

Entrepreneurs Left Without Money

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The devaluation that took place in 2015 has created a number of problems not only for the banking sector, but also for entrepreneurs. The more than twofold loss of manat's value brought caused more debt swamp for entrepreneurs who had taken loans in foreign currency on the one hand, while limiting their ability to borrow on the other hand. Financial resources are key for the development of entrepreneurship, allowing entrepreneurs to expand their businesses, open new jobs, acquire new technologies, and renew manufacturing equipment periodically. When it does not happen, the number of participants creating the supply in the market is reduced, with the competitive environment disrupted.

Bank loans are the most popular source of money resources for entrepreneurs in Azerbaijan. As the capital market is underdeveloped in the country, entrepreneurs attract money mainly from the banking sector. However, the devaluation has hit the banking sector to an extent that businesses' access to the access to the only financial source is gripped due to the banks' tightened credit conditions, lack of interest in risky lending, along with the deteriorating credit histories of entrepreneurs. Entrepreneurs' deteriorating access to loans in the aftermath of devaluation is also evidenced in the official figures of the Central Bank. According to the official figures, the loan portfolio [\[1\]](#), which reached its peak in 2015, started to decline, dropping by 46.3% from 21.7 billion manat to 11.7 billion manat by the end of March, 2018. **(Figure 1)**

The fall has occurred in all areas of lending, including those where small and medium-sized businesses are heavily involved (trade and service, agriculture and processing, transport and communication, construction and property). Over the first quarter of 2015-2018, lending fell by 35.8% in trade and services, 32.7% in transportation and communications, 66.7% in industry and manufacturing, 82.7% in construction and property and 11.8% in agriculture. The low decline rate in agriculture is due to the fact that the National Support Fund for Entrepreneurship continues to provide preferential financing **(Figure 1)**

A review of banks' financial statements shows that the deteriorating assets as a result of devaluation led banks to abandon their active lending policy, which they implemented in 2012-2014 years and direct their funds to low-income and low-risk areas. While in 2012-2014 banks directed more than 70% of their assets to lending, this figure dropped sharply to 41% in the first quarter of 2018. **(Figure 2). In other words, the banks are currently lending on only 41 manats of their total 100 AZN.** Given that about 40% of this lending (16 manats per 100 manats) is for consumer loans, we can determine that only 25 manats of every 100 manats of banks' assets are directed to entrepreneurship.

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- ***Since there are no separate statistics of deposits given to the financial sector in 2013-2015 years, loans to the financial sector are included here too.***

But where do the banks direct their funds which they do not assign to loans? After all, bank deposits account for approximately 75% of their liabilities and banks are to pay one part of the their earnings to depositors as interest?

It is apparent that our banks are now pursuing a policy of earning profit in rather a passive way instead of fulfilling such an important task as to supply the economy money. It is not only affirmed by entrepreneurs who cannot get loans, but also by official figures. According to the Financial Markets Supervision Chamber's reports, banks are investing some of their money in securities and the regulatory market instruments of the Central Bank. whilst banks directed only 1,3% of their assets to securities in 2016, this figure increased significantly to 8.3% in the first quarter of 2018. In fact, small and medium-sized enterprises, as well as large entrepreneurs have limited access to the capital market and limited ability to issue their own securities (stocks, bonds), banks largely invest their funds in ***the short-term bonds of the Central Bank***. For example, within 5 months of 2018, the Central Bank has placed 24 short-term (28-day long) notes on Baku Stock Exchange and the annual interest rate of these notes was lowered to 8.01% from the initial 14%. In the placement process, the banks' demand exceeded the supply by at least twofold, and in some cases, the difference was up to 5 times. The banks have earned over \$ 43 million in revenues through these notes this year. This is one of the passive forms for the banks to earn.

Another source of passive earnings is the deposit auction organized by the Central Bank every week, which have taken place 24 times during the January-May period of the current year, with the demand exceeding the supply 3-4 times and banks earning more than 23 million manat in revenues through auctions involving 14-day deposits. Overall, the banks have earned more than 66 million manats during the first five months of this year by participating in the deposit auction and purchasing the short-term notes of the Central Bank. In order to gain this profit, they deposited their funds in the Central Bank as "dead capital" at 8.01% per annum, whereas the annual interest rate asked of entrepreneurs when they go to banks for a loan is 2-3 times higher than the interest rate

charged by the Central Bank. The high risk in the real sector, the increasing number of problematic loans, and the lack of trustworthy customers make banks quit the real sector and instead focus on the open market and deposit operations organized by the Central Bank to regulate the money supply.

As a matter of fact, banks place approximately one-fourth of their assets ***as deposits in other financial institutions, including banks***, which was only around 4% before the devaluation. (Figure 2).

One of the sources of loans to businesses on favorable terms today is the preferential credit line provided by public institutions. The *National Support Fund for Entrepreneurship of the Azerbaijan Republic*, which is the main source among public institutions, allocates preferential loans in the amount of 150-250 million manats per annum for entrepreneurship entities, particularly for the production of agricultural products. The loans allocated by the other state institutions, *State Fund for the Development of Information Technologies* and *State Service for Agricultural projects and programs*, are no more than only a few million manats. In general, the funding resources provided through the state line can satisfy only a small part of the businesses' needs. Hence, the main burden falls on banks. Even though a Credit Guarantee Fund, which would facilitate the access of entrepreneurs to finance by sharing their risks in the financial sector, was created last year it has not yet been able to establish its work completely.

Customers do not need money only to buy goods from a store or pay for a restaurant. It is also important for manufacturers to set up and operate such commercial and public-catering facilities. When producers cannot find money to satisfy the consumption, there will be a lack of products and services in the markets, for which a consumer needs even more money. Therefore, in order to be able to endure the competition, entrepreneurship entities must be able to access as much money

as they need for the production, sales and services.

[\[i\]](#) The main reason for the sharp increase in credit investments in 2015 is the fact that loans in foreign currency have doubled in manat terms as a result of devaluation.