



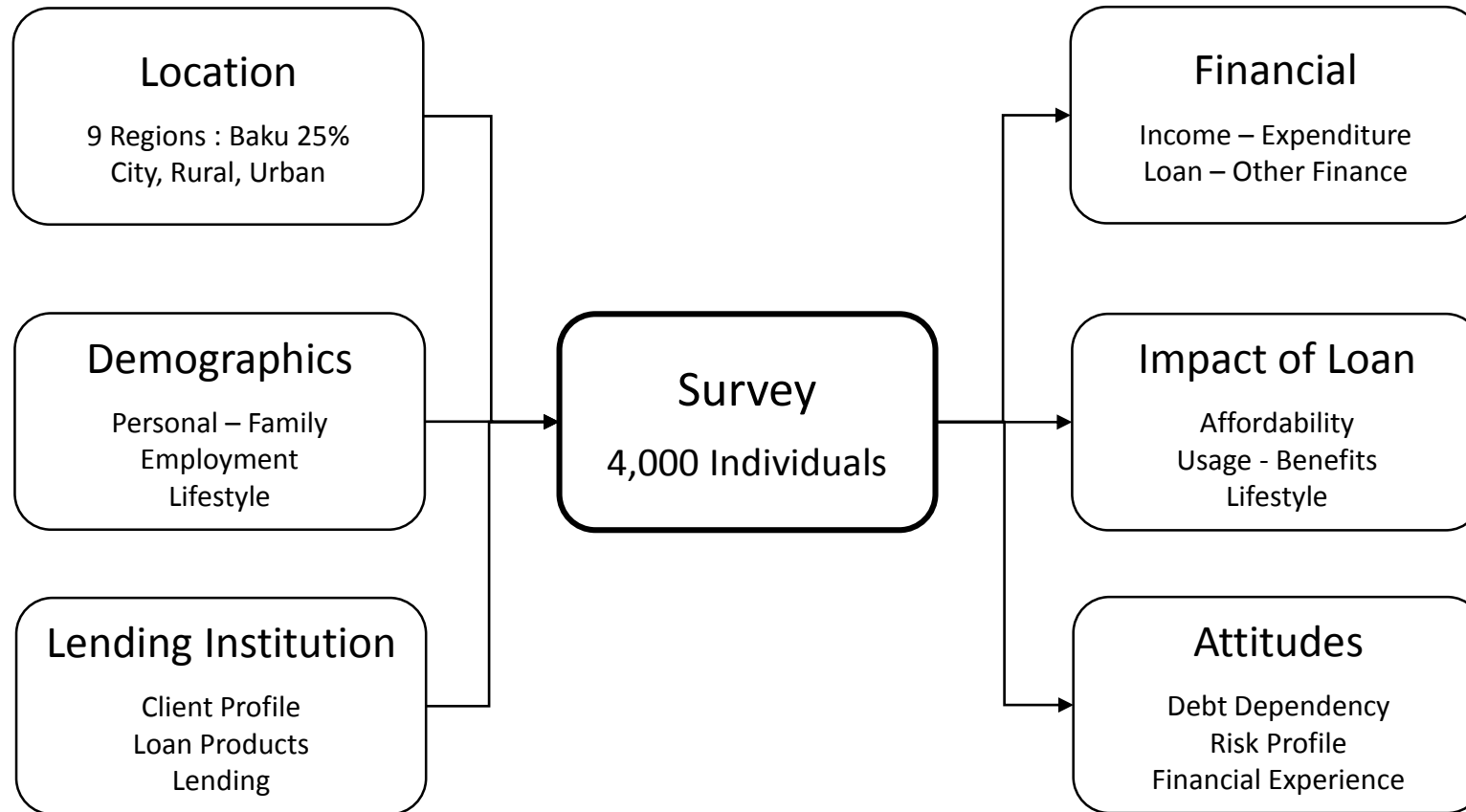
Azerbaijan

Indebtedness of Individuals

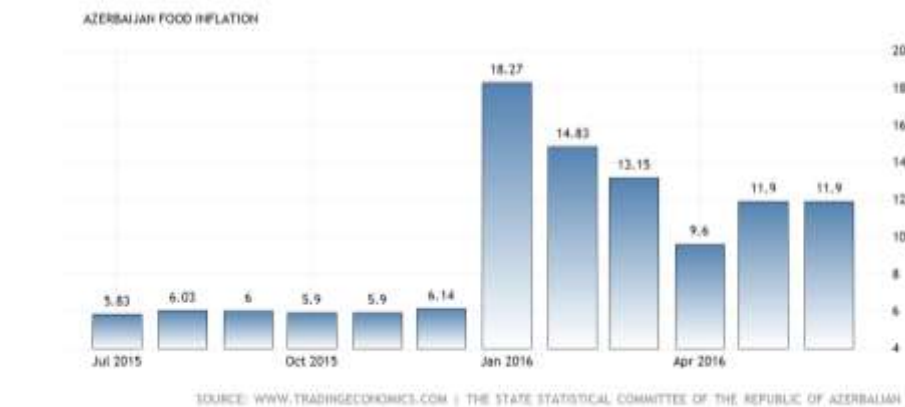
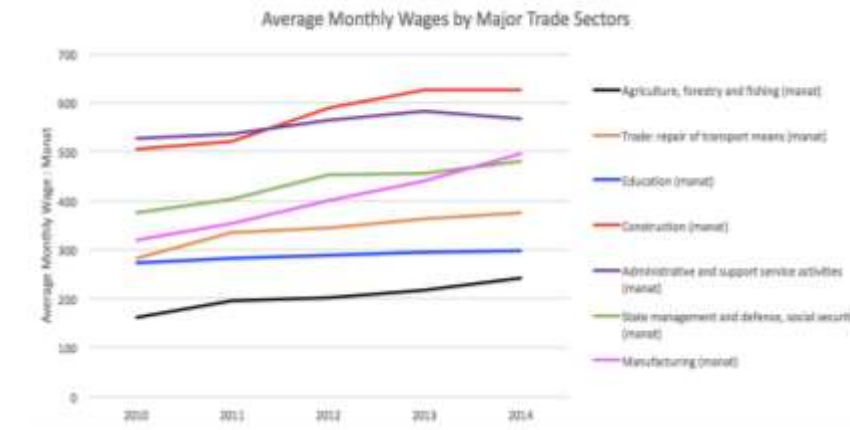
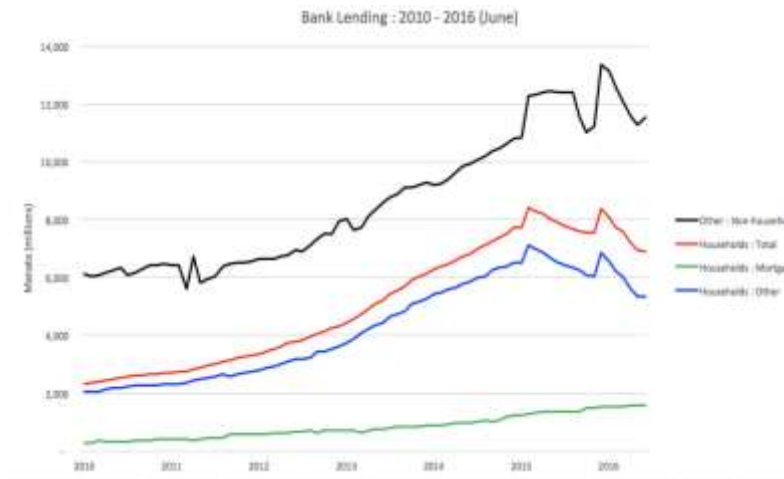
Roy Pratt

December 2016

Survey Framework



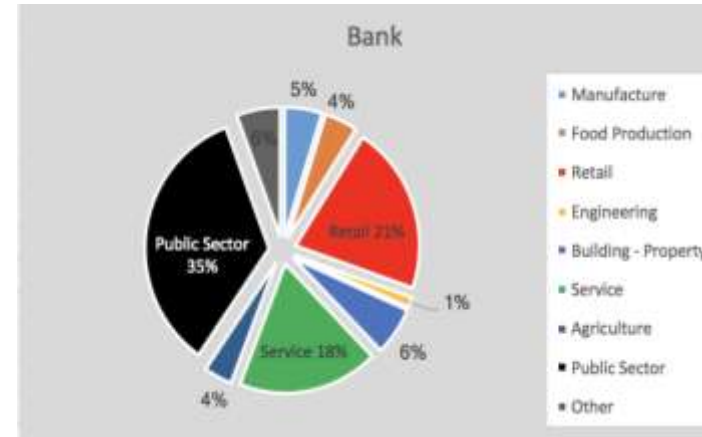
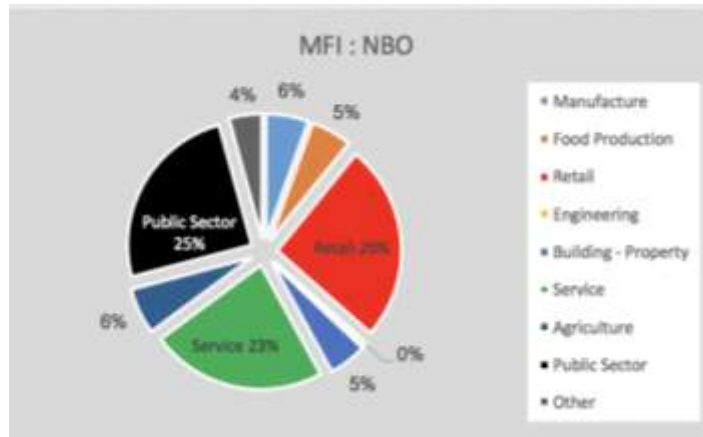
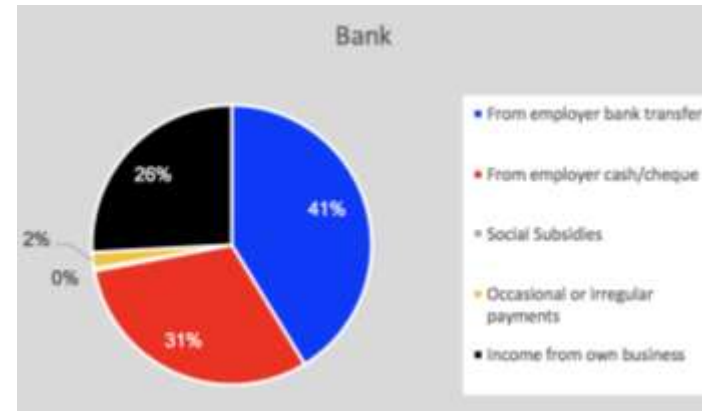
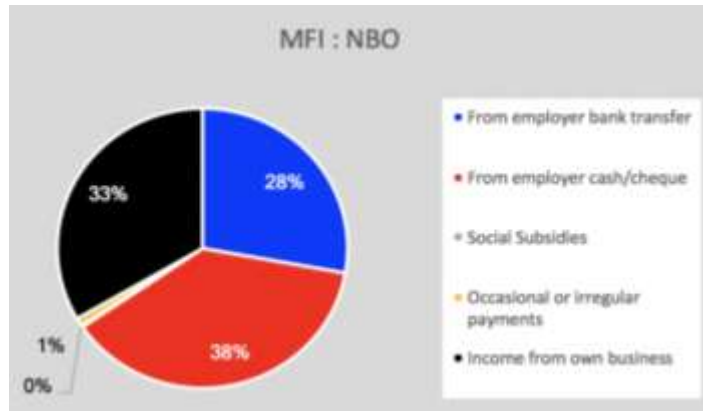
External Trends affecting the Survey



