



Completion Report

Project Number: 46536-001
Technical Assistance Number: 8621
June 2017

Azerbaijan: Microfinance Sector Development

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TA Number, Country, and Name:			Amount Approved: US\$ 600,000	
TA 8621-AZE: Microfinance Sector Development			Revised Amount: N/A	
Executing Agency: Central Bank of Azerbaijan (until July 2016) / Financial Market Supervisory Agency (from August 2016)		Source of Funding: TASF-Others (\$300,000) / Financial Sector Development Partnership Fund (\$300,000)	Amount Undisbursed: US\$ 167,300.88	Amount Utilized: US\$ 432,699.12
TA Approval Date: 21 Feb 2014	TA Signing Date: 24 Mar 2014	Fielding of First Consultant: 05 May 2014 ¹	TA Completion Date Original: 31 Oct 2016 Actual: 31 Dec 2016	
			Account Closing Date Original: 31 Jan 2017 Actual: 29 Mar 2017	

Description

The technical assistance (TA) was expected to assist the Government of Azerbaijan (GoA) in developing a financial inclusion strategy, enhance regulatory and supervision practices, and enhance the Central Bank of Azerbaijan (CBA) support for financial inclusion. On the longer term this was expected to help develop new services (e.g. payments, saving products, micro insurance) and new delivery mechanisms, such as mobile financial services.

Expected Impact, Outcome, and Outputs

The TA's expected impact was improved access to a wider range of financial services by low-income individual and microenterprises outside of Baku (an increase in the number of financial services clients outside Baku by 10% for male and 15% for female in the 2013–2018 period). The expected outcome was an improved policy, regulatory, and supervisory framework for microfinance service providers. The TA had three outputs: (i) financial inclusion diagnostic report and related assessments completed; (ii) financial inclusion strategy and related implementation roadmap on regulatory and supervision reforms presented to CBA and other stakeholders, and implementation initiated; and (iii) CBA staff capacity to regulate and supervise microfinance sector operations, institutions, development and deepening of service provision improved. The TA design at the outset was relevant addressing (i) access to finance as a key constraint for economic growth and supporting diversification of the economy toward private activities; and (ii) consumer protection and financial literacy on over indebtedness of retail borrowers, although these issues were not formally recognized in the GoA's policy agenda.

Delivery of Inputs and Conduct of Activities

The original TA envisaged 3 international consultants and 2 national consultants for a total of 10.5 person-months and 13 person-months respectively, and a national firm to conduct a household survey. The final TA inputs were 11 person-months of international consulting services (6 consultants: two financial inclusion experts, a microfinance regulation expert, microinsurance expert, payments expert and an editor), 6 person-months of individual national consulting services (financial inclusion expert) and a national survey firm. The start of the TA was delayed by 5 months to September 2014 due to the government's delayed concurrence to field the consultants. TA implementation subsequently suffered from (i) limited CBA top level ownership of the TA; (ii) the onset of a banking crisis in mid-2015 that required GoA focus on financial sector stabilization; and (iii) the transfer of TA responsibilities to the newly created Financial Market Supervisory Authority (FMSA) in August 2016. The original implementation period was extended by 2 months to allow the completion of the household survey. The funds were not fully utilized (39% was undisbursed) due to these implementation delays.

The consultants prepared sector assessments covering supply and demand for financial services (loans, savings, insurance, payments) in the different regions of Azerbaijan. A special focus was placed on understanding the reasons for exclusion (e.g. access, product design, regulation). Focus group discussions and roundtables were held to inform the findings and consult with relevant stakeholders. Requested by

¹ The notice to proceed was issued in May but the inception mission was delayed till September 2014, awaiting Government's concurrence.

