

## Downscaling: Introduction of MSE Lending

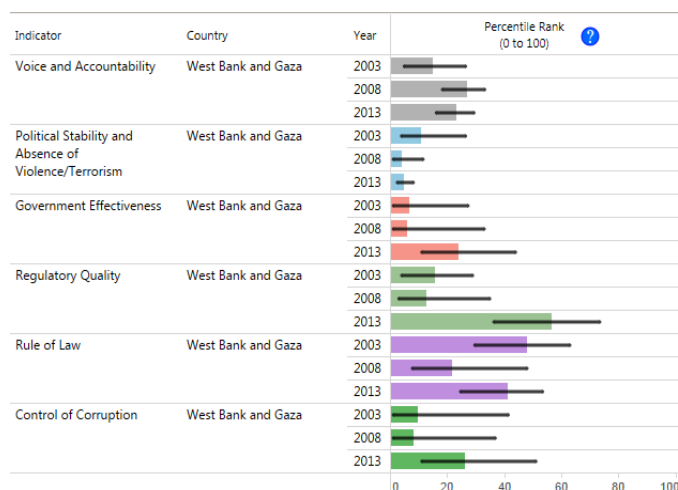
Cairo Amman Bank, West Bank and Gaza

### 1. Development relevance

**Economic and Poverty Context:** The Palestinian economy is characterized by a high percentage of poverty averaging around 26% of the population, with rates in Gaza twice as high as in the West Bank. Due to the extreme volatile political situation and Israeli restrictions, and as a result of the grim fiscal situation, with a higher than expected budget deficit and less than expected donor support in 2014, the economy entered into a recession in 2014. Unemployment rate is currently around 25%, with 16% in the West Bank and 45% in Gaza strip. Economic activity will continue to be drastically reduced for the duration of the conflict. Real GDP is expected to grow by 2,9%, compared to a decline of 2,7% in 2014.<sup>1</sup> Inflation rate is expected to drop to 1,8% in the second half of 2015 compared to more than 2% in 2014. While there are improvements in government effectiveness, control of corruption and regulatory quality, many governance challenges remain (see graph).


**Governance Indicators (2014)**

Population and Economic indicators <sup>ii</sup>			
Population (in million) (2013)	4,17		
GDP growth (average: 2009-2013)	7,4%		
Inflation (average: 2009-2013)	2,8%		
Foreign Direct Investment (net) (% of GDP) (2012)	1,6%		
Personal remittances, received (% of GDP)	18,3%		
Net ODA & official aid received (% of GDP) (2012)	17,8%		
Poverty indicators			
GDP per capita (current USD) (2012)	2'783		
Gini Index (0= equality 100= inequality) (2013)	35,5		
Multidimensional Poverty Index (2014)	0,01		
National Poverty Line (% of poor) (2012)	25,7%		
Rural poverty headcount ratio at national poverty lines (% of rural population, 2011)	19,4%		
Labour Force Statistics (in %) <sup>iii</sup>			
	West Bank & Gaza	West Bank	Gaza
Unemployment	26,3	16,0	45,1
Youth unemployment (15 to 29 years)	39,5	25,3	63,3
Female Unemployment	39,6	26,9	60,8



**Financial Sector Context:** The formal Palestinian financial sector is still comparatively young, having been established in 1993 following the signing of the Oslo peace accords. Despite the difficult environment, the Palestinians have established a financial sector composed of banks, a securities market, insurance companies, housing finance companies, financial leasing companies, and microfinance institutions. The

number of banks has been increasing, reaching 17 banks with more than 200 branches and offices in the West Bank and Gaza. Among these banks are seven local banks, two Islamic banks, and 10 foreign banks, most of them Jordanian.<sup>iv</sup> Palestine does not have a national currency and generally uses the New Israeli Shekel currency, in addition to the USD and Jordanian Dinar.

The small loan and microfinance market has made notable developments. There are about 12 establishments, 11 of which are listed on Mix Market and members of the network "Sharakeh". This network aims to empower the service providers to promote their work and facilitate access to their services for small and medium enterprises (SMEs) and low-income beneficiaries. In 2014 there were 65'091 borrowers with a total of USD 172,5 million loans and 9'471 depositors with a total of 198 million deposits.<sup>v</sup> However, access to finance is still a major constraint to economic development of small businesses. The combination of an incomplete legal framework, conservative lending practices, continuing political risks, and financial illiteracy constrains access to financial services. Most commercial banks require loans to be more than 100%

collateralized due to the above-described difficult conditions, but also to unfamiliarity with cash-flow-based lending methods.

