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**"The impact of microfinance services
on the poverty in Azerbaijan "**

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I. Main features of microfinance

Generally microfinance is small financial services to poor people who don't have access to traditional bank services. Microfinance services could be divided to three groups:

1. Microcredits. *Microcredits are the small loans provided by MFI to poor and low-income households and their microenterprises. Microloans have the same advantages:*

- *Unlike other loan, clients are not required to provide collateral to receive loans;*
- *Most of MFI usually go to their clients to provide loans and receive payments, rather than requiring clients to come to them.*

2. Additional microfinance services. *Additional microfinance services include savings, insurance and remittance transfers.*

3. 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.*

I. Main features of microfinance

Together with advantages there are also much criticisms of the microfinance approach to poverty alleviation. 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 discriminates 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.

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.

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 don’t cover generations and all regions. The most biting indictment against microfinance is that it requires the poor to be entrepreneurial.

II. 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. For example:

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)

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.

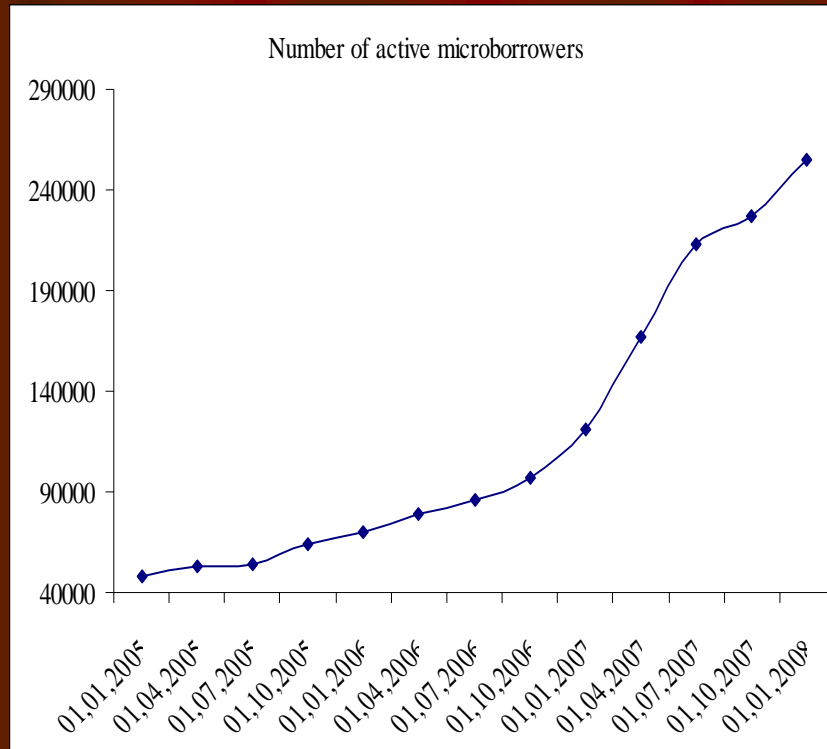
II. The impact of microfinance on poverty reduction in foreign countries

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 MkNelly and Cristopher Dunford 1999)

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 MkNelly and Cristopher Dunford 1998)

Indonesia. In Indonesia borrowers increased their incomes by 12.9% compared to increases of 3 percent by non-borrowers. 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)

III. Development of microfinance services 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.
- 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.

