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GEORGIA MICROFINANCE STABILIZATION AND ENHANCEMENT

Akhalkalaki Grants Program Final Report

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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.



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Akhalkalaki door and window installation store owner Sergei Galustian (R) and shop worker Gevorg Tonakanian (middle) negotiate a sale with a customer.

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FRONT COVER: Meri Tsetskhladze tends to a plot of farmland in the rural Georgian village of Azmana. Seeds for carrots and other cold-weather vegetables were purchased using a microloan from Constanta.

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BACK COVER: (L-R): Tina Nikovosyan, milk handler, and Misha Vartanyan, cheese maker, weigh the results of that night's milking. They are two of six employees of the Arzumanyan family farm in Ninotsminda.

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EXECUTIVE SUMMARY

The remote, impoverished Akhalkalaki region did not join the rest of the Republic of Georgia on the path to economic recovery following the Rose Revolution in 2003. Instead, this region — which is predominantly ethnically Armenian — suffered a series of economic blows, including the loss of income from Russian remittances and the closure of the Russian military base in Akhalkalaki resulting from political change and tension between Georgia and Russia.

Given the region's underdevelopment, the Government of Georgia and USAID made it a priority to reduce poverty there by creating private-sector economic opportunities. However, Akhalkalaki's private sector was hobbled by a lack of affordable, accessible credit for small rural entrepreneurs, the backbone of the sector. USAID's Georgia Microfinance Stabilization and Enhancement (GMSE) Akhalkalaki grants program awarded \$450,000 to each of two microfinance institutions, Constanta Foundation and VF Credo Foundation. With the money, these institutions established branches in the town of Akhalkalaki to offer microloans to small entrepreneurs in the rayons of Akhalkalaki and Ninotsminda.

Compounding the challenge of opening branches in rural areas, neither Constanta nor VF Credo had any previous experience reaching out to a minority population and were unfamiliar with local Armenian culture. The project got off to a slow start as the microfinance institutions (MFIs) worked to convince a cautious population inexperienced with credit to take advantage of their services. After this slow beginning, the MFIs were surprised to find that they had tapped into a market with an enormous demand for microcredit.

After the first year, both their portfolio value and client reach grew dramatically. Today, demand continues to outpace the supply the MFIs can provide given their personnel and infrastructural resources. To date, VF Credo has achieved financial and operational sustainability in the Akhalkalaki region, and Constanta is well on the way to attaining the same. After two years of financial support from USAID, both MFIs are committed to staying in the region and continuing to expand their products and operations to meet demand.

The GMSE Akhalkalaki grants program has enabled microfinance services to reach a significant number of rural small and micro entrepreneurs in the region. The indicators of success that USAID set for the GMSE Akhalkalaki grants program have been either met or exceeded. So far, 685 loans worth \$1,138,295 have been given to 648 small and micro businesses, and 153 jobs have been created, increasing economic opportunities for the residents of Akhalkalaki. In addition, microfinance has helped the Akhalkalaki population survive economic misfortunes. Small loans helped the population recover from jobs lost when the Russian military base closed by enabling small entrepreneurs to grow microbusinesses that sustain jobs and increase the region's income. In addition, microcredits helped many small farmers survive the failure of the 2006 potato harvest, Akhalkalaki's major crop, by providing capital to purchase seeds for the spring planting.

Since the arrival of Constanta and VF Credo, competing banks have entered the market for small entrepreneurs' loan business. Such competition ensures that interest rates will remain low and that the MFIs will need to remain creative to meet the market's needs. The MFIs are growing along with their client base. As for the clients, after they see the positive impact of microcredit on their businesses, they are returning to obtain further credit to invest in their businesses' growing productivity and profit. In addition, to date, the program has reached less than 1 percent of the region's population, which leaves significant potential for the expansion of microfinance in Akhalkalaki.

The success of this project rests on (1) the MFIs' successful techniques for educating and gaining the trust of local populations and (2) a program design in which USAID's economic growth objectives and the grantees' priorities complemented each other. The Akhalkalaki grants program has improved access to financial services for small and medium-sized businesses in Georgia and has expanded economic opportunities in rural areas. USAID could successfully repeat this program in other predominately rural Georgian regions where microfinance is not currently present, such as Guria, where the potential for economic growth is substantial, but the cost and risk associated with establishing a branch is too high for MFIs to enter the market without support.

CHAPTER ONE

SMALL BUSINESSES’ STRUGGLE FOR AFFORDABLE CREDIT

IN GEORGIA

Since 2000, the Republic of Georgia has made immense strides towards reducing poverty by transitioning from a state-run economy and revitalizing its private sector. As a result, its private sector growth has been dramatic, especially that of small and medium-sized businesses (which make up the majority of new businesses registered since 2005). While the Georgian government does not track the contributions of small and medium-sized enterprises to the country’s economic growth and employment, global statistics demonstrate that, in any country, these businesses are key to a healthy private sector.

In a developing economy, small and medium-sized businesses offer the greatest potential for advancing long-term economic growth, productivity, and employment. However, these businesses — especially micro-enterprises, which employ fewer than 10 people — often struggle to find the capital they need to grow their businesses. Small entrepreneurs, especially in the agriculture sector, tend to have less business experience, education, and knowledge of financial options than their larger peers. When they do turn to commercial banks for assistance, they are often turned away as high risk and unprofitable. As a result, they often borrow from usurers or private sources at high interest rates, which limits their potential and stunts their growth. Microfinance provides a solution.

IN THE AKHALKALAKI RAYON

Georgia is divided into 53 administrative units known as rayons. Located in the country’s southwest near the Turkish and Armenian borders, the Akhalkalaki rayon has a population of 62,500, and the Ninotsminda rayon has a population of 33,800. On a map, these ray-

REPUBLIC OF GEORGIA

Rayons of Akhalkalaki and Ninotsminda



ons appear deceptively close to the Georgian capital, Tbilisi. However, the roads that currently link Akhalkalaki to Tbilisi are of such poor quality that the journey is much longer than the distance would suggest. Under the Millennium Challenge Georgia Fund's Samtskhe-Javakheti Road Rehabilitation Activity, these roads will be upgraded, improving the connection between the isolated Samtskhe-Javakheti region (which includes the Akhalkalaki and Ninotsminda rayons) and the rest of Georgia. The Akhalkalaki and Ninotsminda rayons are separated not only by physical distance from the capital but also by cultural difference. Ninety percent of the population is ethnically Armenian, and only 6.7 percent speak Georgian. These factors have combined to cut the region off from the rest of Georgia and to make its inhabitants suspicious of the outside world.

Akhalkalaki is also a historically disadvantaged region. For example, its population has had limited opportunities to pursue higher education. According to OSCE regional statistics, 7 percent of Akhalkalaki residents hold a post-secondary degree (the other regions in Georgia average 9 percent, while 40 percent of Tbilisi residents hold such a degree).

Recently, the region's poverty has been compounded by the closing of a 15,000-soldier Russian military base (finalized in June 2007) that was an important source of income and employment for the town. In addition, when Russia severely limited work visas for Georgian citizens in 2006, many in Akhalkalaki lost an important source of

income, since family members could no longer travel to Russia for seasonal work. With their primary sources of income limited — as well as those of their customers — Akhalkalaki's small entrepreneurs have found themselves in even greater need of affordable credit.

Before the GMSE program, even established small business owners in Akhalkalaki found it nearly impossible to secure affordable credit. For example, Sergei Galustian and Armen Shirinian had a successful business installing high-quality doors and windows to protect against mountainous Akhalkalaki's bitter winter temperatures, which can fall to negative 20 Celsius. To finance a second shop, they traveled five hours to Tbilisi to apply for small loans from various commercial banks. However, every bank rejected them. The only access they (and others in Akhalkalaki) had to credit was either (1) through private lenders who charged exorbitant monthly rates of 5-10 percent or (2) through the formerly named First Commercial Bank (now the Tao Bank) in exchange for a gold guarantee at a monthly rate of 3-5 percent. These extremely high interest rates made it very difficult for small entrepreneurs to pay back their loans without selling their fixed assets and effectively disinvesting in their businesses. However, the emergence of microfinance in the region has given small entrepreneurs like Sergei Galustian and Armen Shirinian easy access to affordable capital they can use to grow their businesses.



