

Caucasus Research Resource Center (CRRC) - Azerbaijan

Grants to Support Social Science and
Policy- Oriented Research

Final Analytical Report

The impact of microfinance services on the poverty in Azerbaijan

research project

by

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Baku - 2007

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Preface

Poverty alleviation is the main target of developmental projects in different countries. Today, microfinance is considered to be an effective tool in hitting this target and achieving Millennium Development Goals in the world. Thus, international financial organizations, led by the World Bank, support the development of microfinance institutions throughout the world. Sometimes microfinance is called banking for the poor.

Poverty reduction effectiveness of microfinance differs from country to country. Microfinance may have big positive impact on poverty in one country (Bangladesh, Shri Lanka), while non-effective, from poverty reduction point of view, in another country (Samoa). Real impact of the microfinance to poverty depends on economic, social and cultural features of the country. If increase of microfinance services to poor was accompanied by increase in other indicators, such as consumption expenditures, human capital investment, children's participation in education, women's assets, employment of family members, it would mean that microfinance gave social benefits.

The government authorities of Azerbaijan also recognize the importance of the efficient microfinance system that may promote poverty reduction. Thus, broadening access to microfinance services has formulated a special task in poverty reduction program approved by the government. The estimation of concrete results of this measure would be very interesting. According to official information from Ministry of Economic Development of Azerbaijan, poverty in Azerbaijan declined from 49% in 2003 to 20% in 2006. Is there any contribution by microfinance to this decline? Do social benefits of microfinance exceed its costs in Azerbaijan? Answers of these questions require special deep research.

Despite sufficient experience and a number of institutions providing microfinance services particularly to the poor, there is limited knowledge about the impact of microfinance on poverty alleviation in Azerbaijan. The study fills this gap by studying some important issues related to the microfinance sector. Thus, the aim of this research is the assessment of the impact of microfinance on poverty

reduction in Azerbaijan, to analyze the features of microfinance in Azerbaijan, to prepare concrete recommendations on microfinance development in Azerbaijan.

Unlike other research about the development of microfinance in Azerbaijan, this research mainly focused on microfinance's effects on living standard of the poor. This research does not give big attention to development of microfinance in Azerbaijan from financial market deepening point of view. The experience of Azerbaijan on microfinance is enough for estimation poverty effectiveness of microfinance.

According to main hypothesis of research, microfinance has positive impact on poverty reduction in Azerbaijan through increase in microborrower's incomes and assets. This hypothesis has been tested by questionnaire among some microborrowers.

The views of this research do not represent the views of CRRC, EPF or the Carnegie Corporation of New York and are wholly the views of the author.

Acknowledgements

The author would like to recognize the generous support received from the Caucasus Research Resource Center (CRRC) Azerbaijan - a program of the Eurasia Partnership Foundation (EPF). This project was completed through the CRRC Publication Fellowship Program, with funding from the Carnegie Corporation of New York.

The author is grateful to Jhale Hacıyeva (Executive Director of Azerbaijan Micro-Finance Association), Mejid Asadov (General Director of Credit Implementing Agency), Sarat Das (Chief of mission of International Organization for Migration in Azerbaijan) Siddiga Ahmedova (Gender & Training Coordinator of International Organization for Migration in Azerbaijan), Rafiq Mammadov (Head of Lenkoran regional office of Credit Implementing Agency), Khalil Aliyev (Founder of Nakichevan Credit LLC), Gulmira Abbasova (Loan Officer, International Organization for Migration, Nakichevan), Fariz Ahmadov (Chemonics, USAID-Trade and Investment Reform Support Program), Nigar

Pirmammadova (Chief Accountant/Finance Manager of AMFA) for research assistance.

Overview

Popularity of microfinancing as an effective tool of poverty alleviation has been increasing over last years. Since microfinance has made important progress in Azerbaijan, analyzing of its impact on poverty is a very actual problem. Only after such analysis we can decide whether poverty reduction by expanding of microfinance is realistic objective or not.

This report, which provides overview of the social aspects of microfinance in Azerbaijan is organized into the following sections.

The first part will present brief overview of microfinance nature. Main types and features of microfinance services will be mentioned in this section. It will be clear from this section that microfinance has some advantages among financial services provided by credit institutions.

The second part will present foreign experience on poverty reduction effectiveness of the microfinance. As we know microfinance has very good results from poverty reduction point of view in such countries as Bangladesh, India, and Indonesia. Reviewing these countries' experience gives us the opportunity to see the impact of microfinance in Azerbaijan in international content.

The third part will present analysis of the development of microfinance in Azerbaijan. Obstacles in development of microfinance will be discussed in this part as well. These obstacles have been determined based on individual interviews among specialists of MFI.

The fourth part will present the contribution of the microfinance to the poverty reduction in Azerbaijan. This part is a more important part of research paper. The poverty reduction effectiveness of microfinance in Azerbaijan is estimated in the face of 240 microborrowers of Nakichevan and Lenkoran. Questionnaires which were organized among these borrowers cover relationships between social indicators of borrowers and microcredit services. These regions

have been selected because they are in different situation. Nakhchevan is a blockaded region with relatively high level of poverty. Lenkoran has favorable natural environment and therefore better business opportunities. Regions with different situations allow better comparison than similar cases. Analysis of results of questionnaires confirms hypothesis according to microfinance reduces poverty in Azerbaijan by improving social status of microborrowers.

The conclusion in the end will present the important findings of the research. This part will also present recommendations and their explanation on development of microfinance.

1. What is microfinance? Main features and criticism of microfinance

There is not single definition of the microfinance. Generally microfinance is small financial services to poor people who don't have access to traditional bank services. "Relying on their traditional skills and entrepreneurial instincts, poor people use financial services from organizations called microfinance institutions (MFIs) to start, establish, or expand self-supporting businesses"¹.

Unlike from other credit institutions vast majority of MFI were created for poverty alleviation and empowerment for the poor. In spite of social orientation MFI can also make a profit. So, MFI may have financial sustainability when many other services that aim to improve the life of poor (hospital clinics for the poor, public schools, health and vocational classes, agricultural programs) are dependent on subsidy from either the government or private donors.

The set of MFI further developed in developing counties where shadow economy is big. In developed countries microloans are provided by usual banks. MFIs differ in size and reach: some serve a few thousand clients in their immediate area, while others serve hundreds of thousands of very poor people through hundreds of branches covering large regions. Grameen Bank of Bangladesh, which

¹ http://www.grameenfoundation.org/what_we_do/microfinance_in_action/faqs/

was founded by 2006 Nobel Peace Laureate Dr. Muhammad Yunus, is the world's largest and most successful MFI. It serves more than seven million clients.

Dr. Yunus is known as architect of banking for poor. Before Dr. Yunus, the poor were not allowed access to credit and loans due to the widespread belief that the poor could not repay loans. Dr. Yunus had proven that the poor are able to repay loans.

Microfinance services could be divided to three groups: 1. Microcredits; 2. Additional microfinance services; 3. Support systems

Microcredits. Microcredits are main type of microfinance services. Microcredits are the small loans provided by MFI to poor and low-income households and their microenterprises. In different countries different amount of loan could be described as microcredit. For example microloans are loans less than 100 000 in USA while less than 10 000 in Azerbaijan.

Microloans have the same advantages. "Unlike other loan, clients are not required to provide collateral to receive loans. This allows people who do not qualify for loans at traditional financial institutions to receive credit"². Micro lending is based on group guarantee. Within this mechanism if the group member does not pay back the loan, he will be under the influence of group pressure. Microcredits are also more client-friendly type of loan than traditional bank credits. So, most of MFI usually go to their clients to provide loans and receive payments, rather than requiring clients to come to them.

Providing microloans to poor people is quite expensive, especially in relation to the size of the transactions involved. This is one of the most important reasons why banks don't give small loans. A \$100 dollar loan, for example, requires the same personnel and resources as a \$20,000 one, thus increasing per unit transaction costs. Loan officers must visit the client's home or place of work, evaluate creditworthiness on the basis of interviews with the client's family and references, and in many cases, follow through with visits to reinforce the repayment culture. It can easily cost US\$25 to make a microloan. While that might

² http://www.grameenfoundation.org/what_we_do/microfinance_in_action/faqs/

not seem unreasonable in absolute terms, it might represent 25% of the value of the loan amount, and force the institution to charge a “high” rate of interest to cover its cost of loan administration.

Additional microfinance services. Additional microfinance services include savings, insurance and remittance transfers. For example, Grameed Bank uses voluntary client saving account as an additional source of income. Clients may deposit funds into a saving account and withdraw at will. Savings provides security for the clients to think about their money for long-term goals in the future, it enables money to be passed on to children and allows for risk-taking.

