Agenda

1. Setting the Stage
2. Main Findings of the MSME A2F Survey
3. Key Policy Recommendations
Setting the Stage

- Overview of the Azerbaijani Financial Sector – public data
- Financial constraints to MSME finance – public data
While financial sector nearly doubled along the oil boom, it remains fairly small.

Many SMEs in Azerbaijan have bank accounts, but still don’t have access to loans.

### Percentage of SMEs With a Checking or Savings Account

- **High Income**: 87%
- **Middle Income**: 88%
- **Least Developed Countries**: 82%
- **Azerbaijan**: 65%

### % SMEs with line of credit from financial institution

- **High Income**: 51%
- **Middle Income**: 45%
- **Least Developed Countries**: 18%
- **Azerbaijan**: 15%

Source: Enterprise Surveys World Bank, 2010-2014
Azerbaijani SMEs rely primarily on self financing, while banking financing is the main source of external finance due to underdevelopment of other forms of financing.

**Financial sources for working capital**

- **High Income**
  - Internal Financing: 67%
  - Banking Financing: 10%
  - Supplier Credit Financing: 8%
  - Other Financing: 11%

- **Middle Income**
  - Internal Financing: 70%
  - Banking Financing: 7%
  - Supplier Credit Financing: 12%
  - Other Financing: 11%

- **Least Developed Countries**
  - Internal Financing: 76%
  - Banking Financing: 6%
  - Supplier Credit Financing: 8%
  - Other Financing: 11%

- **Azerbaijan**
  - Internal Financing: 93%
  - Banking Financing: 5%

**Financial sources for investment**

- **High Income**
  - Internal Financing: 60%
  - Banking Financing: 6%
  - Trade Credit Financing: 3.7%
  - Other Financing: 23%

- **Middle Income**
  - Internal Financing: 67%
  - Banking Financing: 4.8%
  - Trade Credit Financing: 18%
  - Other Financing: 18%

- **Least Developed Countries**
  - Internal Financing: 81%
  - Banking Financing: 9%
  - Trade Credit Financing: 2.8%
  - Other Financing: 71%

Source: Enterprise Surveys World Bank 2007-2014
While bank credit is the main source of formal finance, the depth of the market is much lower than in peer economies.
Constrained finance is the key business growth impediment

% of MSMEs reporting access to finance as a major obstacle to business operations

Source: WBG Enterprise Survey 2013, WEF Global Competitiveness Index
Collateral based lending is dominant, with reliance on cash flow/business analysis still rare.

% of MSME loans requiring collateral

Source: WBG Enterprise Survey 2013
While requirements for collateral exceed 200% of loan value and rarely feasible for MSMEs.
MSME Access to Finance Survey: What are the Key Findings?
Access to Finance is a Major Constraint for MSMEs

% of MSMEs cited the reason as the most important obstacle to business growth

Constrained access to finance is the most severe in Aran /Daglig-Shirvan region and is especially felt by the construction and trade sectors

<table>
<thead>
<tr>
<th>Azerbaijan</th>
<th>Georgia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to finance</td>
<td>51.0%</td>
</tr>
<tr>
<td>Tax rates</td>
<td>13.8%</td>
</tr>
<tr>
<td>Other</td>
<td>6.3%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>6.2%</td>
</tr>
<tr>
<td>Transport and other...</td>
<td>5.8%</td>
</tr>
<tr>
<td>Access to land</td>
<td>4.7%</td>
</tr>
<tr>
<td>Competitors that operate...</td>
<td>4.4%</td>
</tr>
<tr>
<td>Corruption</td>
<td>2.4%</td>
</tr>
<tr>
<td>Economic instability</td>
<td>1.5%</td>
</tr>
<tr>
<td>Electricity</td>
<td>1.3%</td>
</tr>
<tr>
<td>Business licensing and...</td>
<td>1.2%</td>
</tr>
<tr>
<td>Difficulty hiring or retaining...</td>
<td>1.1%</td>
</tr>
<tr>
<td>Courts</td>
<td>0.2%</td>
</tr>
<tr>
<td>Customs and trade regulations</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

Source: Azerbaijan MSME Access to Finance Survey, 2014
Loan usage among MSMEs remains low through sectors and size

While 2/3 of firms have a bank account, only 13.5% of MSMEs have a loan/ a line of credit with a bank

Loan usage among MSMEs by sector and size

Source: Azerbaijan MSME Access to Finance Survey, 2014
Loan rejection rates are high, especially in agriculture, for micro firms and businesses in some regions.