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Both VF Credo and Constanta established branch offices in the remote impoverished Akhalkalaki region in August 2005. Two years later, both institutions have exceeded initial targets set for the number and value of loans disbursed over that period. Both have employed creative methods for reaching clients.

CHAPTER TWO

THE EMERGENCE OF MICROFINANCE INSTITUTIONS IN AKHALKALAKI

GEORGIA MICROFINANCE STABILIZATION AND ENHANCEMENT TECHNICAL ASSISTANCE

In 2003, USAID launched the GMSE program to develop the country's microfinance industry and extend the reach of Georgia's MFIs beyond their very limited base in Tbilisi's bazaars and marketplaces. GMSE staff provided technical assistance that clarified the legal environment, helped partner MFIs enhance their operational and financial sustainability, established linkages between institutions, and created public awareness of microcredit's role in the sustainable development of the economy. All of these actions were designed to establish microfinance as a mainstream option for Georgia's small entrepreneurs and to provide this group with easy access to affordable capital.

During program design, GMSE staff commissioned a survey of the nationwide demand for credit in Georgia. The survey determined that — while the agricultural sector was responsible for 20 percent of Georgia's GDP and 50 percent of employment — it accounted for only 3 percent of all commercial bank loans. These numbers demonstrated the pressing need for MFIs to serve Georgia's rural areas. GMSE staff assisted partner MFIs to develop products and operational techniques that would enable them to grow their rural portfolios.

In July 2005, with the impending closure of the Russian military base, the Akhalkalaki region faced increased unemployment. Through its Akhalkalaki grants program, the GMSE project competitively awarded two non-bank MFIs — Constanta Foundation and VF Credo Foundation (formally Credo Vision Fund) — an institutional grant of \$450,000 each to establish branches and make loans

GMSE MICROFINANCE INSTITUTIONS

Constanta Foundation was established by Save the Children as a nonprofit foundation in 1997 but, by the end of 2007, will legally become a for-profit, non-bank financial institution.

Constanta's professionalism and determination to be a leader in the industry paid off in November 2006, when Planet Rating awarded it a B+ with a positive outlook. A B+ is a "good" rating on a scale from E ("immediate risk of default or very insufficient") to A+ ("excellent").

This grade indicates that Constanta's "procedures are well developed, effective, and incorporate a long-term perspective. Some improvements could be made. Long-term risks are identified in the strategic plan."

VF Credo Foundation, founded in 1997 by World Vision International, registered in 2005 as a non-bank financial institution and is now owned by Vision Fund International, a U.S.-based nonprofit.

While VF Credo is a smaller organization, it has enjoyed substantial growth over the last five years. In April 2006, Microfinanza Rating gave VF Credo a BB+ on a scale of D to AAA. A BB+ is slightly better than a BB, which is the highest average rating and indicates that Microfinanza believes Credo has limited vulnerabilities with respect to its financial obligations, adequate operations, and stability.

According to www.mixmarket.org, Credo's level of operational self-sufficiency and profitability has improved since it was rated in 2006.

in the Akhalkalaki region. Constanta and VF Credo were selected because they were well-established, national, non-bank MFIs with solid management capabilities. They also demonstrated reasonable long-term plans to extend microfinance services to a large number of rural small and micro entrepreneurs. Both MFIs had been working in partnership with GMSE to expand their portfolios and improve their institutional capacity and sustainability.

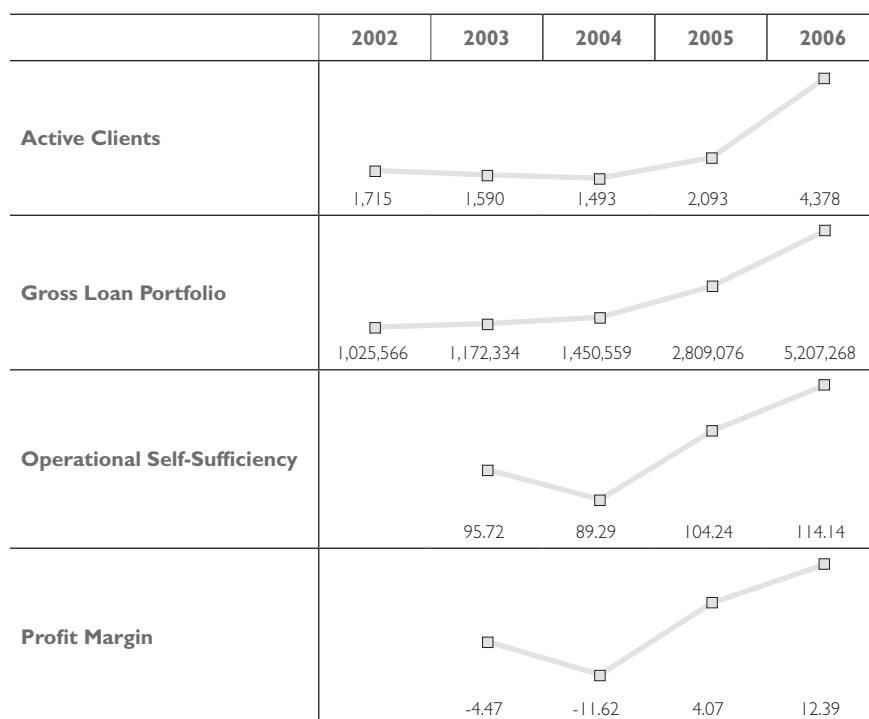
INCREASED ACCESS TO CREDIT

After being awarded the GMSE grants in July 2005, the MFIs took several months to set up their branch offices as they needed to find space, hire/train staff, and plan kick-off activities. VF Credo started disbursing loans in October 2005 and Constanta followed in December. Between October 2005 and July 31, 2007, these two MFIs disbursed \$1,138,295 in loans, helping to revitalize the Akhalkalaki region's private sector.

The GMSE project has supported Akhalkalaki's principal economic sector — agriculture — and has assisted individuals transitioning from migrant work, work at the Russian base, and unemployment to become productive small entrepreneurs. These people are now supporting their families and contributing to the region's economy. To date, 648 small urban and rural entrepreneurs have taken advantage of microfinance's presence in Akhalkalaki to establish and grow their businesses and farms.

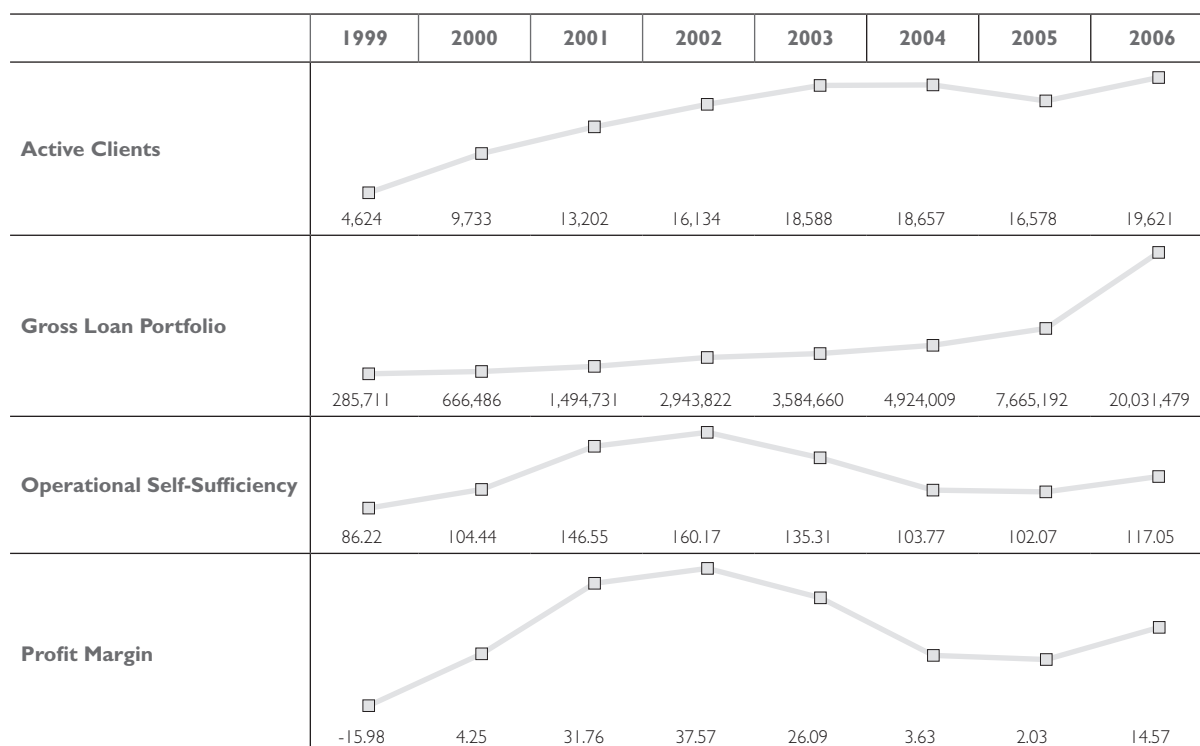
Sergei Galustian and Armen Shirinian have received two individual SME loans from VF Credo: the first for \$15,000 to open another