III. Development of microfinance services in Azerbaijan

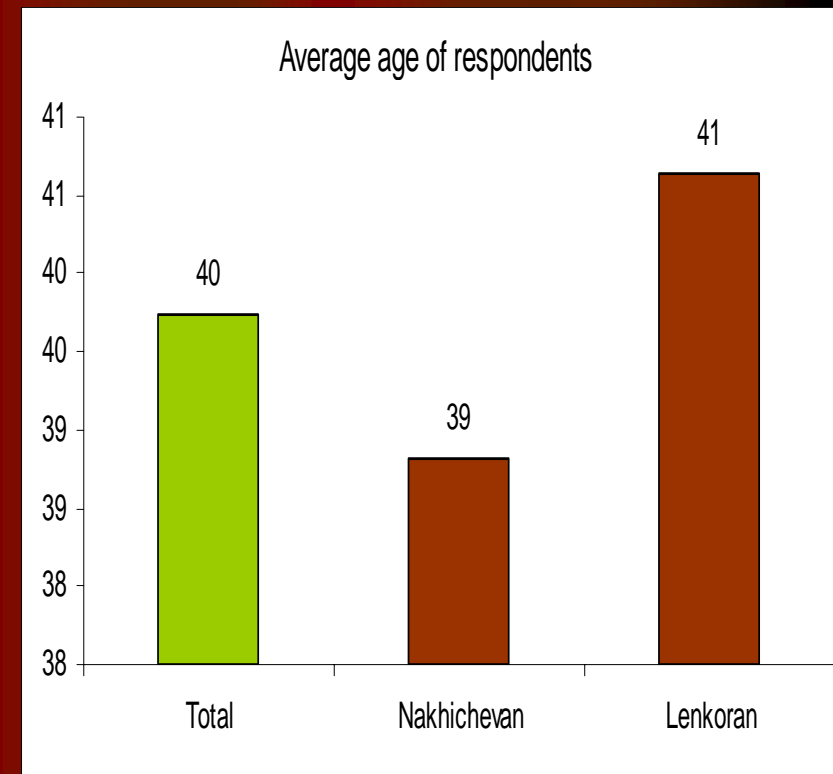
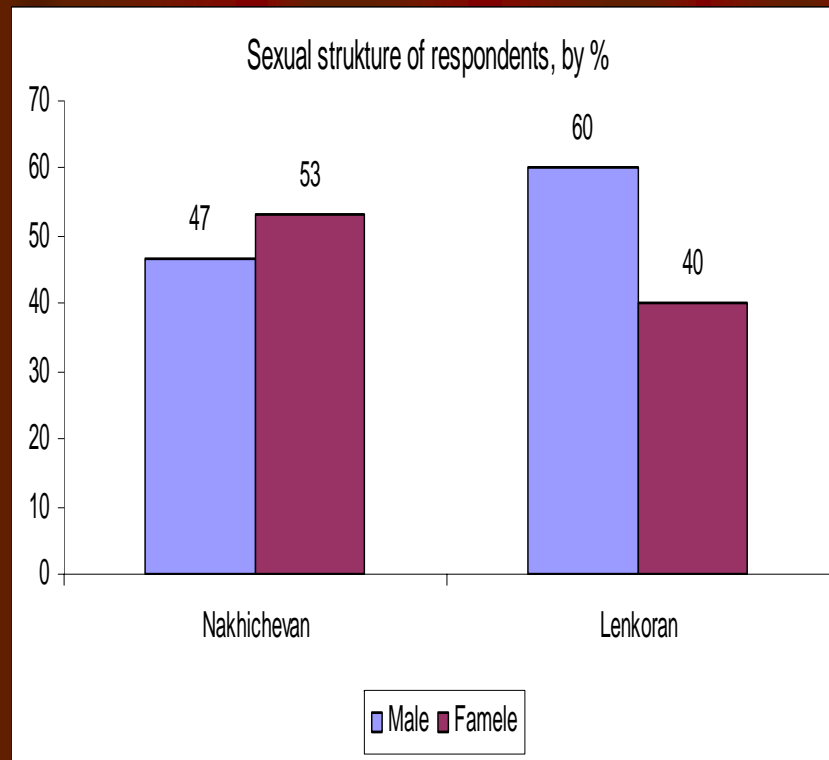
Microfinance services in Azerbaijan are provided by:

1. Microfinance institutions (MFI). *At present, sixteen microfinance institutions operate in the country with forty one branches.;*

