# Microfinance and Internally Displaced Persons in Azerbaijan

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## Introduction

International donors and host governments often make major investments in microfinance initiatives for refugees and displaced persons, with the expectation that access to this kind of financial services will enable them to take advantage of economic opportunities and generate livelihoods wherever they may have settled. Microfinance, it is thought, represents an appropriate transitional intervention once the crisis that has produced displacement has receded and the situation has been stabilized. In large part this is because microfinance is market driven. It is expected to forestall the onset of dependency, and to offer hope for a prosperous future based on self-reliance and initiative. Microfinance is expected to develop skills and habits that will enable participants not only to meet immediate needs, but also to prepare for the demanding requirements of a future return to their places of origin.

To what extent has microfinance lived up to these expectations? Is it up to the challenge? In this article we reflect on the experience of microfinance institutions (MFIs) serving internally displaced persons in Azerbaijan, particularly the Foundation for International Community Assistance (FINCA) Azerbaijan and Normicro, an MFI established by the Norwegian Refugee Council. We explore the extent to which microfinance has proved to be a sustainable livelihood strategy for this group. We also examine the factors that have influenced the ability of microfinance to deliver the expected results, and we reflect on what can be done to enhance the effectiveness of microfinance and its impact on the well-being of displaced populations in Azerbaijan as well as elsewhere.

## Context

Microfinance was introduced into Azerbaijan in the mid-1990s as a strategy for addressing the economic requirements of as many as 1,000,000 internally displaced persons (IDPs) and refugees who were uprooted during the Nagorno Karabakh conflict. Over the past 10 years, against the background of repeated failures to resolve the territorial dispute between Azerbaijan and Armenia, microfinance has become an increasingly popular means of addressing the chronic economic insecurity facing these displaced persons.

The majority of displaced persons in Azerbaijan remain isolated from the economic growth that is being experienced in the country. Most have not been integrated into the regions where they are now living. They continue to live apart, in organized camps or in hostels located in public buildings. Most IDP livelihoods continue to be dependent on external support.

In recent years, the U.S. Agency for International Development (USAID), the United Nations Development Program (UNDP), and a number of European governments have made increasingly large investments in microfinance along with other development activities to address the needs of displaced persons as well as the local population. The Government of Azerbaijan has itself invested World Bank funds in microfinance, and has issued soft loans to a number of MFIs and credit unions for the purpose of stimulating economic development among the displaced population.

**Microfinance as a Livelihood Strategy for IDPs in Azerbaijan**

The increasing investment in microfinance by these international donors is in large part a reflection of microfinance's growing reputation and general acceptance as a powerful tool for poverty alleviation and for promoting self-reliance among the world's poor. But does this generalization apply to displaced populations as readily as it does to other groups – even groups living in the same region? In proceeding with this analysis, it is appropriate to ask why it might not apply. What unique challenges, if any, must microfinance deal with if these services are to achieve positive economic impact among displaced populations?

It is important to note that in Azerbaijan, some displaced persons have become assimilated into the general population. In these cases their livelihoods, living standards, and daily circumstances are indistinguishable from those of the local population. However, there are still large numbers of displaced persons living in camps or in hostels in urban centers. These areas are often characterized by absolute poverty. IDPs generally lack the resources that are available to local populations, such as houses, access to garden plots, or connections to local markets. As a result of years of humanitarian assistance and government welfare programs, IDPs have often developed a sense of entitlement that is not found among the local population and which may inhibit their participation in sustainable microfinance initiatives.

In spite of these challenges and unique circumstances, it has been shown that microfinance can be a viable livelihood strategy for displaced persons in Azerbaijan. While no large-scale formal study of microfinance impact has yet been conducted in Azerbaijan, the available evidence, both quantitative and anecdotal, suggests that thousands of displaced persons are taking advantage of microfinance services and generating household income through entrepreneurship. MFIs, including FINCA Azerbaijan and the Norwegian Refugee Council's Normicro, have found widespread demand for microfinance services in IDP communities.

MFIs now serve more than 6,000 IDPs in Azerbaijan. The combined outstanding IDP loan portfolio of microfinance institutions working with soft loan financing from the government's Social Fund for the Development of Internally Displaced Persons (SFDI) has grown to more than $2 million. MFI staff members have observed large numbers of IDP clients operating successful enterprises, ranging from trade in goods and services to market gardening. Repeat borrowing is common. For example, more than 90% of FINCA Azerbaijan's IDP borrowers are repeat borrowers. Many of these borrowers have participated in microfinance programs over several years. Better impact data is clearly needed, but in its absence this may be taken as a proxy indicator for positive economic impact at the household level.