VF CREDO IN GEORGIA: SNAPSHOT



Source: www.mixmarket.org

CONSTANTA IN GEORGIA: SNAPSHOT



Source: www.mixmarket.org

CONSTANTA AND VF CREDO IN GEORGIA

Location of Branches



shop in the center of town and the second for \$20,000 to buy additional equipment for their operations. Their new shop has enabled them to employ 10 additional workers, increase their business two-fold, and substantially improve their personal incomes.

Of the \$900,000 in grants funds from USAID, \$738,954 (or 82 percent) was used for loan capital. Constanta disbursed 80 percent of the grants as loan capital, and VF Credo disbursed 84 percent. As the tables on the next page illustrate, the GMSE Akhalkalaki grants program exceeded its target indicators in the number and value of loans made.

LOAN PRODUCTS THAT MEET MARKET NEEDS

In 2005, VF Credo and Constanta entered Akhalkalaki with limited loan products but, over the last two years, have expanded their services to offer a full range. Both MFIs offer individual or small business loans as well as large and small agricultural loans (the latter can be as small as \$50). While commercial banks require collateral for individual and agricultural loans, VF Credo and Constanta have developed an express loan to serve clients who lack collateral. It carries slightly higher rates and requires a third-party guarantee instead of collateral. When a customer has sufficient collateral, a third-party guarantee is not necessary.

While agricultural loans have slightly higher interest rates, they offer other features that are important to agribusiness owners. Most

TOTAL NUMBER OF LOANS DISBURSED

(October 1, 2005 – July 31, 2007)

	Total	To Women	To Men	Microloans*	Small Loans	Agro	Urban	To Georgians	To Armenians
VF Credo	622	197	425	584	38	522	100	48	574
Constanta	146	49	97	146	0	84	62	18	128
Total	768	246	522	730	38	606	162	66	702
Target	685								

* Credo defines a microloan as less than \$2,000. Constanta defines a microloan as less than \$30,000.

TOTAL VALUE OF LOANS DISBURSED

(October 1, 2005 – July 31, 2007)

	Total	To Women	To Men	Micro-loans*	Small Loans	Agro	Urban	To Georgians	To Armenians
VF Credo	\$714,873	\$238,991	\$475,882	\$563,273	\$151,600	\$582,827	\$132,047	\$57,861	\$657,013
Constanta	\$423,422	\$80,542	\$342,880	\$423,422	0	\$224,081	\$199,341	\$20,180	\$403,243
Total	\$1,138,295	\$319,533	\$818,763	\$986,696	\$151,600	\$806,908	\$331,388	\$78,040	\$1,060,256
Target	\$721,000								

* Credo defines a microloan as less than \$2,000. Constanta defines a microloan as less than \$30,000.

notably, they have more flexible payment options, such as (1) offering a six-month grace period for expected payments, (2) allowing recipients to pay back only interest for a limited period of time, or (3) rewriting the loan repayment schedule. This kind of flexibility is needed by businesspeople who cannot control all the factors of production. When potato crops failed last year due to inclement weather, many farmers needed additional credit in the spring to buy seeds in time for planting. Without the MFIs' flexibility — which lets farmers start to repay loans at harvest and offers them the affordable credit they need to keep their businesses running even after a failed harvest — many of these rural entrepreneurs (and their employees) would have been thrust deeper into a cycle of poverty.

While Akhalkalaki's owners of nonagricultural small businesses are less concerned with the uncertainties of the weather, they do face the challenge of operating with a cash-poor client base. For them as well, MFIs can mean the difference between success and failure. For example, VF Credo offers small business owners consumer leasing loans, which allow them to obtain financing to purchase consumer goods from stores that have consumer credit lines with Credo. Four years ago, Ashot Nakhatakian opened the first TV and home appliance store in Akhalkalaki. However, he consistently struggled with unpaid receivables as most of his customers were only able to pay for a small portion of their purchase up front. To manage the resulting risk and limited cash flow, Ashot opened a consumer credit line

with VF Credo. At that time, 29 clients owed him \$20,000. Today, instead of providing unfunded credit to customers, Ashot is able to refer his clients with small businesses who wish to purchase goods on credit to VF Credo. As a result, Ashot is able to both reduce his risk and increase his cash flow, which allows him to invest in inventory.

STREAMLINED MFI OPERATIONS

Since Constanta and VF Credo entered the region, they have expanded and streamlined their operations, increased the independence of their Akhalkalaki branches, and improved their ability to penetrate their target markets. For example, in 2005, VF Credo started its Akhalkalaki branch as a satellite office with one loan officer and one administrator. Currently, this office has a branch manager, two loan officers, two loan officer interns, and a full administrative staff.

Early on, both Constanta and VF Credo delegated very little authority to the branches and managed many functions from the central office in Tbilisi. Today, both MFIs have decentralized their operations, thereby increasing their operational efficiency and decreasing their costs. The branch offices have access to the centralized databases of their respective head offices, which means they can get all the information and forms they need to operate independently. For example, both branch offices have the authority to grant larger loans (VF Credo: \$5,000; Constanta: \$6,000) without consulting the head office. Given the average size of a loan in Akhalkalaki, this authority greatly facilitates the granting of loans. The branch offices' experience and demonstrated competence earned the head office's trust, allowing for this improvement.

With respect to the funding of the MFIs' operations, the GMSE Akhalkalaki grants program paid their personnel costs (including salaries/fringe for local staff) and other operational expenses, such as office space, office supplies/equipment, utilities, travel, Internet access, and promotional activities. Of the \$900,000 in grant money, \$163,386 — or 18 percent — was spent on operational costs. About a third of this \$163,386 paid for salaries and fringe, and two thirds were spent on other operational expenses. The grantees' operational expenses came in under budget, and they both contributed more than the required 10 percent of total operational costs.

EFFECTIVE OUTREACH AND MARKETING

The loan officers in the MFIs' Akhalkalaki branches now have responsibility for much of their marketing strategy, and this decentralization has allowed for greater responsiveness to needs of the marketplace. To reach out to the community, both MFIs distribute leaflets, hang banners, and offer promotional discounts on rates during slower periods (such as the summer) or as an incentive for referrals.

However, the MFIs face several challenges that leaflets and banners cannot overcome, specifically those related to geography, knowledge

SUCCESS STORY

Rural Georgians Show Neighbors the Benefits of Microfinance

Microfinance institutions gain rural communities' confidence by partnering with trusted local leaders



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Ramaz Gogoladze believes that he can extend the benefits of microfinance to other remote villages.