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

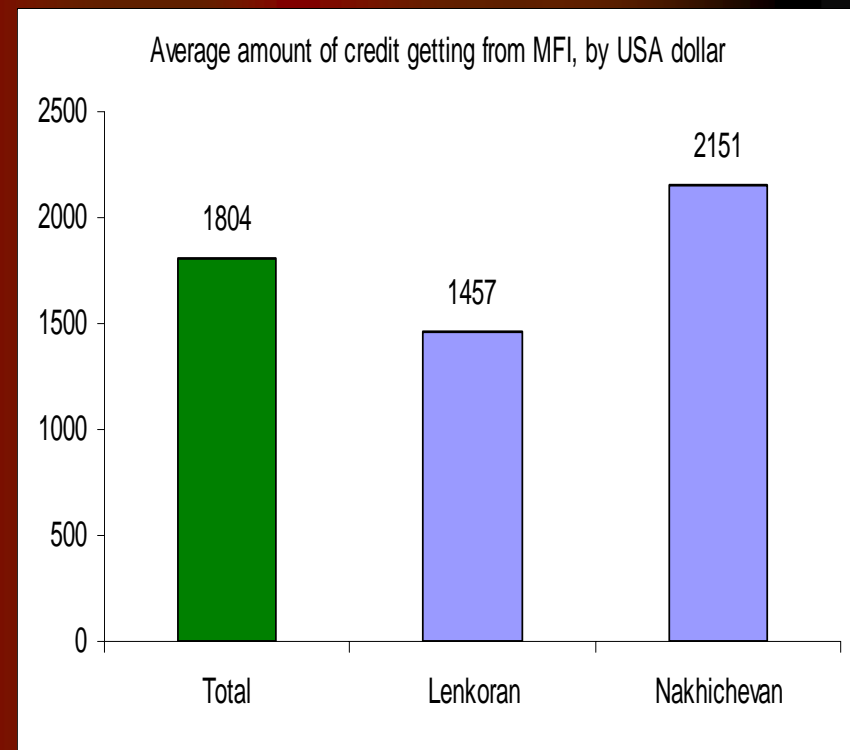
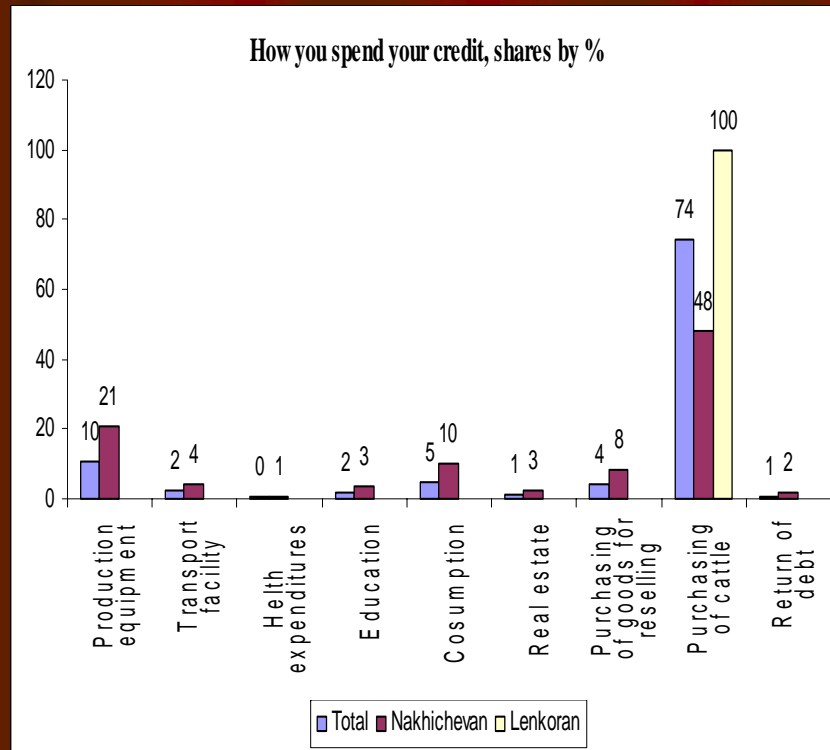
3. Banks. *It is observing increasing role of banks in microfinance service market last times. Thus, by end of 2007 the share of banks in microfinance portfolio constitutes approximately 60%. There is a stand-alone Microfinance Bank operating in the country with its 9 branches.*

