Serving the Very Small Enterprise (VSE) Segment by Microfinance Institutions in the Arab World

IN PARTNERSHIP WITH:
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SANABEL
The Microfinance Network of Arab Countries

IFC International Finance Corporation
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Abbreviations

MENA	Middle East and North Africa
MFB	Microfinance Bank
MFI	Microfinance Institution
NBFI	Non-Bank Financial Institution
NGO	Non-Governmental Organization
SE	Small Enterprise
SME	Small and Medium Enterprise
VSE	Very Small Enterprise

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Foreword

Increasing access to finance for Very Small, Small and Medium Enterprises (VSEs/SMEs) has become an important goal for many governments and development agencies as VSEs/SMEs are viewed as main drivers of economic growth and creators of employment. However, a missing middle between the ceiling of MFI lending and the segment defined by banks as SMEs is currently underserved and in some markets even unserved, despite the fact that it presents a significant growth opportunity for MFIs looking to upscale and/or to grow with their best clients.

The report presents the findings of Sanabel's and IFC's VSE Survey which aimed to identify what has been done to date to serve the VSE segment, and how successful MFIs as well as other players in the region have been in catering to this segment and upscaling lending activities.

What is clear from this survey is that MFIs in the Arab World do indeed recognize the opportunity that the VSE segment presents and as such are interested in upscaling to serve VSEs. Several reasons have been cited for this interest including job creation, supporting growing micro clients and business growth opportunities for the MFIs. Despite the high level of interest though, efforts to target VSEs in the region have remained quite humble to date. Limited know how, particularly relating to product development, has emerged as the most critical internal challenge that MFIs seeking to target this segment face.

While this report documents where the sector stands today in terms of serving the VSE segment, it also offers some lessons learned by MFIs who have already upscaled to serve VSEs from the region and beyond, which MFIs in the Arab World can benefit from in order to be able to better serve this segment.

This report represents the second report in a series of leadership papers, Voices, developed by Sanabel, the Microfinance Network of Arab Countries, and the International Finance Corporation (IFC).

We hope you enjoy this report.

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1. Contextual Background

Over the last few years, some microfinance institutions[1] (MFIs) in the Arab World have started to upscale and target the very small enterprises (VSE) segment[2].

Some MFIs recognized the market opportunity and intentionally expanded to serve the segment. But most have done so more organically, looking to retain clients whose business needs can no longer be met through micro- loans. However, these shifts are still in the nascent stage, and though some successes have been observed across the region, the results remain mixed.

This report, a joint effort between IFC and Sanabel3, is based on: i) a survey conducted in May-June 2015 by IFC and Sanabel4 to better understand the efforts of MFIs in Arab countries to target the VSE segment and respond to their needs; ii) IFC's experience providing advisory services to MFIs in the MENA region to help them expand their loan offerings and target the VSE segment; iii) a series of regional IFC workshops on lending to VSEs; and finally iv) a 2014 IFC study on MFI lending to VSEs in Latin America.

This report: i) attempts to define the VSE segment; ii) reviews the microfinance sector's efforts to serve the VSE segment, based on survey results; iii) assesses the scale of these efforts; iv) identifies key challenges; v) assesses the levels of MFI interest in serving this segment; and finally vi) draws some lessons from the experiences thus far and offers some guidance for next steps.

2. Definitions

What is a VSE? Defining a very small enterprise is challenging -- a consensus definition has yet to be created. In general, the VSE segment can be seen as a segment that overlaps with the upper micro- and lower small enterprise segments, as shown in Figure 1.

According to the Microfinance Information Exchange (MIX), microfinance loans are loans whose average outstanding balance does not exceed 250 percent of the average income per person (GNI/capita). But looking at the current average MFI loan balances as a percentage of GNI/capita in the region today reveals that MFIs are still largely only targeting clients with the lowest income (average loan balance is about 10 percent of GNI per capita). Given these considerations, the definition proposed in this paper is that a *VSE loan is a loan that has an average loan balance from 25-250 percent of GNI per capita* (see Annex 2 for further details of this proposal).

[1] The term 'microfinance institution' (MFI) in this report refers to all kinds of institutions that provide microfinance services. These include NGOs, for-profit and not-for-profit companies and microfinance banks.

[2] VSE segment is typically defined as the segment between the micro and small enterprise segments.

[3] The Microfinance Network of the Arab Countries.

[4] The survey was sent to 32 MFIs, belonging to 10 different countries. Combined, the 32 responding MFIs are serving over 75% of the region's active borrowers. Of the 32 MFIs surveyed, 25 have indicated that they do serve VSEs. Details on the survey methodology and the profile of respondents can be found in Annex 1.

