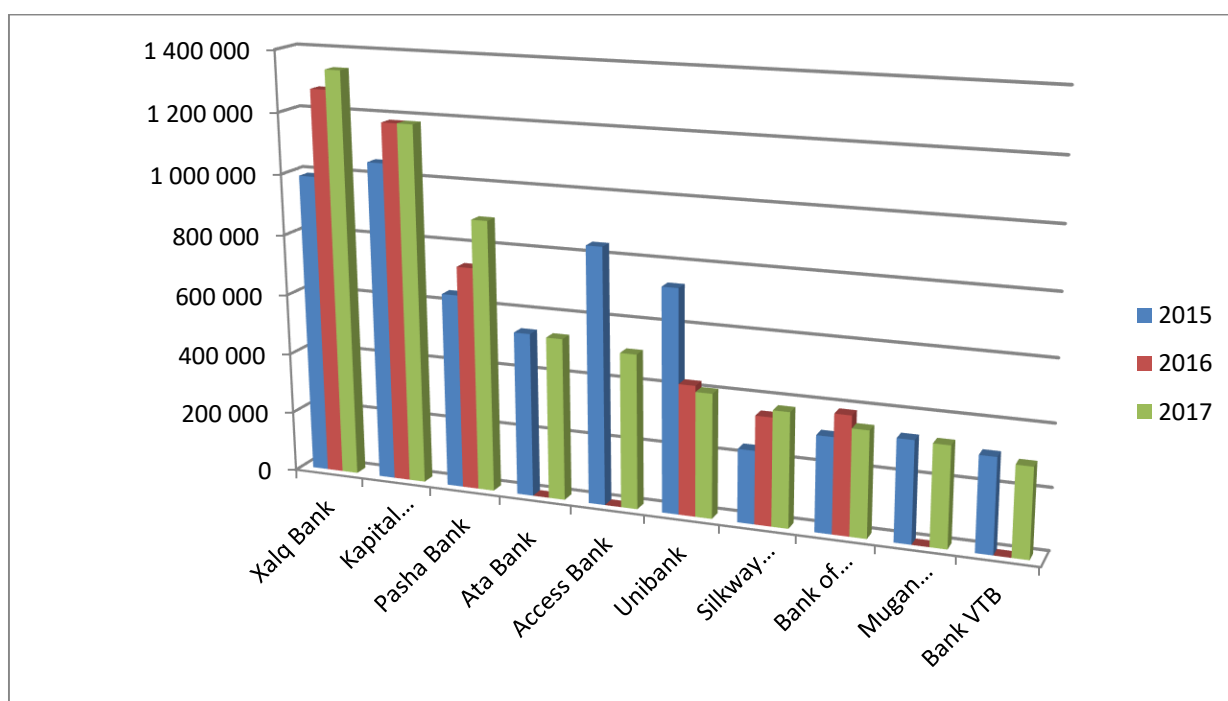
Ratings of banks according to the volume of loan portfolio:

<b>Banks</b>	<b>Loan portfolio (thousand manats)</b>	<b>Date</b>
Xalq Bank	1338869	30.06.2017
Kapital Bank	1181778	30.06.2017
Pasha Bank	891761	30.06.2017
Ata bank	532495	30.06.2017
Access bank	507163	30.06.2017
Unibank	406999	30.06.2017
Silkway Bank	375649	30.06.2017
Bank of Baku	346022	30.06.2017
Mugan Bank	327987	30.06.2017
Bank VTB	291556	30.06.2017

*Source: the websites of relevant banks.*

**Diagram 3.**

*Loan portfolio of top 10 Banks of Azerbaijan for 2015-2017 years.*



**Source: Table 8.**

The volume of credit portfolio of 31 banks operating in Azerbaijan on June 30, 2017 amounted to 13 billion 462.1 million manats 46% of this sum, or \$ 6.2 billion, is in the top 10 banks.

During the first half of 2017, Xalq Bank has invested \$ 1.34 billion in customers. Kapital Bank invested 1.18 bn. manat , "Pasha Bank" for the amount of 820 mln. AtaBank has 532 million manat, from AccessBank 507 million manats loans were issued.