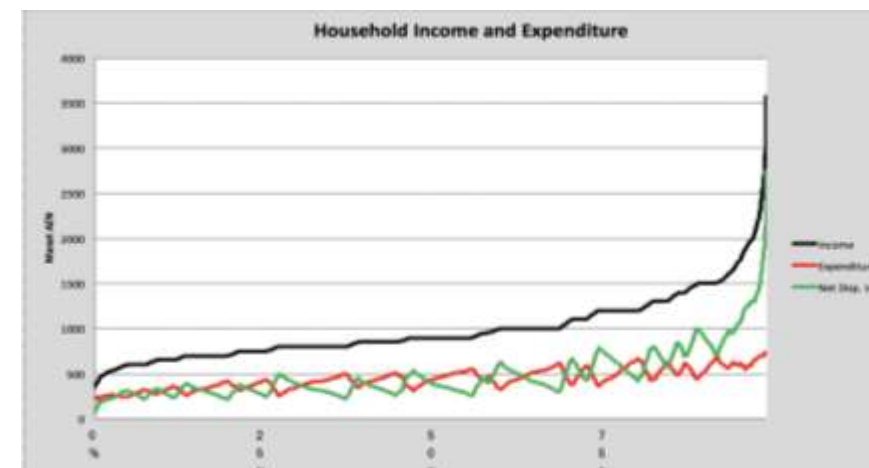
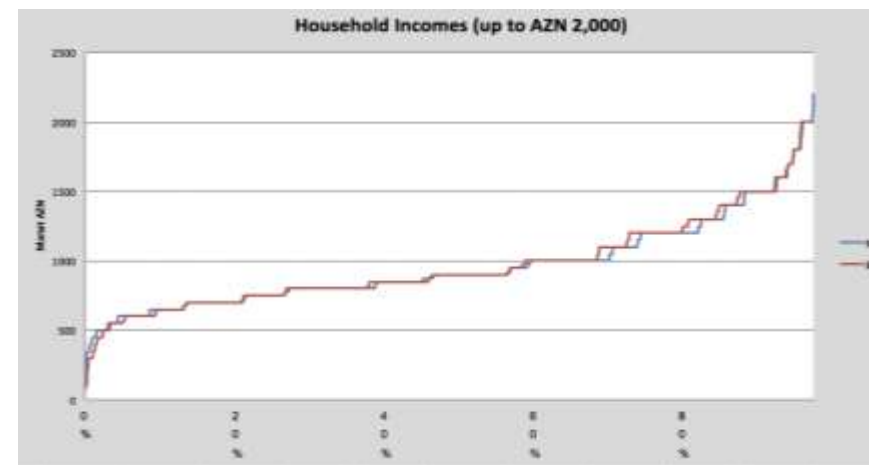
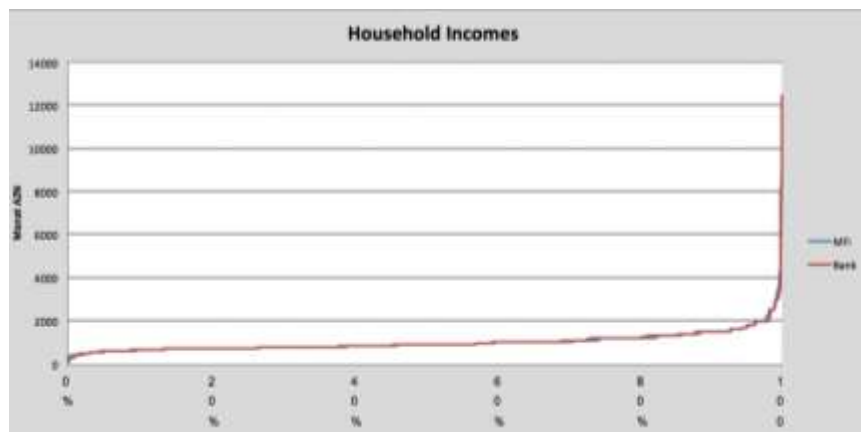
Headlines

- Significant differences between Baku and Other Regions
- Loan arrears : 36 % with 'own business' : 8 % with 'employed'
- Domestic budget pressures : 50 % of borrowers in Baku – 75% in Other Regions
- 50 % usage of loan funds by 'employed' for domestic consumption
- 'Own Business' and 'Foreign Currency' portfolios shows high risk vulnerability
- High overlap of MFI and Bank clients in demographic and income profiles
- Low reputation of lending institutions for
trustworthiness, integrity and understanding client needs

Loan Portfolio : Distribution of Survey Respondents



Similar income profiles of MFIs and Banks



Total Expenditures as % of Income					
	<25%	26-50%	51-75%	76-100%	>100%

MFI : Baku	1 %	22 %	56 %	18 %	3 %
Bank : Baku	1 %	25 %	45 %	23 %	6 %
MFI : Other Regions	0 %	3 %	41 %	55 %	1 %
Bank : Other Regions	0 %	2 %	47 %	49 %	1 %

Higher loan leverage by banks than MFIs

AZN	Household Income	Household + Utility Costs	Loan Repayment	Net Income	Outstanding Loan Balance
Baku : MFI	1,250	525	200	525	2,100
Baku : Bank	1,225	500	250	475	3,900
Other Regions : MFI	900	515	160	225	1,750
Other Regions : Bank	920	510	170	240	2,100

Debt payment pressure is high ... and more severe in regions outside Baku

	Loan Arrears	Loan Repayments more than can Afford	Food Expenditure Reduced to make Loan Payment	Need to Borrow to Maintain Lifestyle	Loan from Friends
Baku : MFI	3 %	8 %	2 %	4 %	3 %
Baku : Bank	20 %	29 %	32 %	22 %	8 %
Other Regions : MFI	19 %	57 %	81 %	59 %	19 %
Other Regions : Bank	19 %	50 %	75 %	56 %	16 %

Loan approvals have slowed for MFIs and across regions outside Baku

<i>Time Since Last Loan Approval</i>	Within 1 month	1 – 3 Months	4 – 6 Months	7 – 12 Months	Over 12 Months
Baku : MFI	0 %	3 %	13 %	41 %	42 %
Baku : Bank	1 %	4 %	19 %	37 %	35 %
Other Regions : MFI	0 %	4 %	13 %	28 %	54 %
Other Regions : Bank	0 %	4 %	14 %	26 %	55 %

Former clients have lower incomes ... but is life better without debt?

AZN	Household Income	Household + Utility Costs	Loan Repayment	Net Income	Quality of Life Improved in last 12 months
Baku : Bank Current Borrowers	1,225	500	250	475	21 %
Baku : Bank Former Borrowers	1,050	450		600	53 %
Other Regions : Bank Current Borrowers	925	500	175	250	10 %
Other Regions : Bank Former Borrowers	900	550		350	9 %

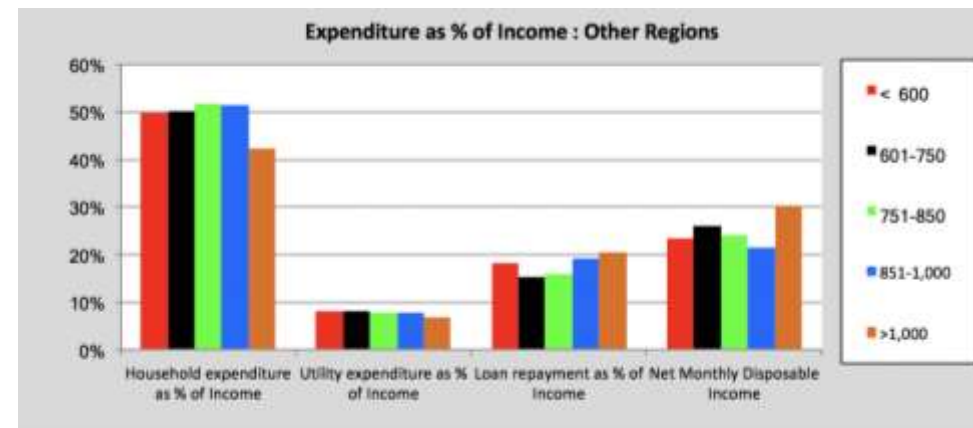
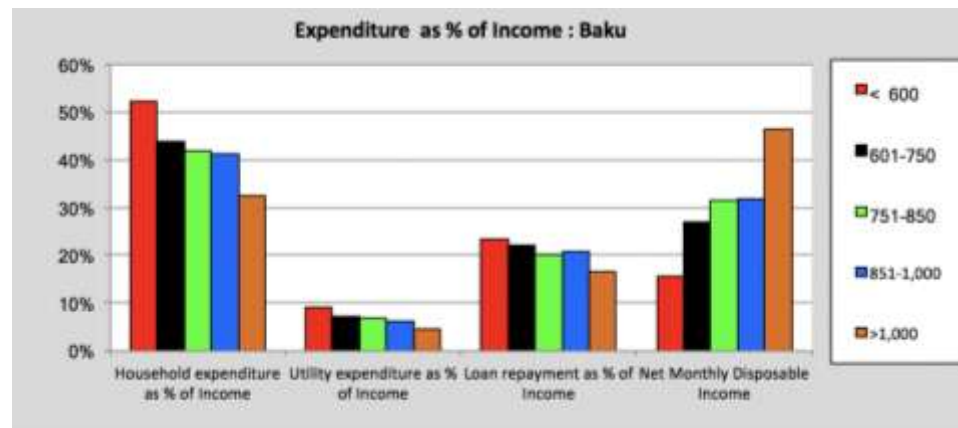
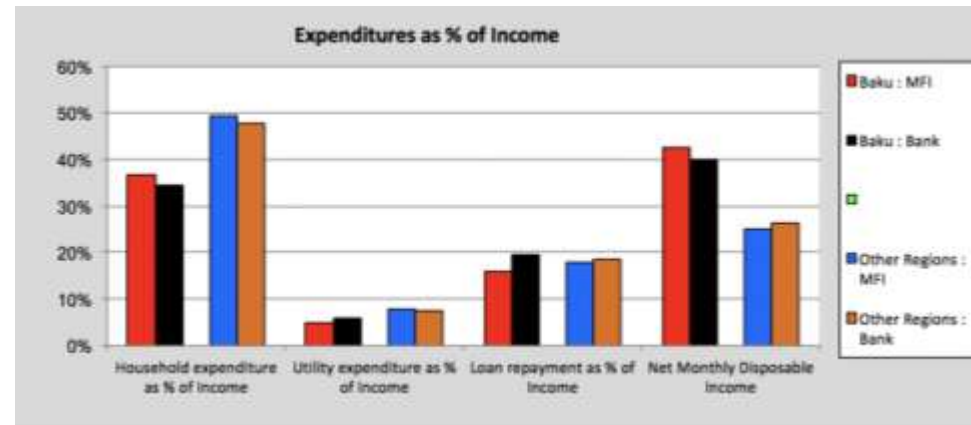
Low income borrowers below AZN 750 ... 18% in Baku ... 31% in other regions

