

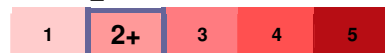
Azerdemiryolbank, Azerbaijan

Azerdemiryolbank (AzDB) was established in 1989 by the Azerbaijani State Railway Company (ASRC) as a limited liability company and then re-registered as a joint stock bank in 1992. Azerdemiryolbank's **vision** is to offer its clients all types of financial services and to contribute to their welfare and development. Azerdemiryolbank's **mission** is to act as a universal, business development, socially-oriented and responsible bank. As part of a bank community, Azerdemiryolbank aims at carrying out high standards of corporate management and at working for transparency, responsibility, profitability and financial stability. Initially involved only in corporate banking, AzDB has diversified into retail banking with micro, SME, consumer and mortgage finance after the exit of ASRC in 2003. In March 2009, AzDB served 48,614 borrowers and 4,843 savers through a network of 29 branches and 2 units spread over the country.

Social Performance Rating

Rating

Incipient



Detailed scales provided on the last page.

Date of the Rating

May 2009

Country Profile – 2006/2007

Indicator	Azerbaijan	ECA
Demography		
Urban population	48%	63%
Health		
Life expectancy	67	69
Access to safe water	78%	94%
Education		
Adult literacy rate	99%	99%
Combined gross school enrolment ratio	66%	81%
Gender		
% of parliament seats held by women	11%	15%
Poverty line		
< the National line	15.8%	
Gini index		
HDI	0.758	0.808
Rank out of 179 countries	97	

Source: UNDP, 2008

Planet Rating Contact

Edouard Sers
esers@planetrating.com
+ 33 1 49 21 26 30

MFI Contact

Mr. Roman Amirjanov
+ 994 4402429
demir@azerdemiryolbank.com

Rating highlights

- AzDB's social mission has not yet been formally institutionalized. The bank has nevertheless progressively strengthened its commitment to support entrepreneurs, notably thanks to its shareholders' support and of the availability of funding.
- Although willing to be a socially-oriented bank, AzDB has not developed the systems to actively monitor its social performance and responsibility at the levels of the management team and Supervisory Board.
- With a 2.5% penetration rate of the households in the country, AzDB still serves a small portion of its target clientele. Although AzDB has developed its outreach in the provinces of Azerbaijan, 74% of the clientele is still concentrated in Baku.
- As a universal bank, AzDB offers diversified services as expected by its clientele. However, AzDB's loan offering could still be refined to further meet the clients' needs: formal client studies to measure clients' satisfaction have been initiated only recently and the client drop-out rate is not yet tracked.
- With an average Effective Interest Rate (EIR) estimated at 28%, AzDB offers lending products within market prices. Transaction costs remain high due to collateral and transport costs, but are reduced by the provision of efficient services.
- Services are sufficiently transparent as AzDB charges declining interest rates, provides a copy of the contract to the client, and communicates all conditions as required by law. Efforts to disclose the EIR are needed on a sector wide level.
- Adequate systems are in place to ensure that clients receive a fair treatment (hotline, code of ethic, satisfaction survey) but need to be completed by more independent clients' visits.
- Prevention of over-indebtedness is satisfactory but could still be enhanced with a more systematic use of the credit bureau information as per the policy. Life-insurance is provided only to a minority of clients.
- Human Resources are professionally administered which has contributed to the fair treatment of staff. Moreover, staff remuneration has kept pace with the cost of living. However, trainings could be provided more systematically to all staff as only 14.9% received more than two days of training in 2008. Gender equity is not ensured as women are making-up only 39% of total staff and 15% of management.
- AzDB has taken acceptable steps to act as a responsible bank by setting-up an anti-money-laundering department, avoiding financing socially irresponsible activities, and participating to the credit bureaus. However, at the field level, AzDB does not provide any pre-credit training or orientation to its microfinance clients.

REF: ES220908

Note: Refer to the appendixes for social and institutional performance indicators.

Microfinance Sector

The beginning of microfinance in Azerbaijan may be linked to the perestroika period, around the 1980s, when Soviet Authorities started providing loans to small businesses. Microfinance further developed with the arrival of international relief organizations around 1994, due to the humanitarian crisis following the war with Armenia over Nagorno-Karabakh. However, it was only from 1997 that traditional microfinance began when international NGOs such as FINCA and ADRA entered the sector. Over the past few years, the microfinance sector has evolved with remarkable growth in outreach, scale and increased competition among MFIs. Microfinance has already reached a significant scope: as of December 2008, microfinance providers served 319,337 clients (i.e. 16.6% of the household in the country) throughout 60 of the 77 districts in the country, with an outstanding portfolio of 554 M USD. Microfinance services are offered through three types of institutions: commercial banks, non-bank financial institutions (NBFIs) and credit unions. AccessBank (a Bank) and Finca (an NBFI) together dominated the market with a combined market share of 48% in borrowers and 50% in outstanding loan portfolio.

MFI	Active clients	%	Av. Loan (USD)	% Women
AccessBank	69,144	21.7%	3,010	16%
Bank Respublika	21,730	6.8%	1,147	0%
Parabank	14,462	4.5%	749	32%
AzerDemiryolBank	10,766	3.4%	2,901	13%
Other banks	21,330	6.7%	2,070	23%
<i>Sub-total banks</i>	<i>137,432</i>	<i>43.0%</i>	<i>2,323</i>	<i>16%</i>
Finca AZE	83,817	26.2%	796	36%
Azercredit	21,509	6.7%	793	43%
Normicro	14,638	4.6%	974	34%
CredAgro	13,754	4.3%	3,704	25%
Viator	9,751	3.1%	465	49%
FinDev	6,086	1.9%	1,068	34%
Azeri Star	5,973	1.9%	403	65%
Mikromaliyye	4,150	1.3%	170	45%
Agrarcredit	2,512	0.8%	8,368	15%
Komak Credit	1,889	0.6%	817	41%
Nakhchivan Credit	1,428	0.4%	1,032	36%
Agroinvest	1,279	0.4%	2,038	37%
Others	15,119	4.7%	2,094	35%
<i>Sub-total NBFIs&CU</i>	<i>181,905</i>	<i>56.9%</i>	<i>1,217</i>	<i>37%</i>
Total	319,337	100.0%	1,693	28%