**Partner Financial Institution:** Cairo Amman Bank (CAB) was founded as public shareholding company in Jordan in 1960. Its general management is located in Amman while its Regional Management for Palestine is based in Ramallah. CAB has the third largest branch network in Palestine, providing financial services to 166'000 active clients. It offers a variety of financial services including personal loans, SME loans for privately owned businesses, short-term commercial loans for working capital finance, and long-term loans for investment requirements as well as electronic banking. In addition, it has a widespread network of ATM machines (48 in 2014) strategically located in various key spots of Palestine. Through its 21 branches and offices in Ramallah, Nablus, Jenin, Hebron, Bethlehem, Jericho, Rafah, Dair Al-Balah, Qalqilya, Tul-Karem, Gaza City and Khaniones, CAB strives to service an ever growing client base by reaching every corner of Palestine, including the Gaza Strip where it is present with three branches. It is the third largest Palestinian bank in terms of deposits, lending, assets, profit, and number of ATMs. According to the Association of Banks in Palestine, its market share is 9% in terms of deposits and 7,6% in terms of lending.

Cairo Amman Bank <sup>vi</sup>	2012	2013
Total assets (USD)	2'834'070	3'098'157
Gross loan portfolio (USD)	1'410'272	1'974'380
Total deposits (USD)	1'960'455	1'996'425
Total staff / women	2'161 / of which 51% women	2'161 / of which 53% women
Total branches	21	21
NPL %	4,52%	4,78%
Net income	49'400	57'117
Total Office	21 branches	21 branches
Provision coverage ratio in %	95,2%	101,2%



## 2. Intervention approach and additionality

CAB approached GFA Consulting Group in 2013 to set up, pilot and roll out with support from the SCBF inclusive best practice micro and small enterprises (MSE) lending operations all over Palestine and thus to maximize outreach to MSEs in remote areas, while coping with the high risks and costs associated with servicing them. The main activities were:

- Develop and implement MSE lending products and related policies and procedures based on the results of the needs assessment and a market study;
- Anchor solid MSE finance knowledge in the Bank through extensive on-the-job and classroom training;
- Test the newly developed products in two pilot branches, develop and implement a marketing concept and support the bank during the roll-out to selected branches.

The Deputy General Manager, who is also the Regional Manager in CAB Palestine, was always involved in the intervention and provided all necessary support together with his team. Regular monthly meetings with the management were organized to update them on the work accomplished, providing their feedback, views, comments on the bank needs and strategy. To summarize, following tasks and outputs were implemented:

Activities / Milestones	Performance Indicators	Status	Comments	
Assessment Phase	Needs assessment	Process-oriented	<i>Processes and procedures are analysed and recommendations on the organizational and operational structure are submitted and discussed</i>	The needs assessment confirmed the demand and potential for microfinance.
	Market Study		<i>Market study is finalized and results are analysed and discussed with CAB</i>	Although there are 11 MFIs (microfinance institutions) operating in Palestine, the market has not reached the saturation point.
	Concept development		<i>Implementation concept developed and agreed upon with CAB; baseline defined</i>	A streamlined concept was developed that would take the borrower from the microfinance stage all the way to the upper end of the SME lending.
Implementation Phase	Product development	Output-oriented	<i>New MSE lending products developed</i>	Quite innovative products were developed (incl. financial projections), including microinsurance, which is currently not offered in Palestine.

Pilot testing	<i>Pilot products are launched and tested in two branches</i>	Three branches were identified in the northern part of the West Bank with potential to expand into other areas including Gaza.
Marketing concept	<i>Marketing concept developed and implemented</i>	Marketing concept was developed, but training remained outstanding.
Staff trained	<i>12 loan officers, 5 middle management employees, 3 future trainers trained (ToT)</i>	Was not implemented due to the halt of project
Roll-out	<i>800 new clients reached</i>	Was not accomplished due to halt of project.
		Not implemented
		Partly completed
		Fully completed

The implementation phase was only partially effected as the intervention was stopped prematurely. Due to the political situation as a result of the most recent conflict in Gaza, the project was on hold since July 2014 and finally stopped on 04.11.2014. The war had a significant impact on microfinance lending as most of the war occurred in poorer areas, traditionally inhabited by MFI borrowers. Many of the borrowers were directly affected through loss of lives or businesses. Agriculture was very much affected as many small farmers saw their lands and crops destroyed. Since all the MFIs operate in the West Bank and Gaza, it impacted their overall activity. Noteworthy, the extended family concept plays a very important role in Palestine, hence touching many that were not directly affected by the war and spilling over into the West Bank. In a very short time, the non-performing-loans level (PAR 30) rose from less than 3% to close to 25%. The majority of financial institutions, including MFIs, halted or significantly reduced their lending activities.