<i>Income Range</i>	Distribution : Clients		Distribution : Balances		Outstanding Loan	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
< AZN 600	9 %	9 %	4 %	5 %	1,200	1,000
601 - 750	9 %	22 %	5 %	10 %	1,700	900
751 - 850	12 %	22 %	8 %	14 %	1,900	1,200
851 – 1,000	18 %	27 %	14 %	28 %	2,300	2,000
> 1,000	53 %	20 %	70 %	43 %	4,000	4,100

Risk profiles differ across incomes and regions

<i>Income Range</i>	Net Income (after loan)		Loan Payment as % of Net Income (after Essentials)		Loan Arrears	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
< AZN 600	75	125	60 %	44 %	15 %	12 %
601 - 750	200	175	45 %	37 %	11 %	6 %
751 - 850	250	200	39 %	40 %	8 %	9 %
851 – 1,000	300	200	39 %	47 %	10 %	27 %
> 1,000	775	400	26 %	40 %	12 %	37 %

Different loan affordability across the regions



Debt pressures are more than loan arrears

<i>Income Range</i>	Loan Repayments More than Borrower Can Afford		Food Spend reduced to meet Loan Payments		Debt Payments Cause Problems in my Family	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
< AZN 600	23 %	54 %	31 %	66 %	26 %	42 %
601 - 750	21 %	49 %	23 %	79 %	27 %	41 %
751 - 850	12 %	43 %	18 %	82 %	19 %	38 %
851 – 1,000	22 %	57 %	15 %	84 %	22 %	54 %
> 1,000	17 %	66 %	15 %	70 %	20 %	56 %

Loan structures vary across incomes and regions

<i>Income Range</i>	Collateral		Foreign Currency Loan		Refinance in last 12 months	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
< AZN 600	9 %	30 %	1 %	3 %	16 %	12 %
601 - 750	11 %	21 %	6 %	2 %	15 %	4 %
751 - 850	12 %	27 %	5 %	9 %	13 %	5 %
851 – 1,000	20 %	50 %	8 %	27 %	11 %	9 %
> 1,000	33 %	73%	19 %	37 %	13 %	19 %

Strong sensitivity to changes in prices of food and household essentials

Expenditures (Food, Essentials, Utility, Loan) as % of Income				
< 25 %	26 – 50 %	51 – 75 %	76 – 100 %	> 100 %

Baku	1 %	24 %	51 %	21 %	25 %	4 %
Other Regions	0 %	3 %	44 %	52 %	53 %	1 %

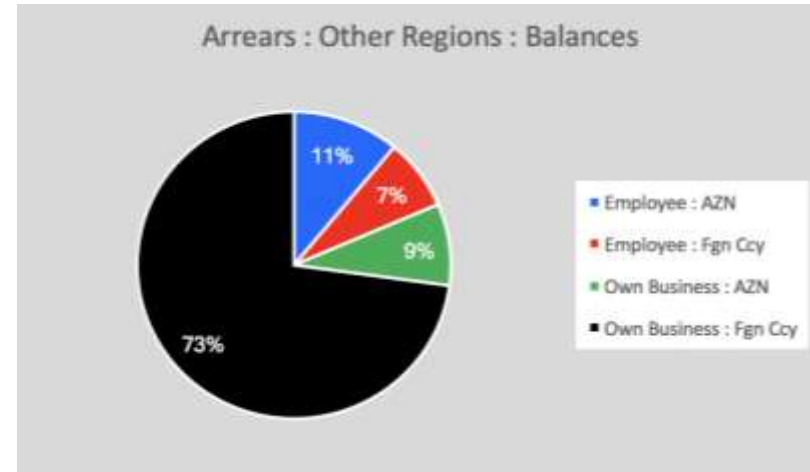
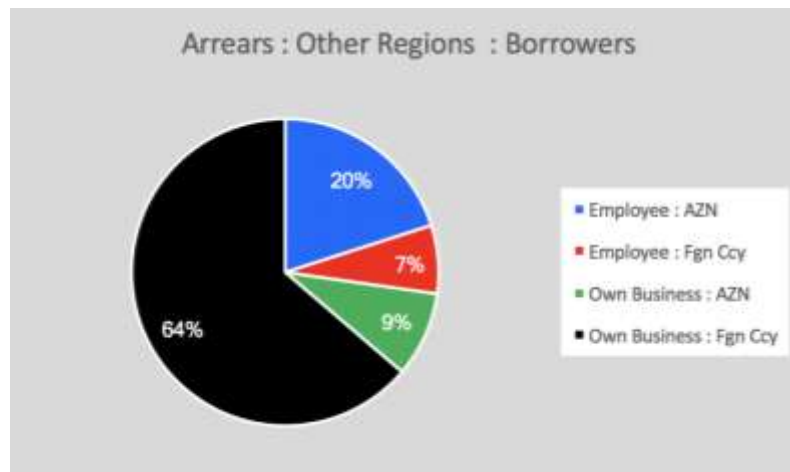
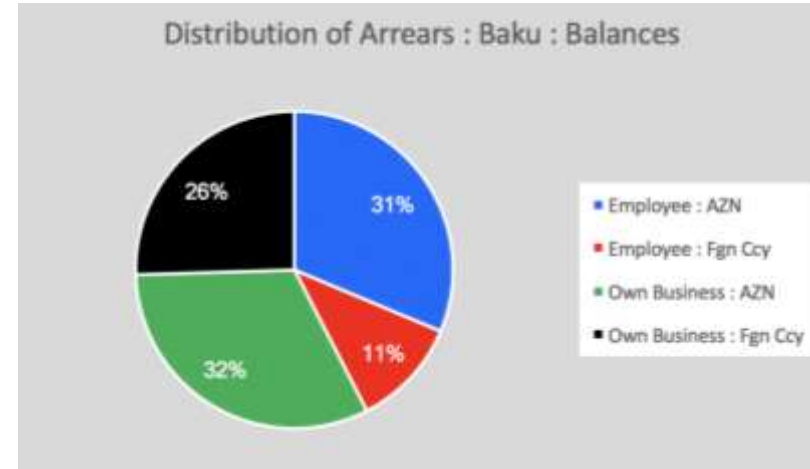
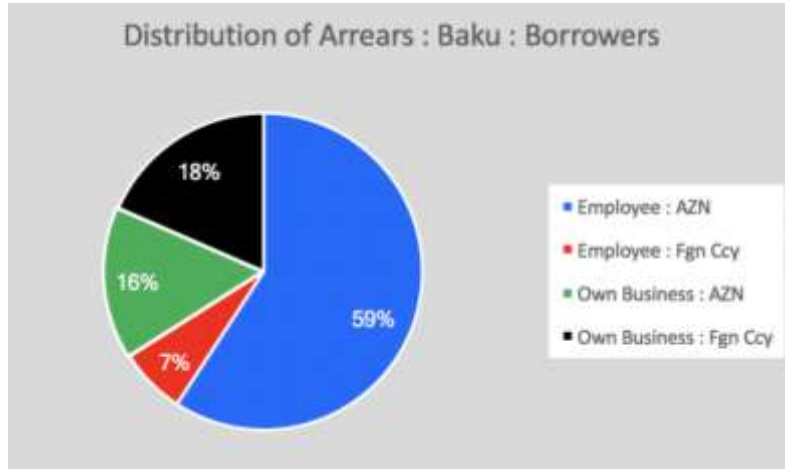
**+ 5 %
Increase
Only Food
and Essentials**

Baku	1 %	20 %	50 %	23 %	28 %	5 %
Other Regions	0 %	2 %	35 %	61 %	63 %	2 %

**+ 10 %
Increase
Only Food
and Essentials**

Baku	1 %	17 %	50 %	25 %	32 %	7 %
Other Regions	0 %	2 %	28 %	68 %	70 %	2 %

Loan arrears concentrate in 'Own Business'



Major client segments : Employees and Own Business

AZN	Household Income	Household + Utility Costs	Loan Repayment	Net Income	Outstanding Loan Balance
Employed : Baku	1,100	475	175	450	2,400
Employed : Other Regions	825	475	125	225	1,200
Own Business : Baku	1,675	600	325	750	4,600
Own Business : Other Regions	1,100	600	250	250	3,500

Major differences of risk exposure

	Loan Arrears	Loan Repayments more than can Afford	Food Expenditure Reduced to make Loan Payment	Need to Borrow to Maintain Lifestyle	Loan from Friends
Employed : Baku	10 %	17 %	18 %	13 %	6 %
Employed : Other Regions	8 %	47 %	77 %	51 %	16 %
Own Business : Baku	14 %	21 %	14 %	11 %	5 %
Own Business : Other Regions	44 %	69 %	82 %	72 %	22 %

Loan approval levels – a supply-side strategy or demand-side reluctance

<i>Time Since Last Loan Approval</i>	Within 1 month	1 – 3 Months	4 – 6 Months	7 – 12 Months	Over 12 Months
Employed : Baku	0 %	4 %	20 %	39 %	34 %
Employed : Other Regions	0 %	5 %	17 %	36 %	42 %
Own Business : Baku	0 %	2 %	9 %	41 %	46 %
Own Business : Other Regions	1 %	1 %	5 %	13 %	80 %

Loan Usage to support Domestic Consumption

	Domestic : Consumption	Domestic : Appliances	Autocredit	Holiday - Travel - Family Event	Mortgage
Baku : Public Sector	45 %	29 %	12 %	3 %	8 %
Baku : Other Employed	49 %	27 %	9 %	3 %	8 %
Other Regions : Public Sector	58 %	11 %	2 %	23 %	2 %
Other Regions : Other Employed	61 %	7 %	6 %	19 %	3 %

The challenge of 'Own Business'

	Baku		Other Regions	
	MFI	Bank	MFI	Bank
Retail and Service Trade Sectors	84 %	71 %	81 %	85 %
Business failure in last 6 months	36 %	38 %	74 %	70 %
Loans improve the quality of life	1 %	30 %	58 %	50 %
'Employed' with informal credit from retailers	4 %	12 %	3 %	2 %
Loan repayments more than can afford	12 %	35 %	70 %	67 %
Need assistance to resolve problems with lenders	22 %	76 %	95 %	94 %