Still, many countries of the region – including Sudan, Morocco, Tunisia, Egypt, Bahrain, and Yemen – maintain a cap on MFI loan size (see Table 1). The cap ranges from $3,500 in Sudan to $18,000 in Bahrain. Yemen is a slight exception because its ceiling is equal to one percent of shareholder equity - meaning that it can be raised by increasing an MFB's equity[5]. Jordan, Lebanon[6], Iraq, and Palestine do not cap MFI loan size. At first glance, it appears that the range in caps is quite broad. But if we assess the cap in relation to GNI per capita in each country, we find that, with the exception of Bahrain[7] , MFIs are generally allowed to disburse loans that are relatively equal to their country's GNI/capita (between 85 percent - 130 percent). Even though there are regulatory ceilings in place in many countries, MFIs often have the potential to disburse larger loans and remain within these ceilings.

Figure 1: Representing the VSE Segment

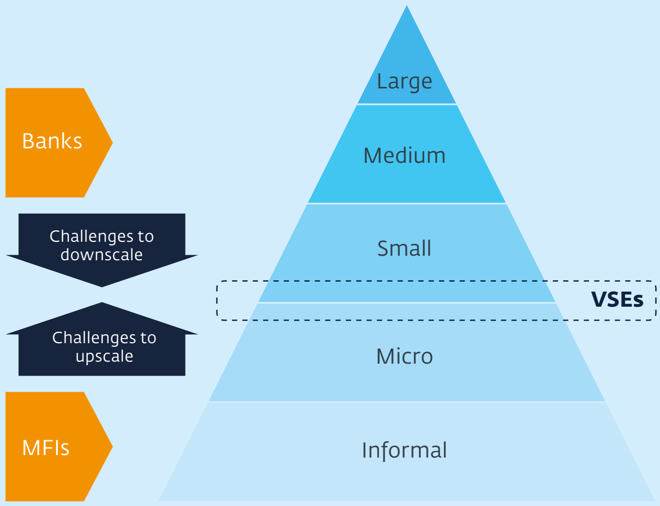


Table 1: Caps on Loan Size for MFIs and GNI/Capita by Country

Country	Sudan	Morocco	Tunisia	Egypt	Bahrain	Yemen	Jordan	Lebanon	Iraq	Palestine
Cap on loan size ($)[8]	3,500	6,000	10,000	13,000	18,000	1% of total shareholder equity. As minimum capital is 500M Riyal/ approximately 2M USD, this is equivalent to USD 20,000	--- No cap ---			
GNI per capita ($)	3,920	7,100	10,600	10,260	37,650	3,650	11,910	17,910	14,440	5,080
Cap on Loan Size as % of GNI/Capita	89%	85%	94%	127%	48%	547%[9]				

Notes:
- Cap on loan size for MFIs is based on microfinance laws in respective countries
- In Tunisia, the ceiling presented here is that placed on NBFIs. NGO MFIs may only disburse loans up to $2,500
- GNI per Capita data is extracted from World Bank Database

[5] While this is applicable to the MFBs regulated by the Central Bank, it does not apply to the MFIs registered with the Ministry of Labor and Social Affairs. However, the average loan size of these NGOs and companies have been very small compared to those of MFBs as a result of self-imposed caps.

[6] In Lebanon, while there is currently no microfinance law or regulations, the Central Bank defines small (microfinance) loans as loans up to $7,000.

[7] While the ceiling on loan size in Bahrain appears to be the highest in absolute terms, it is in fact the lowest when we calculate the ceiling as a percentage of GNI/capita.

[8] These values are approximate based on FX rates as of 29 January 2016.

[9] The cap on loan size in Yemen is based on the minimum capital requirement for microfinance banks. A microfinance bank can increase its loan size by increasing its capital.

To account for the fact that no clear definition exists for the segment[10], the survey asked the responding MFIs to include their own definition of what constitutes a VSE loan so that there is clarity on their understanding of the segment. These responses are summarized in Table 2[11].

Table 2: VSE Definitions as Presented by Survey Respondents

Country	Definition
Egypt	No definition provided
Iraq	VSEs are formal and informal enterprises with loans between $10,000 and $25,000
Jordan	No definition provided
Bahrain	No definition provided
Lebanon	No definition provided
Morocco	The VSE segment constitutes both formal and informal enterprises, employing 5-49 employees. VSE loans are loans that range from $10,000 to $50,000
Sudan	The VSE segment constitutes enterprises with 5-49 employees. VSE loans range from $10,000 to $50,000
Tunisia	The VSE segment constitutes formal enterprises with 3-6 employees
Yemen	No definition provided

While a definition for the VSE segment has been proposed here, for simplification purposes and to also incorporate the responding MFIs' views, throughout the remainder of this paper, *it will be assumed that VSE loans are loans between $5,000 and $50,000*[12].