Loan rejection rates for MSMEs by sector, size, and region

- Services: 12.0%
- Construction and Trade: 20.4%
- Manufacturing: 23.2%
- Agriculture: 27.5%
- Medium: 6.3%
- Small: 10.6%
- Micro: 36.6%
- Lankaran/Guba-Kharchmaz: 56.9%
- Ganja-Gazax/Sheki-Zagatala: 29.5%
- Baku/Absheron: 6.2%
- Aran/Dagli-Shirvan: 35.7%

Source: Azerbaijan MSME Access to Finance Survey, 2014
Main reasons why MSMEs do not apply for a loan?

% of MSMEs that cited the reason as the main reason for not applying for a loan

- Application procedures were complex: 39.5%
- Collateral requirements were too high: 39.3%
- Did not think it would be approved: 8.2%
- Loan amount and maturity were insufficient for the company or the minimal amount or term were exceeding company requirements: 7.0%
- Interest rates were not favorable: 3.6%
- Other: 2.2%

Source: Azerbaijan MSME Access to Finance Survey, 2014
What Types of Collateral were Required for Outstanding Loans?

% of different types of collateral used for outstanding loans

- Personal assets: 31%
- Machinery and equipment: 26%
- Accounts receivable and inventories: 13%
- Immovable property of the firm: 23%
- Third party guarantees: 6%
- Other forms of collateral: 1%

Source: Azerbaijan MSME Access to Finance Survey, 2014
MSMEs are not familiar and don’t use key financial products such as LC, insurance, leasing and factoring

% of MSMEs aware, seeking, and receiving other sources of financing

<table>
<thead>
<tr>
<th>Service</th>
<th>Familiarity</th>
<th>Seeking</th>
<th>Receiving</th>
</tr>
</thead>
<tbody>
<tr>
<td>Later payments on purchase of goods</td>
<td>67.4%</td>
<td>57.5%</td>
<td>56.7%</td>
</tr>
<tr>
<td>Advanced payments from customers</td>
<td>71.3%</td>
<td>59.9%</td>
<td>52.2%</td>
</tr>
<tr>
<td>Letters of credit</td>
<td>20.8%</td>
<td>1.2%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Trade insurance</td>
<td>25.8%</td>
<td>5.3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Leasing</td>
<td>32.1%</td>
<td>5.8%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Factoring</td>
<td>17.4%</td>
<td>2.3%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Other</td>
<td>0.5%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: Azerbaijan MSME Access to Finance Survey, 2014
MSMEs know about Government’s program but rarely access it

% of MSMEs seeking and receiving supports from different type of government program

<table>
<thead>
<tr>
<th>Aware</th>
<th>Seeking</th>
<th>Receiving</th>
</tr>
</thead>
<tbody>
<tr>
<td>70% of the MSMEs were aware of the existence of government support programs for their field of activity</td>
<td>Special loan programs for a company’s sector – 5.1%</td>
<td>Special loan programs for a company’s sector – 1.7%</td>
</tr>
<tr>
<td></td>
<td>Subsidies by the government – 10.2%</td>
<td>Subsidies by the government – 2.6%</td>
</tr>
<tr>
<td></td>
<td>Technical assistance for a company from donor agencies or government – 2.7%</td>
<td>Technical assistance for a company from donor agencies or government – 2.7%</td>
</tr>
</tbody>
</table>

Source: Azerbaijan MSME Access to Finance Survey, 2014
MSMEs most interested in Government’s support to lower cost of funds, especially for micro and agribusinesses