Own Business – a segment under severe pressure

	Foreign Currency	Collateral Assets	Loan Approved within last 12 months	Loan Refinance in last 12 Months	Would like help to resolve debt problems with lender
Employed : Baku	7 %	15 %	66 %	12 %	34 %
Employed : Other Regions	4 %	23 %	58 %	5 %	78 %
Own Business : Baku	29 %	49 %	51 %	16 %	43 %
Own Business : Other Regions	52 %	84 %	16 %	18 %	95 %

High loan leverage for foreign currency borrowers

	Household Income	Household + Utility Costs	Loan Repayment	Net Income	Outstanding Loan Balance
Manat AZN : Total	975	500	175	300	1,900
Foreign Currency : Total	1,250	625	275	350	4,100
Manat AZN : Baku	1,175	500	200	475	2,700
Manat AZN : Other Regions	850	475	150	225	1,500
Foreign Currency : Baku	1,675	600	350	725	5,100
Foreign Currency : Other Regions	1,100	625	250	225	3,800

Severe pressures on foreign currency borrowers

	Loan Arrears	Loan Repayments more than can Afford	Food Expenditure Reduced to make Loan Payment	Need to Borrow to Maintain Lifestyle	Loan from Friends
Manat AZN : Total	8 %	38 %	56 %	39 %	12 %
Foreign Currency : Other Regions	59 %	66 %	74 %	67 %	21 %
Manat AZN : Baku	10 %	17 %	17 %	12 %	5 %
Manat AZN : Other Regions	7 %	48 %	75 %	51 %	16 %
Foreign Currency : Baku	23 %	31 %	21 %	16 %	7 %
Foreign Currency : Other Regions	70 %	76 %	91 %	83 %	25 %

Higher loans linked to availability of collateral

	Household Income	Household Expenditure and Utilities	Loan Repayment	Net Disposable Income	Outstanding Loan
Collateral : MFI	1,075	550	225	300	2,700
Collateral : Bank	1,150	575	275	300	4,700
Non-Collateral : MFI	950	500	125	325	1,200
Non-Collateral : Bank	950	475	150	325	1,800

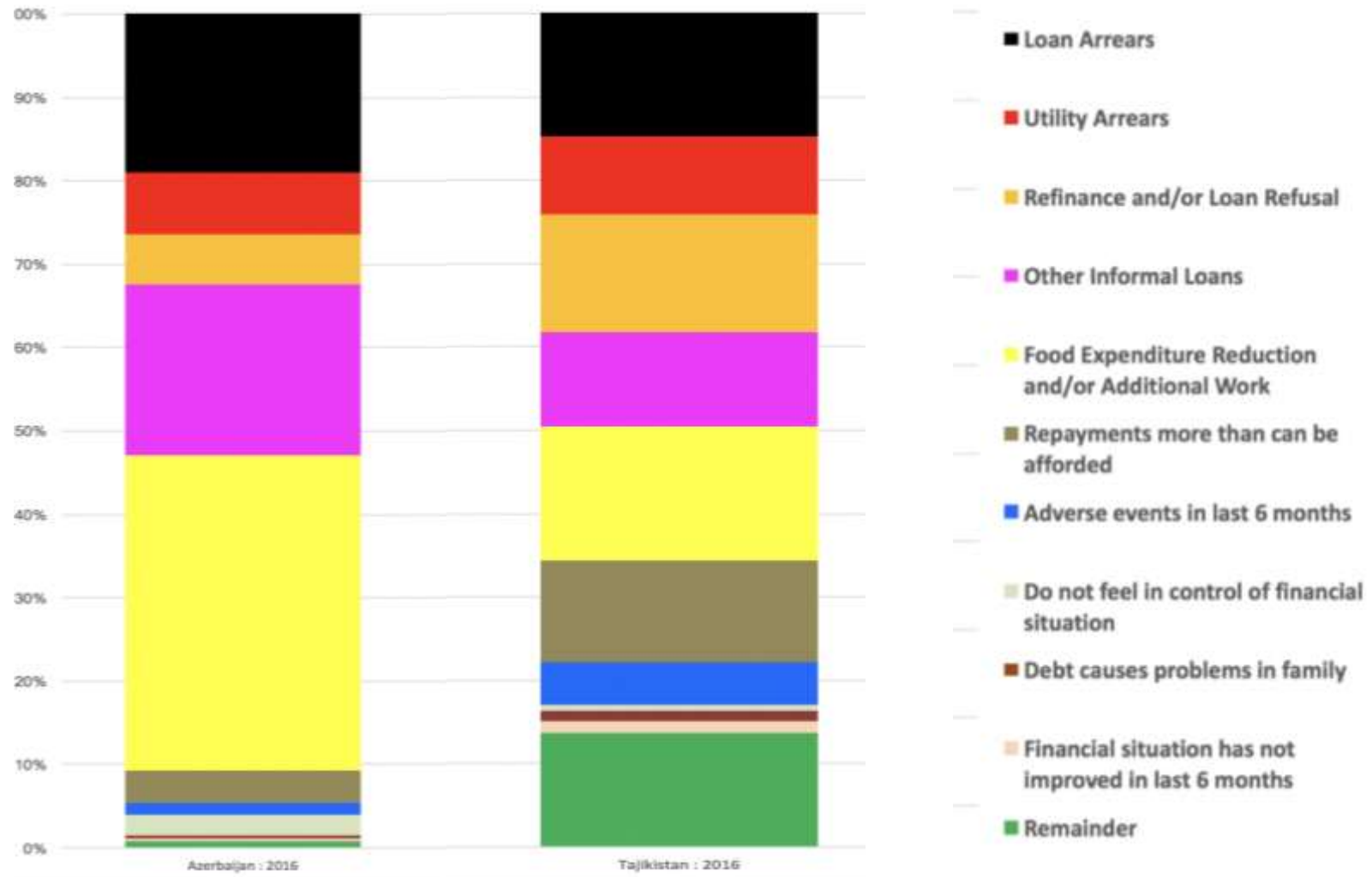
Stronger debt payment pressures amongst collateralised loans

	Loan Arrears	Loan Repayments more than can Afford	Food Expenditure Reduced to make Loan Payment	% of Loans in Foreign Currency	% of Loans Approved in last 12 months
Collateral : MFI	26 %	54 %	67 %	33 %	34 %
Collateral : Bank	37 %	61 %	70 %	41 %	28 %
Non-Collateral : MFI	6 %	33 %	49 %	6 %	61 %
Non-Collateral : Bank	11 %	36 %	58 %	7 %	61 %

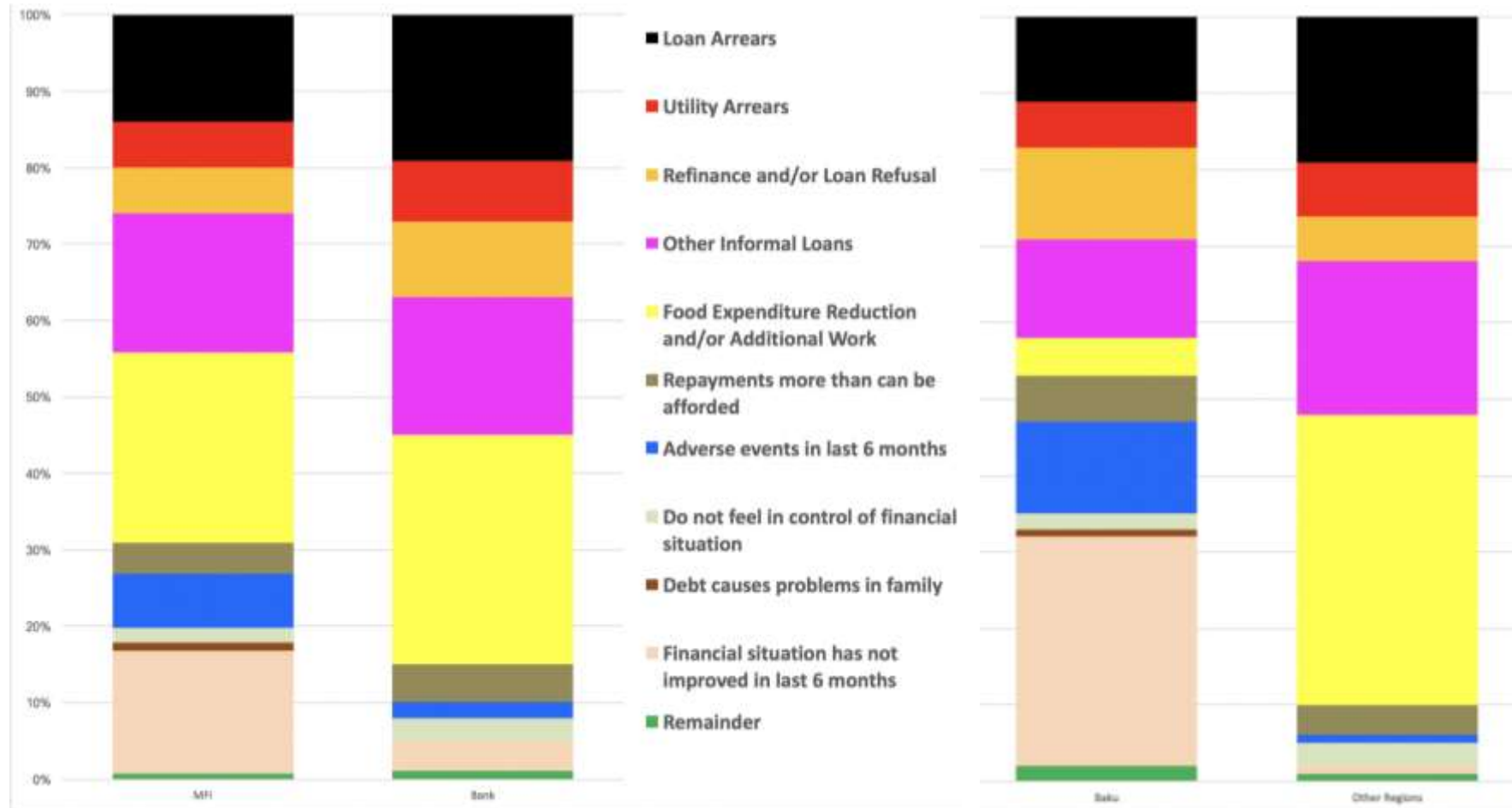
Collateral : Types of Asset

	Property : Business and Residential	Business Equipment	Domestic Assets	Vehicle	Gold / Jewellery
Baku : MFI	19 %	6 %	1 %	57 %	16 %
Baku : Bank	45 %	6 %	5 %	33 %	20 %
Other Regions : MFI	5 %	47 %	24 %	3 %	20 %
Other Regions : Bank	8 %	44 %	17 %	15 %	14 %