Characteristics of VSE: Regardless of the country context, VSEs in the Arab World tend to share similar characteristics and have similar business needs. In contrast to micro-enterprises, which are generally run by a sole entrepreneur, VSEs typically have 2-10 employees and in some cases as many as 20. In most cases, they are family owned and run and their starting capital is generally put up by the owner. They often have fixed assets and a fixed place of business in contrast to many micro-enterprises (e.g. informal vendors[13]). Ownership and management are typically the same individuals, and they generally maintain simple financial recordkeeping, often separated for business and household (Nails & Sian, 2008). VSEs sometimes have more than one location/branch and have some degree of legal formalization and credit/financial history. In fewer cases, VSEs actually hire accountants to file taxes (IFC, 2014). Figure 2 below summarizes the basic characteristics and needs of typical VSEs.

[10] In most cases if a definition exists, it is specifically for micro and small enterprises and not very small enterprises. Annex 3 presents some of the currently existing definitions in the different countries covered in this report.

[11] It is important to note that not all responding MFIs have provided a definition. The definitions presented here a summary of the responses received to this question.

[12] This is a broad range which is expected to differ by country. Table 6 in Annex 2 presents suggested range by country. However, for the purposes of simplification, this definition will be used throughout the remainder of this paper.

[13] On the other hand, microenterprises are usually: one of multiple household income sources, composed from a household or sole- entrepreneur, have no or minimal fixed assets and is considered a "survival strategy" for poor households.

Figure 2: Characteristics and Needs of VSEs

CHARACTERISTICS

BUSINESS
- High concentration of semi — formal firms
- Defined Business location & some fixed assets
- Some degree of legal formalization
- Organization structure and management is more sophisticated compared to Micro
- Have informal employees (including family members)
- Prime household income source
- Heterogeneous groups with divergent financial needs
- More vulnerable with volatile growth, but also more flexible (compared to SME segment)

FINANCIAL MANAGEMENT
- Some form of financial records
- Bookkeeping is more sophisticated compared to most
- Micro- but still opportunity for improvement
- May have tax ID/ pay minimal or partial taxes

OWNER(S)
- Have some basic financial education but could benefit
- From additional financial, accounting, and management skills
- Typically older (over 35)
- More men than women

NEEDS

CREDIT
- Fast decision making on credits
- Solutions for working capital financing and/or investments
- Higher loan limit, compared to Micro customers
- Demand investment products and some fee based services
- Lower requirements in terms of collateral (compared to SME Segment) & cash based analysis

NON CREDIT
- Tailored solutions/ products bundles for daily banking
- Simple solutions for deposits and cash management
- Simple and fast FI access (e.g. accessible channels)
- Insurance solutions to absorb shocks
- Non-financial services to increase their access to market opportunities, training (e.g. financial management, accounting), and network to improve their business performance

OTHER
- Predictability of costs for banking and financial services (transparent banking policies)

3. Why should MFIs target the VSE segment?

Market Opportunity: In the Arab World, serving the VSE segment represents a substantial market opportunity for MFIs. A 2008 IFC study developed by McKinsey estimated that the Arab region had about five million VSEs. As shown in Figure 3 below, only 10 percent of them are well-served, leading to a credit gap of roughly $13.5 billion (McKinsey Data for IFC, 2008)[14].

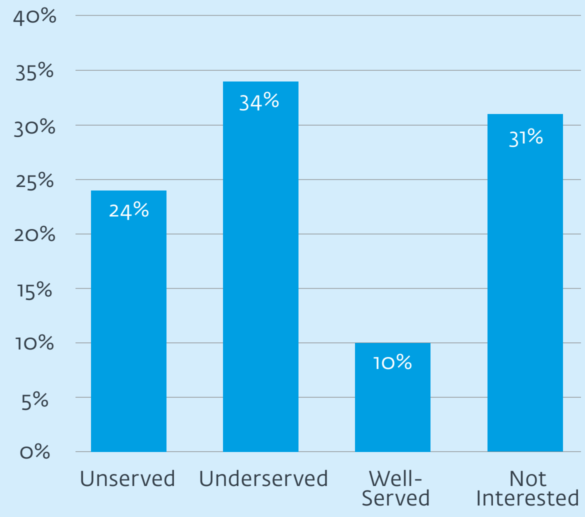
These statistics do not take into account informal VSEs, which are typically smaller and are estimated to be more numerous than formal ones and with even less access to credit. Banks have typically shied away from lending to this segment as they lack the knowledge to accurately assess credit risk and thus perceive them as highly risky and more costly to serve. Furthermore, in some countries, regulations prohibit banks from extending business financing to unregistered businesses. In some of these markets, banks work around the regulations by extending consumer loans to individuals. But regulations in some countries proscribe consumer loans to individuals without formal salaries. Serving VSEs thus presents a key, and potentially profitable, growth area for many MFIs in the region today.