Source: AMFA Matrix – Dec. 2008

Although microfinance institutions have been targeting the underprivileged and middle strata of the population, some groups are still underrepresented. According to the 2008 AMFA assessment¹, the poverty rate of the microfinance clientele could be estimated at 19% (national poverty line) which is slightly higher than the one for the general

¹ Assessment of Microfinance Impact and Social Performance of MFIs in Azerbaijan, AMFA, 2009. Results are based on a sample of 2,000 clients selected among the clientele of 12 microfinance providers.

population (15.8% in 2007). Micro-entrepreneurs would be mostly self-employed (42.2%) or employed in the public sector (27.6%) while the unemployed, students, pensioners and women are still under-served. Women represented only 28% of total clients in 2008. In some programs, mainly the ones managed by international humanitarian organizations, women and minorities are yet largely represented. The majority of microfinance providers have been operating in urban areas even though some of them have more expanded outside of Baku and in rural areas in the recent years (e.g. CredAgro, FINCA).

Originally limited to credit services, the scope of services offered by microfinance service providers has expanded to savings, micro-insurance and money transfer services, notably with the arrival of banks in this market. But NBFIs (serving 56% of borrowers) are restricted from taking deposits since no related regulation was put in place yet (the NBAR is working on a draft law since 2007). Even though savings habits are still generally under-developed in Azerbaijan, there is potentially a high demand for flexible and secured savings services². Microfinance clients would also need access to services such as life, health and car insurances, housing loans, supplier credit, and consumer loans.

Microfinance providers offer group and individual lending to micro, small and medium entrepreneurs for amounts ranging, in average, from a minimum of 243 AZN to a maximum of 139,068 AZN for terms ranging from 3 months to 3 years (7 years in one case). However, as high amounts and long terms are subject to the provision of collaterals, respectively 34.8% and 28.2% of micro-entrepreneurs consider the low amount and short term of loans as major drawbacks, according to AMFA. Overall, micro-entrepreneurs nevertheless reported to be very satisfied (10.9%) or satisfied (78.3%). 79% of them declared using the loans for business needs, including 7% to start a new business. Others used the loans for personal/consumption purposes (14.5%), housing (5.8%) and education (1.9%).

Interest rates on loans range from 1.5% to 5% per month with no clear evolution trend over the years³. According to the AMFA study, 79.1% of micro-entrepreneurs complain about high interest rates. As it is often the case in microfinance, a majority of borrowers (58.5%; AMFA) were not required to provide hard collaterals (they did not provide any or used joint liabilities or guarantor/co-

² According to the AMFA assessment, 70.1% of the interviewees declared making savings, either by keeping cash at home (70%), investing in precious metal (21%) or in their business (12%).

³ Based on data reported to the Mix from 2003 to 2008, the evolution of portfolio yields (used as a proxy for Effective Interest Rates) does not reflect any global trend in the pricing of loan products.

signers). Legal barriers have however reportedly made it difficult to register collaterals such as properties and land with the State Register Service, which could hamper the development of collateral-based microfinance.

Client protection could be greatly improved in the microfinance industry. NBFIs currently do not have a formal access to the national credit bureau, which increases the risk of cross-indebtedness in the industry. Although banks are to report on all outstanding loans to the Centralized Credit Register since August 2008 (vs. only loans above 1,000 AZN before that), it is still unclear whether all banks have been complying with this new amendment to the regulation.

The Azerbaijan Micro-Finance Association (AMFA) has been in place since 2001 following the Microfinance Conference held in Baku. AMFA has progressively strengthened its capacities and recent initiatives have been taken towards social performance. Even though microfinance is considered as one of the ways to fight poverty in the various state poverty reduction programs since 2003, the impact of microfinance on poverty reduction has not yet been rigorously measured by practitioners or regulatory bodies.⁴

Socio-economic Environment

Azerbaijan enjoys an exceptional strong economic growth which has resulted in higher job creation, income per capita and poverty reduction. In 2007, Azerbaijan had one of the fastest growing economies with a 25.4% growth and is expected to have among the highest gross domestic product per capita in the region over the coming years. However, the country is still challenged by high inflation which was at 20% in 2007. Moreover, development of the non oil economy, regional integration and fiscal sustainability remain key macroeconomic challenges.

In 2001, the government of Azerbaijan prepared a State Programme on Poverty Reduction and Economic Development, which was instrumental in fighting poverty. For example, poverty level in the country was at 46.7% in 2002 and dropped to 15.8% in 2007. A new State Programme on Poverty Reduction and Economic Development was designed for 2008-2015. It has a focus on meeting the social needs of vulnerable populations (disabled people, war veterans, young families, etc.). Therefore, poverty level should keep decreasing and improvements are expected also in the provision of stable

⁴ Studies performed so far have measured the effects of microfinance but did not use control groups required to measure impact.

water supply, energy, education and health through the construction of schools, hospitals, housing for refugees, etc. Azerbaijan has a natural population increase and women represent around 52% of the population. Legally, women have same rights than men. Yet, the issue of equity and gender balance in benefiting from education, employment is yet to be solved. The unemployment rate was at 6.5% in 2007 which affects not only refugees and internally displaced persons but also people with higher education whose share among unemployed is high.

In terms of competitiveness, Azerbaijan ranks 66 out of 131 economies and the inadequately educated workforce has been a challenge. Therefore, government has placed education as a priority, currently it is the third sector in public expenditure, after construction and industry.

There are some concerns related to environmental sustainability, like many former Soviet Union countries which enjoyed rapid economic development and human activity, Azerbaijan has been faced with inefficient usage of natural resources and ecological problems (low-quality water to inhabited regions, degradation of soil, improper regulation of industry and housing, decline in forest reserves and fauna, etc.). To face these issues, laws and state programs have been developed and approved but it will still take a long time to fix many of the environmental problems.