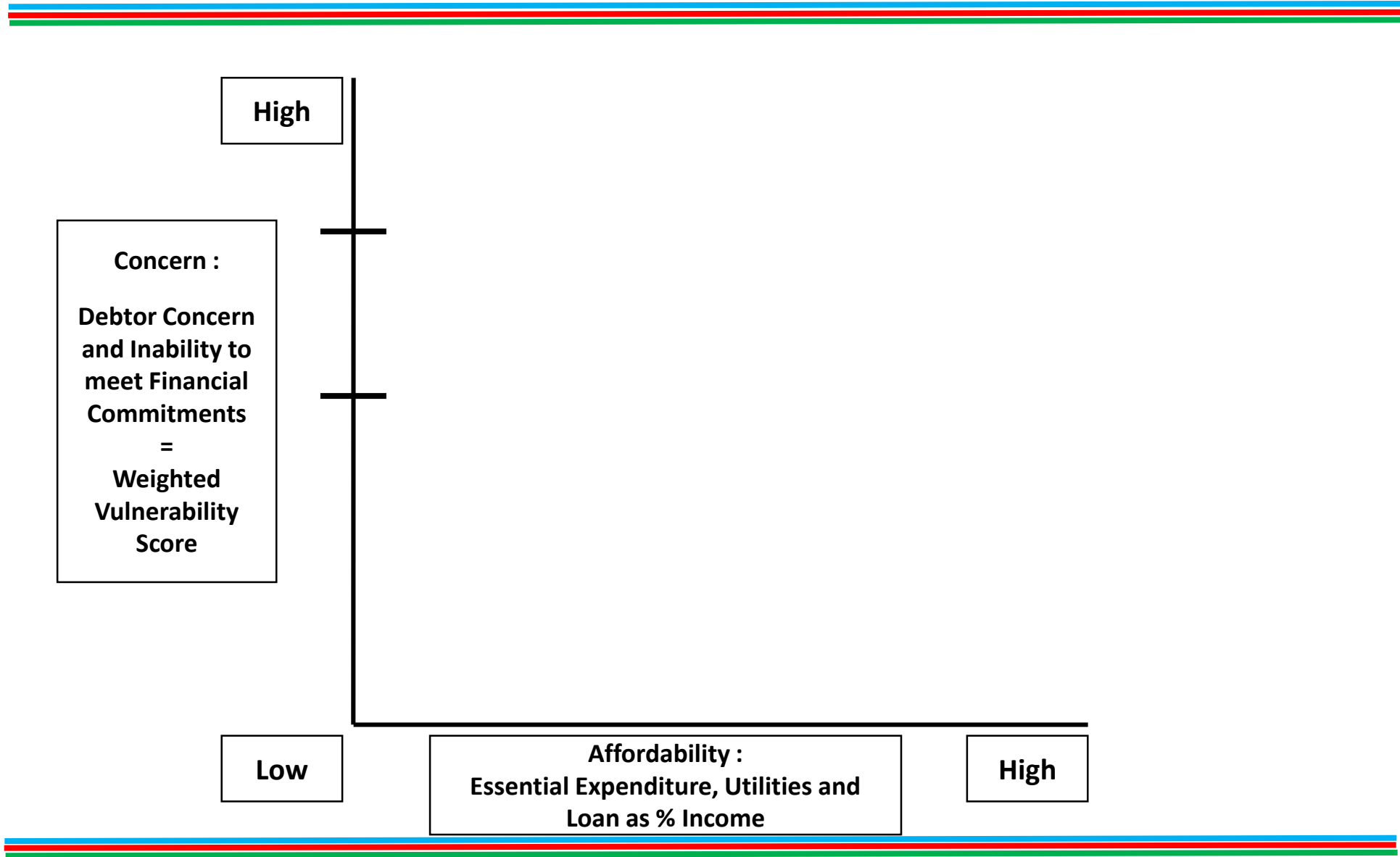
Loan Arrears : "The Tip of the Iceberg"



Similar profiles for MFIs and banks ... significant Baku and other regions differ greatly



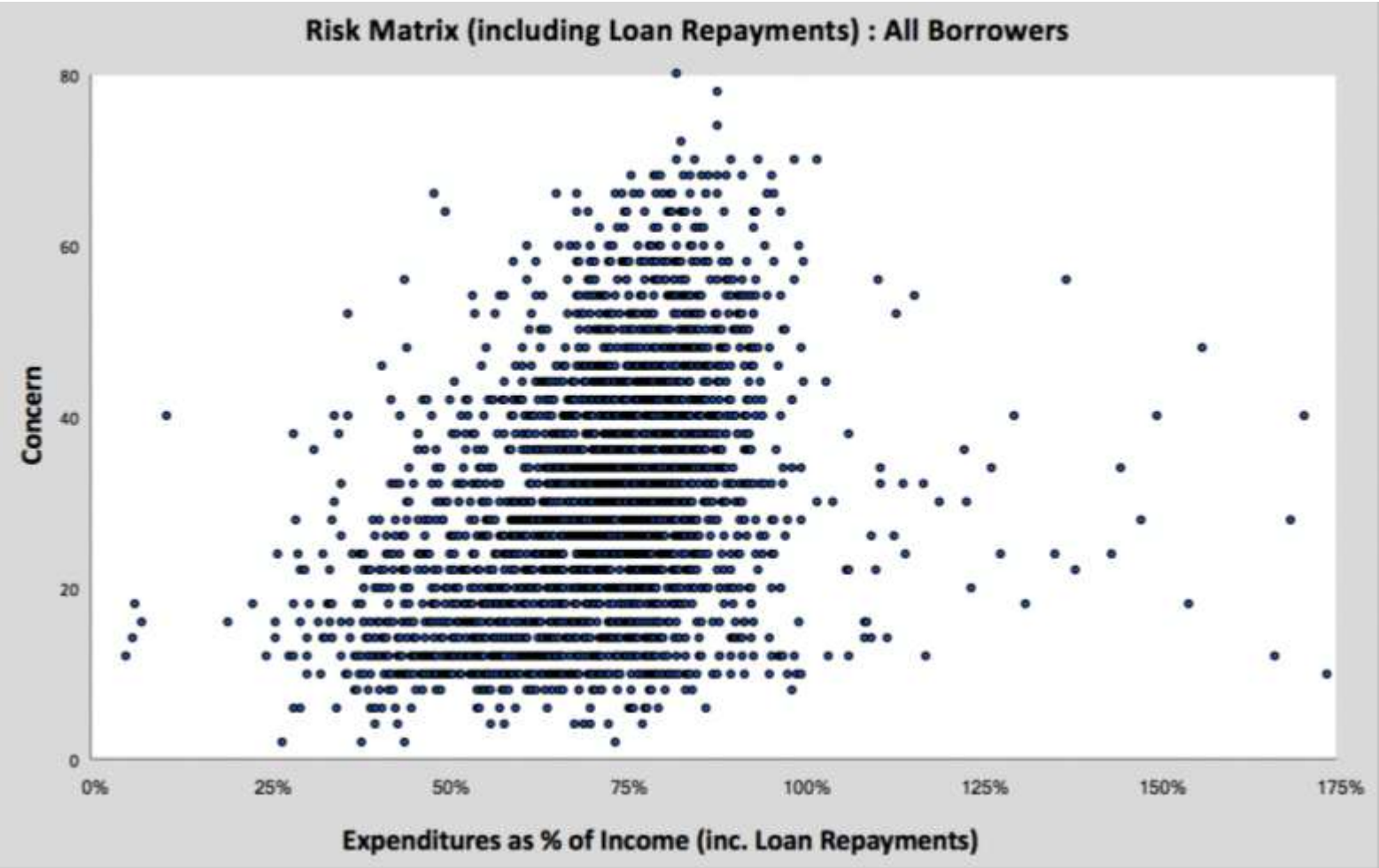
Concern and Affordability



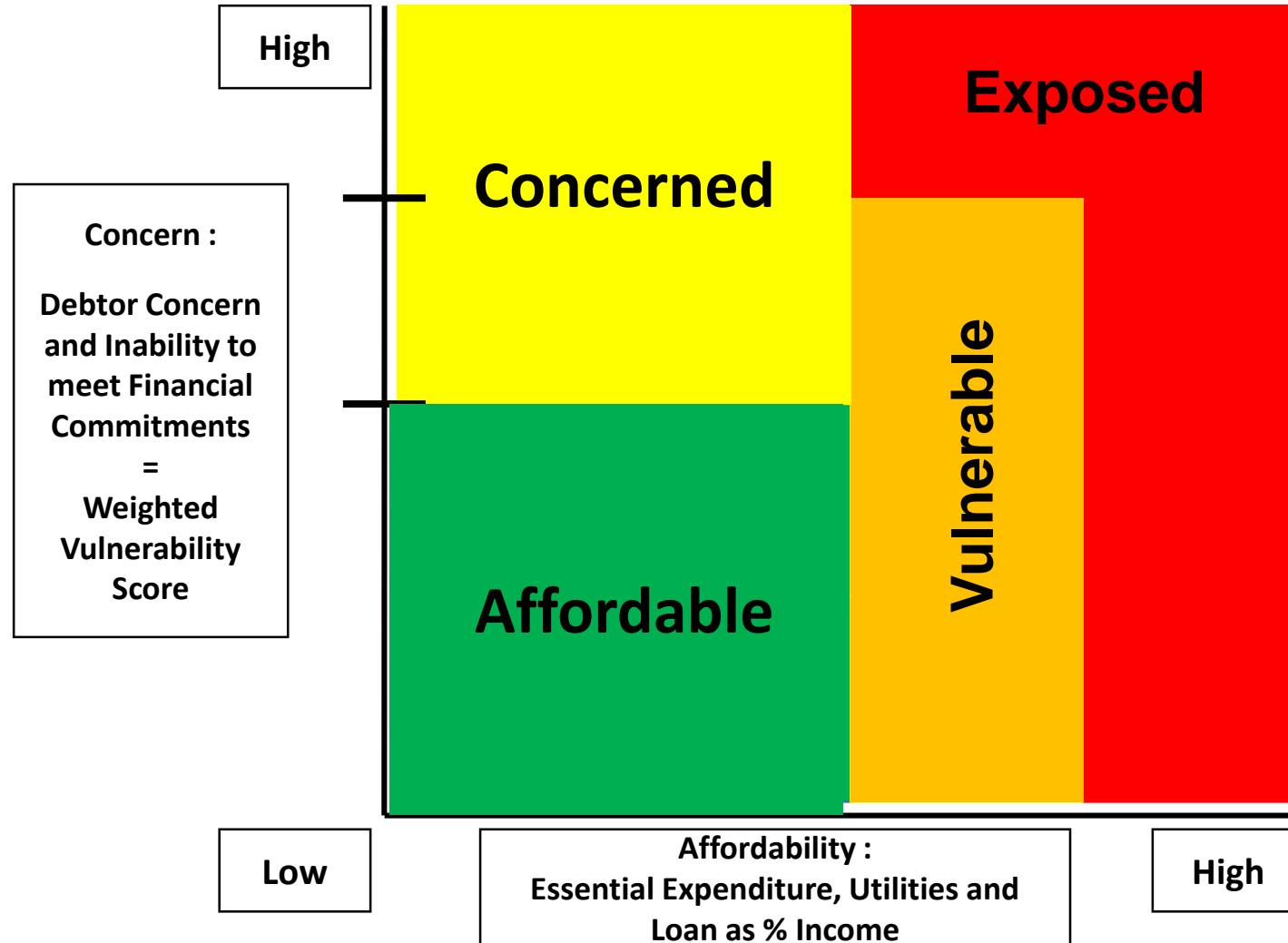
Concern : Questions and Responses

Component Issues and Score Distribution	0	1	2	3	4	5
Loan Arrears	97 %					3 %
Utility Arrears	93 %					7 %
Loan refinance & / or loan refusal	90 %			10 %		0.1%
Other loans	68 %		26 %	5 %	1 %	0.1%
Reduced food expenditure &/or additional work	51 %			36 %		13 %
Repayments more than I can afford	59 %	9 %	4 %	24 %		4 %
Adverse events in last 6 months	63 %	26 %		8 %	2 %	1 %
Do not feel in control of financial situation	24 %	70 %	1 %	4 %		1 %
Debt causes problems in family	13 %	63 %	2 %	18 %		4 %
Financial situation not improved in 6 months	14 %	69 %	3 %	13 %		1 %