[14] The data shows the percentage of enterprises who are well-served, under-served, unserved or not interested for each segment. It must be noted here that the authors considered enterprises classified as 'micro' and 'very small' in the initial dataset as 'VSEs' and enterprises classified as 'informal' as 'micro'. The reason for this reclassification is that, according to the survey, micro enterprises are formal enterprises with 0-4 employees and very small enterprises are formal enterprises with 5-9 employees. However, in practice, micro enterprises tend to be informal and do not have additional employees whereas VSEs have a higher degree of formality and a few employees. The definitions used throughout the study are as follows:

- *Well-served: Enterprises that need credit and have access to it*
- *Unserved: Enterprises that need credit but don't have access to any form of credit*
- *Underserved: Enterprises that need credit and find financing as a constraint i.e. do not get access to desired credit.*

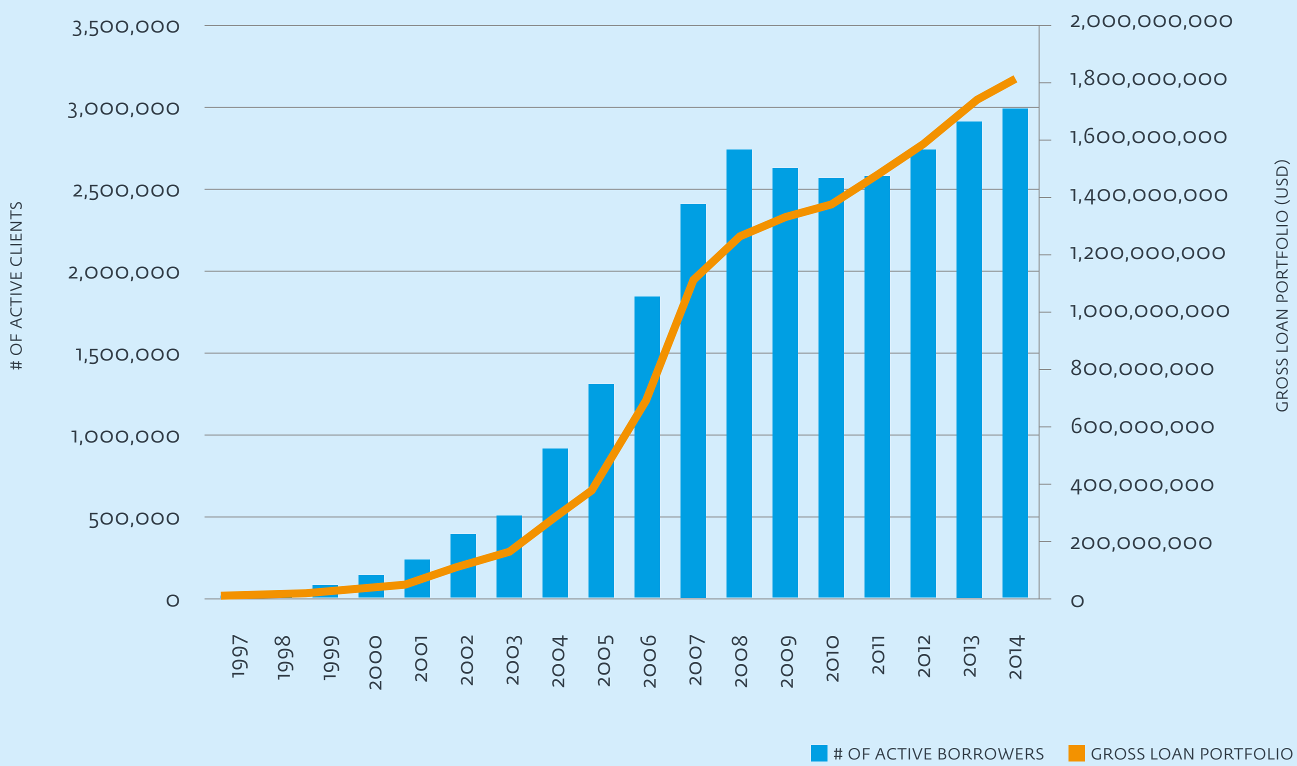
Diversification: Serving the VSE segment also presents MFIs with an opportunity to diversify their product offerings. As shown in Figure 4 below, since 2008, the micro credit market has largely stagnated. In 2008, the sector's outreach (measured in terms of credit) was 2.74 million active borrowers, with an outstanding loan portfolio of $1.26 billion. By the end of 2014, the sector had only grown to 2.99 million active borrowers with an outstanding loan portfolio of $1.82 billion[15]. Several factors have caused this decline in momentum, including political instability arising from the Arab Spring, security concerns in parts of the region, and the repayment crises in some of the larger markets (IFC and Sanabel, 2015). It is believed that such instability has manifested itself in risk-averse behavior on the part of MFIs, resulting in a lack of interest in product diversification. Today, MFIs in the region offer one main credit product, despite variations in names and slight variations in specifications. With adequate risk management systems in place, VSEs offer MFIs an opportunity to grow their portfolios and spread their risk as they move beyond dependence on one product and begin to serve new client segments.