Support systems. MFI’s usually educate local communities about the opportunity to improve their life with microfinance. The local MFI might also offer microfinance plus activities such as entrepreneurial and life skills training, advice on topics such as health and nutrition, sanitation, improving living conditions and the importance of educating children. MFI assists clients in solving some of the life challenges they may face. Many MFI provide social services, such as basic health care for clients and their children. A few of them also use focal centres where clients gather to conduct financial transactions and receive other social services. The peer support system practiced by many microfinance programs is another unique feature. When clients gather on weekly basis “centre meetings” to make loan payments, or informally in smaller support groups, they share successes and discuss ideas for solving business and personal problems. Maybe most importantly, they empower each other to stay on the path out of poverty. This mutual support strengthens their resolve. In addition, MFI staff members share vital information and resources to improve their clients’ well-being. This might include bringing in local nurses to provide health and nutrition counselling, or providing help with literacy.

Together with advantages there are also much criticisms of the microfinance approach to poverty alleviation. Indeed the critics have even questioned whether microfinance alleviates poverty at all. There are five main arguments against microfinance. (Tessie Swope 2005)

1. Microfinance does not reach the poorest of the poor. According to this criticism, loan officers often discriminate between very poor borrowers and favour the “richer” poor who can afford to take out larger loans. Additionally microfinance is not always an attractive option to the very poor. A destitute family that struggles every day to survive will rarely have the energy to launch into an ambitious, business enterprise.

2. MFI is rarely financially sustainable. According to this criticism microfinance practice will be discontinued, because financial services to poor are very risky business.

3. Microfinance is potentially harmful to women, since in some countries men feel that women’s independence is a direct threat to traditional patriarchal power. Microfinance is hailed as the means of promoting economic opportunity and empowerment to women, however, when take out a microcredit loan to start a business it is often the men who control how the loan is used. In most Third World communities, the men have better income-generating status than women. Another challenge that women face with microfinance is that they have double workload of running a business and childcare.

4. Borrowing may create a heavy debt for some poor families in countries where small business are subject to a great number of obstacles. In this circumstance, borrowing money is a risk for the poor who already experience extremely vulnerable economic shocks.

5. Microfinance is not universal in application. According to this argument, microfinance doesn’t cover generations and all regions. The most biting indictment against microfinance is that it requires the poor to be entrepreneurial. But, it is clear that most people are not entrepreneurial. Critics stress on the need to find more universal approach to poverty alleviation.

Though this criticism is valid, there is ample evidence to show that the benefits of microfinance outweigh the costs.

2. The impact of microfinance on poverty reduction in foreign countries

International experience shows that the availability of financial services for poor people is one of critical factor of poverty reduction. Let's us briefly review the experience on poverty reduction effectiveness of microfinance in different countries.

Bangladesh. A detailed impact assessment study of MFI clients in Bangladesh suggested that microborrowers who used the microloans for more than four years increased household expenses by 28 % and assets by 112 percent. (S.Mustafa, et al, Beacon of Hope 1996). Another analysis of household level data demonstrated that access to financial services enabled microborrowers to reduce their vulnerability through smoothing consumption, building assets, and receiving services during natural disasters. (Hasan Zaman 2000)

A comprehensive study of microfinance conducted by the World Bank in the early 1990s in Bangladesh found that female clients increased household consumption by 18 takas for every 100 takas borrowed, and that 5 percent of clients graduated out of poverty each year by borrowing and participating in microfinance programs. (Shahidur Khandker 1998) An important, earlier study of the Grameen Bank (MFI in Bangladesh) also found statistical evidence of economic welfare. The incomes of Gramen clients were 43% higher than incomes of non-borrowers. (M.Hossain 1988)

World Bank in collaboration with the Bangladesh Institute of Development Studies showed that the Grameen Bank not only “reduced poverty and improved welfare of participating households but also enhanced household’s capacity to sustain gain over time. (Tessie Swope 2005)

India. A study of microborrowers in India documented that three-fourths of them who used microfinance services for longer periods saw significant improvements in their economic well-being (based on sources of income, ownership of productive assets, housing conditions) and that half of the clients graduated out of poverty. There was marked shift in employment patterns of

clients-from irregular, low-paid daily labor to diversified sources of earnings, increased employment of family members, and a strong reliance on small business. (Simanowitz 2002)

Latin America. Two-thirds of CRECER clients had increased their incomes after using microloans in Bolivia. Moreover clients reported “consumption smoothing” over the year as a result of diversifying income sources. Eighty-six percent of clients said their savings had increased. 78 percent did not have any savings prior to using microcredits. (Barbara McNelly and Cristopher Dunford 1999)

In the case study of microfinance clients in Lima, Peru is reported that “only 28% of clients live below the poverty line compared to 41% of non-clients”. The Save the Children foundation also confirms a 50% increase in household income (Tessie Swope 2005).

Africa. Microborrowers had increased their incomes by 36\$ compared to 18\$ for non-borrowers. Clients of MFI had also significantly diversified their income sources. Eighty percent of microborrowers had secondary sources of income versus 50 percent of non-borrowers. (Barbara McNelly and Cristopher Dunford 1998)

Indonesia. In Indonesia borrowers increased their incomes by 12.9% compared to increases of 3 percent by non-borrowers³. Another study on Bank Rakyat Indonesia borrowers on the island of Lombok in Indonesia reports that the average incomes of clients had increased by 112 percent and that 90 percent of them had moved out of poverty. (Panjaitan-Drioadisuryo, D.M.Rositan, and Kathleen Cloud 1999)

Overall, the evidence is overwhelmingly in favor of microfinance as a tool to increase household income, smooth consumption, and enable the poor sustains to gain over time. Microfinance enables many impoverished families to earn income to rise above the poverty line and therefore an effective method of poverty

³ Joe Remenyi and Benjamin Quinones Jr., eds., *Microfinance and Poverty Alleviation:Case Studies from Asia and the Pacific* (New York:Printer Publishers, Ltd., June 2000), page 79

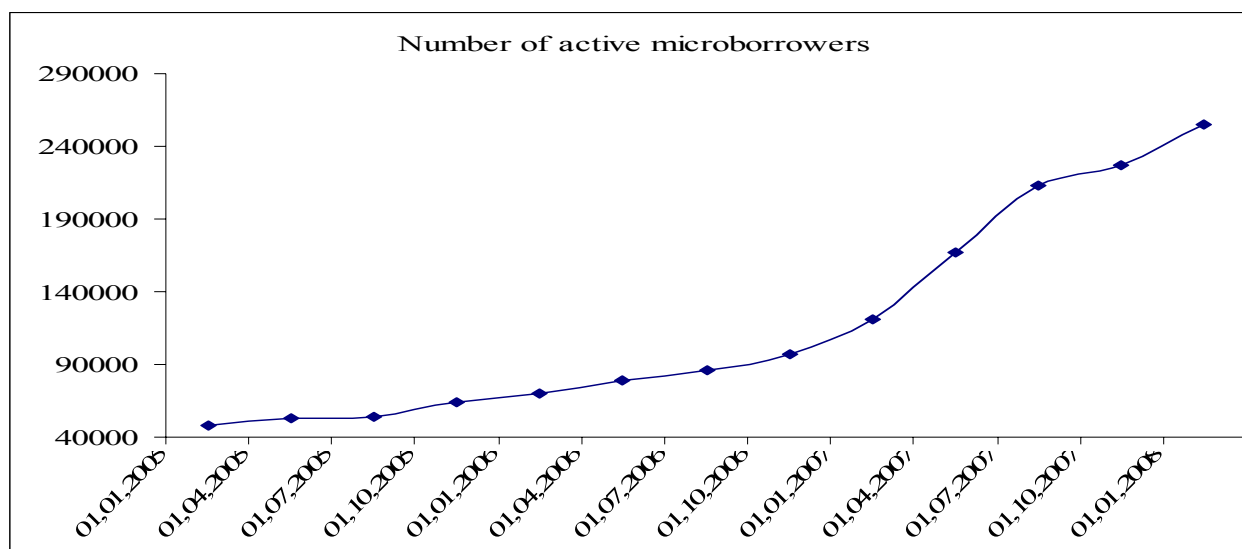
alleviation. Microfinance makes impact on more than just household income. Case studies indicate that microfinance has substantial effect on the nutrition and health of the poor.

3. Development of microfinance services in Azerbaijan

Microfinance business comprises a dynamic of the domestic financial market in Azerbaijan.