At the same time, the history of microfinance among displaced persons in Azerbaijan has not been free from difficulty. In the late 1990s, several microfinance programs experienced major repayment problems in IDP communities. Many IDP clients had become over-indebted as a result of supply-driven services. Displaced persons often mistook microfinance for a different type of grant mechanism and consumed loans intended for productive purposes. Many defaulters were subsequently taken to court. During that period, at least two microfinance programs for displaced persons failed completely, resulting in the discontinuation of the activity. What lessons have been learned from this experience? What factors influence the effectiveness of microfinance as a livelihood strategy for displaced persons?

**Factors Influencing the Effectiveness of Microfinance for IDPs**

The experience of MFIs in Azerbaijan suggests that the viability of microfinance as a livelihood strategy for displaced persons, and the viability of microfinance as a sustainable development activity, depend upon the following factors: (a) clients' access to economic opportunities and the prevailing economic conditions surrounding the participating communities, (b) the existence of a good credit culture, underpinned by the commitment of the government authorities to sustainable microfinance, (c) donor and the MFI to sustainable service delivery, (d) the nature and content of other humanitarian assistance and development activities that are being implemented in participating communities, (e) the timing of the intervention, and (f) the design of the service methodology and loan products available to borrowers. Each of these factors is discussed below.

Access to Economic Opportunities

The experience of FINCA Azerbaijan, Normicro, and other MFIs working in IDP camps and settlements suggests that microfinance is most effective as a livelihood strategy when there are a range of labor-intensive economic opportunities in areas close by, and when displaced persons pursue these opportunities. For example, in some camps in the south of Azerbaijan, government authorities have provided IDPs with access to local agricultural land where they engage in market gardening, planting, and animal husbandry. Micro-loans provided on suitable terms have enabled these clients to take full advantage of these opportunities. In other areas, IDPs living in hostels near bazaars or other marketplaces are able to use micro-loans to establish trading operations that serve the local population. However, in the case of IDPs living far from centers of economic activity, where economic opportunities are lacking, microfinance is likely to be of limited utility.

Credit Culture

Microfinance can only be a viable livelihood strategy for a significant number of displaced persons if the services on offer are sustainable. Sustainability requires commitment from the government authorities to the development of a credit culture, including contract enforceability and non-interference in market-based initiatives. In the early years of microfinance in Azerbaijan, the government was reluctant to support MFI legal claims against defaulters among the IDP population due to the political clout carried by this population. Correspondingly, courts did not enforce contracts or execute decisions against IDPs. One MFI in Azerbaijan was forced to close as a result of its inability to recover the losses resulting from default among IDPs. Other MFIs in turn became wary of serving displaced persons until the government began to provide greater support for the development of a conducive credit culture.

## Commitment to Sustainability

In Azerbaijan, there is a correlation between donor and MFI commitment to sustainability from the outset of microfinance programs, and program success. Conversely, there has been a correlation between lack of commitment to sustainability on the part of both donors and MFIs, and program failure. In general, it is fair to say that microfinance programs launched with the vision of self-sufficiency and sustainability from the outset have experienced higher quality portfolio growth, faster attainment of self-sufficiency, and fewer problems with delinquency and default.

Such programs, backed by adequate capitalization and best practice systems, policies, and procedures, have been able to communicate a clear vision and methodology to the communities in which they work, and thereby to develop the credibility, confidence, and trust that is needed for a sustainable intervention. Other programs, however, particularly those launched under the rubric of humanitarian assistance initiatives, have had a much more difficult time creating the necessary relationships with their borrowers. When it has not been clear that a microfinance program was there for the long haul and that sustainable service delivery was the goal of the activity, credibility has suffered. In such cases, it has often been difficult to collect repayments. From the borrowers' point of view, unsustainable microfinance programs may be disruptive and harmful because they contribute to unpredictability and undermine the capacity of displaced persons to plan for their economic futures.

## Other Assistance Activities in the Community

It is clear that microfinance cannot address the full range of needs experienced by displaced persons. Therefore, the effectiveness of microfinance as a livelihood strategy is linked to the existence of other development activities in the community. In the case of Azerbaijan, where many people have grown up in IDP settlements, the ability of IDPs to use microfinance services effectively is contingent upon the level of education, training, health care, and other basic services that is available. Business development services programs may also enhance the ability of IDPs to take full advantage of financial services.