“ Village counselors can be successful in other villages in the Akhalkalaki region provided that Credo can identify a leader in the village who truly cares about improving the lives of community members. ”

RAMAZ GOGOLADZE

Getting supplies across the underdeveloped roads and opening its office in October 2005 in this rural, impoverished area was the easy part. VF Credo then faced the challenge of reaching across ethnic lines to establish working relationships with a population unfamiliar with microcredit and inherently distrustful of outsiders.

VF Credo's solution was both simple and innovative: Earn their trust through one of their own. Today, the MFI reaches a handful of Akhalkalaki's villages through a local and trusted social entrepreneur who helps Credo advance the idea of microfinance in even the most risk-averse communities.

Akhalkalaki native Ramaz Gogoladze recognized that he had come across a way to advance the prosperity of his neighbors when he heard about Credo's frustrated efforts to build trust with villagers and introduce microfinance products.

Ramaz's previous history implementing rural donor-funded projects told him that the villagers' trust would come slowly but surely. As "village councilor," he first began promoting microfinance in his village of Baraleti by patiently describing the benefits of microcredit in informal conversation with friends and neighbors. Eventually, Ramaz gained his first client, who borrowed \$1,500 from Credo to improve his village shop. The villager quickly repaid the first loan and borrowed another twice as large to purchase cattle. Bystanders quickly caught on, and Ramaz soon had an active list of clients. Today, Ramaz has 41 clients in five villages that he monitors and supports closely, making him Credo's most active village counselor.

Because of his position in the community, Ramaz feels a deep sense of personal commitment to microfinance initiatives in Akhalkalaki and the improved economic conditions they bring to his community. After a failed potato crop in 2006, many of his friends and neighbors used microcredit to keep their farms afloat while waiting for this year's harvest to arrive.

of microcredit, and distrust of outsiders. Many of the region's 70 villages are far from the town of Akhalkalaki and spread throughout the green foothills that make up the region's striking landscape. These distances are increased by the disrepair of local roads. Farmers from the villages are unlikely to see a banner hung in the town center and, even if they did, the high cost of the multiple trips to town needed to obtain a loan might dissuade a farmer from applying.

In addition, while microcredit is a new concept for the region's inhabitants, they usually have knowledge of loans (and likely high-interest ones, which they view negatively). George Khazhomia, the regional manager for VF Credo, said that when VF Credo enters a region, usually it is not the first financial institution to arrive there. Often, a bank is already actively offering loans, though these loans are not always available to small agribusiness owners (given the collateral requirements). As a result, small business owners are familiar with loans, and often those owners with previous bad experience with the exorbitant interest rates of First Commercial Bank or private sources are suspicious of credit.

Gaining the trust of a geographically isolated population that has not been previously exposed to microcredit is not simple. However, with the right tools, both MFIs have been making strides. Both MFIs send loan officers to selected villages, where they visit gathering places to present their products and explain the conditions and process for loan applications. They describe success stories from neighboring regions to illustrate the possibilities microcredit can offer a farmer. The loan officers also take any opportunity to speak informally with locals about the value of microloans to their small agribusinesses and farms. In addition, the MFI representatives offer to make multiple visits to a town to facilitate the loan application (and save the applicants money and travel time), which leaves the applicant with only one required trip to the town of Akhalkalaki to complete the transaction.

VF Credo has taken the innovative step of hiring a local village leader to act as VF Credo's local representative (known as a "village counselor") as a way to build trust. Given that the village counselor has existing relationships within the village, the population gives the advice of this individual more credence than that of a loan officer from the outside. Currently, three village groups have village counselors, and VF Credo is actively recruiting additional ones. Locating a successful village counselor is not easy. It is necessary to find an individual like Ramaz Gogoladze, who not only has the trust of his fellow villagers but also cares deeply about the welfare of the village and its inhabitants.

Constanta and VF Credo also work to develop informal village networks, whose members can educate rural entrepreneurs about both the availability and the process of obtaining credit. Referrals

are an important driver of microfinance growth in any community. However, given the unfamiliarity of microcredit and the local culture of privacy regarding finances, these networks took longer to develop in Akhalkalaki than in other regions. Kakha Kavrelishvili, Constanta's branch manager, reports that while his organization does not specifically track referrals, anecdotal evidence suggests that the branch's business from referrals is growing substantially

The impact of village networks is mostly clearly demonstrated in Azmana, a village of internally displaced refugees who lost their homes to severe mudslides in the Batumi region 15 years ago. The government resettled the mudslide victims in Akhalkalaki region, but it has not been easy for villagers to begin their lives anew. However, they have found microloans a resource that can help them accomplish that goal. Today, 36 percent of the village (or 16 of 45 households) have taken loans from Constanta. Each neighbor's success has inspired another neighbor to follow him or her to Constanta.

An important element of Constanta and VF Credo's marketing strategy is to ensure potential clients know that their application procedures are simplified, making credit accessible as well as affordable. As the MFIs gained greater understanding of both the region and the process, they reduced the application to a single page and eliminated all additional documents not required by law. They also eliminated unnecessary questions that frightened applicants, such as those requiring detailed answers or those about family and credit history. The MFIs still collect necessary data about collateral and credit history, but do so through site visits or publicly available documents.

A DREAM BROUGHT WITHIN EASY REACH

Naira Tarzyan, a single 31-year-old hair dresser, wanted to open her own beauty salon with modern equipment (such as a hot water heater) to create a comfortable environment for her clients.

She had never had a loan but met Constanta loan officers and eventually visited their office to discuss a loan. After filling out an easy one-page application, a loan officer visited her to discuss her current business, understand her future plans, and evaluate her collateral. After agreeing on a \$3,000 loan and collateral with the loan officer, Naira knew in less than a day that her application had been accepted.

Today, she owns the most modern hair salon in town, which has become a gathering place for the young female population. Since opening, Naira's client base has grown by 30 percent. Naira's experience applying for a loan is fairly typical for microfinance clients in Akhalkalaki — simple and efficient.

SUCCESS STORY

Rural Georgians Embrace Microfinance After Neighbors' Success

Small loans allow transplanted community to put down roots



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Amiran Meladze surveys the village's communal sheep herd, many of which are his. With his microloan, he purchased livestock and is the proud owner of a new tractor.

“ Microfinance has a very substantial positive effect on the community, because it provides immediate cash flow, which allows farmers to take advantage of market opportunities. ”

**GIORGI ARANIDZE,
AZMANA
ENTREPRENEUR AND
LOAN RECIPIENT**

Amiran Meladze lost his home and his livelihood 15 years ago to a disastrous landslide near the subtropical, coastal Batumi region. He and 44 other families were resettled by the Georgian government to Azmana, a village tucked in to the foothills of the rolling Lesser Caucasus mountains separating Georgia from Turkey. The government provided the families with new homes and plots of land, but they found it difficult to start over in the cold and unfamiliar climate.

Most of the village's families lacked money to buy livestock and eked out a less-than-modest living by growing potatoes despite market volatility. These families needed to diversify but lacked access to reliable credit outside of pawn shops or usurers charging exorbitant interest rates of up to 120 percent annually.

With the arrival of Constanta and VF Credo in Akhalkalaki, this situation changed for the better. Farm-owner Amiran, a father of two, first heard of Constanta through a neighbor returning from Akhalkalaki. The rates and terms seemed fair, he said, and a perfect solution to his family's dwindling income. With Constanta's guidance, he took out a nine-month loan to purchase four cows and 10 sheep. Less than two years later, 16 of the 45 families in Azmana (or 36 percent) have taken at least one rural microcredit from Constanta.

The town of Azmana is a living demonstration that positive examples are influential vehicles of change. Every villager cites someone else's success as their own motivation, and many have become savvy about the process.

Azmana's businesses, income, and opportunities are expanding. Since taking a loan for vegetables, village farmer Malkhaz Mekheshidze has purchased a taxi cab for his eldest son and paid tuition for his youngest son to attend school in Akhalkalaki. Residents point to a dramatic increase in the size of the communal herds of sheep and cattle, new technical equipment, and home improvements as evidence of positive change in their community.