It should be noted that the loan portfolio of banks decreased by 15.5% compared to the year 2016. In terms of manat, loan portfolio decreased by 2 billion 476.2 million manat. Xalq Bank, Kapital Bank and Pasha Bank have the largest loan portfolio.

*\*\*\*As The International Bank of Azerbaijan did not publish the results it did not appear in the rating.*

As you can see from the chart, we have looked at the indicators of the last 3 years, where the lowest level of Pasha Bank's assets is in 2015. There is no sharp difference between 2016 and 2017. The noticeable increase in AccessBank's assets seems to have in 2016-2017. The apparent devaluation did not go unnoticed by these banks. While Pasha Bank, Kapital Bank and Xalq Bank`s total volume of assets were changed, they have maintained their stability and competitiveness at a certain level.

Indicators of Kapital Bank, Pasha Bank and Xalq Bank those which ranked the first third place, increased by 12%, 39%, and 35% respectively in 2017. AccessBank and Unibank`s loan portfolios declined by 40% and 45% respectively over the mentioned years.

The noticeable decline in volume of credits can be explained by: as banks offered loans in dollars to hedge themselves from future currency fluctuations and maintain

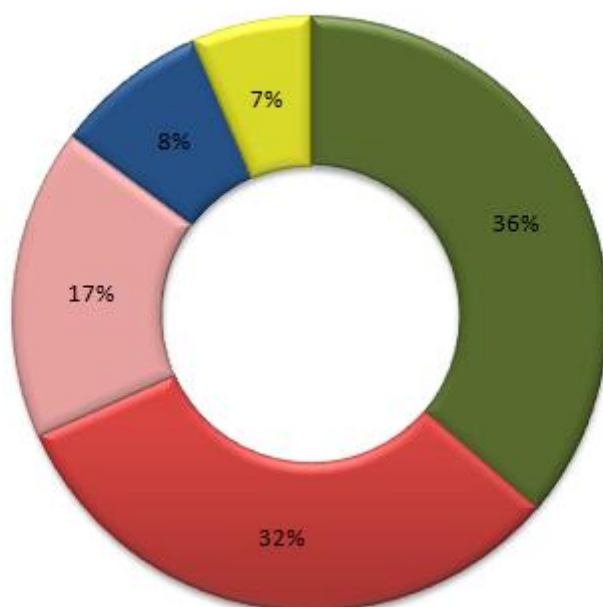
their currency positions, while clients want to borrow in manats. Regardless of who is favorable, this factor also reduces the amount of loans.

The main reason for the increase of the Bank's assets is the increase in securities investments.

*Figure 5.*

*The strongest 5 banks in terms of loan portfolio for the year 2017*

■ Paşa Bank ■ Kapital Bank ■ Xalq Bank ■ ASB Bank ■ Bank Respublika



*Source: Table 8.*

**Table 9.**

<b>Banks</b>	<b>Deposit portfolio (thousand manats)</b>	<b>Date</b>
Paşa Bank	2.642777	30.06.2017
Kapital Bank	2.332906	30.06.2017
Xalq Bank	1.230598	30.06.2017
ASB Bank	607688	30.06.2017
Bank Respublika	470563	30.06.2017
AccessBank	313463	30.06.2017
Bank of Baku	304435	30.06.2017
Atabank	291182	30.06.2017
Turanbank	260776	30.06.2017
Nikoil Bank	234472	30.06.2017