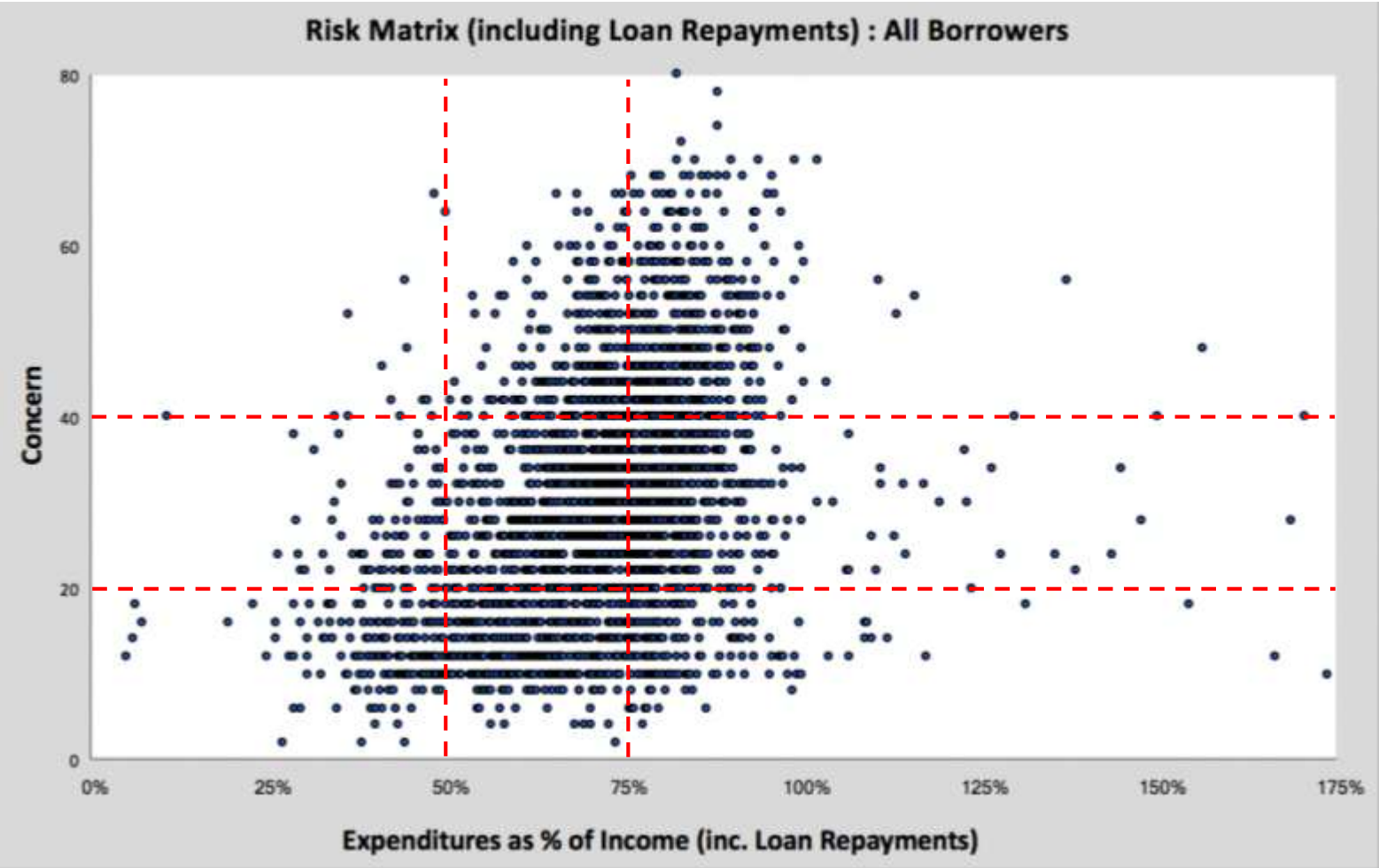
The diversity of risk appetite and budget capacity



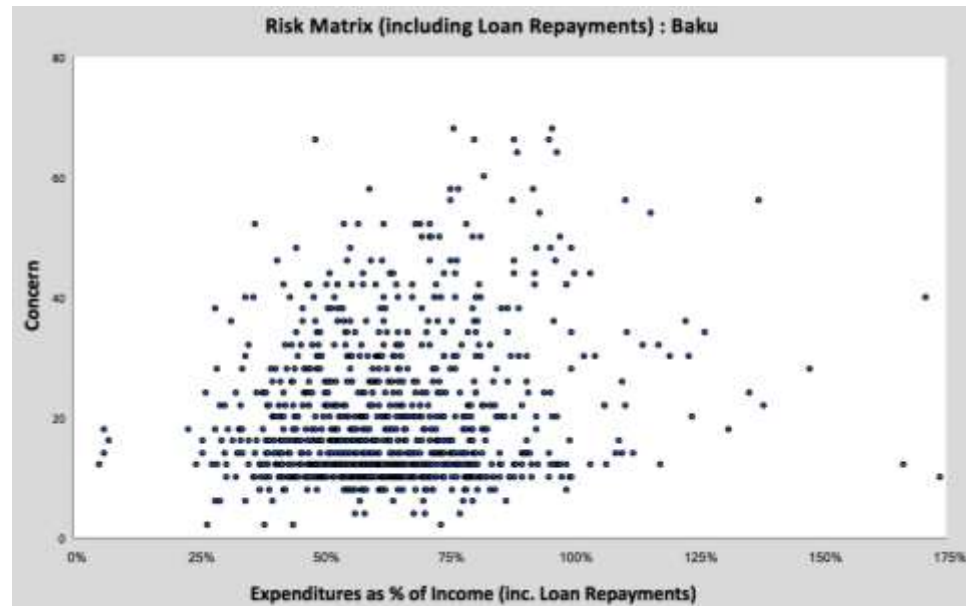
Different risk and service propositions – it is not a simple financial formula



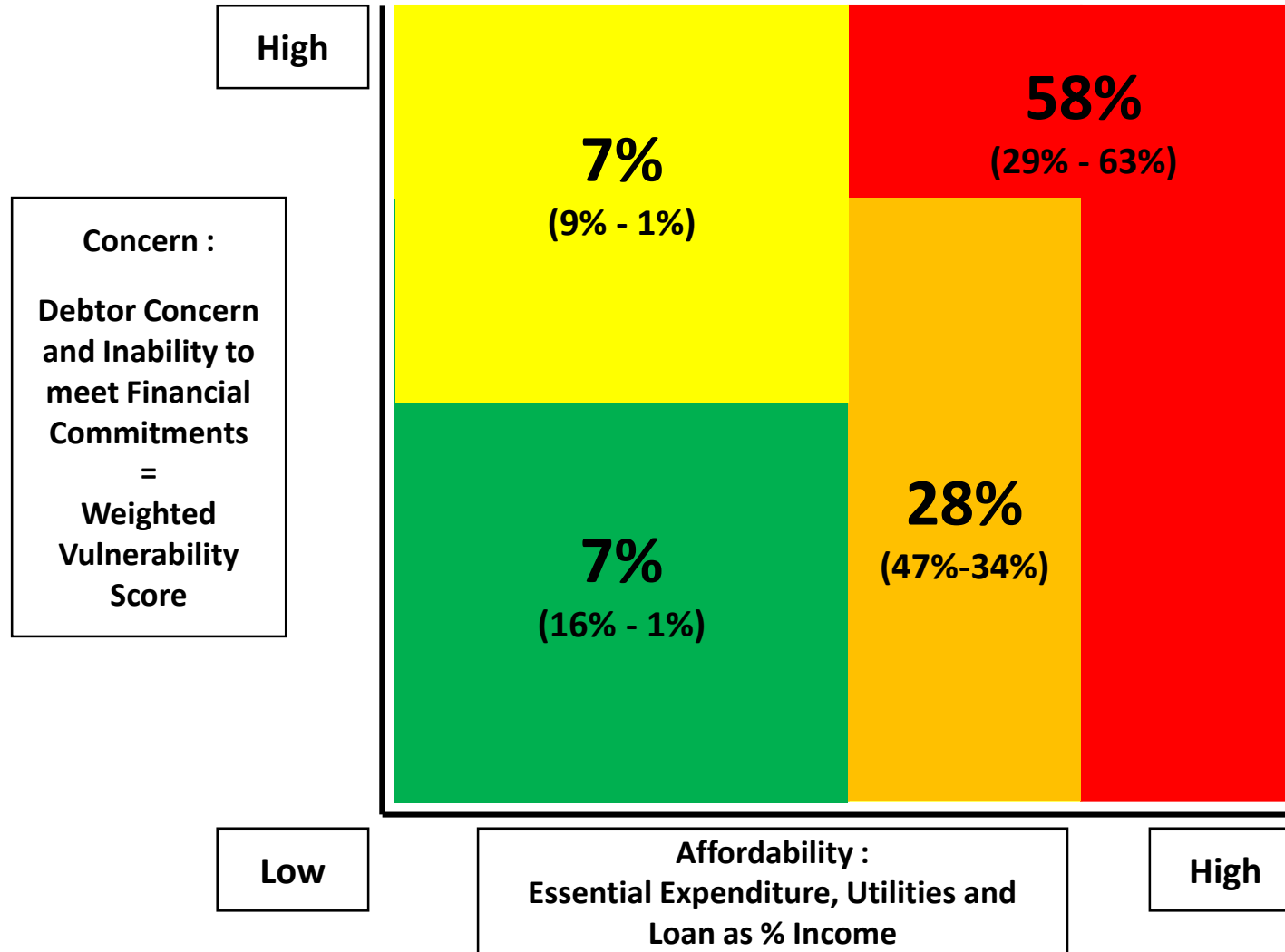
The segmentation of client attitude and behaviour