Loan officers guide applicants through each step of the process and, after reviewing applicants' business plans, help them determine a loan amount appropriate for their plans, debt ratio, and repayment capacity. These streamlined and supportive procedures help the MFIs reach a population previously unfamiliar with credit and easily intimidated by lengthy application forms requiring a great deal of personal information. These simplified procedures also give the MFIs a competitive advantage over the banks that have recently entered Akhalkalaki's microcredit sector.

THE SUSTAINABILITY OF CONSTANTA AND VF CREDO'S OPERATIONS

Constanta's Akhalkalaki branch is at 76 percent operational sustainability and 69 percent financial sustainability. However, this branch disbursed the same amount in loans in the past eight months as it did during the entire previous year, and Constanta estimates that it will be 100 percent sustainable by mid-2008.

VF Credo's Akhalkalaki branch is already fully sustainable. Over the past eight months, its growth has been three times what it was during the entire previous year. The branch is at 130 percent operational sustainability and 103 percent full financial sustainability. "Operational sustainability" means the MFI can cover all non-financial costs of lending (and the effects of inflation) using program fees and interest charges.¹ "Financial sustainability" is defined as the MFI's ability to cover both the non-financial and financial costs of lending, calculated on a commercial basis.²

Both MFIs are also working to further boost their sustainability by decreasing operational costs. By decentralizing daily operations and streamlining application procedures, both VF Credo and Constanta have considerably increased the efficiency of their operations and decreased the cost of doing business in Akhalkalaki.

However, for both institutions, the Akhalkalaki branches are not competitive in terms of sales or sustainability when compared to their other branches in Georgia. The value of the Akhalkalaki branches' portfolios is smaller, and they have not reached 120 percent financial sustainability (the figure an average branch should achieve in Georgia). That said, the growth achieved in Akhalkalaki far surpasses the MFIs' initial expectations. Just a little over a year ago, in April 2006, Constanta was only at 50 percent operational sustainability and VF Credo was at 39 percent. Though their growth has been significant, it is also true that the branches took time to

1 Operational sustainability here is calculated as revenue / (loan loss provision expense + operating expense).

2 Financial sustainability is calculated as adjusted revenue / (financial expense + loan loss provision expense + operating expense + expense adjustments).

establish (when compared with branches elsewhere in Georgia), due in large part to the population's inexperience with and mistrust of microfinance. Now that the MFIs have crossed some of those hurdles, their growth rate has accelerated, and they are well positioned to take advantage of the region's untapped demand. To do so, both MFIs have increased the number and value of loans they disburse in the Akhalkalaki region.

Given the number of villages and their distance from the center, neither MFI has been able to target all the region's villages in the past year and a half. VF Credo reports that it has been so busy this past spring meeting current demand that it has had no time to expand its marketing campaign to new villages. To meet the current (and growing) demand, VF Credo is hiring two additional loan officers and considering opening a satellite office in the neighboring town of Ninotsminda to better serve nearby villages. Constanta has also struggled to meet existing demand. It currently operates in the Ninotsminda rayon and has increased the reach of its operations by actively visiting more villages in both Ninotsminda and Akhalkalaki rayons.

The Akhalkalaki rayon presents still more opportunities and challenges. One of its notable particularities is its strong culture of repayment. Constanta reports that 99.8 percent of its portfolio is on schedule for repayment, and VF Credo reports that 100 percent is on schedule. The delinquency rate is remarkably low compared to other Georgian branches, where 4-5 percent is usually behind schedule. In Akhalkalaki, borrowers repay their loans quickly and often early, despite early closure penalties. They prefer repeated short-term loans to keeping an outstanding loan. While this characteristic reduces the MFIs' risk, it is also one of the challenges they face in achieving a comfortable level of sustainability.

VF Credo and Constanta are committed to staying in the region because they view the long-term potential for growth as substantial. Without current market survey data of the region, it is difficult to estimate the demand for credit and the market penetration either of the MFIs has achieved. VF Credo estimates that their market penetration may be as low as 1 to 3 percent, leaving significant opportunity for growth. The limited data available show that 648 people (.06 percent of the region's 96,300 people) have taken out a loan. VF Credo and Constanta estimate that average market penetration for a microfinance institution in Georgia is around 10 percent.



CHEMIONICS / LISA FACKLER

(L-R): Salon owner Naira Tarzyan pauses while putting the finishing touches on a client's haircut. After taking a \$3,000 loan from Constanta, she renovated and purchased her current space, which now offers modern salon services and a pleasant atmosphere. She says that the loan allowed her to make the necessary investments to own and grow her business. In the last year, she estimates that she has seen a 30 percent increase in sales.

SUCCESS STORY

Small Loans Build Local Economy in Rural Georgia

Access to affordable credit enables rural small businesses to support expanded supply chains



Gagik Arzumanyan brands finished cheese blocks with ink stamps. He plans to expand from producing soft Georgian cheese to hard European-style cheeses.

A 2004 GMSE nationwide demand for credit survey revealed that while the agricultural sector was responsible for 20 percent of Georgia's GDP and 50 percent of employment, it accounted for only 3 percent of all commercial bank loans.

The Arzumanyan family farm's wholesome cow-milk cheese is famous for its rich flavor, a product of the high altitude at which it is made. Sought after by consumers in the know, it is all that farm owners Gagik and Laura Arzumanyan can do to meet the market demand for their soft Georgian cheese.

Despite the farm's apparent success – in the last 10 years the number of mature and adolescent milking cows on the farm has increased from six to almost 80 – earlier this year the Arzumanyans struggled to find affordable credit.

Prior to the arrival of USAID-supported microcredit in Akhalkalaki and the neighboring town of Ninotsminda where the farm is located, Georgian commercial banks viewed even a successful agribusiness like the Arzumanyans' as a risky client.

In the spring of 2007, the Arzumanyans used a \$10,000 loan from Constanta to invest in additional cows and cheese-making equipment, and to increase their cash-on-hand to buy extra milk and pay their six farmhands' regular salaries.

The positive effects of their small loan reach beyond the gates of their family farm. Increased cash supplies enable them to purchase more milk from village families. When it opened in 1996, the farm bought 500-600 liters of milk from the village during the entire summer. Gagik estimates that this summer, the farm will purchase 400 liters of milk per day from 10 village families, who bring their milk by car, or more often by foot, to the farm daily.

For a cash-poor economy, where many villagers live on subsistence farming, a steady source of income such as this is a welcome boon. For the Arzumanyans, this means that they are both better able to support their supply chain and improve the community. If his farm's income increases, said Gagik, so will the income of his village.

CHAPTER THREE

SUPPORTING THE GROWTH OF AKHALKALAKI'S PRIVATE SECTOR

SUPPORT FOR MICROENTERPRISES

Microfinance has developed Akhalkalaki's small and micro business sector, which is vital to integrating this underdeveloped region into Georgia's rapidly growing economy. As discussed above, microenterprises face important constraints when seeking loans from formal lending institutions. However, microcredit in the Akhalkalaki region enabled 648 businesses to grow, leading to increased income, productivity, and employment in the region. The data reveals that 520 agribusinesses received loans. Behind the numbers are stories of beneficiaries such as potato farmer Ararat Oganessian, who sustained his business through 2006's devastating crop losses with the help of microloans, and the Arzumanyan family, which can pay the workers on its cheese farm (providing needed income to families in the neighboring village) thanks to microcredit.

BUSINESS SUPPORTED, BY TYPE

(October 1, 2005 – July 31, 2007)

	Total	Retail	Service	Production	Agricultural
VF Credo	535	55	21	7	452
Constanta	113	39	5	1	68
Total	648	94	26	8	520

As mentioned in the previous section, an ongoing challenge for small businesses in the region is the matter of outstanding receivables. Microfinance helps diminish the impact of this problem. For example, Rifessime Stepanyan took out a loan from Constanta to expand her retail clothing business from a kiosk in the bazaar to a

fully stocked store in the center of town. Since she took the loan in October 2006, Rifeshire estimates that her business has grown by about 30 percent. However, her largest problem is not attracting clients, but finding clients that have the means to pay for their purchases. Rifeshire allows clients to purchase items on the honor system, effectively creating a system of secondary credit. Currently, 130 clients owe her \$12,000. While her clients reliably honor their debts and repay her when they can, the level of outstanding receivables makes it very difficult for her to restock her inventory or make improvements to the store. Microcredit helps the many retailers like Rifeshire break out of these protracted, unfunded business cycles and indirectly supports Akhalkalaki's informal secondary credit market.