IV. The impact of micro services on poverty in Azerbaijan



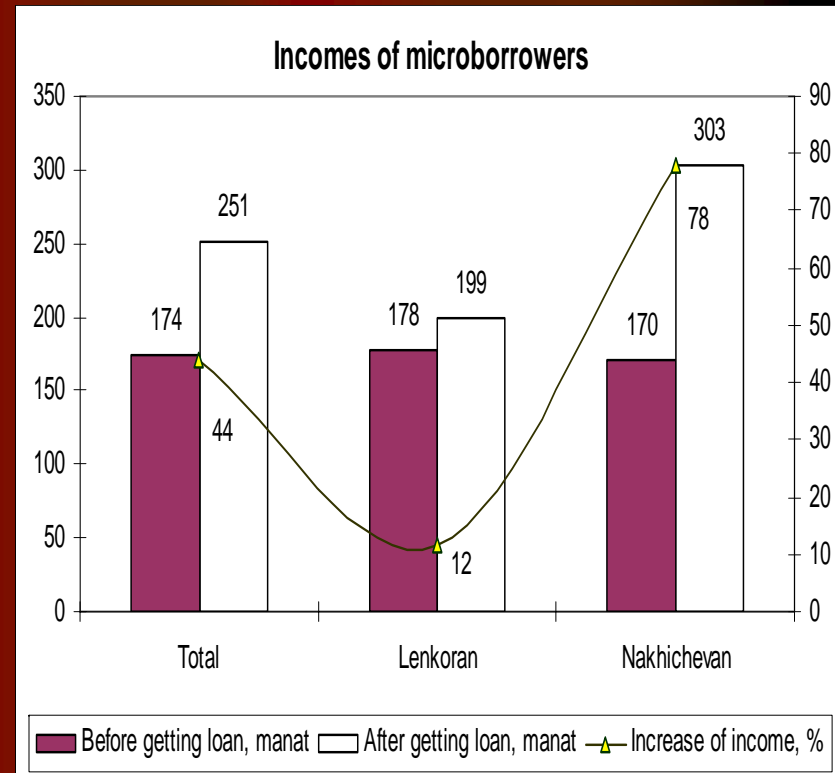
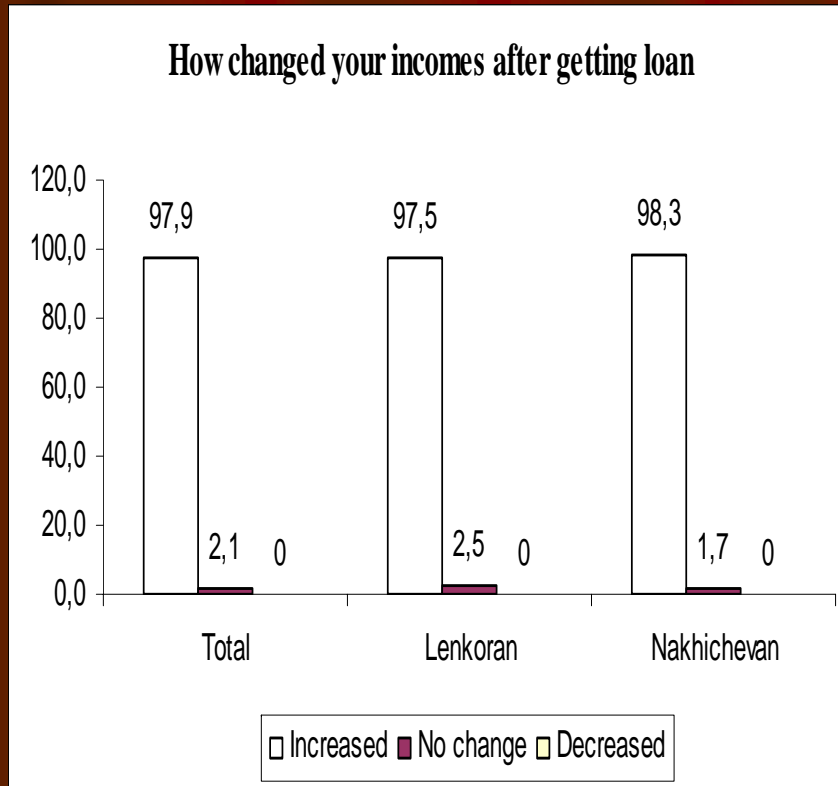
- To assess the impact of microfinance to living standards in Azerbaijan, a questionnaire was developed and 120 micro borrowers in Nakhichevan (clients of Nakhichevan Kredit LSD) and 120 borrowers in Lenkoran (clients of Credit Implementing Agency) were surveyed.

IV. The impact of micro services on poverty in Azerbaijan



- 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.
- 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.
- In Nakhichevan, borrowers have more diversified structure of credit utilization. 1/5 of credits in spent on the purchase of production equipment and 10% goes to consumption.