According to Azerbaijan Microfinance Association (AMFA) the number of active microborrowers increased 5.3 times during the last three years. More than two thousand people have been granted access to microfinance services in the country as of 1 January of 2008, of which 1/3 is women's share. According to some heads of MFI this is only half of outreach. The demand for microcredits much exceeds supply.

Chart 1.



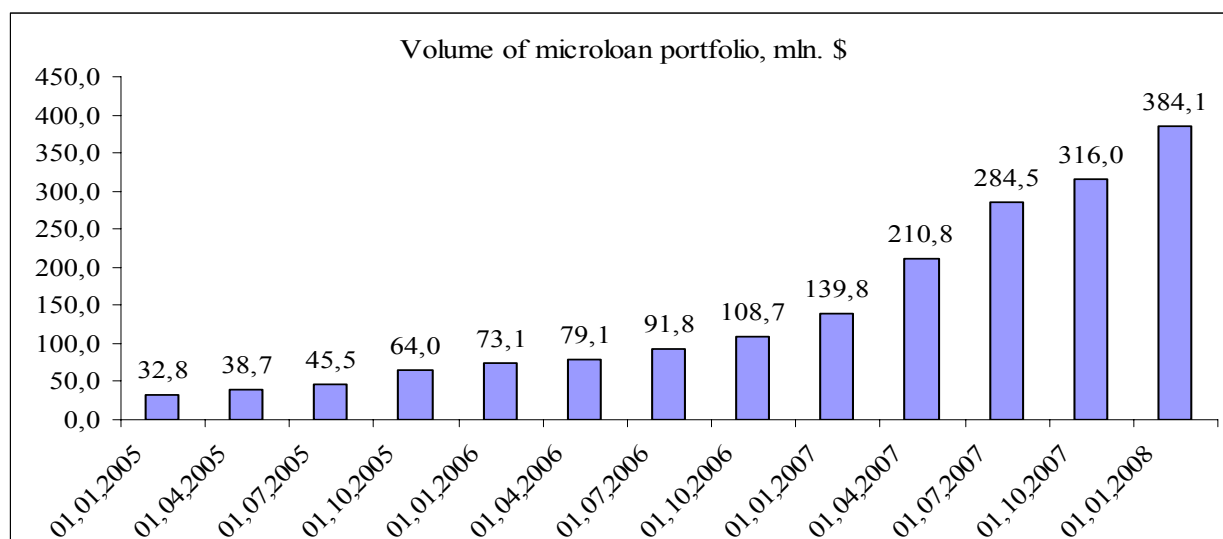
Source: AMFA

Currently sixty regions of Azerbaijan are covered by microfinance services. For some regions, such as those located close to Nagorno-Karabakh where the majority of Internally Displaced Persons (IDPs) are, or for Nakhchivan, which as an autonomous exclave is isolated from the rest of the country, microfinance programs are crucial in satisfying the basic needs of the people.⁴

⁴ Chingiz Mammadov, "Microfinance in Azerbaijan", Microfinance in CEE and the NIS Journal Issue No.1/2003, page 11

The microcredit portfolio has increased by 10 times within the last three years and has reached \$384 million by 1 January of 2008. Average size of a microloan (microcredit per client) in Azerbaijan increased from \$680 on 1 January of 2005 to \$1507 on 1 January of 2008.

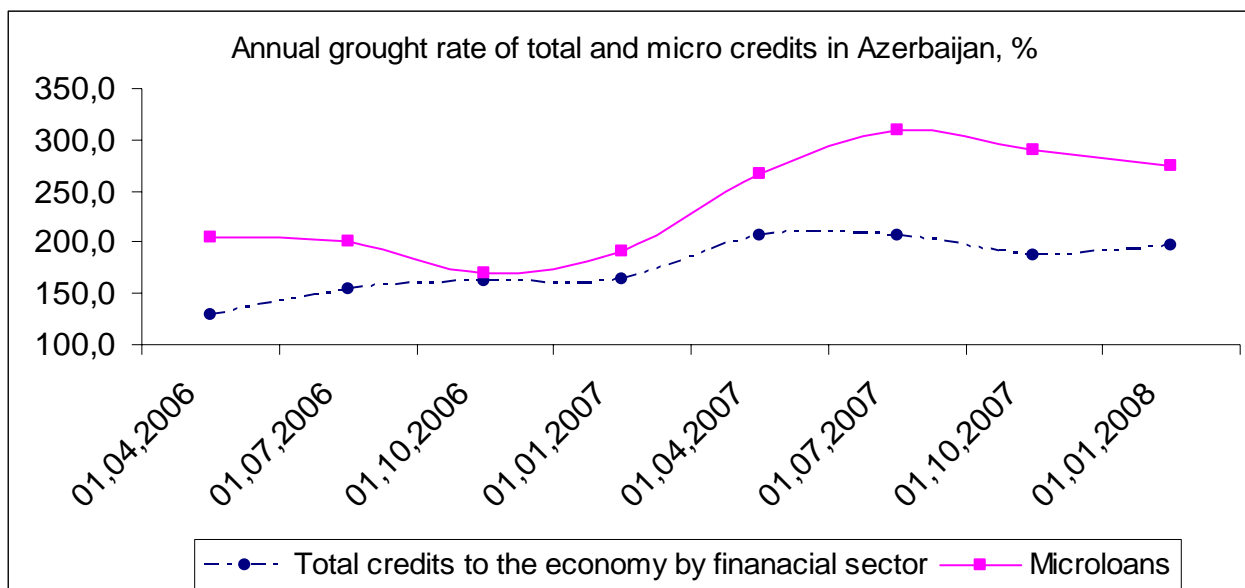
Chart 2.



Source: AMFA

Interest rates for microloans are higher than those for traditional type of credits. With the average annual interest rate for bank credits being 16-17% in September of 2007, the largest MFI in Azerbaijan – Finca-Azerbaijan extends micro-credits at 2.5-3.5% monthly interest rate. As in other countries interest rates for microcredits are higher in Azerbaijan because of higher transaction costs. Despite of high interest rates, microloans are more accessible for low-income population, since there are no collateral requirements and documentation procedures are relatively shorter.

Chart 3.



Source: AMFA and NBA

Annual growth rate of microloans usually exceeds annual growth rate of total credit to the economy in Azerbaijan for last years. So, in 1 January of 2008, compared with same period of previous year total volume of credit to the economy increased by 2 times, while microloans increased by 2.7 times.

These figures and high level of repayment rate demonstrates attractiveness of microfinance for economic agents. High repayments rates also shows that microfinance in Azerbaijan have financial sustainability, which is very important from poverty reduction point of view.

Big share of shadow economy creates good conditions for development of specialized MFI in Azerbaijan. According to WB the share of shadow economy in Azerbaijan consists approximately 60%.

Microfinance institutions (MFI), credit unions and banks are the main agents providing microfinance services in the country.

MFI's in Azerbaijan. MFIs have been operating in Azerbaijan since mid-90's. Some of them are international relief organizations which came to Azerbaijan in response to the humanitarian crisis caused by the occupation of Azerbaijan's territories by Armenia. At present, sixteen microfinance institutions operate in the country with forty one branches.

Table 1. Information about MFI in Azerbaijan, in mln. AZN

	Charter capital	Assets	Number of branches
2003	0.04	6.77	6
2004	0.06	22.31	13
2005	0.06	38.39	13
2006	2.37	58.97	29
2007	2.37	127.92	44

Source: NBA

The total assets of these institutions have been increased by 3.3 times in 2004, 72% in 2005, 53.6% in 2006 and 2.1 times in 2007.

The majority of microfinance institutions use the solidarity principle to issue loans to groups of clients. In group lending the number of clients within the group varies from three to 25 though most groups have 10 to 15 people. Most organizations follow mixed gender policies, though there are some that think that separate-gender policies are more effective. Overall, female participation in microfinance has been quite successful. In some programs, 80% of clients are women. For solidarity group loans the minimum loan size fluctuates from organization to organization depending on the type of business, varying from \$50 to \$250. The maximum amount of the loan is \$30,000.⁵

Banks in microfinance business. It is observing increasing role of banks in microfinance service market last times. Thus, by end of October of 2007 the share of banks in microfinance portfolio constitutes approximately 60%.

There is a stand-alone Microfinance Bank operating in the country with its 9 branches. Other banks have also recently entered the microfinance market. Only in the last few years, six commercial banks have established microfinance departments to provide micro credits.⁶

Credit Unions. The Credit Unions play limited role in microfinance market comparatively with MFI's and banks.