Figure 3: VSEs Access to Credit



Source: McKinsey data for IFC (2008)

Figure 4: Outstanding Loan Portfolios for MFIs in Arab World



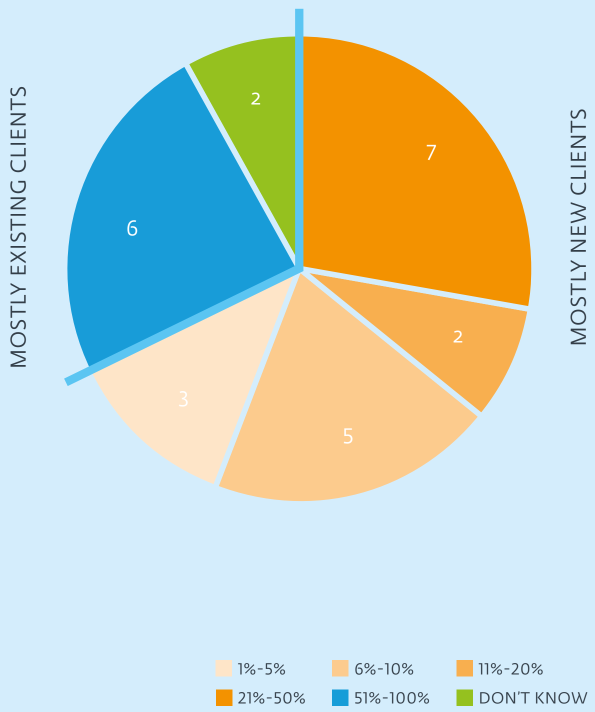
[15] IFC aggregated date on the outreach of the microfinance sector in the Arab World.

Job Creation: Promoting access to finance, particularly for VSEs, has become a priority for many governments in the Arab World. Despite noticeable economic progress in some countries, the region continues to suffer from high unemployment, poverty, and illiteracy, particularly in rural areas. Observers widely agree that financing VSEs and supporting entrepreneurship can create jobs for little cost and spur empowerment and economic development, given their potential to generate employment at a lower capital cost. It is also believed that the development of such enterprises can play a critical role in social inclusion and reduce political unrest.

Client Retention: Serving the VSE segment enables MFIs to support micro clients along their growth trajectory. This allows MFIs to support job creation and retain their best and most loyal clients -- those who have shown potential to grow and may have already outgrown the typical smaller loans.

But according to the survey, the majority of responding MFIs in the MENA region that offer VSE loans do not offer them to existing micro- clients, but rather to entirely new clients. As shown in figure 5, less than a quarter (24 percent) of responding MFIs believe that existing clients make up more than half of their VSE portfolio. This is an interesting result given that "following growing micro clients" was identified by respondents as one of the main reasons MFIs target VSEs. This suggests there are different types of expansion models- MFIs may upscale organically – by graduating their clients – or proactively, as outlined in Box 1.

Figure 5: Percentage of VSEs that began as micro clients

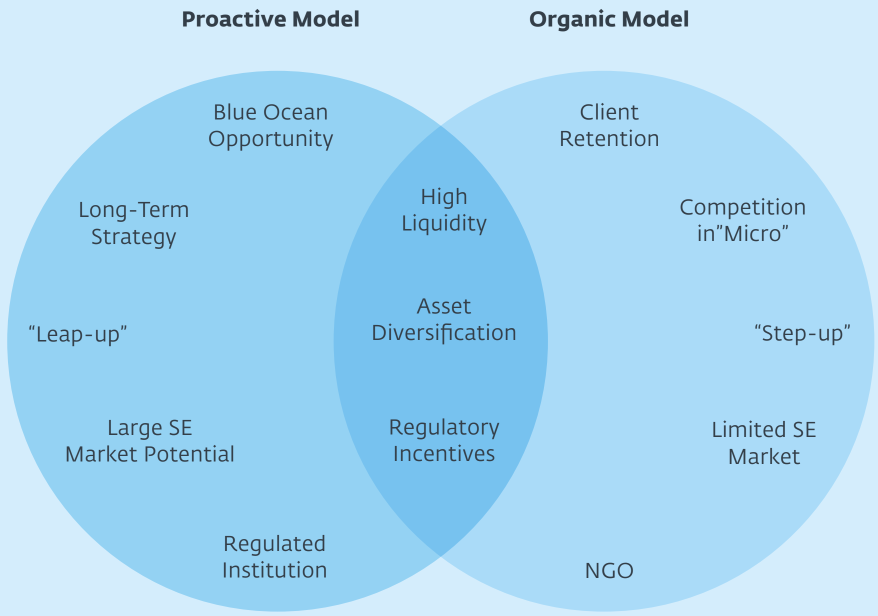


Box 1: Serving VSEs: Proactive vs. Organic Models

MFIs generally follow two types of business models when moving into the VSE segment. The first is the Proactive Model, which borrows from the know-how and processes typical in banks, including those that have downscaled to VSEs. It is more complex and in many ways more deliberate in that it requires important structural decisions and adaptations from the start.