Preferred government actions in % by MSMEs in different region, sector, and size

<table>
<thead>
<tr>
<th>Region and Sector</th>
<th>Lowering of taxes</th>
<th>Simplification of regulations</th>
<th>Cheaper financing available</th>
<th>Incentives to keep employees on payroll</th>
<th>Other (specify)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lankan/Guba-Kharchmaz</td>
<td>23.4%</td>
<td>28.6%</td>
<td>47.8%</td>
<td>0.2%</td>
<td></td>
</tr>
<tr>
<td>Ganja-Gazax/Sheki-Zagatala</td>
<td>8.2%</td>
<td>21.8%</td>
<td>65.0%</td>
<td>3.4%</td>
<td></td>
</tr>
<tr>
<td>Baku/Absheron</td>
<td>48.8%</td>
<td>25.8%</td>
<td>19.9%</td>
<td>1.1%</td>
<td></td>
</tr>
<tr>
<td>Aran/Daglig-Shirvan</td>
<td>15.1%</td>
<td>38.2%</td>
<td>45.7%</td>
<td>0.2%</td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>35.2%</td>
<td>36.6%</td>
<td>22.9%</td>
<td>5.3%</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>30.2%</td>
<td>36.8%</td>
<td>30.9%</td>
<td>1.1%</td>
<td></td>
</tr>
<tr>
<td>Micro</td>
<td>35.2%</td>
<td>22.0%</td>
<td>38.2%</td>
<td>0.2%</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>52.9%</td>
<td>17.0%</td>
<td>20.0%</td>
<td>2.0%</td>
<td></td>
</tr>
<tr>
<td>Construction and trade</td>
<td>25.5%</td>
<td>36.5%</td>
<td>37.7%</td>
<td>0.3%</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>39.3%</td>
<td>26.2%</td>
<td>31.0%</td>
<td>1.1%</td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>13.1%</td>
<td>27.0%</td>
<td>57.1%</td>
<td>1.5%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Azerbaijan MSME Access to Finance Survey, 2014
## MSMEs have high demand for finance in the next 12 months

<table>
<thead>
<tr>
<th>Region/Sector</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lankaran/Guba-Kharchmaz</td>
<td>92.9%</td>
</tr>
<tr>
<td>Ganja-Gazax/Sheki-Zagatala</td>
<td>81.5%</td>
</tr>
<tr>
<td>Baku/Absheron</td>
<td>60.9%</td>
</tr>
<tr>
<td>Aran/Daglig-Shirvan</td>
<td>85.3%</td>
</tr>
<tr>
<td>Micro</td>
<td>64.7%</td>
</tr>
<tr>
<td>Small</td>
<td>82.2%</td>
</tr>
<tr>
<td>Medium</td>
<td>85.5%</td>
</tr>
<tr>
<td>Services</td>
<td>50.3%</td>
</tr>
<tr>
<td>Construction and trade</td>
<td>83.5%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>63.9%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>92.3%</td>
</tr>
</tbody>
</table>

Source: Azerbaijan MSME Access to Finance Survey, 2014
MSMEs have poor business practices

Business Management and Financial Reporting Practices

Written financial records

- 65% Agriculture
- 52% Manufacturing
- 40% Construction and Trade
- 36% Services, Tourism, etc

Written business plan

- 53% Agriculture
- 38% Manufacturing
- 24% Construction and Trade
- 27% Services, Tourism, etc

Financial statements

Source: Azerbaijan MSME Access to Finance Survey, 2014
MSMEs with financial records and business plans have lower rejection rates

Financial constraints and loan rejection rate by different business practices

Source: Azerbaijan MSME Access to Finance Survey, 2014
Recommendations
Enhance state policy and state financial support

- Introduce MSME development strategy as a key pillar of Azerbaijan growth and diversification strategy Vision 2020

- Evaluate, streamline and rationalize existing government financial support programs against international best practices in order to improve design, uptake and effectiveness of existing measures

- Review the existing legal and regulatory framework to foster development of sound, broader and deeper financial market, encourage investments/FDI

Source: Azerbaijan MSME Access to Finance Survey, 2014
Broaden and deepen markets and products, foster innovation for more efficiency and financial inclusion

- Encourage new innovative financial instruments and lending technologies to tailor financial products to the MSME needs, including those for agribusinesses and rural entrepreneurs.

- Explore impediments to and opportunities to the development of leasing, factoring and trade financing (including domestic supply chain financing and export financing).

- Facilitate development of non-bank financial institutions and products, including non-bank credit and investment institutions, capital markets investment vehicles (for collective investments and voluntary pension savings program).

Source: Azerbaijan MSME Access to Finance Survey, 2014
Build credit market infrastructure and simplify procedures

- Encourage simplification and standardization of lending procedures and guidelines for MSMEs including loan application processes; enhance risks management

- Improve credit market infrastructure
  - Foster creation of a private credit bureau and ensure adequate regulatory framework for overview of its activities, data safety and consumer protection
  - Create movable assets secured transactions legal and registry system

Source: Azerbaijan MSME Access to Finance Survey, 2014
Enhance MSMEs transparency and financial capability

- Address low levels of financial capabilities of MSMEs – particularly in new sectors and among agribusinesses – through providing simplified training to MSMEs in business & financial management (financial ‘rules of thumb’)

- Coordinate and consolidate efforts of private and public institutions, including the private financial sector, NGOs and training centers, to effectively enhance MSMEs’ financial capabilities by launching financial literacy programs to target groups via various distribution channels

Source: Azerbaijan MSME Access to Finance Survey, 2014