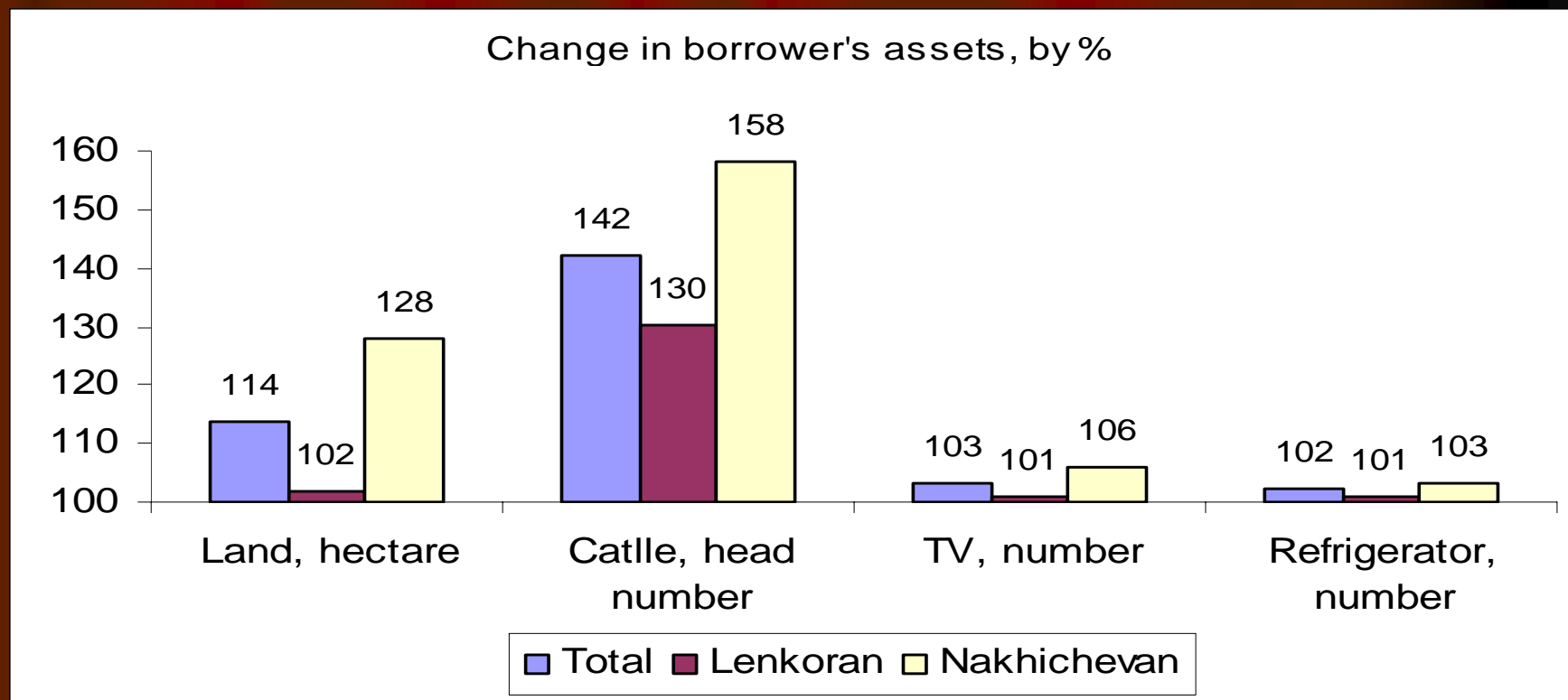
IV. The impact of micro services on poverty in Azerbaijan



- 98% of respondents indicated that their incomes had increased after getting loans from MFI.
- Nominal monthly income of micro-borrowers saw average growth of by 44%, from 174 manat to 251 manat^[1]. Incomes of micro-borrowers in Lenkoran grew by 12% and in Nakhichevan this figure was reported to be 78%.