⁵ Chingiz Mammadov, "Microfinance in Azerbaijan", Microfinance in CEE and the NIS Journal Issue No.1/2003, page 12

⁶ Jhale Hajiyeve (AMFA), Scott Gaul (MIX), Azerbaijan Benchmarking Report 2004, June 2006, page 3

Table 2. Information about Credit Union of Azerbaijan, in mln. AZN

	Charter	Assets
2003	0.9	2.18
2004	1.26	3.87
2005	2.3	6.69
2006	3.01	8.76
2007	4.25	12.7

Source: NBA

Differently from MFI Credit Unions don't have branches in Azerbaijan. According to interviews among management of MFI some Credit Unions seriously think about transformation to MFI, since MFI works in Azerbaijan more successfully.

In spite of above mentioned achievements, the microfinance has some problems in Azerbaijan.

First of all it should be mentioned that there is not any special law which regulate activity of MFI. In the juridical vacuum circumstances MFI can not feel themselves confident.

Some legislative rules limit the active joining of Credit Unions to microfinance market in Azerbaijan. Credit Unions allow giving credit only to member organizations when in Baltic counties credit unions may also give credit to non-members. This rule limits development of microfinance in Azerbaijan.

Lately times increasing inflation and unstable exchange rate have negative impact on poverty reduction effectiveness of the microfinance. Additionally corruption has negative impact on poverty reduction effectiveness of the microfinance.

4. The impact of microservices on poverty in Azerbaijan

Before analyzing poverty reduction effectiveness of microfinance let us briefly review poverty level dynamics in Azerbaijan. Poverty in Azerbaijan is determined by Household's Survey of Living Conditions organized by State Statistical Committee. To monitor poverty dynamics, it has used such indicators as

“absolute poverty”, “relative poverty” and “extreme poverty”. According to results of Survey the poverty level in Azerbaijan is as in following table:

Table 3. Poverty level in Azerbaijan Republic, by %

	2002	2003	2004	2005	2006	2007
Absolute	46.7	44.7	40.2	29.3	20	16
Relative	8.8	12	8.7	6.1		
Extreme	-	9.6	4.9	2.2		

Source: Ministry of Economic Development

Poverty level in the regions is higher than in the capital. So in 2005 poverty for country was 29.3%, when the same figure consists 17.2% for Baku. Additionally poverty risks in families with women head are higher than families with men head. Poverty is also high in big families in comparison with small families. So, families with 5 or more than 5 members are more vulnerable to the poverty. Poverty also depends on the education level of family head. If the head of family have high education, poverty risks are small.

There is not single view about impact of microfinance on poverty in Azerbaijan. According to the local “Hesabat” journal, micro loans led to bankrupts of small agricultural producers. Journal explains it by active intervention of foreigners to microfinance market. Foreign MFI determines very high interest rates for microloans which bankrupt small entrepreneurs.⁷ But, many other experts indicate positive impact of microfinance to poverty reduction in Azerbaijan. For example Mr.Mehman Abasov (Former head of Poverty Reduction Strategy Secretariat) believes that “there is direct relationship between the expansion of microfinance services and poverty reduction. Microfinance Institutions contribute to satisfy the daily needs of the population and to finance same seasonal business activities that bridge gaps in the income flow of households.” According to Mr. M.Abasov State Poverty Reduction Program includes 6 strategic fields as follows:

- macro-economic stability, sound fiscal management and economic growth;
- creation of income-generating opportunities;
- targeting of social benefits;

⁷ “Min bir xırdavat” Hesabat jurnalı, 11 fevral 2006 No. 42, səh 15

- improved delivery of basic health and education services;
- improved infrastructure, particularly in rural areas;
- improved living standards for refugees.

Microfinance is important in that it affects two of these six goals: creation of income-generating opportunities and improved living standard for refugees.⁸

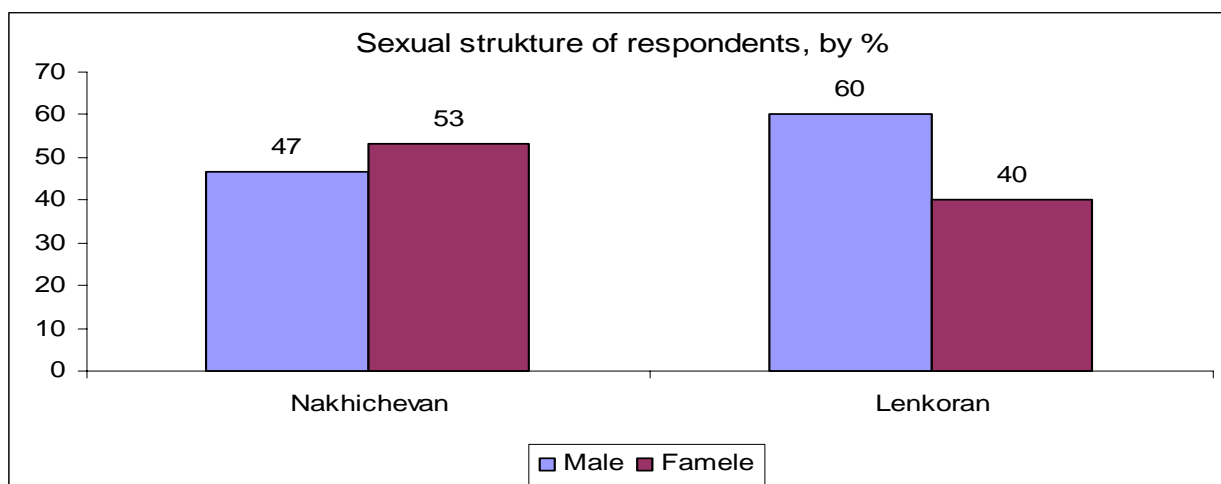
To assess the impact of microfinance to living standards in Azerbaijan, a questionnaire was developed and 120 micro borrowers in Nakhichevan (clients of Nakhichevan Kredit LSD) and 120 borrowers in Lenkoran (clients of Credit Implementing Agency) were surveyed. 120 borrowers is 10% of Nakhchivan Credit LSD client and 3% of Credit Implementing Agency in Lenkoran. Geography of the questionnaire covers villages of the Lenkoran city as Balady, Zovla, Hovzova, Kerqelan and such district of the Nakchivan Autonomic Republic as Kengerly (villages Karabaqlar, Qivraq), Shahbuz (Mezelik), Babek (Zeyneddin), Ordubad (Andemish), Sherur (Danyery, Dudenge, Arbatan, Xetai), Sederek.

Household sample survey questionnaire of Impact Assessment Study of the Family Development Fund, Egypt (1998) has been used as a model in preparation of questionnaire for Azerbaijan.

The number of respondents covers approximately 10% of clients. 53% of total respondents were male and 47% female.

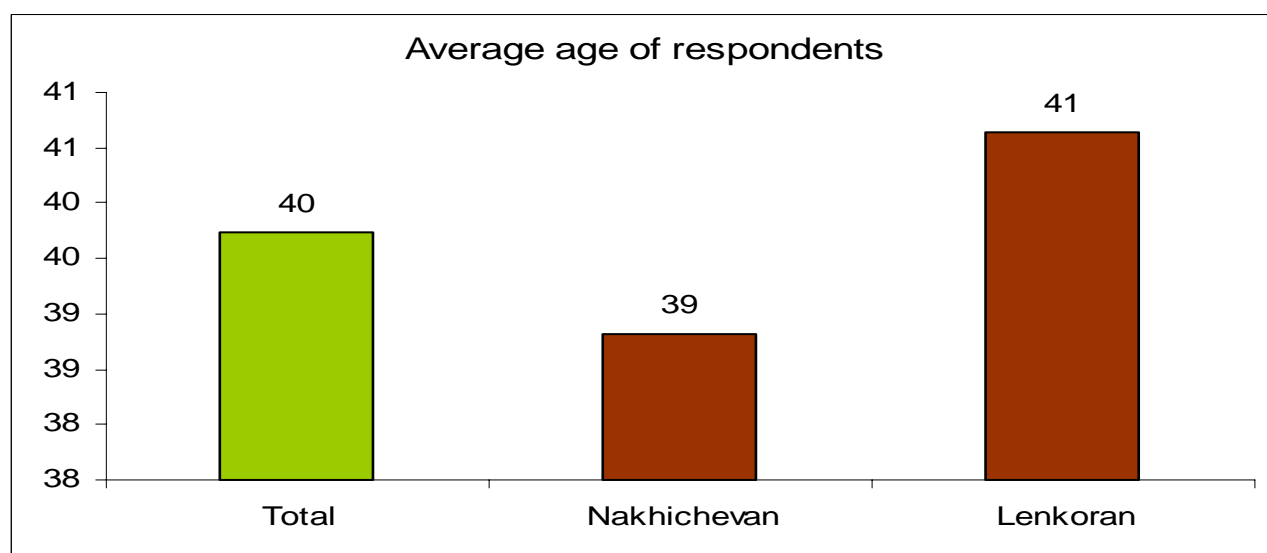
Chart 4.