Source: EFT Country Plan 2009 "Azerbaijan/UNDP"

Institutional Presentation

Social Vision, Mission and Objectives

Azerdemiryolbank's **vision** is to be a socially oriented bank offering all types of financial services to its clients and contributing to their welfare and development. As part of the bank community, Azerdemiryolbank (AzDB) aims at carrying out high standards of corporate management and to work for transparency, responsibility, profitability and financial stability. AzDB's **mission** is 1) as a socially oriented bank, to support entrepreneurship and take part in the realization of state programs on regional development thanks to a wide branch network; 2) as a universal commercial bank to satisfy all financial needs of its clients; 3) as a business development bank, to help clients solve their financial and business problems while ensuring bank secrecy; and 4) as a trustable and responsibility bank to promote fair business, preserve its reputation and accomplish its obligations towards its clients.

Among its strategic **objectives**, AzDB aims at creating a status and maintaining an image of a socially oriented bank

through a corporate social responsibility strategy consisting of the bank's participation to programs in entrepreneurship support, regional development, employment creation and increased access to financial services.

AzDB has not yet defined any specific target group. Despite its current limited outreach, the aim of the bank is to provide all segments of the society with an opportunity to get access to financial services.

Characteristics of Outreach

AzDB provides banking services to corporate and individual customers, the former representing 0.7% of the clientele but 51.6% of the loan portfolio.

- Corporate clients are mainly located in Baku but also in the provinces of Azerbaijan, where socio-economic development has been identified as a priority for the development of the country.
- Mainly benefiting from consumption and productive loans, individual clients are stemming from the general population (e.g. employees, students, entrepreneurs, teachers, and pensioners), and are in average 35 years old according to AzDB's 2008 client study⁵. In the same study, the total monthly household income was estimated less than 200 AZN (for 14% of the clientele vs. 9.2% in the general population), between 200 and 500 AZN for 36% of the clientele (vs. 38.5%), between 500 and 1000 AZN for 20% (vs. 32.5%) and between 1000 and 3000 AZN for 19% (vs. 14.6%). 70% of interviewed clients also declared being able to save (vs. 30% in the non-clients sample).

The table below provides, per economic region where AzDB operates, a more detailed overview of the proportion of rural population and income levels in 2008.

Economic Region	#	Individual Borrowers	Individual Savers	% rural **	Income /capita*
Baku city	13	32,912	3,194	0%	131
Absheron	2	3,291	389	6%	93
Sheki-Zagatala	2	2,855	117	72%	106
Ganja-Gazakh	4	2,780	162	54%	104
Aran	6	2,514	92	62%	102
Guba-Khachmaz	2	2,039	752	66%	108
Lankaran	2	1,449	28	76%	102
Dakhlik Shirvan	1	385	109	72%	101
Total	32	48,225	4,843	48%	114

Source: www.azstat.org; Note: # number of branches and units in the economic region; * Income per capita in 2008 (AZN); ** proportion of rural population in the region (2008).

⁵ Estimates extracted from the December 2008 study conducted by Business Insight International Group; 706 individuals (potential customers) were interviewed door-to-door and 501 clients filled in a satisfaction study in AZDB's branches; other results are presented in the Service Design section.

Market Penetration

With 30 branches and 2 units, AzDB serves clients across 8 out of the 11 economic regions of Azerbaijan and has one of the largest private bank branch networks of the country. As of March 2009, AzDB had a market penetration of 2.9% in terms of active individual borrowers reported to the total number of households in the economic regions where it operates. When reported to the total number of households in Azerbaijan, this market penetration decreases to 2.5%⁶. The table below shows the global and penetration rate per economic region.

Economic Region	#	Penetration by borrowers	Penetration by savers	Number of households
Baku city	13	7.1%	0.7%	464,165
Absheron	2	3.7%	0.4%	89,592
Sheki-Zagatala	2	2.4%	0.1%	121,085
Ganja-Gazakh	4	1.1%	0.1%	256,133
Aran	6	0.7%	0.0%	378,184
Guba-Khachmaz	2	2.0%	0.7%	101,069
Lankaran	2	0.8%	0.0%	177,654
Dakhlik Shirvan	1	0.6%	0.2%	61,830
Total AzDB	32	2.9%	0.3%	1,649,712

Source: www.azstat.org; Note: # number of branches and units in the economic region; penetration rate = number of individual borrowers or savers / number of households; the total penetration rate is calculated based on the number of households in the regions where AzDB operates.

Banking services are also offered by competitors throughout the country, though to different extents. Competition is very strong in Baku while financial services are still expanding in the regions. State banks are providing banking services in each administrative settlement while more and more regions are covered by non-banking credit organizations (NBCO) with 64 branches⁷. AzDB reportedly faces a low competition level from private bank and NBCO in 42% of its branches.



⁶ Penetration rate calculated based on a number of 1,918,587 households (www.azstat.org) in the country.

⁷ NBCOs had a total of 64 branches as of Dec. 2008 according to NBAR.

Products and Services

AzDB offers corporate and retail loans which are meant to be collateralized above 150%. In addition, they include a 1% withdrawal fee and penalty fees varying from 0.1% to 1%. On average, AzDB's Effective Interest Rate (EIR) is estimated at 28%.