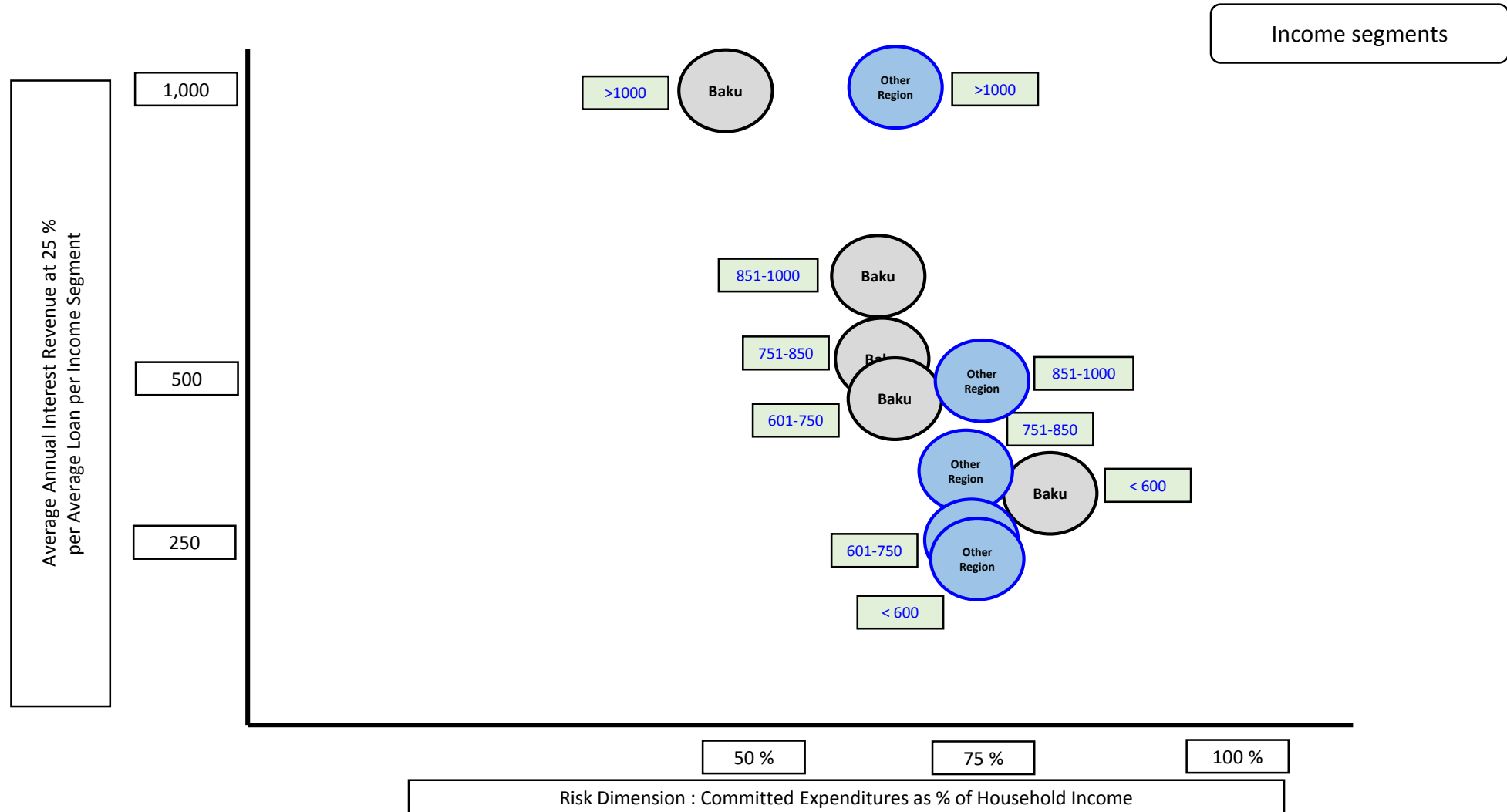
Two markets ... what driving factors ?



Vulnerability : low capacity to absorb higher costs



Quality of Loan Interest Income and Profit Impact



The reputational challenge ...

	Lending Institutions are Trustworthy		Lending Institutions act with Integrity		Lending Institutions seek to Improve the Lives of their Clients	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Current Borrowers : MFI	2 %	11 %	2 %	3 %	1 %	3 %
Current Borrowers : Bank	39 %	9 %	38 %	4 %	32 %	3 %
Former Borrowers : Bank	65 %	12 %	59 %	1 %	45 %	2 %
Tajikistan : 2016	89 %		86 %		86 %	

Reputational differences of client segments and regions

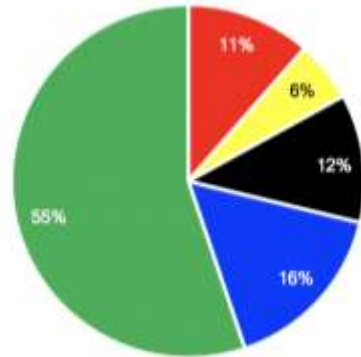
	Lending Institutions are Trustworthy		Lending Institutions act with Integrity		Lending Institutions seek to Improve the Lives of their Clients	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Employed	22 %	10 %	22 %	3 %	19 %	3 %
Own Business	14 %	8 %	12 %	4 %	8 %	3 %
Employees : Public Sector	26 %	13 %	25 %	6 %	22 %	4 %
Own Business : Retail	7 %	7 %	7 %	3 %	5 %	3 %

Transparency in loan terms but not currency risks ...

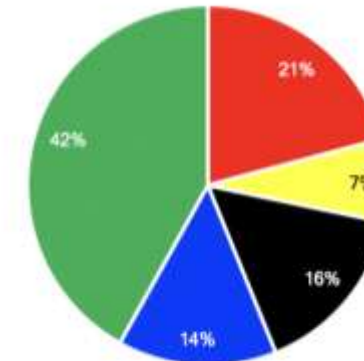
	Loan charges (interest and fees) were explained and borrowers knows what is being paid		Lending institution explained the risks of foreign exchange <i>(foreign currency clients only)</i>	
	Baku	Other Regions	Baku	Other Regions
MFI	98 %	77 %	30 %	5 %
Bank	90 %	77 %	40 %	4 %

Different recognition of debt pressures ...

Distribution of Borrowers : Baku

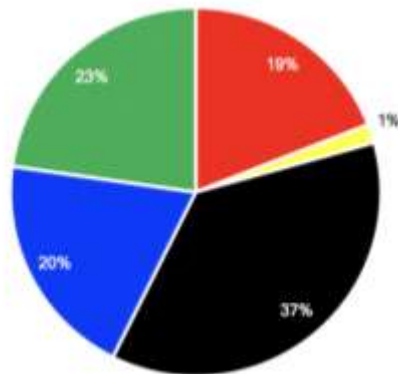


Distribution of Loan Balances : Baku

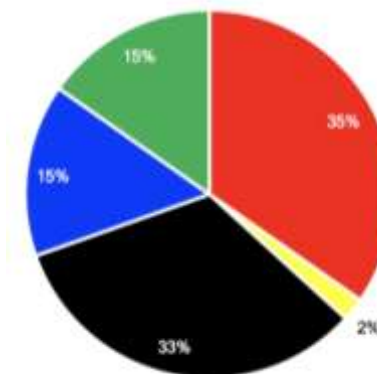


- Arrears
- Lender Refusal
- Repayment Difficulty
- Expenditure > 75%
- Remainder

Distribution of Borrowers : Other Regions

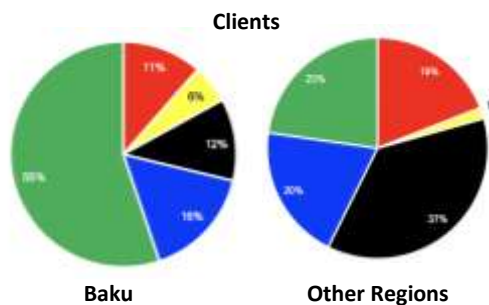


Distribution of Loan Balances : Other Regions



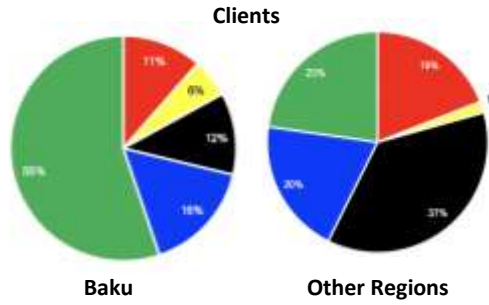
- Arrears
- Lender Refusal
- Repayment Difficulty
- Expenditure > 75%
- Remainder

A challenge of communication to clients with different budget pressures

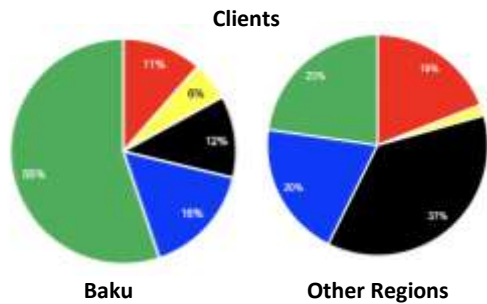


	Household Income		Net Income (after loan)		Loan Payment as % of Net Income (after Essential Payments)	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Arrears	1,175	1,025	350	225	47 %	53 %
Lender Refusal	1,175	1,000	475	300	31 %	40 %
Repayment Difficulty	1,225	875	500	225	33 %	41 %
Expenditure >75% of Income	950	850	100	150	74 %	52 %
Remainder	1,350	900	675	330	21 %	27 %

The challenge and pressure of resolving the debt problem ...



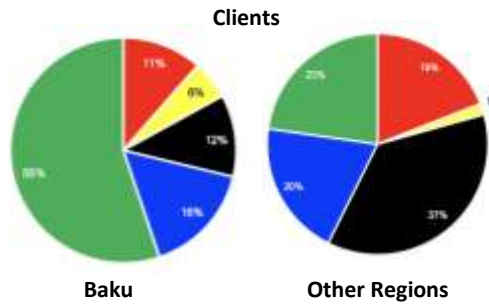
	Collateral		Foreign Currency		I would like help to resolve debt problems with my lender	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Arrears	26 %	77 %	26 %	70 %	72 %	97 %
Lender Refusal	17 %	44 %	19 %	32 %	46 %	78 %
Repayment Difficulty	25 %	41 %	14 %	9 %	81 %	92 %
Expenditure >75% of Income	34 %	31 %	8 %	8 %	26 %	73 %
Remainder	21 %	22 %	11 %	2 %	21 %	65 %



Do borrowers in Baku show undue optimism ?