⁸ Workshop on Microfinance Sector Development: Issues and challenges, 26 August 2003, Microfinance Sector Development Project, ADB No. 4093 AZE.



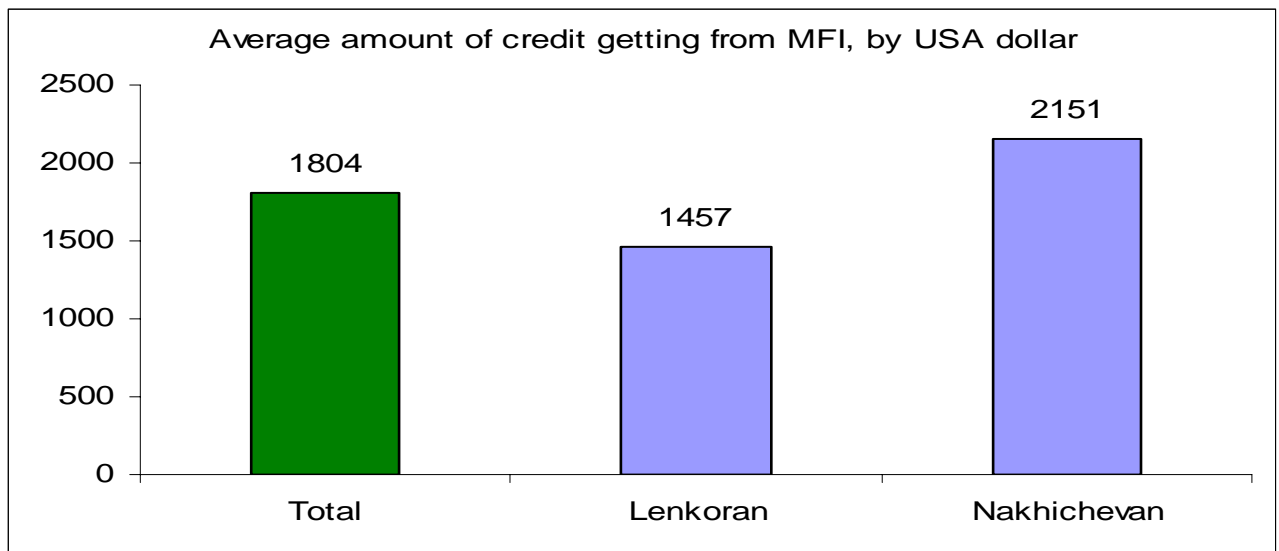
Average age of respondents was 40, including 39 in Nakhichevan and 41 in Lenkoran.

Chart 5.



The average amount of credit obtained from MFIs was reported to be \$1804. These respondents averagely got loans 3 times during the last 2.65 year.

Chart 6.



Credits accessed by respondent borrowers were mainly short-term at average interest rate 2.25% per month.

Table 4. Length and interest rates of credits

	Total	Nakchivan	Lenkoran
Length of credit, in month	9-12	9-12	9-12
Interest rates of loans, per month	2.25	2.4	2.1

Despite of high interest rates and short maturity, credits in Nakhichevan and Lenkoran have been used by reviewers mainly for investment purposes.

Table 5. Credit destination, shares in percent

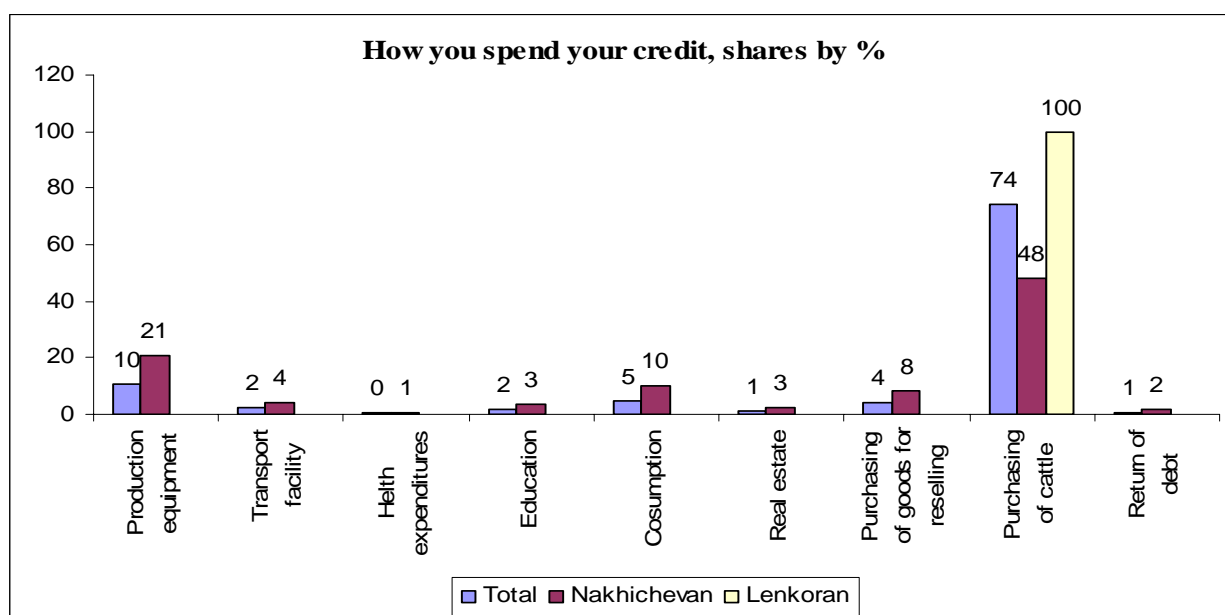
	Total	Nakhichevan	Lenkoran
Investment (including investment in human resources)	93	86	100
Consumption and other	6	12	0

Thus, 93% of total credits were of investment nature (while 86% in Nakhichevan and 100% in Lenkoran). Existence of consumption oriented credits (6% of total) means that microfinance is also consumption smoothing⁹ tool in Azerbaijan.

In most cases, borrowers use credits for the cattle purchase because the cattle breeding business generates high return in regions through increasing meat and milk sales. So, in Lenkoran borrowers spend their credits only to cattle.

Chart 7.

⁹ Consumption smoothing is a balancing out spending and saving to attain and maintain the highest possible living standard over the time.



In Nakhichevan, borrowers have more diversified structure of credit utilization. 1/5 of credits is spent on the purchase of production equipment and 10% goes to consumption. Existence of the consumption oriented loans shows that micro-loans are also used as expenditure smoothing tool in the regions of Azerbaijan.

Box 1. Mehman Huseynov started his small private furniture repair business in 1998 when there were not many business opportunities in Nakhchivan city. He was self-employed and earned hardly enough income to hire one employee in 2004. The quality of the service and the capacity of his business were not very satisfactory. Mehman needed an additional source of finance in order to solve this issue. It was November of 2005 when he received his first loan from the CDMC's urban micro-credit project to revitalize his business. The amount of borrowed loan was US\$2,000 with a monthly interest rate of 1.5%.

Mehman used the first loan to purchase better quality inputs for his business. The quality of the services and products improved, increasing the number of orders received. In result, the monthly sales revenue from the services rendered increased threefold while the input cost decreased twice.

Since the first loan was successfully repaid in a timely manner, Mehman applied and received the second loan in the amount of US\$4,000 in July, 2006. He improved the technology through purchasing new equipment and thus, increased the overall capacity of the business as well as improved the quality of the services and products.