**Source: the websites of relevant banks.**

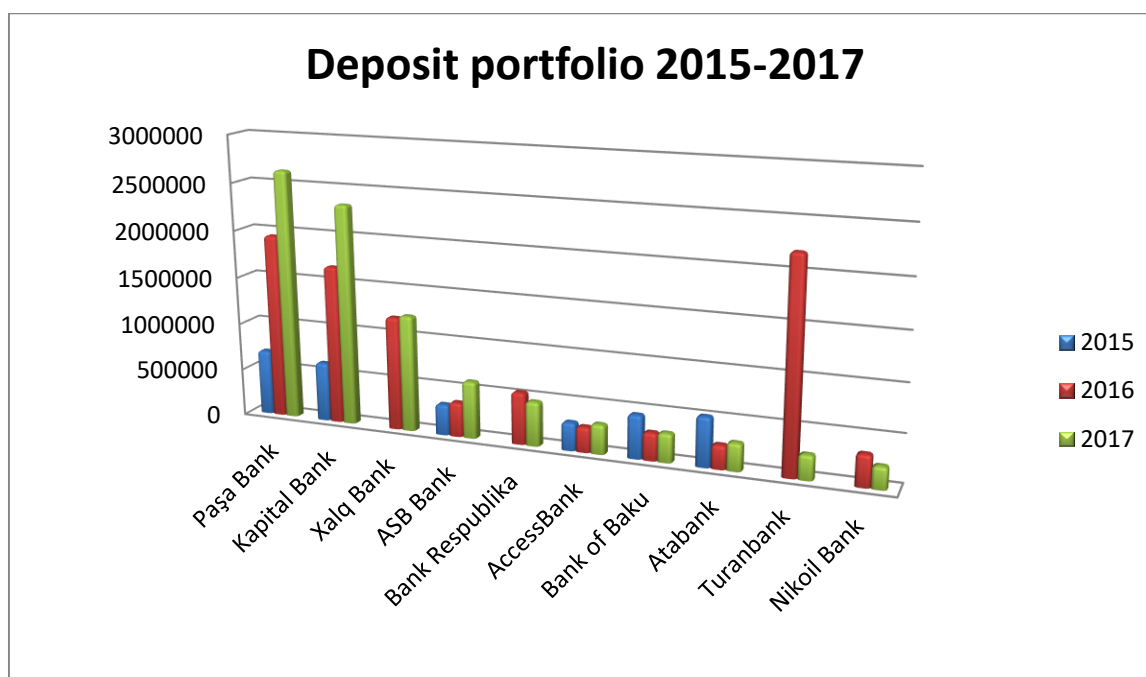
As it shown on the table the first five are the Pasha Bank, Kapital Bank, Xalq Bank, ASB Bank and Bank Respublika with 83% of total 10 ones in this rating.

Kapital Bank attracted from people 2.33 billion, Xalq Bank -1.23 bln. manats, ASB Bank totaled 608 million, and Bank Respublika - 471 million manats during 2017 year.

If to analyze and compare those figures it can be stated that first 3 place for their market share in the banking sector belongs to Pasha Bank, Kapital Bank and Xalq Bank. The main share of the market in the banking sector is their account.

*Diagram 4.*

*Deposit portfolio of top 10 banks of Azerbaijan (2015-2017)*



*Source: Table 9.*

Pasha Bank, the largest bank in the country, has increased its deposit portfolio by 2016. In 2016, the volume of deposits in this bank amounted to \$ 948.3 million manats.

Second place is occupied by Kapital Bank, another bank of Pasha Holding. During 2016, this bank will increase the amount of deposits to \$ 790.9 million. Manat compared to 2015.

AtaBank and Bank of Baku have decreased their deposit portfolio for the analyzed period.

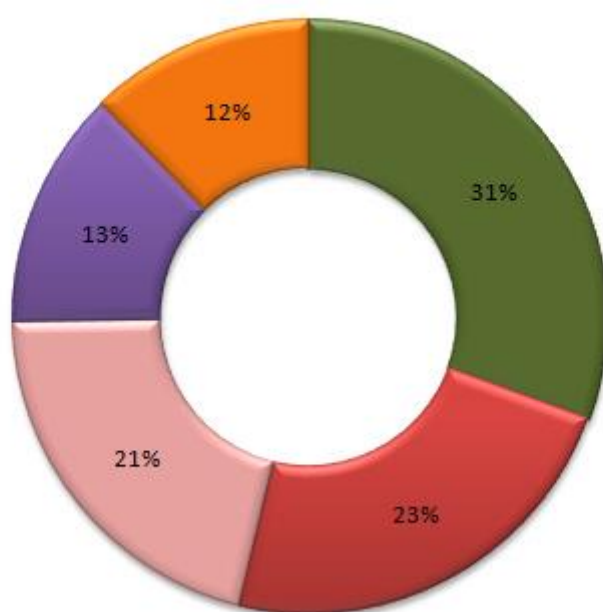
According to the expert-economist Vuqar Bayramov`s words "There are several reasons for sharp decline in population deposits in banks, and one of them is related

to change in exchange rate, if 38 percent of banks' deposits were in foreign currency in 2014, in 2017 this figure rose to 82 percent, which means that the rate of manat falling ".