- Corporate loans (52% of the portfolio) are issued to companies in the trade, service, construction and manufacturing sectors. They are on average around 250 K AZN (304 K USD) and the loan amount cannot exceed 20% of bank's total equity. The loan term is on average 26 months and the interest rates charged are between 16% and 24% on a declining basis. Repayments are monthly, yearly or bullet payment and beneficiaries may obtain a grace period of up to 1 year. However, the ones under the National Fund for Support of Entrepreneurship (NFSE) may have a grace period for up to 3 years. Collaterals are comprised of real estate, inventory, equipments, letters of guarantee, etc. The EIR rate for corporate loans is estimated at 25%.
- Trading loans to entrepreneurs (retail) cover 19% of the portfolio and are on average 3,000 K AZN (3,650 USD) for around 1 year with a grace period of up to 6 months. Interest rates are between 22% and 28% declining basis. Repayments are similar to corporate loans and collaterals are comprised of real estate, residual inventory, deposits and guarantee. Microfinance loans are within this category of loans. The EIR for trading loans to entrepreneurs is estimated at 29%.
- Consumer loans (retail) cover 11.5% of the portfolio and are on average 600 AZN (730 USD) for an average length of 11 months and a declining interest rates between 26% and 36%. Repayments are monthly and yearly. Collaterals are comprised of goods purchased and guarantee. The EIR is estimated at 38%.
- Auto loans (retail) cover 11.3% of the loan portfolio and have an average loan size around 11 K AZN (13 K USD). The loan length is on average around 12 months. Interest rates charged are between 19% and 27% (declining basis) and repayments are done on a monthly and yearly basis. Collaterals included cars purchased, real estate, third party. The EIR for auto loans is estimated at 29%.
- Plastic cards (retail) are on average around 3,200 AZN (3,900 USD) for an average length of 8 months. Interest rate is 25% declining and repayments are monthly, yearly or bullet payments. Collaterals include real estate, guaranty and deposits. The EIR is estimated at 28%.
- Mortgage loans (retail) are on average 40 K AZN (49 K USD) for an average length of 14 months, except the ones issued under the Azerbaijan Mortgage Fund line which have an average maturity of 20 years and sub-loans with average maturity of 15 years issued under the

IFC mortgage line. Interest rates are between 4% and 25% declining basis with monthly and yearly repayments. Collaterals included properties, moveable assets, securities, deposits. The EIR for mortgage loans is estimated at 22%.

AzDB offers also demand and fixed term deposits, which are guaranteed for up to 30,000 AZN under the State Deposit Insurance Fund⁸. The savings offering to retail clients was recently revamped into four attractive packages (Green, Red, Blue, and Yellow) with various interest rates and terms. AzDB also offers other services such as utility payments⁹, money transfers¹⁰ and foreign currency exchange.

Social Performance Rating

▪ Institutionalization of the Mission

Social Mission and Strategy

AzDB's social mission is mainly seen as the support of entrepreneurship in a socially responsible manner to support the development of Azerbaijan. However, AzDB's social mission has not yet been formally defined and institutionalized within the bank. Though mentioned in some internal documents, AzDB's mission is not clearly stated in guiding documents such as the bank's charter or the business plan. The bank has not yet developed a specific knowledge of the challenges faced by the different new market segments it serves such as micro-entrepreneurs.

Over the past six years, AzDB progressively strengthened its commitment to support entrepreneurs in Azerbaijan by expanding its geographic coverage to underserved regions and serving new segment of entrepreneurs with micro, small and medium enterprise (MSME) lending. The arrival of socially oriented shareholders (EBRD in 2005 and FMO in 2007) has contributed to this shift in AzDB's social commitment. This trend was also fueled by the availability of international funding for MSME lending as well as, since 2001, governmental funds for financial institutions to support the provinces.

⁸ The maximum amount insured was increased from 6,000 AZN to 30,000 AZN in May 2009 as per the amendments made to the Law on Deposit Insurance.

⁹ In 2008, 252,790 utility payments were realized through AzDB for power, gas, water and communication services for a total amount of 15 M AZN.

¹⁰ In 2008, 59,480 money transfer operations were realized through AzDB's seven partners for a total amount of 75.7 M AZN.

Overall, the different stakeholders share AzDB's core mission as reflected by key decision (in terms of service offering and geographic expansion) taken in line with AzDB's aim to support entrepreneurship. However, at the Supervisory Board level, other social performance areas such as the bank's social responsibility are not really discussed as specific reports or indicators are not provided. Moreover, in the planning, no clear social objectives and related target indicators are set and communicated to staff as such.

Social Performance Monitoring

AzDB social performance monitoring is very limited (indicators are mainly on outreach), notably due to the lack of formal social objectives (cf. previous section) and the limitations of the current MIS.

- The main indicator that can be related to social performance at AzDB is the number of entrepreneurs and microentrepreneurs among its clientele. In that regard, no targets were set but reporting is done for the National Fund for Entrepreneurship and the German Azerbaijan Fund. The number of refugees is tracked only for external reporting purposes.
- The current MIS does not capture other data collected during the loan application process (e.g. on gender, jobs created, etc.), limiting the production of additional indicators.
- AzDB is expected to be able to generate much more social performance indicators with its new MIS (SAP banking equipped with its Customer Relationship Management module), however these indicators will not be available in the short term given the necessary delays of implementation¹¹.

AzDB has had recourse to additional tools, initiating a better social performance monitoring in terms of client satisfaction and social responsibility to the environment.

- The focus group discussions and quantitative study on current customers conducted by a survey company¹² provided valuable client-level statistics and feedback on customer satisfaction to AzDB. However, the Bank has not yet set specific targets for future monitoring given some limitations on the result¹³ and since it was the first survey of this kind.
- The environmental risk of loans financed by the EBRD is monitored at AzDB and EBRD/BSTDB level (cf. "Social Responsibility to the environment" section).

¹¹ SAP is planned to be implemented over the next three years, with some modules that might be ready earlier.

¹² Business Insight International Research Group, 2008.

¹³ Refer to the "Service Design and Client Satisfaction" section.

Staff Mobilization

The lack of a formal social mission affects AzDB's staff mobilization in understanding the social orientation claimed by the bank. Most staff shares AzDB's social mission but not the social objectives which come along with the mission.

- Background checks are performed before hiring employees to review their past experience and performance and get feedback on their personality. Front office employees received further assessment on their customer service knowledge.
- AzDB's staff demonstrates a sufficient knowledge of the bank's code of ethics, especially on prohibited activities and promoted attitudes within the bank (customer service and leadership). Furthermore, AzDB has taken steps to make sure that staff complies with its code of ethics, individually through checks by the HR department and overall through a client survey.
- AzDB has not designed yet an incentive system taking social performance indicators into account, in order to motivate staff towards its social objectives.

Communication to staff towards AzDB's social objectives could also be improved. Staff receive little information on the Bank's social performance such as investment in social activities, outreach to excluded groups (e.g. refugees), and commitment to social responsibility.