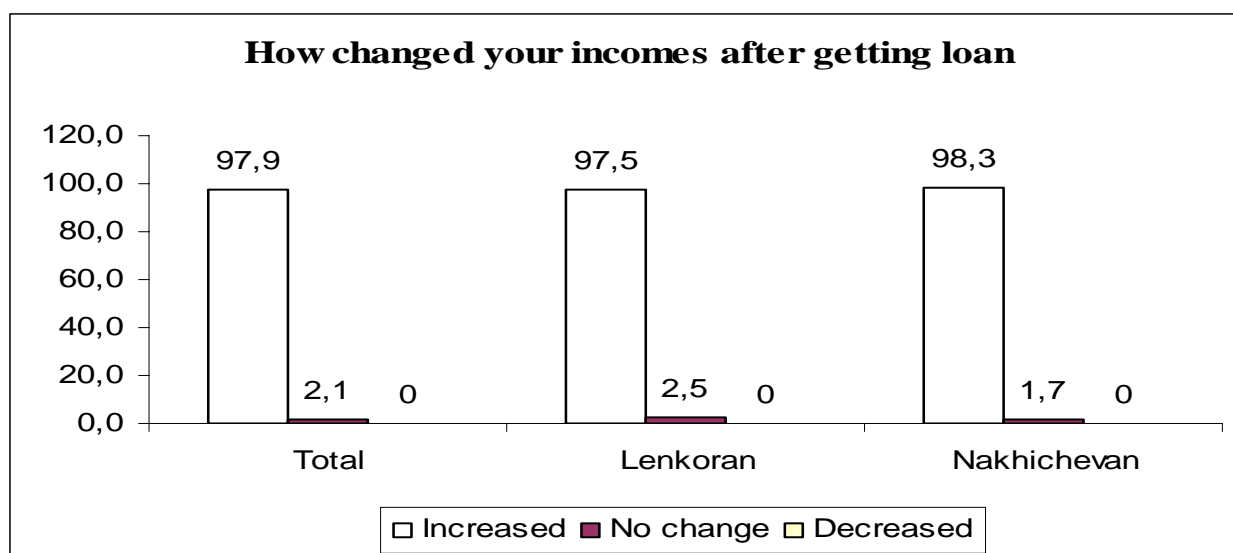
Today, Mehman's furniture repair and assembling business serve not only customers in Nakhchivan city, but also outside the city and various markets across the region. The business

adds value to its services and products by providing free delivery of orders within city boundaries. His business employs 5 skilled workers and about 28 persons (including family members of both owner and employees) benefit directly and indirectly from its success.

The future plans for the business expansion include purchasing of more equipment and renewing the old equipment. Purchase of a vehicle is also being planned as well as three additional employees are to be hired. Mehman intends to add new services, including carpet cleaning and production of blankets, mattresses and pillows. (16)

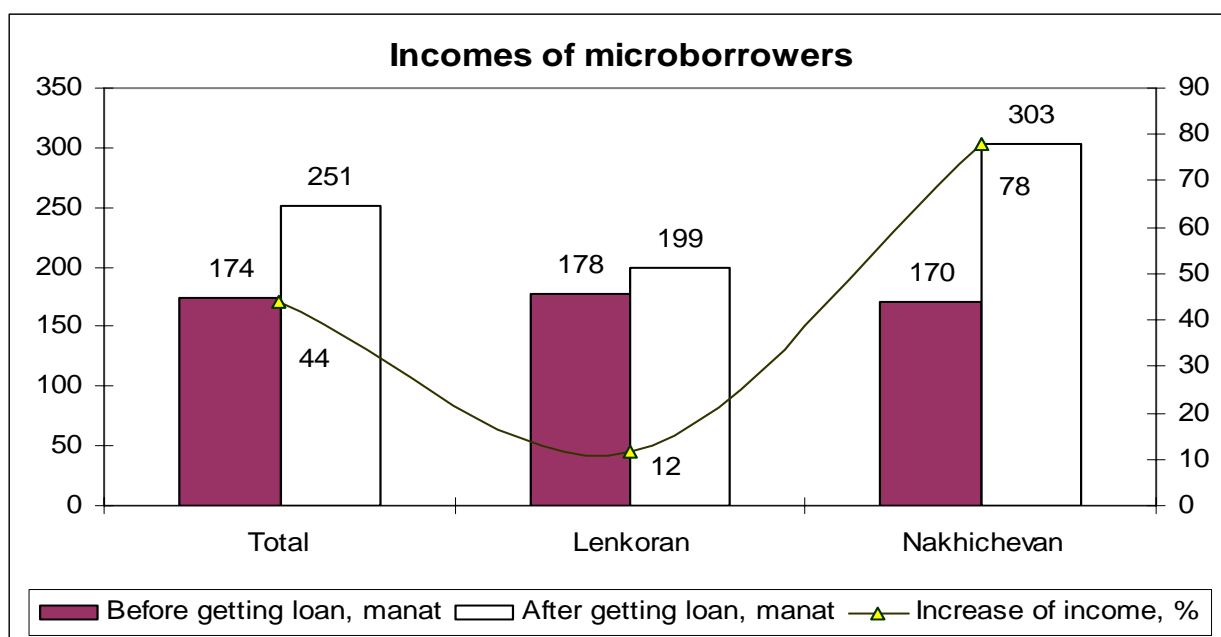
According to survey result, in general microcredits have in general positive impact on the growth of borrower's income.

Chart 8.



Hence, 98% of respondents indicated that their incomes had increased after getting loans from MFI.

Chart 9.



Nominal monthly income of micro-borrowers saw average growth of by 44%, from 174 manat to 251 manat¹⁰. Incomes of micro-borrowers in Lenkoran grew by 12% and in Nakhichevan this figure was reported to be 78%.

Of course, the establishment of the micro-credit scheme should not be considered as the only reason behind the borrower's incomes. The income of entire population of Azerbaijan has been increasing in the last years due to high growth dynamics observed in the country. Expanding micro-financing activities seem to be an additional impulse to the income growth process.

Box 2. Sandal Ismailov 40 year old. He lives in Bolady village of Lenkoran district together with their 6 family members. He obtained credit from Credit Implement Agency first time in Mart of 2003. Since that time he obtained credit 5 times totally by 2800\$. Before obtaining credit Hacibala had 2 head cattle. But now he has 6 head cattle. During the last 4 years he sold 7 cattle. Additionally he sold milk and meat and totally gained 4900\$ profit. He is very satisfied from using microloan.

Ramiz Sayadov has similar history. He was born in Hovzova village at Lenkoran city. He has 5 family members. He first time accessed credit in 2003. From this time he obtained loans 5 times, totally 3765 \$ credit for purchasing of cattle. Before obtaining credit, Ramiz had 3 head cattle. Now he has 7 head cattle. During the last 4 years he gained 6120 \$ profit from selling cattle, milk and meat.

Gurcu Sadixova was born in 1963 year. She has 4 family members. She obtained credit first time in May of 2005. From this time she took short-term credit 3 times totally by 1765 \$. Before

¹⁰ 1 USD equal 0.83 Azerbaijanian manat

obtaining credit she had 5 head cattle. But now she has 8 head cattle. During the last two years, she obtained 8000 \$ profit from selling cattle, milk and meat.

Comparison of monthly income of borrowers before getting loan with poverty level in Azerbaijan shows that most of them were not poor. So, in the case of Azerbaijan we can agree with first criticism of microfinancing concerning that microfinance doesn't reach the poorest of the poor.

Table 6. Average monthly poverty levels in Azerbaijan in AZN

	2002	2003	2004	2005
Absolute poverty level	35,0	35,77	38,8	42,6
Relative poverty level	25,03	25,94	28,9	33,56
Extreme poverty level	-	24,83	26,86	29,5

Source: Ministry of Economic Development

But, taking into account number of family members the monthly income of borrowers is much smaller. Family members of microborrowers were 5 both in Lenkoran and Nakchivan.

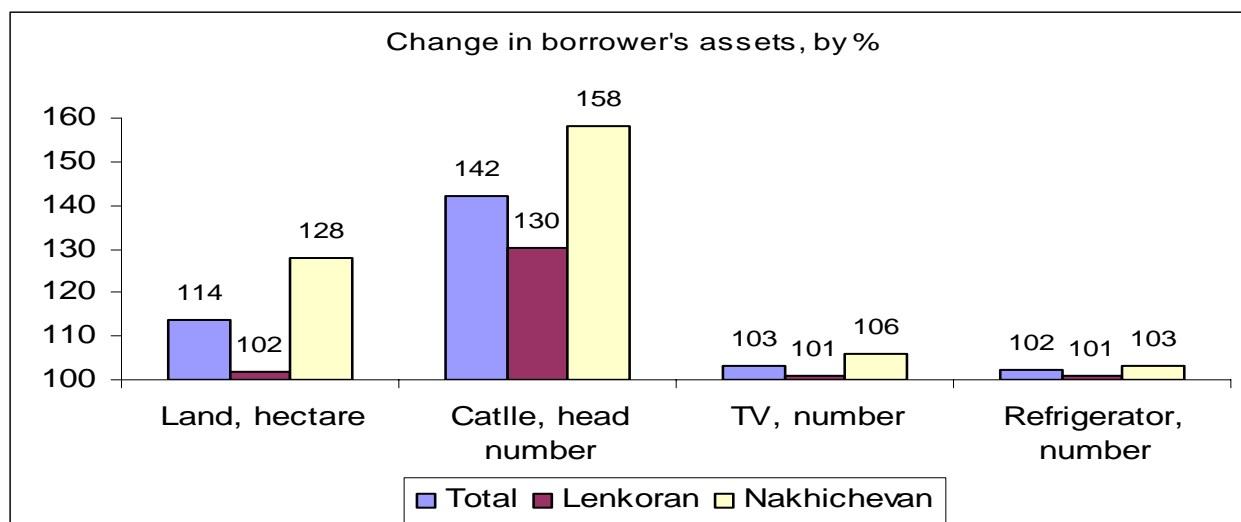
Table 7. Income per family member in manat

	Total	Lenkoran	Nakchivan
Family members	5	5	5
Monthly income before getting loan, in manat	174	178	170
Monthly income per family member before getting loan, in manta	34.8	35.6	34
Monthly income after getting loan, in manat	251	199	303
Monthly income per family member after getting loan, in manat	50.2	39.8	60.6

Table 2 shows that we may not agree with last criticism of microfinance concerning microfinance is not universal in application. Family members of micro borrowers in Azerbaijan indirectly benefit from microfinance. Microfinance in Azerbaijan probable does not exclude the young, the old, ill and the handicapped, since these people are all part of a family. The family of the microborrower will benefit through an increase in household income, which translates into better health and nutrition, opportunities for higher education and decrease in vulnerability to economic shock.