Given the vast difficulties facing small businesspeople in Georgia, it is difficult to isolate the impact of gender. However, a 1999 report entitled "Small and Medium Enterprise Development in Georgia: Assessment and Recommendations for USAID's Strategy" (by Development Alternatives Inc. and PricewaterhouseCoopers LLP) concludes that women-owned businesses face even greater challenges accessing affordable credit than their male counterparts. These challenges arise because women-owned businesses are usually very small and because Georgian women tend to have less business experience than men. In addition, women often lack the collateral needed to access credit, while men more often own land or other fixed capital they can use to secure a bank loan.

Microfinance's more flexible approach to collateral helps give women access to capital. Rifeshire and 245 other women received loans from USAID's Akhalkalaki grants program. Helping women develop their small businesses gives them not only the power to improve their economic standing in the community but also the opportunity to advance their social (and even political) position in society.

JOBS CREATED AND SUSTAINED

In growing Akhalkalaki's private sector, microfinance created and preserved jobs. As is documented in the table on p.24 ("Jobs Created"), GMSE's Akhalkalaki grants program not only successfully created new full-time jobs in the region — exceeding its target — but also sustained jobs that continue to provide Georgians a means to make a living and support their families. Microfinance sustains jobs and increases income rather than create a large number of additional jobs because of the small size of the average loan recipient — microenterprises that employ less than 10 people.

Behind the numbers are stories of the long-term unemployed, the migrant laborers who can no longer obtain visas, and the former employees of the closed Russian military base. Many of these people found employment and income through microfinance.

SUCCESS STORY

Microfinance Helps Rural Women Achieve Financial Security

Access to affordable credit enables female entrepreneurs in rural Georgia to build small businesses and share their success



CHEMONICS / LISA FACKLER

(L-R) Store clerk Sofia Karaguryan and store owner Rifisime Stepanyan assist a customer.

“ Microfinance is positive because it affects family life. ”

RIFESIME STEPANYAN

Rifisime Stepanyan worked for 25 years as a school teacher in Akhalkalaki until the fall of the Soviet Union in 1991. She, along with hundreds of other teachers, local government officials, and factory workers in town, lost her job and turned to petty trade, selling clothing and shoes in Akhalkalaki's open-air marketplace. The small amount of income she earned was not sufficient and provided no opportunity for her to reinvest in her business.

Compounding the problem, women-owned businesses in Georgia face immense challenges acquiring affordable loans from formal lending institutions as the businesses tend to be too small, lack fixed collateral, and their owners are generally less experienced in business than men.

Since the arrival in October 2005 of Constanta and VF Credo, 246 women in Akhalkalaki have obtained loans, in large part due to the MFIs' flexible lending procedures. Women make up 47 percent of the MFIs' total client portfolio in the region. Both institutions accept movable collateral, such as livestock or personal assets, and use simplified application processes meant to encourage apprehensive clientele.

Rifisime obtained her first loan from Constanta in October 2006 and used it to open and stock a clothing store in the center of town. She hired a full-time shop assistant, Sofia Karaguryan, an Akhalkalaki native and mother of two. Sofia similarly lost her job as a librarian after the fall of the Soviet Union, and says that this is the first steady job she has had in 12 years.

Rifisime's business has increased by 30 percent since taking the loan, and she plans to take another in September to improve the store and expand her sourcing to the United Arab Emirates.

Profits from her business have allowed her professional and private financial security. She financially supports her elderly parents and helps her extended family with otherwise prohibitive items such as school fees.

JOBS CREATED*

(October 1, 2005 – July 31, 2007)

	Total	Male	Female	Youth	Agricultural	Georgian	Armenian
VF Credo	68	27	41	0	12	3	65
Constanta	85	30	35	18	56	6	79
Total	153	54	74	18	68	9	144
Target	76						

* A created job is defined as a new full-time job (both agricultural and non-agricultural) that has existed more than two weeks.

Sofia Karaguryan, a former school librarian, had been without a job for 12 years. Like many teachers, factory workers, and government officials, Sofia lost her job with the end of the Soviet Union. When she could no longer find employment in Akhalkalaki, she sought work in Russia as a seasonal worker. However, as the mother of two sons, she found the life of a migrant worker too difficult. When Rifisime Stepanyan (mentioned above) obtained a loan from Constanta to open a clothing shop, she hired Sofia as her shop assistant. Now, for the first time in more than a decade, Sofia has a steady income and can stay in Akhalkalaki with her two teenage sons, for whom she is the sole caretaker while her husband works in Russia.

Geverg Tonakanian used to work as a driver in Moscow. Even though living in Moscow meant a high cost of living and being apart from his family half of every year, the job enabled him to fulfill his responsibilities as the sole support for a family of six, including elderly parents and three children. When the Georgian-Russian border closed to seasonal workers in 2006, Geverg found himself in dire need of work in Akhalkalaki. Luckily, Sergei Galustian and Armen Shirinian were looking for 10 new workers for the second door and window installation shop they opened using a loan from VF Credo. Geverg is pleased to have found regular work that allows him to support and live with his family and to enjoy a higher quality of life.

Geverg Tonakanian's story is not unique in the Akhalkalaki region. Tigran Tonakanian, who started working in Russia at the age of 16 even before he finished high school, found himself without a visa and a source of income at the age of 21. Initially, he found work with a friend at a minimal salary, but it was not enough to support his elderly parents. Next, he turned to VF Credo for a microloan to open his own fruit and vegetable stand in the marketplace. After two more loans, Tigran owns three fruit and vegetable stands. Running the three stands is hard, physical work, but Tigran can now comfortably support himself and his family from the income he makes in the market.

Akhalkalaki's Russian military base was officially transferred to the Georgian Army in June 2007. Before 2005, when the transfer began, an estimated 25 percent of the town of Akhalkalaki was employed

SUCCESS STORY

Microfinance Creates Economic Opportunities for Georgia's Youth

Affordable, accessible credit gives youth the opportunity to build better futures for themselves



CHEMONICS / GEORGE KHAZENOMIA

Tigran Tonakanian plans to return to school and continue his path as a successful entrepreneur.

“ The impact of microfinance is obvious to me. It has not only helped me. Just look around the marketplace, you will meet so many other sellers who have taken loans for their businesses. ”

**TIGRAN
TONAKANIAN**

Last year, Tigran Tonakanian returned home to Akhalkalaki after five years as a migrant laborer in Russia after he found himself unable to obtain a work visa. He found work in the Akhalkalaki marketplace but could not bring home enough income to properly care for himself and his parents. He felt destitute, but then learned through a friend about two new microfinance institutions that had opened offices in Akhalkalaki with the assistance of USAID – VF Credo and Constanta.

Tigran saw in microcredit an opportunity to use his natural ambition and experience as a worker in the market to open his own microenterprise and begin to earn a livable income.

With his first \$1,000 loan from VF Credo, he opened a small fruit and vegetable stand in the marketplace. Initially, Tigran was concerned that he would have trouble paying the interest on his loan. However, to his surprise and despite the small size of his stand, his sales quickly enabled him to repay the entire loan.

After this success, Tigran obtained two more loans and has now expanded his business to include three market stands. He has also increased the volume and variety of produce he offers. With income earned from these three stands, he comfortably supports his family and earns more than he would have as a laborer.

Still in his early 20s, Tigran is a successful small entrepreneur and now has plans to continue his education, which he was forced to suspend his education at age 16 to become a laborer.