Targeting and Service Offering

Breadth of Outreach

AzDB still serves a small portion of its target clientele. Despite covering almost all the economic regions of Azerbaijan with its 31 branch/unit network, it currently has a 2.5% penetration rate of the number of households in the country. Looking more specifically at households in regions where AzDB operates, AzDB has a penetration rate of 2.9%. Further growth is expected for AzDB given its country-wide branch network and sufficient access to funding.

Client Targeting

AzDB's targeting is mainly geographic, with an emphasis given to the provinces of Azerbaijan over the last years in order to contribute to their economic development. Studies are conducted by the Organizational Department to identify the regions with the most potential prior to branch opening. However, 73% of the portfolio is still invested in Baku (for 68% of the individual borrowers and 65% of the corporate customers as of Dec. 2008) against 27% in the provinces.

At the individual level, AzDB targets clients ranging from individuals to MSMEs and bigger companies, who are mainly chosen according to their eligibility to AzDB's loans. Presently, no internal targets have been defined in terms of clientele composition. However, the choice of individual borrowers partially depends on AzDB's sector diversification policy¹⁴.

As AzDB plans to expand its activities in the provinces and in microfinance, targeting tools could be refined accordingly. The proportion of clients outside of Baku could be better monitored since this is one of AzDB's objectives to develop economic activities in the provinces. In the medium term, AzDB plans to use of the Client Relationship Management module of SAP Banking¹⁵ to refine its targeting.

Service Design and Client Satisfaction

As a universal commercial bank, AzDB offers diversified services ranging from credit, plastic cards, deposits, money transfers and utility payments, all of them being identified by potential customers¹⁶ as the main services expected from a bank.

AzDB's loan offering could still be refined to further meet the clients' needs. Most successful products are consumer loans (69% of the clientele¹⁷) and loans to entrepreneurs (21.7%):

- Consumer loans, mostly granted in partnership with commercial companies, have a relatively small average amount (551 AZN), limiting the compulsory checks on clients' indebtedness level (cf. Client Protection section).
- Loans to entrepreneurs are quite diverse in amounts and terms (up to 60 months and 500 K AZN) depending on the client's collaterals and business profitability. However, although some rare entrepreneurs have benefited from grace periods, loan schedules are in general not very flexible and notably hardly adapted to seasonal businesses (e.g. agriculture). In terms of micro and SME lending, loan officers need (and currently receive) additional trainings to ensure that clients receive financial services adapted to their needs.

AzDB's savings services were recently reshaped to become more attractive while AzDB's participation to the state

deposit insurance scheme¹⁸ provides the minimum level of security to clients. Attracting savers remains a challenge in Azerbaijan for all banks as the general confidence and awareness in the bank's services is still quite low: during AzDB's 2008 study, 66% of the potential clients interviewed declared being unable to save, a proportion similar to interviewees not interested in banking services.

AzDB's services have been designed based on economic sector, competition and statistic analysis. However, AzDB's marketing department initiated only recently formal client studies to capture expectations from potential customers and satisfaction of current ones. The results of the focus group discussions and quantitative studies have not yet been clearly taken into account to improve the service offering. Some limitations in the studies have also made results less useable.¹⁹

AzDB's clients demonstrate an adequate satisfaction with an overall 90% satisfaction rate comparable to the rate calculated for non-clients (90%) and to available benchmarks (90%²⁰). Detailed results show a better satisfaction than the average in terms of quality of the services delivered by the bank personnel (95% vs. 88%) and a similar one in terms of staff appearance and capacity to quickly handle clients' request. Client satisfaction seems to have improved as many improvements were identified in 2007 in terms of the bank's reputation, customer service and innovation. However, AzDB does not track clientele retention yet and has not identified reasons for client exit. Customer feedback on the characteristics of the products has not been formally analyzed yet.

Cost of the Services

AzDB offers lending products at a financial cost comparable to what is offered by competition. Its average effective interest rate is estimated at 28%, ranging from 25.1% for corporate loans, to 29.1% for loans to entrepreneurs and 38.3% for consumer loans. The development of loans to entrepreneurs and consumer loans resulted in a decrease in the average outstanding loan and an increase the average EIR, as indicated by the evolution of the portfolio yield (used as a proxy) to 24% in 2008 from 20.8% in 2004. This is also the result of the recent increase in rates²¹. Interest rates on loans to entrepreneurs are lower than rates offered by MFIs (who generally have their cash

¹⁴ Main sectors of activities are manufacturing (16.7%), trade (15%), service (10%), construction (9.9%) and agriculture (4.9%).

¹⁵ AZDB chose SAP Banking as its next MIS. Its installation is planned over the next three years.

¹⁶ Business Insight International Group, December 2008.

¹⁷ Sith plastic cards and Auto-loan, the total proportion of loans used for consumption purposes increases to 77.5%.

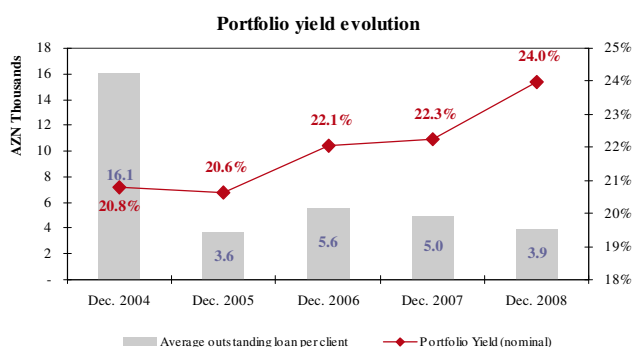
¹⁸ The State Deposit Insurance Fund, introduced in 2006, guarantees repayment of 100% of individual deposits up to 30,000 AZN.

¹⁹ With only 19 participants in 3 focus groups, the scope of Focus Groups remains limited. For the quantitative study on clients, many interviewees skipped some questions as they filled the questionnaires in the branches. These limitations raise issues in terms of representativeness of the sample.