Assets of borrowers have been expanded as well. Borrower's private land expanded at a rate of 14% despite a small share (only 1 %) of credits used on the real estate purchase. The cattle stock saw even more rapid growth – 42% (30% and 58% growth in Lenkoran and in Nakhichevan accordingly).

Chart 10.

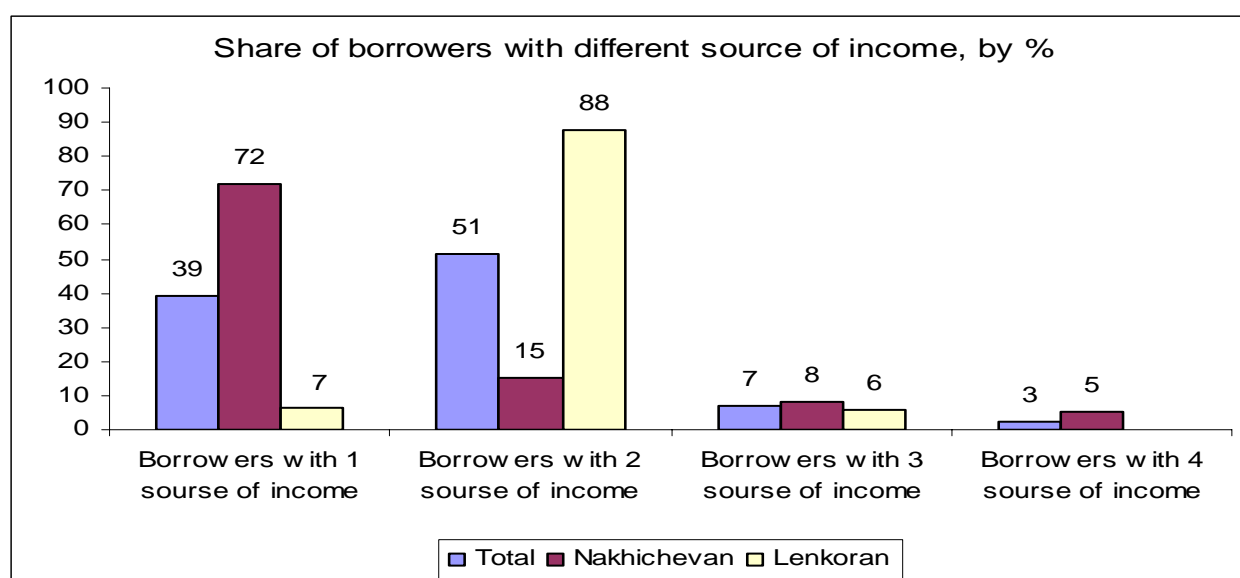


The estimations demonstrate that with the per head cattle stock being only 2.85 on average before getting the loan access in Lenkoran, it reached 3.72 head after access became feasible. Figures for Nakhichevan comprise 2.09 and 3.31 accordingly.

The number of TVs increased by 3 per cent, while the number of refrigerators increased by 2 per cent. Additionally, 26 borrowers indicated that they had reconstructed their homes, 5 of them had bought mobile telephones, one purchased the washing machine and another one automobile.

Microfinance also has a positive impact on the diversification of the income by structure: more than 60% of borrowers have secondary source of income now.

Chart 11.



In Lenkoran 93% and in Nakhichevan 28.3% of borrowers have 2 or more sources of income. Formulation of secondary source of income is related with the use of microcredits. Therefore for most respondents, business income and income from agriculture become source income only after access to microcredits. Access to microcredits contributes to diversification of incomes by creating additional sources of income.

Table 8. Information about source of borrower's income

	Total	Nakhichivan	Lenkoran
<i>Borrowers with one source of income</i>	39,2	71,7	6,7
Wage	10,0	20,0	0,0
Business income (small trade)	20,4	40,8	0,0
Pension	2,9	5,8	0,0
Income from agriculture	5,4	4,2	6,7
Targeted sosial assitance	0,4	0,8	0,0
<i>Borrowers with 2 sources of income</i>	51,3	15,0	87,5
Pension and income from agriculture	7,1	0,8	13,3
Wage and income from agriculture	37,1	8,3	65,8
Pension and businnes income	0,4	0,8	0,0
Wage and businnes income	1,7	3,3	0,0
Business income and income from rent	0,4	0,8	0,0
Business income and income from agriculture	2,5	0,8	4,2
Targeted social assistance and income from agriculture	2,1	0,0	4,2
<i>Borrowers with 3 sources of income</i>	7,1	8,3	5,8
Wage, business income and income from agriculture	4,6	5,8	3,3
Wage, pension and income from agriculture	1,7	1,7	1,7
Wage, pension, businnes income	0,4	0,8	0,0
Pension, business income, income from agriculture	0,4	0,0	0,8
<i>Borrowers with 4 sources of income</i>	2,5	5,0	0,0
Wage, pension, business income, income from agriculture	2,5	5,0	0,0
Total	100,0	100,0	100,0

In total, 98% of respondents indicated that micro-loans had positive impact on their business. There was not any case of negative influence.

Table 9. How do you assess the impact of loan on your business, shares in %

	Total	Nakhichevan	Lenkoran
Very good	24,6	33,3	15,8
Good	73,3	64,2	82,5
No impact	2,1	2,5	1,7
Bad	0,0	0,0	0,0
Very bad	0,0	0,0	0,0

Analysis of repayment sources of micro-loans suggests that most borrowers gained profits out of using the credit facilities.

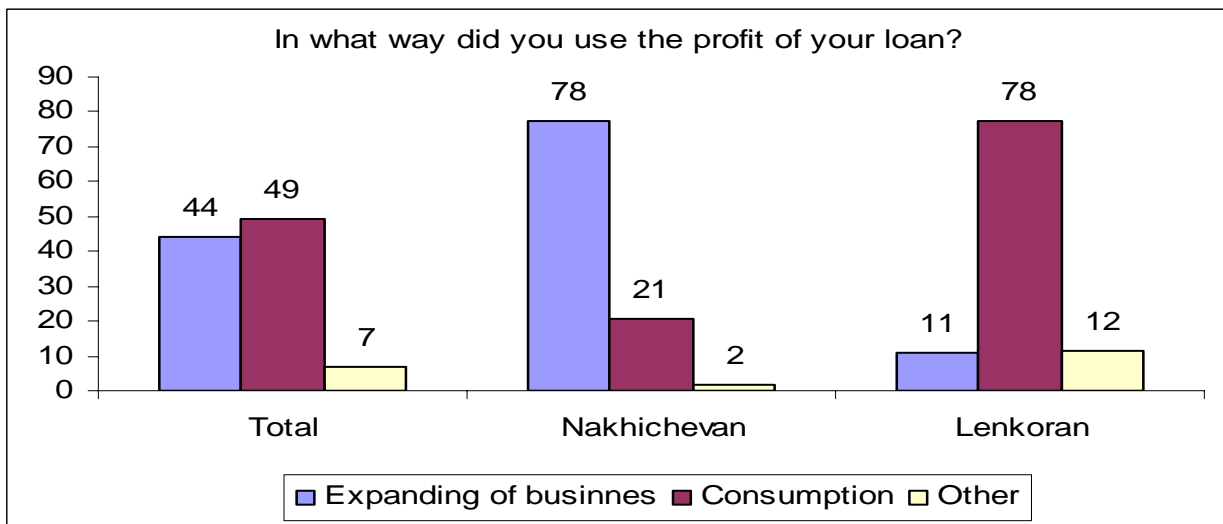
Table 10. How did you repay your loan, shares in %

	Total	Nakhichevan	Lenkoran
Profit from using of loan	30,8	61,7	0,0
Profit from using of loan and wage	10,0	6,7	13,3
Profit from using of loan and income of family members	42,9	1,7	84,2
Profit from using of loan, income of family members and wage	4,2	7,5	0,8
Profit from using of loan and debt from friends	0,4	0,0	0,8
Wage	5,8	11,7	0,0
Income of family members	5,0	9,2	0,8
Loan was repaid by group members	0,8	1,7	0,0

Almost 90% of borrowers (77% in Nakhichevan and 99% in Lenkoran) reported that earnings they gained out of loans used for conducting investment activities have also been a source of the loan repayment. 1/3 of borrowers surveyed, especially in Nakhichevan alleged that their earnings were the only source of the loan repayment. 57.5% of respondents (16% in Nakhichevan and 99% in Lenkoran) used earnings from loan as additional source of loan repayment.