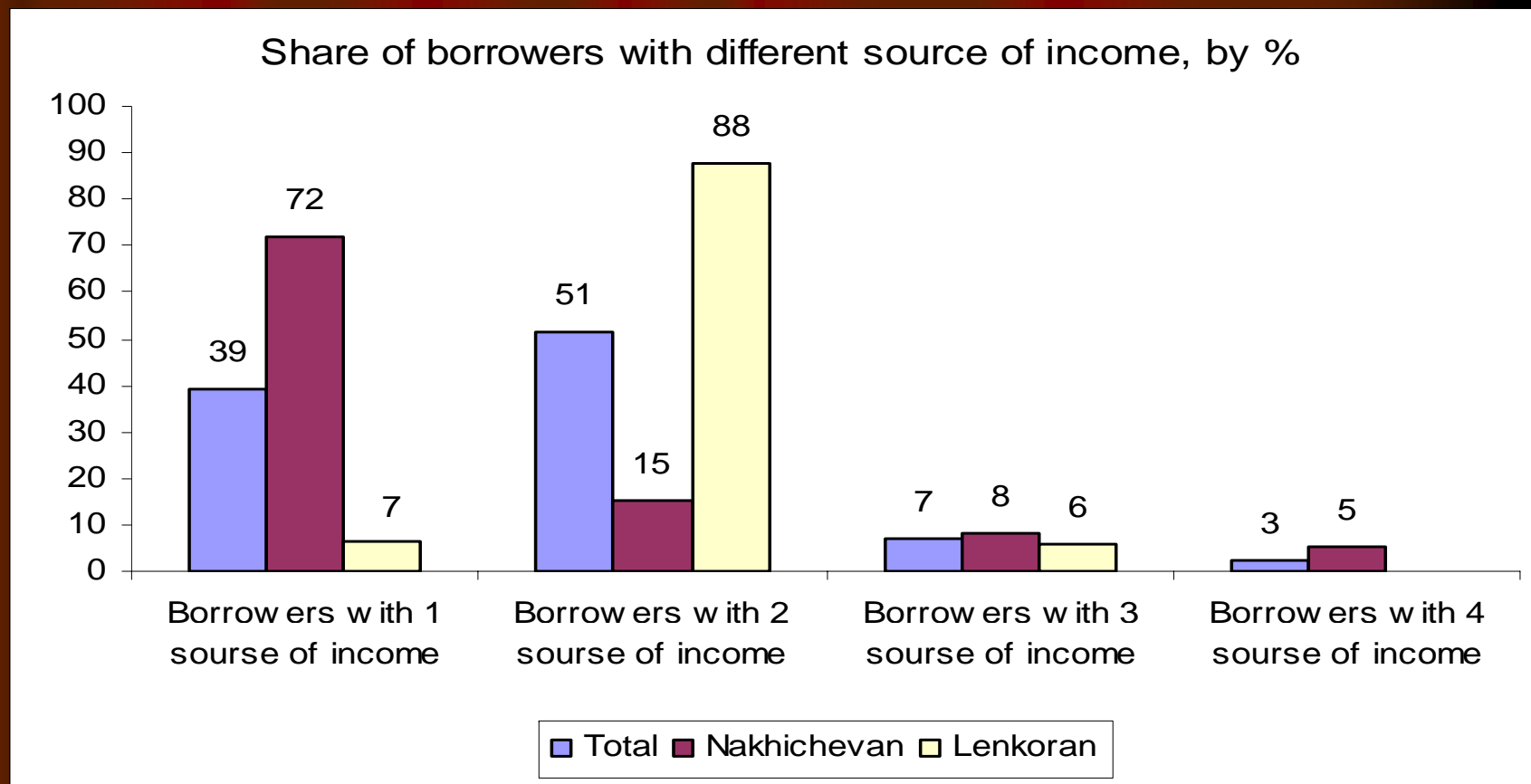
[1] 1 USD equal 0.80 Azerbaijanian manat

IV. The impact of micro services on poverty in Azerbaijan



- 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).