At the same time, other assistance programs implemented in the same geographic area may present problems for the development of the credit culture that is necessary for the sustainable delivery of microfinance services. In Azerbaijan, communities accustomed to receiving grants, food aid, and a wide variety of no-cost training and other services from international organizations have not always been receptive to the concept of credit delivered at market interest rates. The implementation of grant programs alongside interest-bearing loans can send mixed messages to community members and has at times created confusion. This has been particularly true when the microfinance operation is housed within an international NGO that is implementing other, no-cost development programs at the same time. The problem is compounded in communities where the level of dependency is high, and where and a mentality of entitlement is prevalent.

## Timing of the Intervention

The timing of microfinance programs introduction into displaced communities may also influence the outcome. In Azerbaijan, programs introduced very early (i.e. soon after the crisis leading to displacement) were prone to repayment problems. It is difficult to isolate the causes of these problems; however, it seems likely that they were related, at least in part, to (a) the diversion of borrowed capital from productive activities to consumption, as a result of overwhelming need, and (b) the "humanitarian" rubric under which they were delivered and the lack of best practice credentials among the personnel delivering the services. Microfinance is likely to be a more appropriate intervention once the situation has stabilized, when a serious discussion of sustainability can be had.

## MFI Methodology and Product Design

The viability of microfinance as a livelihood strategy for displaced persons is also in many ways contingent upon the quality of the MFI methodology and the design of the loan products that are available. While methodologies and loan products need not necessarily be tailored specifically to IDP circumstances in order to be effective, the Azerbaijan case suggests, rather intuitively, that the MFIs whose terms cater most closely to the needs of the displaced population have been in the highest demand in these communities.

NRC's Normicro is a good example. Normicro has developed a methodology designed to serve displaced persons, and now serves more IDPs than any other MFI in Azerbaijan. Normicro's approach is designed to build trust, convey transparency, and develop credibility in the community before issuing loans. This is done through an extensive communications process, involving community forums, meetings with community leaders and respected seniors, and a substantial pre-credit orientation process with prospective borrowers. Normicro establishes a Board of Directors for each branch office, which is drawn from members of the local community. This procedure is designed to prevent some of the problems that NRC and other NGOs have experienced in displaced communities where they failed to connect with the community and did not convey the intent of the NGO to establish sustainable services. Normicro's commitment to community ownership and involvement, combined with clear communications and the development of trust relationships has resulted in better outcomes for its borrowers, in terms of building good credit histories and gaining long-term access to financial services, as well as in high quality growth for the MFI's portfolio.

In terms of lending methodology, the combined experience of Normicro and FINCA Azerbaijan suggests that solidarity group lending is an effective mechanism for delivering financial services to displaced persons, just as it is for local populations in the country. Collateral-free loans are well-suited to a population that has little capacity to collateralize loans. The cultural importance of a person's image and reputation in the community, and the speed with which news travels in close-knit IDP communities, reinforces the solidarity guarantee that secures the loans. In terms of loan products, the experience in Azerbaijan confirms the conventional wisdom that product design must take account of clients' cash flows. In general, small loan sizes, frequent payments, and relatively short loan maturities are correlate closely with successful lending. FINCA Azerbaijan has also found that savings products, usually structured as "internal accounts" managed at the group level, have also been effective tools for promoting development and self-reliance among displaced persons. Demand for savings products is sometimes slower to develop than demand for credit products, but over time interest has increased among a number of borrower groups for building an effective internal account.

**Summary and Conclusions**

In summary, the experience in Azerbaijan indicates that sustainable, best practice microfinance can be a powerful support to IDP communities. It is most likely to be effective where there is access to productive resources and markets, where a good credit culture has been established, and where it is combined with other development activities such as education, training, primary health care, and business development services. Much also depends upon the relationship of the MFI with the community and on the design of its methodology and loan products.

Microfinance is likely to continue to be an important development activity in displaced communities. Donors and MFIs alike will enhance the prospects for success if from the outset microfinance is conceived as a sustainable activity and is adequately supported throughout implementation.

Note:
The author is currently Country Director of the Foundation for International Community Assistance (FINCA) Azerbaijan, an affiliate of FINCA International.
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