The alternative model is the Organic Model, which is relatively self-explanatory. This shift is often a reaction to a trend observed as an MFI's microenterprise portfolio begins to grow, as larger clients require larger loans and even resort to other financial service providers if MFIs are unable to meet their needs. Both models are common today, and we also see hybrids that borrow practices from both to help balance the trade-offs between efficiency and depth. See Figure 6.

Figure 6: Drivers of Proactive and Organic Models for MFIs



Source: "Experiences of Microfinance Institutions Serving Very Small to Small Enterprises in Latin America", IFC

Microfinance Version 2.0 – The Emergence of Digital Financial Services: As previously mentioned, VSEs offer MFIs an opportunity to diversify their product offering. This will become even more crucial as technological improvements continue to change the way clients interact with financial institutions. The widespread use of mobile and digital technologies has helped develop platforms that enable clients to conduct basic transactions (save, earn interest, and access small amounts of credit) instantly via their mobile phones. This has led to technology companies and mobile network operators (MNOs) increasingly playing the role traditionally played by MFIs in some parts of the world. For example, mobile phone providers can now screen their clients, identify those with a decent phone-payment history, and disburse loans to a mobile wallet on this basis[16]. If loans are repaid on time, higher loan amounts can be offered. If loans are not repaid on time, the client's phone services can be limited. Given that this can all be done through automated processes, such a model can have minimal operational costs for the credit providers, allowing the lender to significantly undercut traditional MFIs while maintaining higher profit margins. Box 2 presents examples in which digital financial solutions have been developed to play the traditional role of MFIs. As this model becomes more widespread, MFIs that want to survive will need to expand their product offerings and move beyond cycled loans – or lending Model 1.0 – by adding value to their client propositions. Providing more financing to VSEs, based on business needs and repayment capacity, is one way to do so – particularly when assessing the repayment capacity of an informal business without reliable financial statements requires skilled loan officers and is thus nearly impossible to automate.

[16] Repayment would typically be $10 per week for 11 weeks. Given the high APR (83%) and the automated disbursement process (no loan officers), the operational cost is minimal and the profit margin is very high, allowing the mobile company to absorb some defaults. If the client pays back on time, then s/he is offered a bigger loan.

Box 2: How Digital Models Can Disrupt Conventional Microfinance

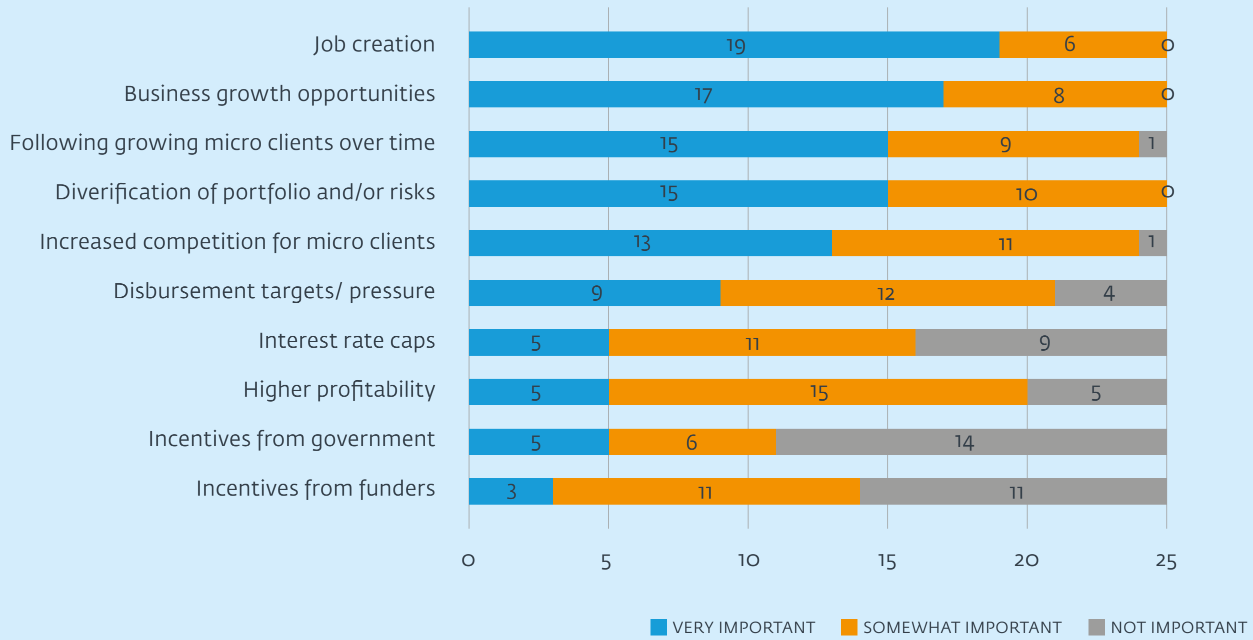
The Case of M-Shwari: M-Shwari is a combined savings and loan product launched in Kenya in November 2012. It is a collaboration between the Commercial Bank of Africa (CBA) and mobile network operator Safaricom, through its mobile money service, M-PESA. The M-Shwari account is issued by CBA but must be linked to an M-PESA mobile money account provided by Safaricom. The only way for a client to withdraw or deposit money is via the M-PESA wallet.