“When I earn enough money from my business to put aside, I want to go back to school to become an auto mechanic,” he said.

directly or indirectly by the base. Egbiazar Aboyan had worked his entire life on the Russian base, where he ran supply stores and a restaurant. As the Russian base gradually closed down, he found his income shrinking as there were fewer and fewer soldiers to buy supplies or eat in his restaurant. With a loan from VF Credo, he and his wife turned a building they own in town into a general store, where they sell groceries, clothing, and kitchen/cleaning supplies. Now, with the assistance of a second loan, they are renovating the top level of the building to open a restaurant, which will be equipped with the equipment from his stores/restaurant on the base. In addition to generating income to support their family, Egbiazar and his wife employ 10 people, enabling them to do the same.

CHAPTER FOUR

AKHALKALAKI'S MARKET FOR MICROCREDIT

DEMAND

To date, the isolation and poverty of the Akhalkalaki region have made it a challenging place for MFIs to establish a thriving microfinance industry. However, the market for microfinance is now developing and appears robustly sustainable. As the environment for small and micro enterprises improves, the demand for microfinance continues to grow. In turn, competition among financial institutions to meet this growing demand keeps interest rates down, terms flexible, and credit affordable.

In 2005, VF Credo and Constanta found locating clients a challenge. Now, an increasingly significant portion of their client base finds them. In addition to word-of-mouth referrals, existing clients return for new business and are an important element of the branches' growing success. Thirty-three of 113 Constanta clients have taken out more than one loan. In 2006, Credo's retention rate in Akhalkalaki was 36 percent and, through June 2007, it grew to 43 percent. (Credo defines its retention rate as the number of repeat clients divided by the number of clients who have repaid in any period.) Seventy-one of Credo's 535 clients have taken out more than one loan. Once small entrepreneurs have successfully grown their businesses through microcredit, they return time and again.

Norik Unanyan, one of Constanta's first clients, is a local dairy farmer who did not have the capital to purchase cattle feed for the winter and thought he might have to sell some of his livestock to get it. Instead, he took out a loan for \$3,000. With this money, he saved his cattle and was therefore able to increase the volume of his cheese

production, which enabled him to pay back the loan. In February 2007, Norik took out another loan for \$7,100. This time, he sought the loan not out of dire need, but because he has figured out how to increase the income from his farm by 35 percent. He will use the money to invest in new iron tanks in which he can store the greater quantities of cheese he is producing. Many rural entrepreneurs have stories similar to Norik's.

For MFIs, repeat business helps them keep operational costs low. The fact that so many Akhalkalaki customers take repeat loans is one of the reasons that VF Credo and Constanta see a promising future there. As Constanta's Branch Manager Kakha Kavrelishvili said, "Microfinance is stabilizing and growing the region. I feel personally satisfied when I see my clients' conditions improving as a result of my work with microfinance in Akhalkalaki."

NEW ENTRIES IN THE MARKET

Apparently, VF Credo and Constanta are not the only institutions that see potential in the Akhalkalaki market. Recently, Tao Bank and the Bank of Georgia have both opened credit offices in the region, which is a positive development for credit consumers. Such competition forces financial institutions to offer different terms for their loan products, creating consumer choice. Both VF Credo and Constanta have lowered their interest rates to be competitive with each other and the new entries. In 2005, when the GMSE program was launched, VF Credo offered the Akhalkalaki market higher interest rates than it charged nationally. Now, VF Credo not only has lowered its interest rates but also (as of March 2007) no longer charges a flat interest rate. Instead, it offers a more affordable declining rate. With these changes, all institutions in the Georgian market offer competitive rates, creating a healthy environment where credit is affordable.

However, neither MFI competes directly with banks for two reasons. First, given the current limited market penetration, there is room for new entries. Second, the Tao Bank and the Bank of Georgia have positioned themselves in a different market niche, though they do offer small credits. Commercial banks do not usually lend to the same clients as non-bank MFIs because of the proportionally higher administrative costs for microloans. Accordingly, the Tao Bank and the Bank of Georgia are not operationally structured to pursue the rural microcredit loans that represent a significant portion of VF Credo and Constanta's portfolios. The average loan at Constanta is between \$3,000 and \$5,000 and is slightly larger than the average loan at VF Credo, which is between \$500 and \$1,500.

VF Credo and Constanta also keep their competitive edge by constantly creating new products that are particularly suited to the marketplace. VF Credo envisions piloting a consumer credit line for

small agribusiness owners, who are the bulk of microcredit consumers in Akhalkalaki. This new product will also help retail shops manage the large number of outstanding deliverables on their books. For its part, Constanta is considering developing a loan product designed to capitalize on the large value of remittances in the region. The new entries into the market keep the MFIs operationally efficient as they invent resourceful methods to cut costs and stay competitive

OPPORTUNITIES

In addition to Constanta and VF Credo's activities, external factors are also developing Akhalkalaki's private sector and, in turn, the market for microfinance. The Millennium Challenge Corporation and the World Bank have started large infrastructure projects that will positively impact Akhalkalaki's economy. They plan to reconstruct the roads that connect Akhalkalaki to the capital, Tbilisi; the first will be done by the end of 2007 and the second in 2008. Once the roads are completed, travel to Tbilisi will take a fraction of the five hours it currently takes, thereby cutting the cost of transportation and increasing profits for farmers who sell their produce in the capital. The improved roads will also create new trade opportunities. Despite the hassle of border crossings and tariffs, the terrible shape of the roads means that it is actually cheaper and easier for Akhalkalaki residents to trade in Armenia than in Georgia. Both MFIs view these infrastructure improvements as an important opportunity for their clients to grow and thus for their own businesses to expand.

Mercy Corps has also entered the rural microcredit market in Akhalkalaki with a grant from the European Council. Mercy Corps' work presents VF Credo with an opportunity to expand its reach. The two organizations will work together to provide loans for some of the new cooperatives that they are developing. For example, 15 dairy farmers in the village of Gogasheni have organized themselves into a dairy cooperative with the assistance of Mercy Corps. They are now interested in obtaining a loan for cattle and dairy equipment for their cooperative from VF Credo.

SUCCESS STORY

Georgians Use Microcredit to Build Rural Economies

Rural Georgians use small loans to create local economic opportunity rather than migrate to Russia in search of it



CHEMONICS / LISA FACKLER

Instead of laboring in Moscow, Ararat now lives with his wife and 8-year-old daughter in Akhalkalaki. Increased profits have allowed him to make upgrades to his home, such as new windows, doors, and appliances.

“ I regularly encourage other small business owners in the community such as shop owners and traders to apply for loans because I have seen what it has done for my business. ”

**ARARAT
NAKHATAKIAN**

After years of working in wholesale trade in Moscow, Akhalkalaki native Ararat Nakhatakian returned to his home town in 2003 with a plan. There, Ararat began to implement his boyhood dream of opening a fish farm, partnered with fellow returnee Misha Makoian.

The partners purchased the pools and pipes but, after spending their Moscow savings, found themselves without enough capital to buy starter fish and food. Although agribusiness represents the backbone of the local economy, affordable credit for small rural entrepreneurs in Akhalkalaki like Ararat and Misha was not available. The arrival, in 2005, of the USAID-supported microfinance institutions in Akhalkalaki allowed the partners to obtain their first loan of \$2,000 from VF Credo.

Microloans from both MFIs are helping returnees from Russia like Ararat and Misha to establish themselves and their small businesses in Akhalkalaki. These small entrepreneurs are investing in their home communities, bolstering the local economy and creating employment.

In the spring of 2006, armed with a second loan for \$10,000, Ararat and Misha built a fish hatchery that increased the farm's production capacity and cut costs by home-growing otherwise costly starter fish. In 2007, the farm will produce 200,000 trout, nearly a 10-fold increase over the 25,000 trout raised in the farm's first year.

Both loans are repaid, and the partners have taken a third loan to replenish fish food supplies. The business is steadily expanding, and in the coming years they plan to open a second fish farm closer to the Akhalkalaki city center to meet untapped demand there. To staff this second farm, they expect to hire additional employees and increase the business' income, enabling them to invest in other local business opportunities.

“Beyond our fish farm, my partner and I have invested in a restaurant and a store in Akhalkalaki,” said Ararat who explained that these investments help them identify additional distribution channels for their fish.