**Figure 6.**

***The strongest 5 banks in terms of deposit portfolio for the year 2017***

■ Paşa Bank ■ Kapital Bank ■ Xalq Bank ■ Atabank ■ Expressbank



**Source: Table 9.**

From the beginning of 2017 the scenario has changed. Some of the citizens holding currency in the dollar prefer to withdraw their deposits and prefer to convert it into manat. This is connected with the strengthening of manat since early February 2017. As a result, some of the foreign currency depositors have withdrawn their savings and turned it into a manat, fearing that the dollar would lose more value. Some of the deposits have not yet returned to banks and are kept in the form of a savings. This affects the total amount of deposits.

Profit is the key indicator which measure the effectiveness of a bank's activity, its financial stability or the size of the investment (shares). The items directly related to the size of the profit are income and loss. Each bank should regularly publish its "Profit and Loss Statement", as the loss is reflected separately, with deductible income. Because, such information is beneficial for economic decisions and has a great impact.

Ranking of the banking organizations of Azerbaijan in terms of net profit for 2017 is shown in the Table 11.

**Table 10.**

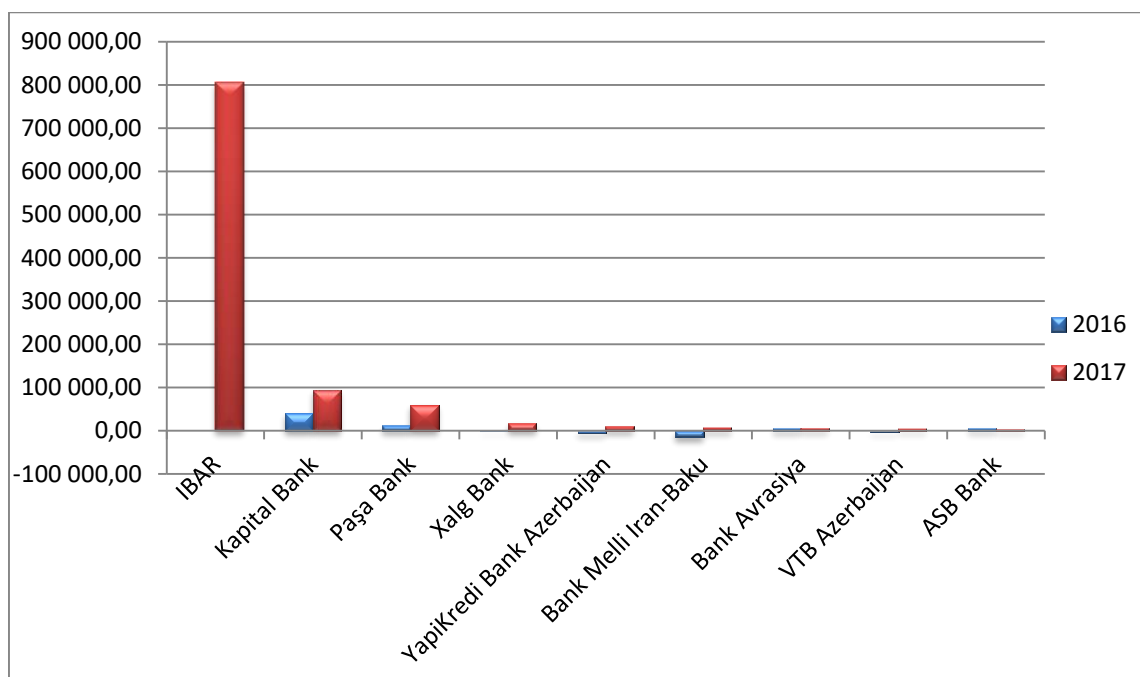
**Banks by profit (TOP-10):**

<b>No</b>	<b>Banks</b>	<b>Net profit (thousand manats)</b>
1	IBAR	806 004,00
2	Kapital Bank	94 840,00
3	Pasha Bank	58 994,00
4	Xalg Bank	17 607,00
5	YapiKredi Bank Azerbaijan	10 110,00
6	Bank Melli Iran-Baku	6 923,00
7	Bank Avrasiya	6 351,00
8	VTB Azerbaijan	4 753,00
9	ASB Bank	4 357,00
10	Gunaybank	4 099,00