²⁰ 2008 AMFA assessment; refer to the Microfinance sector section.

²¹ Interest rates on corporate loans went from 18-19 to 22%, consumer from 30% to 36%, loans to entrepreneurs from 30% to 36%.

transactions on the field and offer smaller loans) and comparable to those offered by banks involved in microfinance (cf. benchmarking). More expensive, consumer loans remain within the market prices.



Interest rates are defined based on an accurate calculation of the weighed average cost of capital and minimum margin required to meet in the shareholders' expectations (ROE over 20%²²). However, the interest rate decrease planned for S2 2009 might not be possible given the recent increase in credit risk and potential increase in funding costs.

AzDB's transaction costs are reasonable for a bank but remain quite high for microfinance clients since collaterals are required up to 150% of the loan amount. In addition, all financial transactions are made in the branches, creating an entry cost for potential remote rural clients. AzDB nevertheless makes significant efforts to reduce transaction costs by expanding its branch and ATM network, and offering clients the possibility to repay loans in any branch or to send a family member. The disbursement process is generally quick and clients are satisfied with the staff efficiency in handling their request.

■ Social Responsibility

Client Protection

AzDB is overall transparent with its clients regarding the cost of the services it offers. Interest rates are charged on a declining basis. As required in the local regulation, loan conditions (nominal interest rates, commissions and other fees) are fully disclosed and clients have a copy of the contract. When needed, employees explain terms and conditions verbally to clients. Efforts are however needed in disclosing more useful and relevant information such as the effective interest rate to enhance the bank's transparency. Nonetheless, this is not yet mandatory for financial institutions in Azerbaijan. Efforts in that regard are needed on a sector wide level.

²² This translates into an ROA over 4% given AZDB's high leverage (D/E at 4.97 in Dec. 2008).

Adequate systems are in place to ensure that clients receive a fair treatment. The hotline (disclosed on billboards, the bank's documentation and website) and suggestion boxes in the branches give the opportunity to clients to voice potential concerns to a specialized team. Calls are recorded, allowing for the dedicated managers to review clients' feedback. However, the hotline is used more for information purposes (characteristics of the loans, request for new products) rather than for clients' complaints. No specific action was taken to ensure that all clients are aware of this opportunity to voice their concerns. Clients with access to internet may also use the website client feedback form. Besides, the 2008 client satisfaction study allowed AzDB to get a feedback from its clientele (no instances of staff misbehaviour were detected). Finally, all staff was trained on and signed the bank's code of ethics, where customer care and related sanctions in case of mishaviour, are clearly detailed.

AzDB has in the past detected instances of staff collecting extra fees from the clients. The sanctions taken, the policies communicated to staff and mechanisms in place described above are expected to have significantly reduced this practice. However, an additional layer of control, such as client visits performed by the Internal Audit department, would be welcome.

Prevention of over-indebtedness is satisfactory but could still be improved. Cross-indebtedness is monitored through the use of the national and GAF²³ credit bureaus and the recent introduction (for all loans over 20,000 AZN) of a credit scoring model taking into account clients' indebtedness. However, consumer loans, with an average outstanding amount of 551 AZN²⁴ and the use of the purchased good as collateral are more likely to lead to over-indebtedness, even though credit risk on consumer loans has remained limited so far. The use of the credit bureau for loans below 5,000 AZN has not been systematic (leading in some cases to clients' over-indebtedness), but the recent reinforcement of supervision is expected to limit new cases of over-indebtedness. According to AzDB's 2008 satisfaction study, the proportion of clients using credit services from other banks remains limited (23%²⁵).

²³ The German Azerbaijan Fund has set-up a credit bureau common to its nine partner banks (29,317 loans were disbursed under GAF as of February 2009). The GAF aims at promoting economic growth of private SME / self employed persons in Azerbaijan and at helping partner banks to expand their business activities especially with regard to SME.

²⁴ Banks used to report only loans over 1,000 AZN to the national credit bureau. The recent amendment of the law that requires banks to report all loans to the credit bureau remains to be fully implemented.

²⁵ Over 501 clients interviewed, 350 answered, among which 200 (57%) declared cooperating with other banks, including 82 (23%) for credit services. The small sample limits the representativeness of this ratio for the whole clientele.

Bank secrecy is required by law and is satisfactorily handled at AzDB. This should improve with the upcoming implementation of SAP. For example, information flow from branches to the HO will be more secure and management of clients' information will be more segregated. As of now, employees within the same branch can review the information of clients handled by their colleagues.

Recovery procedures are quite flexible, well-defined and conducted in a professional manner. After the general 10-day grace period for repayment, phone calls are made, followed by field visits, warning letters, informal intermediation, and finally, legal steps are taken. AzDB has very rarely seized any assets from its clientele and does not disclose private information to the public.

Other risks threatening the clients when using financial services could be better managed. Life-insurance is indeed provided only to a minority of clients (in specific agreements for consumer loans) for 3% of the loan amount. On the other side, AzDB's expanding branch network (clients may withdraw cash from all branches) somewhat decreases the risk of cash transport for the urban clients. Finally, following NBAR's new requirement, deposits up to 30,000 AZN are insured by the central bank insurance fund.

Human Resources Policy

Over the past three years, AzDB has made great efforts in improving HR policy following a higher interest from the Supervisory Board and top management. Human Resources are professionally administered which contributes to the fair treatment of staff. All AzDB's full time employees are under contract with the bank whose conditions are appropriate (in line with national standards) and respected by the bank. However, some improvements can nevertheless still be made. The number of refresher trainings remains low since 14.9% of staff received more than two days of training in 2008 (vs. 23.6% in 2007) for an average number of training days per staff of 0.7 in 2008 (vs. 0.9 in 2007). Staff is promoted based on formal evaluations. However, a clear career path is not yet available for all staff, especially for staff on the field or middle-management outside Baku.

Salaries offered to employees have considerably increased over the past three years to reach currently a competitive level to match competitors and attract qualified staff (the average increase of 59% largely exceeded inflation since 2006). Most staff received adequate level of bonuses regularly (monthly for LOs and quarterly for other staff) based on achievable targets and done on a transparent manner. Moreover, full time employees benefit from social security, health insurance and adequate working hours. Top

level employees benefit also from other fringe benefits such as gym passes.