CBA, the consultants prepared (i) a separate Microfinance Strategy, focusing on the role and development prospects for non-bank credit institutions (NBCIs), which matched CBA's NBCI department mandate but did not include significant activities of banks, insurers and payment services providers); and (ii) a capacity development needs assessment for CBA's NBCI supervision department. Also, (i) guidelines for identification and control of key risks in NBCIs and credit unions; (ii) stress testing instructions; and (iii) a framework for risk-based off-site supervision for NBCIs were developed and used for training CBA staff. A survey on access and use of financial services was carried out, covering 1,200 heads of households in Baku and 8 regions of Azerbaijan. A draft National Financial Inclusion Strategy was prepared by April 2016. However, with the transfer of responsibilities from CBA and the establishment of FMSA, it was only discussed in October 2016. The following reports were prepared under the TA and posted on ADB's website: (i) Creating an enabling regulatory framework for micro-insurance; (ii) Azerbaijan: Electronic Payments and Financial Inclusion; (iii) Microfinance Sector Strategy; and (iv) Financial Inclusion in Azerbaijan: Household Survey Results. The TA also supported other activities that contributed to generate knowledge and exchange best practices in financial inclusion. These included three annual International Microfinance Conferences held in Baku. The TA also helped trigger a strategic partnership with Alliance for Financial Inclusion (AFI) and the CBA, facilitating knowledge exchange. Overall the consultants' performance was *satisfactory* with good quality reports valued by the client and an active engagement with the industry. The TA is assessed as *efficient* in the use of inputs to produce these outputs.

CBA's performance was *less than satisfactory*. The scope of the TA required intensive coordination within CBA. The assigned focal point appears to have had limited authority for such coordination which included obtaining relevant financial information in a substantial and timely manner. With the establishment of FMSA, a deputy chairperson took responsibility of the TA and responsiveness improved substantially. However, priority to address the banking crisis did not justify an extension of the TA to improve the TA results. ADB's performance of headquarters and AZRM staff was *satisfactory* carrying out annual review missions and periodical communication with the executing agency, government counterparts and consultants. ADB staff also made repeated efforts to engage with CBA in a more substantial manner.

Evaluation of Outputs and Achievement of Outcome

Out of the 3 original outputs, two were fully delivered satisfactorily and one was partially delivered. The expected assessments, strategies and capacity development activities were completed (output 1: financial inclusion diagnostics, and output 3: improvement of CBA capacity in microfinance supervision). Overall the consultant reports were of good quality and comprehensive. Output 2 (presentation and implementation of a financial inclusion strategy and implementation of road map initiated) was only partly carried out due to the lack of a champion at CBA and changing priorities related to the banking crisis that set in in mid- 2015. After the impasse that followed the establishment of, and transfer of responsibilities to, FMSA, the dialogue was reinitiated only in August 2016, but priorities had to remain focused on stabilizing the banking sector. Thus, the TA was closed shortly thereafter.

As a result, the TA outcome has not been fully achieved and the TA is assessed as *less than effective*. Although a draft financial inclusion strategy was discussed with the FMSA, there was no time to prepare a final document to be endorsed by FMSA, nor final agreement on a roadmap for policy reforms to enhance financial inclusion. The TA also advised on several regulatory and supervisory improvements for NBCIs, which led to changes in CBA's requirements for NBCI's reporting and a new CBA circular on enhanced supervision of credit unions. Though relevant for this sub-sector, these cannot be considered key regulatory changes.

Overall Assessment and Rating

The TA is rated as *less than successful*. TA results were affected by the unfolding economic recession in Azerbaijan and the effects of several negative shocks on the financial sector. The design of the TA became *less than relevant* in this new context. While the assessment work was considered useful both by the government counterparts and the industry, it did not lead to a government-owned strategy for financial inclusion that would have guided further sector developments and contributed to the desired impact of improving access to a wider range of financial services by low income individuals and microenterprises. The intervention is considered less than likely sustainable, although it served to build ADB's knowledge in

the financial sector and engage in a dialogue with GoA and industry players on policy reforms which could later be used in future ADB assistance. The severe decline of microfinance borrowers from 0.6 million to about 0.3 million since December 2014 indicates that financial inclusion has weakened due to the negative shocks to the economy and that the targeted improvements could not be achieved. It is now essential that the authorities develop a credible strategy supporting the revival of microfinance in Azerbaijan.

Major Lessons

Strategy development and policy reforms require strong government ownership. ADB should only consider this type of TA when a champion is clearly identified. Government's commitment should be reflected in government public statements or strategic plans.

Recommendations and Follow-Up Actions

Survey results and the analytical work performed under this TA indicate that there is wide scope to improve the inclusiveness of the financial system in Azerbaijan. There are also significant gender differences in access and use of financial services and in financial capabilities that should be addressed.

Future ADB assistance in Azerbaijan may use relevant analysis results and policy recommendations that were produced under this TA. Clearly regaining the loss of around 300,000 microfinance borrowers needs to be reversed through a new financial inclusion strategy focusing on restructuring NBCIs and banks, and improving access to other services (savings, insurance, payments) could be enhanced through partnerships between financial service providers, supporting outreach both in Baku and rural areas.

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