IV. The impact of micro services on poverty in Azerbaijan



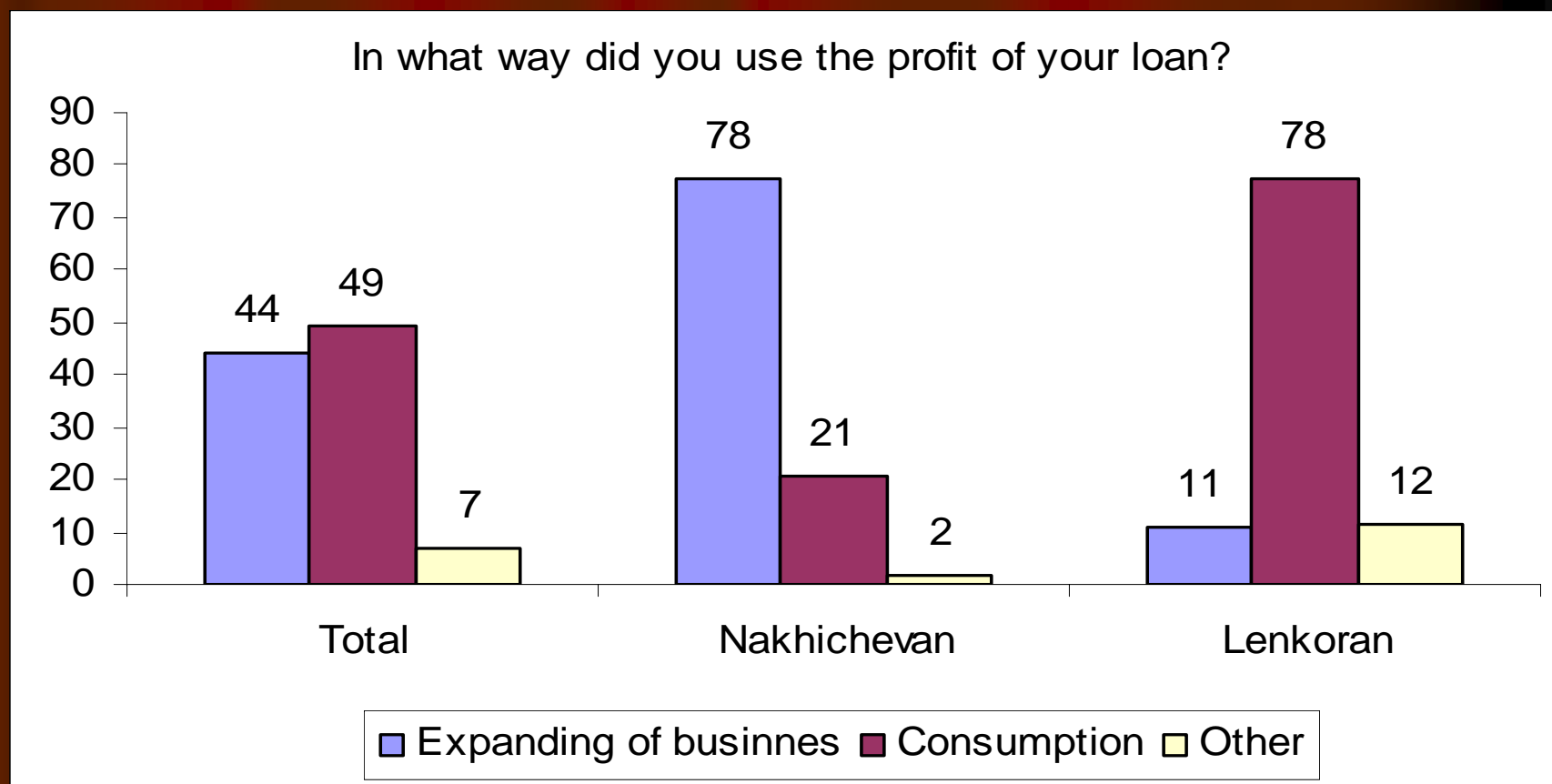
- Microfinance also has a positive impact on the diversification of the income by structure: more than 60% of borrowers have secondary source of income now.
- In Lenkoran 93% and in Nakhichevan 28.3% of borrowers have 2 or more sources of income.