The Case of Cash Credit: Cash Credit is a non-banking financial institution founded in 2011 in Bulgaria that partners with mobile network operators to offer micro financial services to mobile subscribers. The company uses an innovative, proprietary credit scoring approach to offer consumers rapid credit decisions with convenient service and billing through partner operators. Cash Credit offers loans from BCN 200- 2000 (approximately $110-1,100) for 1-18 months. Approval is given within six minutes, disbursement is immediate and repayment is available through five different channels.

Source: www.deltapartnersgroup.com

So what are the main reasons MFIs in the Arab World serve VSEs? The results of the survey show that many MFIs who have begun serving this segment have done so for some of the reasons mentioned above. When asked, as clear in figure 7, MFIs stated that the most important reason for serving this segment was job creation (19 MFIs, or 76 percent of the sample), followed by business growth opportunities (17 MFIs, 68 percent) and following micro clients over time (15 MFIs, 60 percent).

Figure 7: Reasons for Serving VSEs

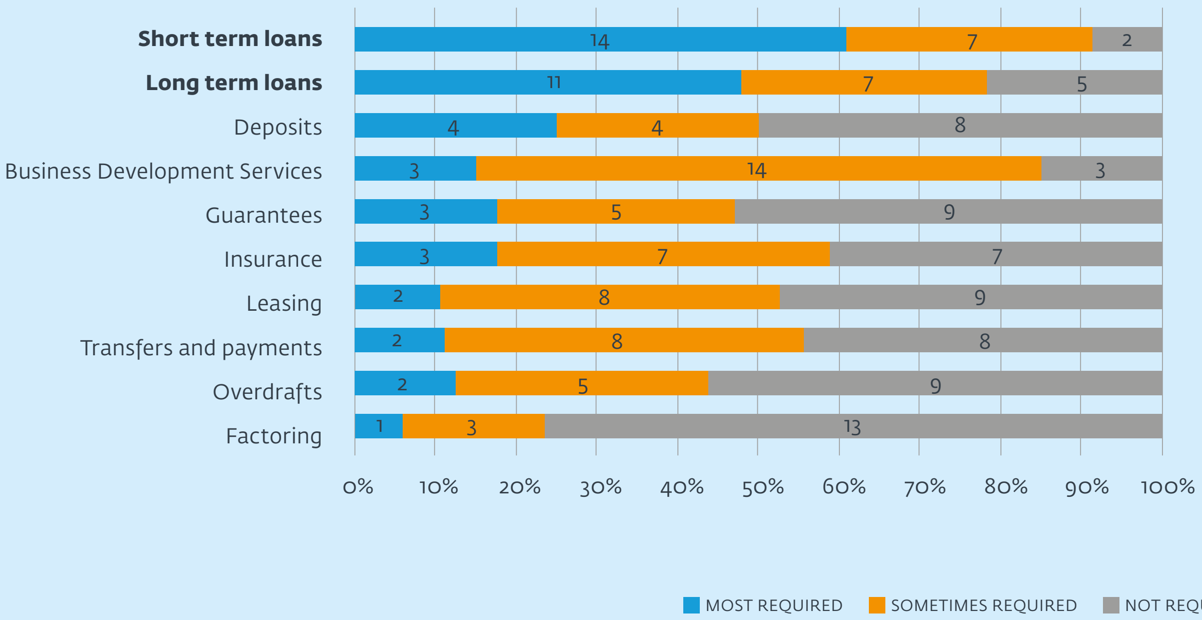


4. What do VSEs need?

When asked in the survey what services are most needed by VSEs, Figure 8 shows that MFIs have pointed to short-term and long-term loans with little emphasis on other products or services. Of course, given the regulatory framework that has historically limited the legal structure of most of the responding MFIs to credit-only institutions, micro and VSE loans are typically the only products these MFIs are able to offer.

Interestingly, the majority of MFIs believe that their offerings already meet the needs of their clients, contradicting the literature, which says VSE clients need an array of financial services such as savings, transfers, and overdrafts. IFC's study of Latin American MFIs upscaling to serve VSEs found that in many cases VSEs, even more so than micro-enterprises, have financial needs that go beyond typical credit products. These include savings and current accounts, transfer and payment services, guarantees/letters of credit, business development services, leasing, insurance, overdrafts, and more[17]. For MFIs hoping to serve this segment in the longer term, the identification, understanding, and design of these products is essential. Furthermore, MFIs need to develop long-term strategies to meet these needs. If the regulations do not allow MFIs to offer certain financial products internally, then MFIs should consider setting up partnerships with other banks or financial service providers such as insurance companies. This is crucial, as taking a broader, longer-term approach to VSEs/SEs can increase the profitability of a relationship with a VSE, as it begins to incorporate not only the VSE loans, but a broader relationship with the enterprise, its owners, family members, and employees.