*Source: the websites of relevant banks.*

**Diagram 5.**

***Deposit portfolio of top 10 banks of Azerbaijan.(2016-2017)***



**Source: Table 10.**

The first place in the ranking of commercial banks for the 2016 year is Kapital Bank with 41.5 mln. manats. The second place is AtaBank with 15.1 million , and third place - Pasha Bank with 12.7 mln. profit for the year. Yapi Kredi Bank, Bank Melli Iran and VTB bank end the 2016 year with loss. In 2017 The IBAR is draws attention with a sharp high profitability compared to others.

From the table below, we can find out the banks' ratings for the capital of banks:

**Table 11.**

<b>Banks</b>	<b>Capital volume (thousand manats)</b>	<b>Date</b>
Pasha Bank	357.226	30.06.2017



Kapital Bank	271.946	30.06.2017
Xalq Bank	245.353	30.06.2017
Atabank	151.731	30.06.2017
Expressbank	143.681	30.06.2017
Bank Silk Way	118.731	30.06.2017
Unibank	116.938	30.06.2017
ASB Bank	88.923	30.06.2017
Rabitəbank	86.079	30.06.2017
AFB Bank	79.398	30.06.2017

***Source: the websites of relevant banks.***

The top three are again are Pasha Bank, Kapital Bank and Xalq Bank. Those one we can indicate as more competitive and stable.

The real situation indicates that after the initial devaluation, the deposit portfolios of our banks mainly increased from 2015-2017 years. During this period, assets of top 10 banks of our country (excluding first 3 banks) hesitated up to 1 mln manats .

## CONCLUSION

The banking system by its nature is the most important component of the mechanism for realizing reproduction relations in the economy. The degree of stability of the banking system can characterize the state of the national economy, the social sphere of society and many other aspects of the country's economic and social life.

Research shows that, the main purpose of banks today is to increase the liquidity level of the bank's assets, increase the volume of active operations, increase the attracted funds, especially the sources of deposits, and ensure the bank's financial viability.

Since the economy of our Republic is built on the oil industry, any small hesitation in world oil prices is certainly affecting the value of our national currency. The depreciation of the valuation and the withdrawal of attracted deposits from the bank all lead to serious problems in banks.

In order to avoid all such problems and improve the bank's performance, there are departments such as risk management, bank performance improvement and forecasting in the banks, whose main purpose is to identify problems that may arise in banks, to identify risks and to counteract these risks. Banks should always be in the focus of profit and profitability indicators, and all those indicators should be included in monthly, quarterly and annual profit and loss statements. In order to increase profits and profitability, banks should always forecast, assess and market their economy, and should always pursue a market-oriented learning strategy.

In the thesis, the necessity of taking into account not only the financial stability factor, but also the loyalty factor of the bank's clients, is taken into account when assessing the bank's competitiveness. At the same time, loyalty should be understood not just customer loyalty to the bank, but also the bank's ability to expand the client

base, creating and maintaining attractive terms of service (low interest rates for loans, high deposit rates).

As a result of analyzes in improving the financial stability of banks in the conditions of the modern market economy, I recommend the following to eliminate existing problems:

- ✓ Reduction of loan interest rates is appropriate
- ✓ Banks need to constantly analyze risk indicators and forecast revenue and expense more accurately to keep their financial standing stable in banks. Banks need to have highly liquid assets and, if necessary, lose the ability to convert assets into cash.
- ✓ Banks should try to attract more long-term deposits
- ✓ The range of operations carried out by commercial banks should be increased, and thus the sources of income should be increased.
- ✓ Particular attention should be paid to the improvement of the training of personnel in banks
- ✓ In the market economy, banks should be selected as the most optimal methods of operations so that banks can benefit from these operations.