	Loan Improve the Quality of Life		Debt Repayments Cause Problems in my Family		I need to continue to borrow to maintain family lifestyle	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Arrears	39 %	51 %	45 %	73 %	30 %	77 %
Lender Refusal	33 %	37 %	25 %	48 %	23 %	48 %
Repayment Difficulty	34 %	57 %	70 %	64 %	37 %	64 %
Expenditure >75% of Income	13 %	65 %	10 %	22 %	6 %	22 %
Remainder	13 %	54 %	8 %	18 %	4 %	18 %

Reputation improves with problem lending in Baku ... but not elsewhere



	Lending Institutions are Trustworthy		Lending Institutions act with Integrity		Lending Institutions seek to Improve the Lives of Clients	
	Baku	Other Regions	Baku	Other Regions	Baku	Other Regions
Arrears	39 %	7 %	26 %	4 %	31 %	3 %
Lender Refusal	21 %	24 %	35 %	17 %	26 %	9 %
Repayment Difficulty	39 %	5 %	31 %	1 %	29 %	2 %
Expenditure >75% of Income	13 %	18 %	19 %	4 %	9 %	3 %
Remainder	14 %	13 %	14 %	6 %	10 %	6 %

Guarantees – what value ?

		Number of Guarantees given by Borrower			
		0	1	2	3
Arrears	Baku	47 %	37 %	14 %	2 %
	Other Regions	4 %	82 %	13 %	1 %
Lender Refusal	Baku	33 %	46 %	19 %	2 %
	Other Regions	15 %	76 %	6 %	3 %
Repayment Difficulty	Baku	40 %	55 %	5 %	0 %
	Other Regions	5 %	93 %	2 %	%
Expenditure > 75 % of Income	Baku	29 %	65 %	5 %	1 %
	Other Regions	4 %	92 %	4 %	%
Remainder	Baku	35 %	59 %	5 %	0 %
	Other Regions	12 %	87 %	2 %	%

Summary

Income / Expenditure

- Substantive differences of Baku and other regions
 - Sensitivity to inflationary pressures
- Strong usage of loan funds to support domestic consumption

Borrowing

- Strong operational credit management ratios in Baku
 - Slow-down in lending to Own Business
- High risk portfolio segments : Own Business, Foreign Currency

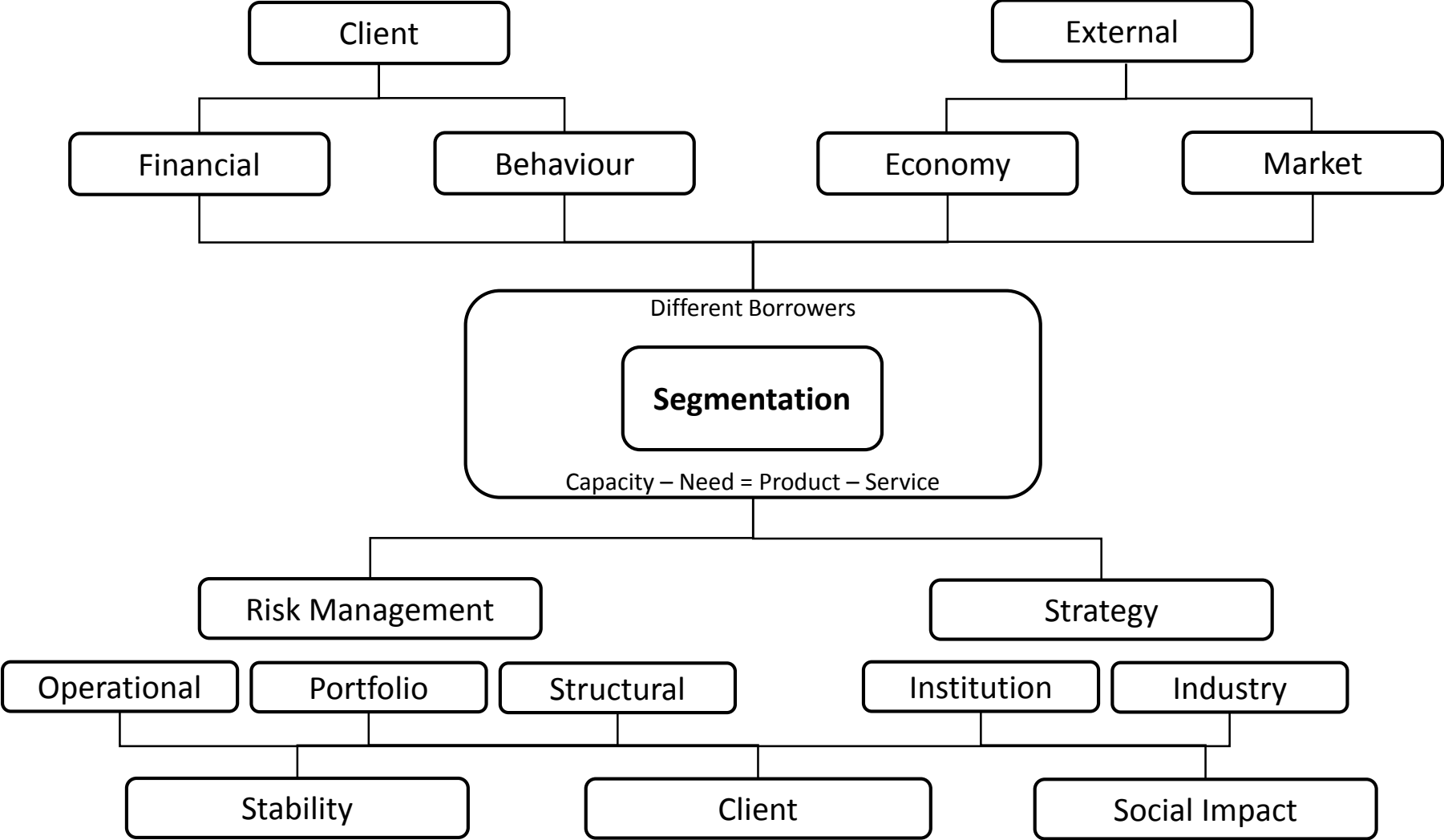
Affordability

- Loan Arrears : 14% in Baku and 19% in other regions
- Loan payment difficulties : 30% in Baku and 60% elsewhere
- Other Regions show greater austerity actions than Baku

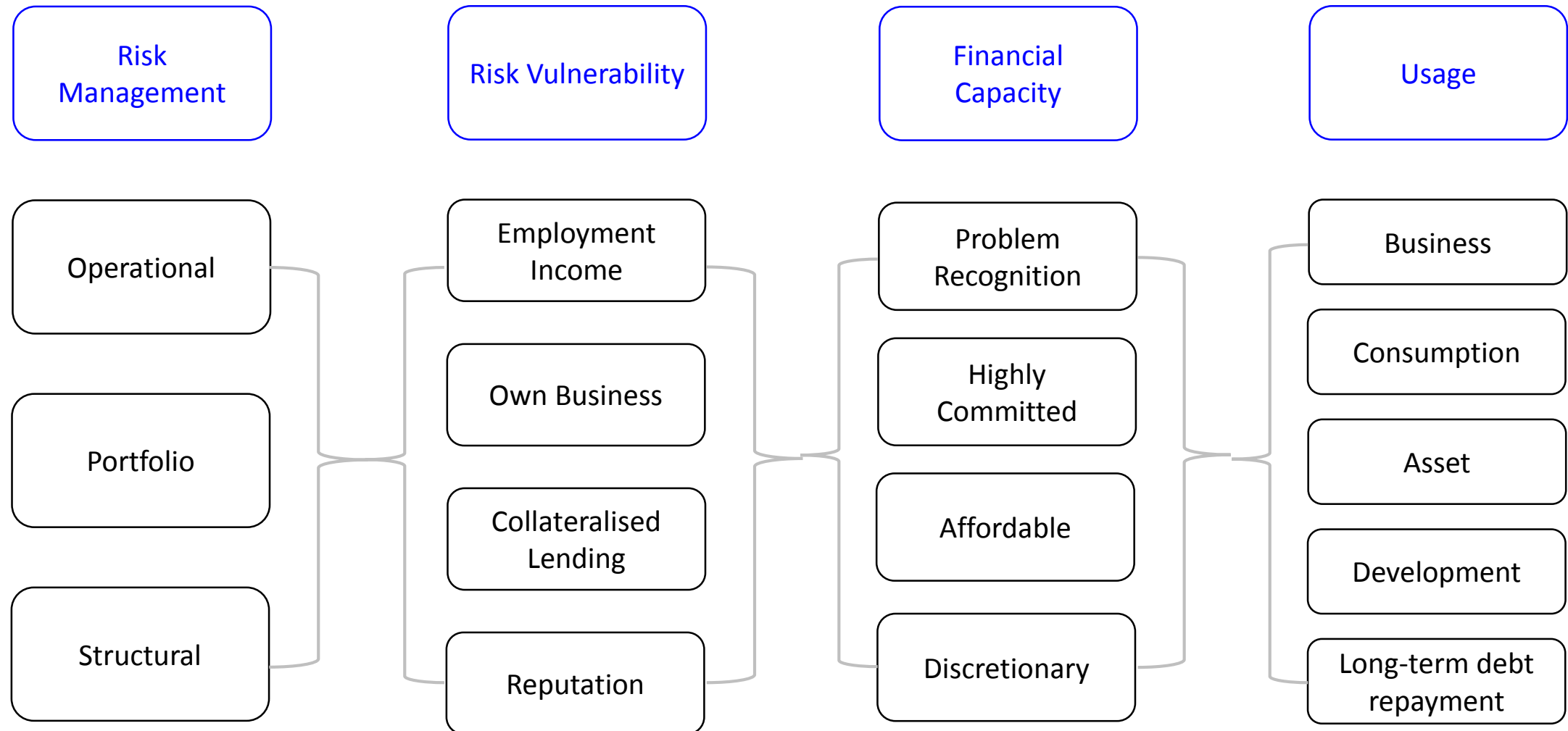
Impact of Loan

- Stronger positive attitudes in Baku ... but some contradictions
 - Major pressures in regions outside Baku
 - Fundamental challenge for 'own business' segment
 - Similar impact profiles for MFIs and banks

A Framework for Segmentation



Development Framework : The Different challenges of Baku and Other Regions



Strategic Considerations

Reputation

- Core values drive the business ethic – what goals
- Implications for client behaviour and responsibility
 - Current motivation of borrowers to repay

Market Development

- Different regional profiles – business model
 - Client segmentation and debt capacity
- Development segments - work-out - containment

Own Business

- Portfolio risk exposure and vulnerability
- Segmented proposition : trading – currency – experience
 - Delivery – service proposition – loan officer skills

Risk

- Structural – portfolio – operational
 - Sensitivity to external trends
- Is the optimism of Baku borrowers well-founded

Lending to Consumers

- Debt dependency – institutional reputation
- Loan approval levels and Usage of loan funds
- Regional differences – decisions of discretionary borrowers



Azerbaijan

Indebtedness of Individuals

Roy Pratt

December 2016