IV. The impact of micro services on poverty in Azerbaijan

How did you repay your loan, shares in %

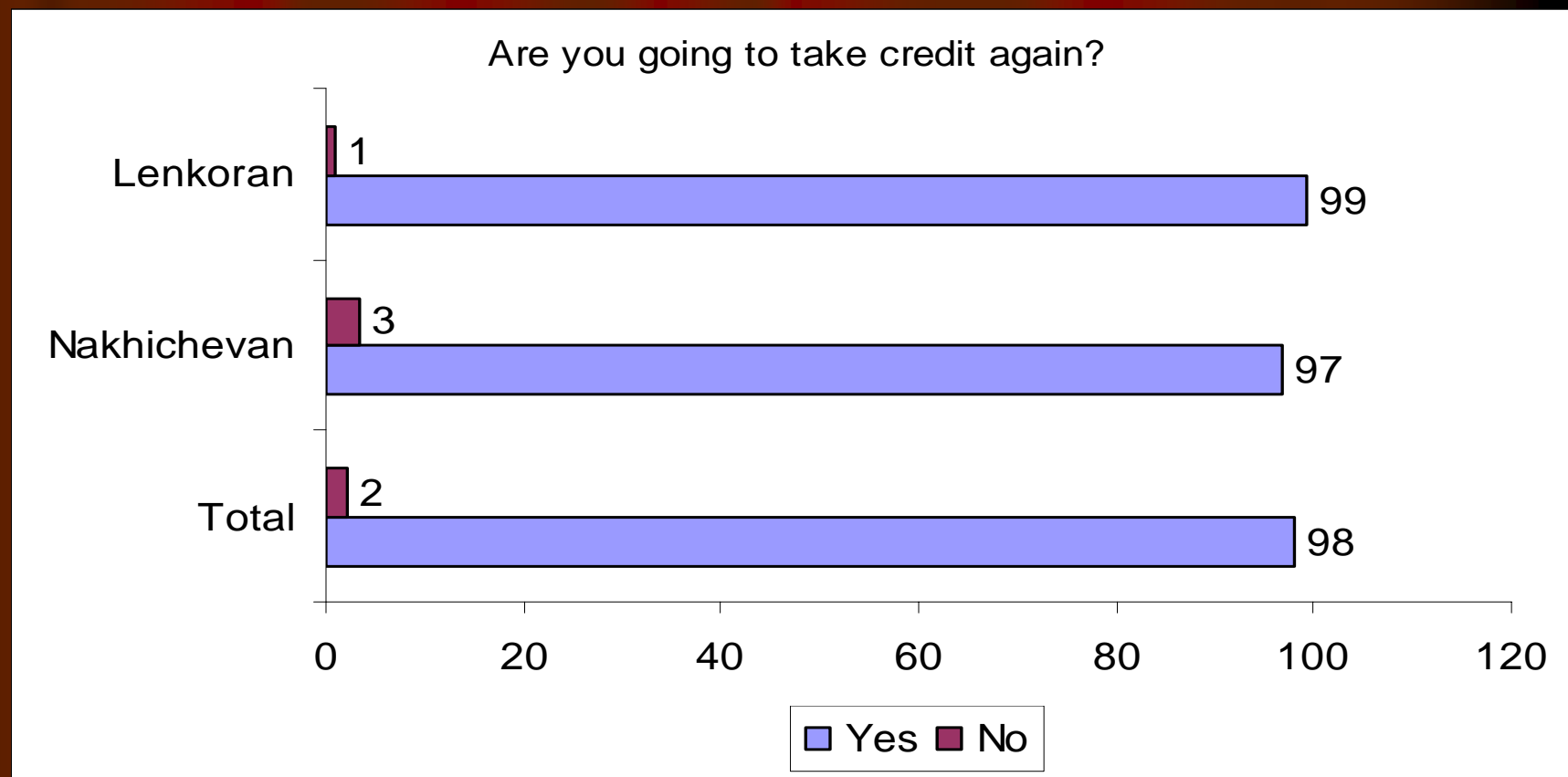
	Total	Nakhichevan	Lenkoran
Profit from using of loan	30,8	61,7	0,0
Profit from using of loan and wage	10,0	6,7	13,3
Profit from using of loan and income of family members	42.9	1.7	84.2
Profit from using of loan, income of family members and wage	4.2	7.5	0.8
Profit from using of loan and debt from friends	0.4	0.0	0.8
Wage	5.8	11.7	0.0
Income of family members	5	9.2	0.8
Loan was repaid by group members	0.8	1.7	0.0

IV. The impact of micro services on poverty in Azerbaijan



- 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).

IV. The impact of micro services on poverty in Azerbaijan



- 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.

V. Conclusions and recommendations

Conclusions:

- Strong demand for microfinance services exist in Azerbaijan;
- Most microborrowers in Azerbaijan are not very poor;
- MFI in Azerbaijan are 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.
- 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.

V. Conclusions and recommendations

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.

Thank you very much!