I want to emphasize once again that as a result of measures taken in the country in the recent years on the development of the banking system, the assets and capital of the banks have increased rapidly, and the resource base has significantly expanded.

Increasing the level of capitalization of domestic banks will increase their competitiveness in the world financial market and ensure the financial stability of the entire Azerbaijani economy on the way to its integration into the world economy.

When reviewing and comparing key financial indicators of banks, it is evident that banks that maintain their competitiveness and stability during a number of difficulties facing our country are Pasha Bank, Kapital Bank and Xalq Bank.

Moreover, given that the International Bank of Azerbaijan does not disclose a number of financial indicators, we can see that the İBAR is ranked first in this sector as it appears in the net income table.

To further develop competition in the banking sector, it is necessary:

- ✓ Strengthen market concentration;
- ✓ strengthen the bank's strategic potential and its resource base;
- ✓ to improve the quality of customer service and the reliability of banks;
- ✓ reduce the interest margin between the price of products, services and the costs of their production;
- ✓ to strengthen confidence in the Azerbaijan banking sector by investors, creditors and investors.

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## Xülasə

Banklararası rəqabətin gücləndirilməsi kontekstində bank sisteminin sabitliyinin mahiyyəti dissertasiyada müəyyənləşdirilmişdir. Bank fəaliyyətinin nəticəsi - bank məhsulu bank əməliyyatlarının aparılması zamanı yaranan iqtisadi əlaqələrin, eləcə də müştərilərə xidmət üçün bank biznes proseslərinin təşkili və texnologiyasını əks etdirir.

Araşdırmalar göstərir ki, bankların əsas məqsədi bank aktivlərinin likvidlik səviyyəsini artırmaq, aktiv əməliyyatların həcmnin artırılması, cəlb olunmuş vəsaitlərin, xüsusən də depozitlərin mənbələrini artıraraq bankın maliyyə imkanlarını təmin etməkdir.

Respublikamızın iqtisadiyyatı neft sənayesi üzərində qurulduğundan dünya neft qiymətlərində hər hansı bir kiçik tərəddüd əlbəttə ki, milli valyutamızın dəyərinə təsir edir. Bunun nəticəsi olaraq, cəlb edilmiş əmanətlərin əhali tərəfindən bankdan çıxarılması banklarda ciddi problemlərə səbəb olur.

Bütün bu problemlərin qarşısını almaq və bankın fəaliyyətini yaxşılaşdırmaq üçün banklarda risklərin idarə edilməsi, bankın fəaliyyətinin yaxşılaşdırılması və proqnozlaşdırılması kimi sahələr var, onların əsas məqsədi banklarda baş verə biləcək problemləri müəyyən etmək, riskləri müəyyən etmək və onlara qarşı mübarizə aparmaqdır. Banklar həmişə mənfəət və gəlirlilik göstəricilərinə diqqət yetirməlidirlər və bu göstəricilər aylıq, rüblük və illik mənfəət və zərər hesabatlarına daxil edilməlidir.

Müasir bazar iqtisadiyyatı şəraitində bankların maliyyə sabitliyini yaxşılaşdırmaq üçün aparılan təhlillər nəticəsində mövcud problemləri aradan qaldırmaq üçün aşağıdakıları təklif edirəm:

- ✓ kredit faizlərinin azaldılması;



- ✓ banklar davamlı olaraq risk göstəricilərini təhlil etməli və onların maliyyə vəziyyətini banklarda sabit saxlamaq üçün gəlirləri və xərclərini proqnozlaşdırmalıdırlar. Yüksək likvid aktivlərə malik olmalı və zəruri hallarda aktivləri pula çevirmə qabiliyyətini itirməməlidirlər.
- ✓ daha uzun müddətli depozitləri cəlb etməyə çalışmalıdırlar;
- ✓ banklar tərəfindən həyata keçirilən əməliyyatların çeşidi artırılmalı və gəlir mənbələri artırılmalıdır;
- ✓ banklarda kadrların hazırlanmasının təkmilləşdirilməsinə xüsusi diqqət yetirilməlidir;
- ✓ bazar iqtisadiyyatında banklar əməliyyatların ən optimal üsullarla həyata keçirməlidir ki, bu əməliyyatlardan faydalana bilsinlər.