In addition to the training directed to prepare staff to their position within the bank, AzDB has contributed for a minority of its staff to significantly increase their employability level. A few employees (5) have benefited from scholarships abroad but this privilege, though transparent and merit based, is not yet sufficiently formalized and shared among all employees.

At AzDB, staff may voice their concerns, most often to immediate supervisors or Heads of Department. Despite the lack of staff representation, the HR department and the HR committee have satisfactorily taken employees' main concerns into consideration. For individual complaints, the HR Manager is in charge of solving the issue. Yet, AzDB would gain from having a staff representation independent of management given the size of the bank (525 employees). Moreover, staff satisfaction surveys are not yet conducted. An intranet has been recently put in place by the HR department so that employees could share ideas and express opinions on various subjects related to the banks' activity.

Women representation within the bank is quite limited, especially in key positions: as of March 2009, women represented 38% of all staff and only 15% of top-management staff. The Bank has not adopted any pro-active policy in this regard.

Social Responsibility towards the Community

Within the banking and microfinance arenas, AzDB has taken acceptable steps to act as a responsible banking service provider.

- As required by law, the bank has adopted in 2006 an anti-money-laundering policy and recently set up a specific department for this. However, all policies are not yet in place (staff training on the department's policies was provided only recently) therefore limiting the current scope of the checks on staff compliance.
- Many of the bank's funders (e.g. EBRD, IFC, and BSTDB) are committed to socially-responsible lending. As a result, procedures designed to prevent the financing of activities deemed socially irresponsible have been initiated through the covenants of their loans. Prohibited activities were communicated to staff but the monitoring of the respect of those guidelines could be enhanced (stricter and more frequent than yearly). The respect of social values by subcontractors is not yet formalized.
- AzDB's competition practices are satisfactory. AzDB has been participating to and using the central bank's and GAF's credit bureau (cf. section on "client protection"). Yet, AzDB would benefit from improving

its interaction with competitors through, for example, more contact with the Association of Banks of Azerbaijan Republic to collaborate on issues such as how to better address the current needs of the unbanked people.

As a microfinance service provider, AzDB could improve its interaction with communities. As microfinance clients often lack financial skills, providing clients access to trainings (e.g. on financial awareness) is necessary. AzDB plans to introduce trainings in the near future. On the other side, field staff mainly originates from the towns AzDB serves, contributing to the bank's good integration within the communities. Finally, AzDB has sponsored a few social projects such as chess competitions, festival and is currently designing a new service which will be purely socially oriented, called the social credit card²⁶.

Social Responsibility towards the Environment

AzDB has adopted a policy regarding its social responsibility toward the environment. All loans disbursed under BSTDB fund, EBRD fund (for loans over 100,000 USD) or ICD fund (i.e. about 10% of loan disbursed in 2008) are classified according to their level of environmental risk, checked against a list of prohibited activities and reported to EBRD and BSTDB. Among these loans, no loans considered to entail high environmental impact were reported in 2008. However, AzDB would gain from training employees on these environmental issues and do more regular check and monitor over clients use of the loans. AzDB does not promote activities particularly friendly to the environment and has no eco-policy in place.

The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution's performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.

²⁶ AZDB plans to introduce a new credit card whose revenues will be redistributed to charity funds.