CHAPTER FIVE

LESSONS LEARNED

While every marketplace has its challenges, the isolation and poverty of the Akhalkalaki region made it an exceptionally difficult market for MFIs to enter. As the first MFIs in the area, Constanta and VF Credo faced potential clients who were unfamiliar with the concept of microfinance and had negative past experiences with loans. To create demand for their products, the MFIs had to educate the population about the benefits of microcredit. It took time for them to build both understanding and, more importantly, trust across ethnic lines. There were several keys to gaining the population's trust, including a highly qualified and dedicated local staff and USAID's program design, which encouraged competition and consumer choice.

LESSON ONE: COMPETING MICROFINANCE INSTITUTIONS ENABLED PROGRAM TO GAIN PUBLIC TRUST.

One key to success was that USAID funded two competitive MFIs, which permitted the program to gain the population's trust. If USAID had funded only one institution, the population would have been suspicious of the monopoly and the intentions of the program. Instead, the institutions were forced to compete for people's business. Thus, residents could compare their different approaches to microfinance and make an informed choice as to which best suited their needs. Now that the Tao Bank and the Bank of Georgia have entered the market, consumers have even more choices and continue to gain comfort with microfinance. In addition, the competition between the two MFIs pushed them to reach more clients. Given the physical and personnel limitations both MFIs faced, neither would have had the capacity to reach all of the current clients.

**LESSON TWO:
INFORMAL NETWORKS ARE KEY TO EDUCATING
PEOPLE ABOUT THE BENEFITS OF MICROFINANCE.**

Without working to gain public trust, neither MFI could have developed informal networks, which are another key to their success in the region. While their start was slow due to mistrust and a culture of privacy, Constanta was surprised at how quickly people became receptive to microfinance once trust was built. Through informal connections, neighbors taught neighbors about the availability of microcredit and about the loan application process. At the beginning of Constanta's activity in Akhalkalaki, a loan officer had difficulty securing information needed for an application even after an extended conversation with the applicant. Now, applicants come prepared with answers to the loan officers' question and show a clear understanding of process.

**LESSON THREE:
HIRING AND TRAINING LOCALS GAVE
MICROFINANCE INSTITUTIONS ACCESS ACROSS
ETHNIC LINES.**

Both MFIs cited human capital as one of their greatest challenges and an important key to their success. They found it difficult to recruit local staff where the population was unfamiliar with microfinance. Because they could not hire staff with experience, they hired smart, driven locals in whom they invested considerable resources to educate them in microfinance best practices. In VF Credo's case, this training included an internship program. The local, Armenian-speaking staff were key to offering the MFIs access to Armenian communities that had not been previously reached because their shared language and cultural understanding helped open doors.

**LESSON FOUR:
BECAUSE THE MICROFINANCE INSTITUTIONS HAD
USAID'S SUPPORT, THEY WERE ABLE TO STUDY
THE MARKET AND CHOOSE THE SECTORS WITH
THE MOST POTENTIAL.**

Another key to success for the MFIs was making strategic marketing choices, especially in selecting the correct market segment. While Constanta focuses on microentrepreneurs in both trade and agriculture, VF Credo targets the rural microenterprises. In late 2006, VF Credo experimented with targeting medium-size enterprises by offering a discounted interest rate for larger loans. However, they quickly realized that this strategy forced them to divide their market, assume greater risk and operational costs, and compete in a market where they do not have a competitive advantage. Because the MFIs were unfamiliar with the Akhalkalaki market, they required time and the financial backing of the GMSE program to identify the best markets for their products and to develop their marketing strategy for the region.

VF Credo's mission

is providing sustainable financial services to the entrepreneurial poor and Georgian micro- and small businesses, with a preference for rural activities and those businesses that create income and employment opportunities for the poor.

Its vision is to enable the poor to increase household incomes and reduce their vulnerability, enabling them to build a meaningful, sustainable, and self-determined livelihood.

Constanta's mission is to provide easily accessible, high-quality microfinance services. The organization's key values are customers, employees, transparency, teamwork, and professionalism.

Future plans of Constanta are quite ambitious, but the main goal – supporting small business in Georgia – remains the same. We believe that financial services rendered to small entrepreneurs will contribute much to the social and economic development of our country.

LESSON FIVE:**BECAUSE THE MICROFINANCE INSTITUTIONS HAD A SOCIAL MISSION, THEY OFFERED PRODUCTS THAT BENEFITED BOTH THE LOCAL COMMUNITY AND THEIR INSTITUTIONS.**

Both MFIs stress the importance of their role in developing a sustainable microfinance market. One of Constanta and VF Credo's goals is certainly to achieve a comfortable level of sustainability. However, they also both have a social mission to improve the lives of their clientele, create economic opportunities, and contribute to the advancement of Georgia's economic development. They could have been tempted to compete with banks for short-term profits by offering large loans that put clients' businesses at risk, but the MFIs recognized the importance of responsible lending that encourages long-term growth for their clients and for themselves. This approach saves VF Credo and Constanta from a portfolio full of loans at risk for default, but it also promotes the prosperity of the community they serve.

LESSON SIX:**THE GMSE PROGRAM ALIGNED THE GOALS OF USAID AND THE MICROFINANCE INSTITUTIONS.**

The final key to success was a program design that met both USAID's economic growth strategic objectives and the MFIs' interest in expanding their rural portfolios. Both parties' goals complemented each other, which gave the grantee every incentive to meet USAID-defined objectives.

While it was within the MFIs' mandate to expand their operations and bring microfinance services to more small and micro entrepreneurs, neither VF Credo nor Constanta would have invested the money or risked entering the Akhalkalaki market without USAID's assistance. In 2005, the Akhalkalaki market was not attractive enough to capture the MFIs' attention given that other less risky, more accessible regions in Georgia were open to them.

Entering the Akhalkalaki market was risky due to its geographic isolation, its lack of clear potential for branch success, and its population's lack of experience with microfinance. Opening these markets (through efforts to educate and gain the trust of the people) required far more time and resources than the MFIs could have spent on their own, without the support of the GMSE Akhalkalaki grants program to defray the operational costs. Now that the MFIs have fully established themselves in Akhalkalaki and understand its significant potential for growth, they both plan to stay in the region and continue to expand their operations. By minimizing the MFIs' financial risks, USAID's aid substantially improved access to microfinance services for small and micro businesses in the region. As a result, it boosted the ability of Akhalkalaki's private sector to generate income and employment in a poor, rural region of Georgia.



CHEMONICS / USA FACKLER

Dried beans are sold along with vegetable seeds, fresh produce, breads, meats, cheeses, and an assortment of household goods and clothing in the bustling Akhalkalaki marketplace. Several market vendors are recipients of microloans from VF Credo and Constanta. Both microfinance institutions will remain in the Akhalkalaki region after the USAID-funded Akhalkalaki grants program has ended, and both see opportunities to expand their portfolios among the urban and particularly the rural population there.

CHAPTER SIX

LOOKING FORWARD

The success of the program suggests that other undeveloped regions in Georgia could benefit from a similar grants program. Both MFIs suggest that Guria, a subtropical region that borders the Adjara region on the Black Sea, would be an attractive fit. During the Soviet Union, Guria was a well-developed region that produced fruit, nuts, and tea and had a small tourism industry. With the collapse of the Soviet Union, it lost its export market and has become neglected. Guria demonstrates great potential for growth, but the cost and risk associated with opening its markets are too high for either VF Credo or Constanta to establish branches there without support.

The largely agricultural Samegrelo region in western Georgia is another potential candidate for a similar program as it has the right mix of risk and potential. Entering this region would entail a much larger outlay of capital than the Akhalkalaki program required because of its large size and the number of urban centers.

As the GMSE Akhalkalaki grants program has demonstrated, the private sectors of high-risk regions can rapidly benefit from a small investment in qualified partner MFIs to establish accessible and affordable credit. The introduction of microfinance requires time, innovation, and financial support on the behalf of MFIs, but pent-up demand easily outpaces supply once small entrepreneurs understand the benefits of microcredit for their small businesses and their families as well as its capacity to reduce poverty in their communities.



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