### 3. Results achieved

#### 3.1. Client level

**Market study:** A market study identified following client needs:

- Full microfinance package, and not just microcredit, as this would make lending much riskier for both the client and the microfinance institution.
- Technical assistance to clients, support in developing good business plans
- Helping clients with marketing through connecting them with bigger clients in the bank.

Following market gaps in microfinance were identified:

- Loan portfolio in local MFIs doesn't reflect or fulfil true client needs;
- Improper definition of client needs led to poorly designed products and non innovative financial approach;
- Lack of comprehensive package of financial and non-financial services such as micro savings, micro insurance, micro leasing & non-financial services in addition to microloan. Most MFIs provide "credit-only", which doesn't help sustain the businesses or expand it at a later stage. The reasons, in part, are due to legal constraints, reluctance to innovate, and low risk appetite.

Having analysed the market gap in microfinance, the following conclusions were made:

- Introducing a full comprehensive microfinance package, including a risk mitigating factor to provide safety and good source of income for clients in case they face crises that might have negative implications on their businesses, as well as including tools to decrease collateral requirements, will be highly attractive to MSEs. In addition, it was planned to design insurance packages and offer them to the borrowers, a first in Palestine.
- CAB's entry in MSE market will put all local MFIs, including major players, in a weaker position. Trending towards commercialization, big MFIs put more focus on SME finance than to microfinance, creating an opportunity for CAB to enter the market.

Visits to pilot branches demonstrated high interest and enthusiasm to start microfinance lending because the demand for microfinance loans is very high in these cities. In case of implementation, it will be crucial that the Bank will dedicate a separate department for this type of lending which requires different techniques.

#### 3.2. Partner financial institution level

**Financial products:** To create a distinct, more pronounced product mix, five new financial products for various segments were developed, including young generation, women and agribusiness. Furthermore, two new products currently unavailable in the market, namely microsaving and microinsurance, were introduced

to CAB Management. Two microinsurance products (health and life insurance) were negotiated with insurance companies. The regional management in Palestine as well as the microfinance Department at HQ in Jordan were encouraged to lessen collateral requirements which will in turn help CAB to reach out to more micro businesses without jeopardizing the quality of lending or invest in riskier loans. Increased awareness of the importance of microfinance lending at the Bank was very obvious, staff was convinced that the microfinance approach and proposed products were different from what is available in the market and will give the Bank an edge over the competition. For the introduction of the new products, final approval from the Board of Directors was necessary, since it involves additional costs such as hiring new staff, training and branch remodelling.

#### 4. Lessons learnt and further challenges

Operating in an unstable political environment is always a challenge. Strategic plans, commitments and projections could change very quickly by outside factors beyond the control of management or the consultant. Much of the events in Palestine are influenced by Israeli actions. While the banking sector may seem to act independently, Israeli influence is constantly present and has significant impact on day-to-day operations, such as cash transfers and clearing, movement of people and goods.

The downscaling project at CAB looked very promising. The Bank committed to its implementation as it saw a need to complement existing providers. The TA services differentiated proposed product offerings by CAB and introduced innovative approaches and microinsurance services. Notwithstanding all of the above, the potential damaging effects of an aggression was not given the proper consideration and weighting by the Bank's management or the consultant. It was naïve to assume that business will continue as usual in the face of a major disaster. The last war in Gaza lasted much longer than previous ones with far more significant damage than previously experienced or envisioned. Given the political climate in Palestine, such a situation should have been given a greater consideration. Still, no one likes to discuss worst case or doomsday scenarios, but it is important to do so and such considerations should be discussed up front.

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<sup>i</sup> Economic Forecast Report 2015 page 9. <http://www.pma.ps/Default.aspx?tabid=205&ArticleID=630&ArtMID=793&language=en-US>

<sup>ii</sup> Sources: <http://data.worldbank.org/indicator>, <http://www.pma.ps/en-us/statistics/monthlystatisticalbulletin.aspx> (PMA Palestinian Monetary Authority: Main Indicators of Palestinian Economy).

<sup>iii</sup> <http://documents.worldbank.org/curated/en/2014/10/20302406/west-bank-gaza-country-assistance-strategy-period-fy2015-16> (WB Data, based on PCBS Labor Force Survey, 2<sup>nd</sup> quarter, 2014).

<sup>iv</sup> <http://www.pma.ps>

<sup>v</sup> <http://www.mixmarket.org/>

<sup>vi</sup> <http://www.cab.jo/node/103> CAB Annual Report 2013.