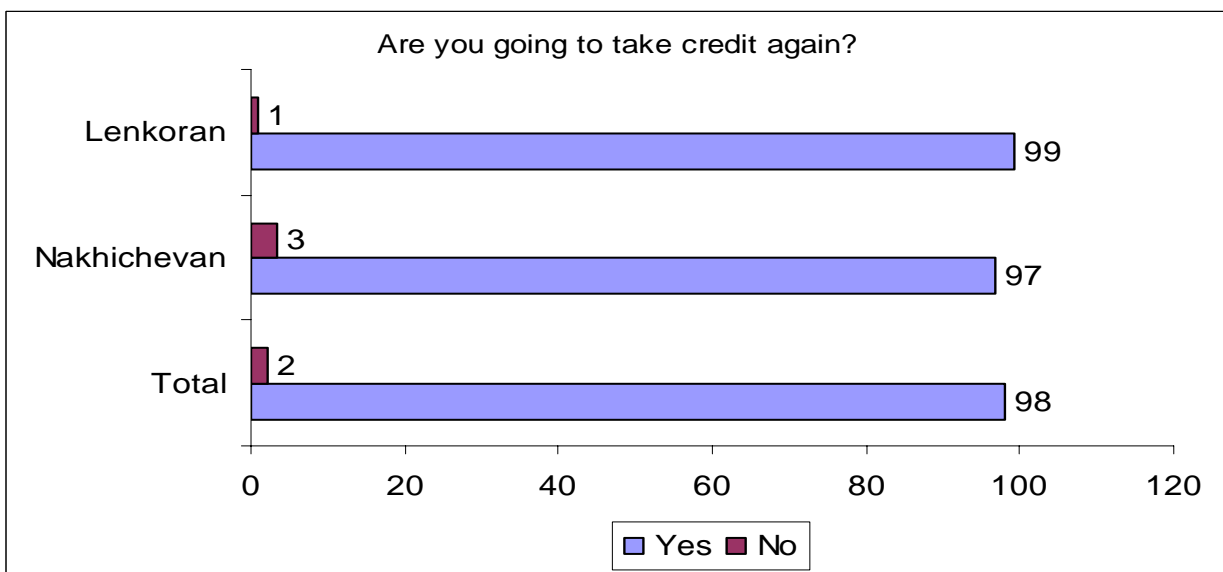
Profits earned out of using credits served as a source of business expansion (44 per cent) and spurred the consumption growth a well (49 per cent).

Chart 12.



Most borrowers, - 98 per cent of respondents (99 per cent in Lenkoran and 97 per cent in Nakhichevan) have their plans to apply for micro-finance loans again.

Chart 13.



This fact also illustrates the existence of a positive impact of micro-loans on the business and living standard of borrowers.

As is seen from results of questionnaire, despite the blockade imposed by Armenia, microfinance have more positive impact on poverty reduction in Nakhichevan. May be it is explained by more favorable business climate in Nakhichevan compared to Lenkoran.

Analysis of outcomes of Community Development and Micro Credit (CDMC) project which was implemented by the International Organization for Migration (IOM) under a tripartite agreement with the United Nations

Development Programme (UNDP) and the Government of Nakichevan Autonomous Republic also showed positive impact of microloans on poverty in Nakichevan. Thus, “the rural credit scheme supported 2290 households from 72 villages. Most members of rural credit groups reported improved economic situations. Real incomes of the client households increased by 75% on average during the period of 1999-2005, while their wealth (value of assets) increased by 90%. A number of economic migrants, who were leaving for Turkey for rural seasonal jobs, now are growing their own crops or raising livestock..... Providing access to finance for 162 small businesses resulted in generating 539 permanent jobs” (International Organization for Migration 2006)

As a result of analyses we can conclude that the broadening activities of microfinance institutions turned to be an important input into the poverty reduction process in Azerbaijan. Clients who participate in microfinance programs have enjoyed increased household income and greater empowerment. They also benefit from consumption smoothing and ability to gain over time.

Conclusions and recommendations

Conclusions

- Strong demand for microfinance services exist in Azerbaijan;
- Most microborrowers in Azerbaijan are not very poor;
- MFI in Azerbaijan is financially sustainable organizations;
- The development of microfinance has had positive impact on poverty reduction in Azerbaijan. Increase of microborrowers' incomes prove this point;
- Microloans assist microbusinesses to grow into small businesses;
- MFI made positive impact on poverty reduction in Azerbaijan through deepening of competition in the financial market. Active entry of the banks to microfinance market confirms this conclusion;
- Microloans assist avoiding “Dutch disease” in Azerbaijan, since these loans are received by non-oil sector of the economy;

- Microloans decrease regional imbalance in the economic development in Azerbaijan, since according to AMFA microfinance covers 60 regions of the country.

- Strong demand for microfinance services exist in Azerbaijan;

- Microfinance has big potential to address poverty through enhancing business opportunities and, smoothing consumption of people. So along with investment oriented credits consumption oriented credits also exist.

Recommendations

- Special law on “Microfinance organizations” should be recently approved in Azerbaijan;

- The government should establish more favorable environment for development of microfinance in Azerbaijan;

- The law about “Credit Unions” should be amended. Credit Unions should be allowed to give credits to non-members;

- In order to decrease credit risks for MFI’s, credit register which is functioning in National Bank of Azerbaijan should also obtain information about borrowers of MFI’s;

- Government should ensure macroeconomic stability (low inflation, stable exchange rate, sound financial sector and other), since it is important for poverty reduction effectiveness of the microfinance.

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Annex 1: Household Sample Survey Questionnaire (2007)

Background information about the respondent

1. Living place of respondent:village ofdistrict

2. Age of respondent:....

3. Sex of respondent

a. male

b. female

4. The number of family members: ...

5. Source of family income:

a. Wage

b. Pension

c. Addressed social assistance

d. Income from business

e. Income from agriculture

i. income from rent

f. Other:.....

Use of loan

6. How many times did you get loans?

7. When was the first time you got a loan?

8. What is the total sum of your loans?:.....

9. Maturity of the loan was mainly:.....

10. Interest rates for loan were mainly:.....

11. In what way did you invest your loan?:

- a. Production equipment
- b. Transport facility
- c. Financing of the health costs
- d. Financing of the education expenditures
- e. Consumption
- f. Purchasing of real estate
- g. Purchasing of good for reselling
- h. Purchasing of the cattle
- i. Return of debt
- j. Other:

12. How did you repay your loan?

- a. From additional income gathered from using credit
- b. From wages

- c. From incomes of family members
- d. Borrowing from relatives or friends
- e. Support of other members of the group

13. How did loans impact on your business?

- a. Very good
- b. Good
- c. No impact
- d. Bad
- e. Very bad

14. In what way did you use the profits of your loan?

- a. Expanding of the business
- b. Consumption
- c. Other:.....

15. Your monthly income before the loan. Sum:

16. How did your income change after using the loan?

- a. Increased
- b. No change
- c. Decreased

17. Your income now. Sum:

18. What kind of assets had your family had before the getting credit?

- a. Land:..... (hectare)
- b. Cattle:..... (head)
- c. TV:..... (number)
- d. Refrigerator:..... (number)
- e. Own business:
- i. Other:

19. What kind of assets did your family get after using credit?

- a. Land:..... (hectare)
- b. Cattle:..... (head)
- c. TV:..... (number)
- d. Refrigerator:..... (number)
- e. Own business:
- i. Other:

20. Are you going to take the credit again?

- a. Yes
- b. No

21. Date of the questionnaire