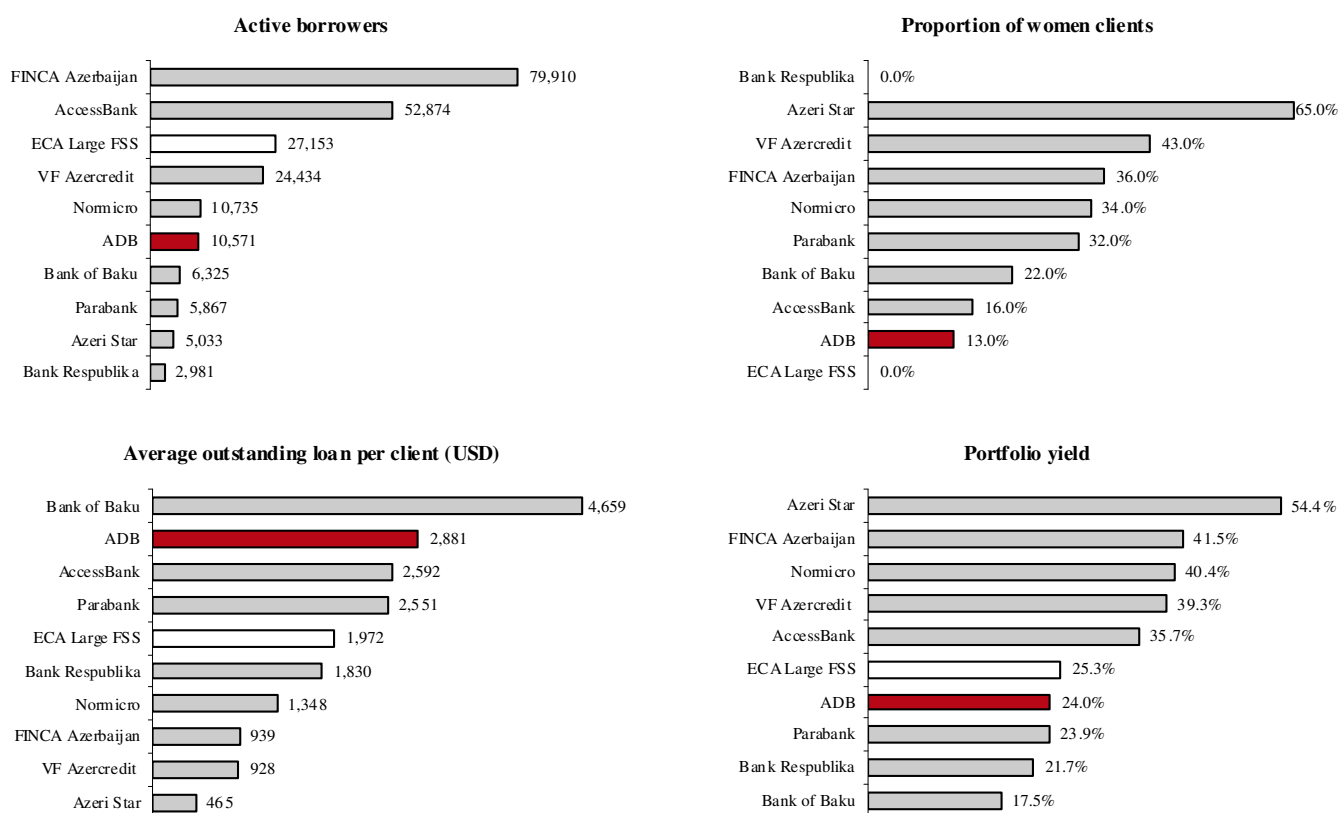
■ Performance Indicators

Social Performance Indicators	Dec.2006	Dec.2007	Dec.2008	Mar.2009
Outreach				
% of women active borrowers (as reported to AMFA)	n.a	n.a	n.a	13%
% of borrowers in the capital city	n.a	n.a	73%	75%
% of borrowers in the province	n.a	n.a	27%	25%
Service Offering				
Proportion of socially-based collateral	0%	0%	0%	0%
% women receiving loans with group guarantee	0%	0%	0%	0%
Share of consumer lending	n.a	n.a	n.a	69%
Retention rate (simple formula)	n.a	n.a	n.a	n.a
Average amount disbursed per loan	4,797	6,140	5,560	n.a
<i>% of GDP per capita</i>	199.9%	168.1%	107.1%	n.a
Portfolio Yield (nominal)	22.1%	22.3%	24.0%	n.a
Effective Interest Rate	n.a	n.a	n.a	27.9%
PAR 31-365	0.2%	0.4%	1.9%	3.8%
PAR > 365	0.1%	0.2%	0.3%	0.5%
Client Protection				
% cross-over clients (with a loan of other loan providers)	n.a	n.a	n.a	n.a
% clients borrowing money from informal money lenders	n.a	n.a	n.a	n.a
% of branch offices in unserved areas	0%	0%	0%	0%
Human Resources Policy				
% of women among your professional staff	36.2%	35.8%	36.8%	37.9%
% of women among management	13.3%	15.1%	17.3%	15.0%
% of employees who received at least two days of training	13.5%	23.6%	14.9%	9.5%
Number of training days per staff	0.9	0.9	0.7	0.4
Min/Max LOs salary ratio	1.9	2.3	4.2	4.2
Min/Max professional staff salary ratio	51.7	59.6	73.1	24.4
Yearly salary increase reported to inflation	-0.2	2.6	1.9	n.a
Life&health insurance expense / personal expense	n.a	n.a	1.2%	5.3%
Traffic accidents per loan officers	0	0	0	0
Instances of assault per loan officer	0	0	0	0
Working hours ratio	100.0%	100.0%	100.0%	100.0%
Turnover	20.4%	18.7%	12.8%	1.4%
Client Composition (new and active)				
% Below the national poverty line	n.a	n.a	n.a	n.a
% Bottom 50% below the national poverty line	n.a	n.a	n.a	n.a
% Earning less than 1 USD a day per household member	n.a	n.a	n.a	n.a
% Earning less than 2 USD a day per household member	n.a	n.a	n.a	n.a
% Poor or low income	n.a	n.a	n.a	n.a
Change in Active Clients (3 years or 5 years old)				
% clients who had a change in their social status	n.a	n.a	n.a	n.a
% old clients above the poverty line	n.a	n.a	n.a	n.a
% old clients who crossed the poverty line	n.a	n.a	n.a	n.a
% old clients still under the poverty line	n.a	n.a	n.a	n.a
School Enrollment				
% School enrollment of clients children	n.a	n.a	n.a	n.a
% girls / boys attending regularly primary/secondary school	n.a	n.a	n.a	n.a
Job Creation and Consolidation				
# of full-time/ part-time hired workers in enterprises supported during the year	n.a	n.a	n.a	n.a
# of full-time/ part-time self-employed workers in enterprises supported during the year	n.a	n.a	n.a	n.a
Non-financial Services				
% of clients who received enterprise, education, health, empowerment training services	0%	0%	0%	0%

Note: These indicators are currently being tested by the social performance taskforce (SPTF) and MixMarket for social performance reporting. The answers to the qualitative indicators being tested by the MiX are stated in the rating.

Benchmarking

Note: in the absence of indicators on social performance, institutional performance indicators are provided for informative purposes.



Sources: AMFA Matrix as of December 2008 (proportion of women clients) and March 09 (other statistics); 2007 Bank of Baku and PARABANK financial statements and 2008 Bank Respublika financial statements (for portfolio yield); Mixmarket, ECA Large FSS (2007).

Formulas

Taux de pénétration : Clients actifs / nombre de ménages dans la zone.

Portfolio yield: Portfolio revenue / 13-month average gross outstanding portfolio.

Retention rate (basic formula): end borrowers / (beg. borrowers + new borrowers).

Retention rate (enhanced formula): (end borrowers - borrowers with the same loan during the period) / (beg. borrowers + new borrowers - borrowers with the same loan during the period).

Retention rate (CGAP formula): repeat loans / repaid loans.

Penetration rate: active clients / number of households

Rating Scale

Rating	Definition
5+	Advanced: Long-lasting commitment to social goals; efficient management of social performance and social responsibility risks; institution very likely to achieve a positive social impact
5	
4+	Convincing: Clear commitment to social goals; reasonable management of social performance and social responsibility risks; institution likely to achieve a positive social impact;
4	
3+	In progress: Clear intent to reach social goals; social performance management systems being implemented
3	
2+	Incipient: Clear intent to reach social goals; low capacity to manage social performance
2	
1+	Intangible: Intention to reach social goals is non tangible; low level of management of social performance
1	