Bankların əsas maliyyə göstəricilərini nəzərdən keçirərkən və müqayisə edərkən, ölkəmiz qarşısında bir sıra çətinliklər yarandıqda rəqabətqabiliyyətliliyi və sabitliyini qoruyan banklar Paşa Bank, Kapital Bank və Xalq Bankıdır.

Bundan əlavə, Azərbaycan Beynəlxalq Bankı bir sıra maliyyə göstəricilərini açıqlamadığını nəzərə alsaq, o bu sektorda xalis mənfəət cədvəlində olduğu kimi birinci yerdədir.

Bank sektorunda rəqabətin daha da inkişaf etdirilməsi üçün aşağıdakılar zəruridir:

- ✓ bazarın konsentrasiyasını gücləndirmək;
- ✓ bankın strateji potensialını və resurs bazasını gücləndirmək;
- ✓ müştəri xidmətinin keyfiyyətini və bankların etibarlılığını artırmaq;
- ✓ məhsul, xidmət və onların istehsal xərcləri arasında faiz marjını azaltmaq;
- ✓ investorlar və kreditorlar tərəfindən Azərbaycan bank sektoruna olan inamı artırmaq.

## Резюме

В данной диссертации была определена сущность стабильности банковской системы в контексте укрепления межбанковского конкурса. Итоги деятельности банка - банковский продукт отражает организацию и технологию банковских бизнес-процессов для банковских услуг, а также экономические отношения, возникшие в ходе банковских операций.

Исследования показывают, что основной целью банков является увеличение уровня ликвидности активов банка, увеличение объема активных операций и обеспечение финансовых возможностей банка путем увеличения привлеченных средств, в частности, источников вкладов.

Поскольку экономика нашей Республики построена на нефтяной промышленности, любое небольшое колебание мировых цен на нефть, конечно же, сказывается на стоимости нашей национальной валюты.

Чтобы избежать всех этих проблем и улучшить работу банка, в банках есть такие области, как управление рисками, совершенствование и прогнозирование деятельности банка, основная цель которого - выявить проблемы, которые могут возникать в банках, выявлять риски и бороться с ними. Банки должны всегда обращать внимание на показатели прибыли и прибыльности, и эти показатели должны включаться в ежемесячные, квартальные и годовые отчеты о прибылях и убытках.

Чтобы устранить существующие проблемы в результате анализа для улучшения финансовой устойчивости банков в современной рыночной экономике, я рекомендую следующее:

- ✓ снижение процентных ставок по кредитам;
- ✓ банкам следует постоянно анализировать показатели риска и прогнозировать их доходы и расходы, чтобы сохранить их финансовое положение стабильным в банках. Они должны обладать высокими

ликвидными активами и, при необходимости, терять свою способность конвертировать деньги в наличные деньги.

- ✓ попытайтесь привлечь более долгосрочные депозиты;
- ✓ необходимо увеличить диапазон транзакций, осуществляемых банками, и увеличить доходы от источников дохода;
- ✓ особое внимание следует уделить совершенствованию подготовки персонала в банках;
- ✓ в условиях рыночной экономики банки должны проводить операции с наиболее оптимальными методами, чтобы они могли извлечь выгоду из этих операций.

При рассмотрении и сравнении основных финансовых показателей банков Паша Банк, Капитал Банк и Халг банк являются банками, которые сохраняют свою конкурентоспособность и стабильность, когда есть некоторые трудности, с которыми сталкивается наша страна.

Для дальнейшего развития конкуренции в банковском секторе обязательным является следующее:

- ✓ усилить концентрацию рынка;
- ✓ укрепить стратегический потенциал и ресурсную базу банка;
- ✓ повысить качество обслуживания клиентов и надежность банков;
- ✓ уменьшить разницу между ценами на продукт, услугу и производство;
- ✓ повышение доверия к банковскому сектору Азербайджана инвесторами и кредиторами.