Figure 8: Services that are mostly required by VSEs



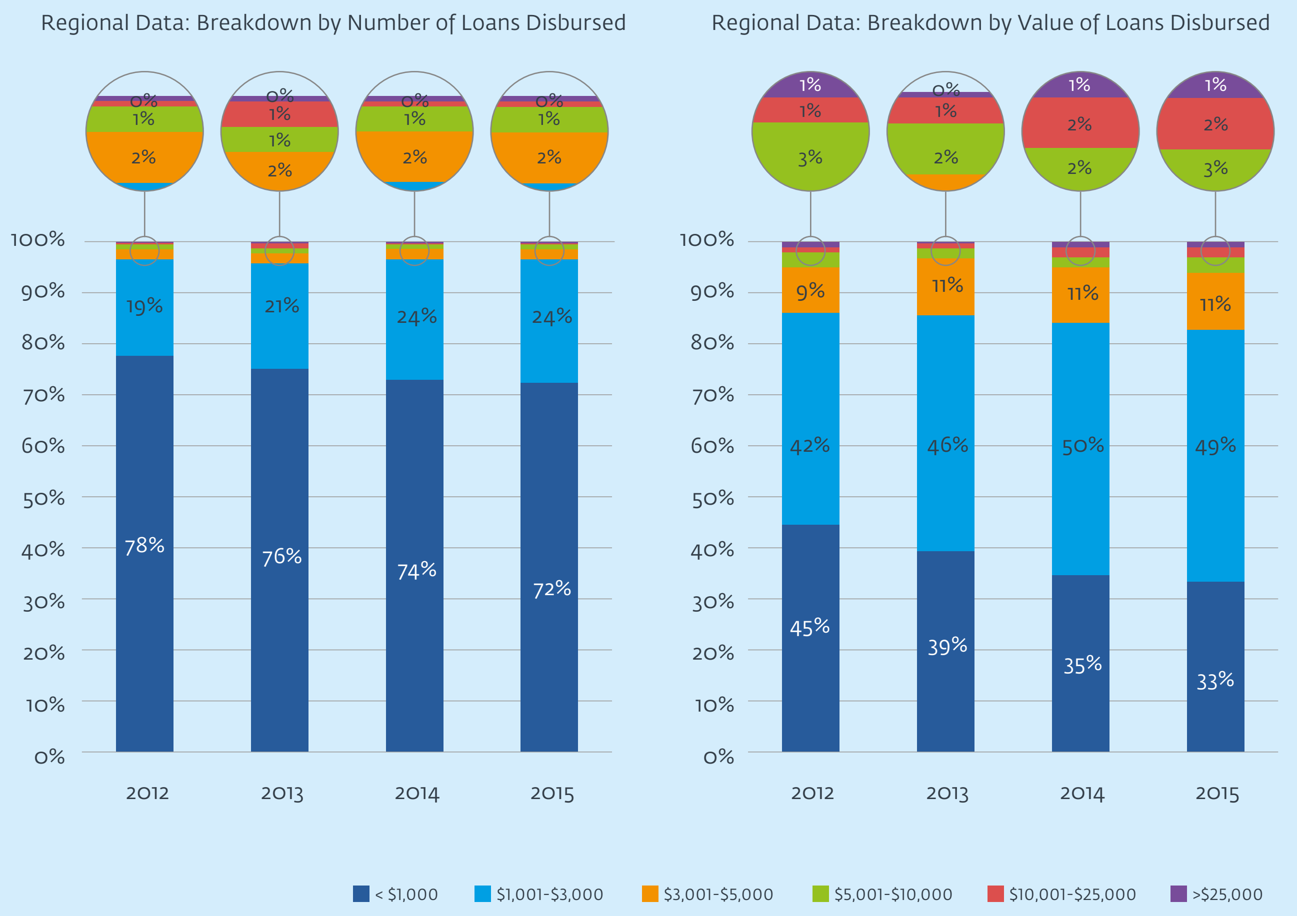
[17] In fact, research has shown that not only do very small enterprises need an array of products and services besides credit, financial institutions that effectively target these segments typically start with payments and savings products as the transaction decision point is simple and low risk. Furthermore, these products and services provide a higher financial return for the financial service provider when compared to credit products.

5. How well are MFIs targeting the VSE Segment in the Arab World?

Very Humble Results to Date: Despite the fact that the majority of the responding MFIs (78 percent) said that they do serve VSEs, when we examine their portfolio data, we see a different picture.

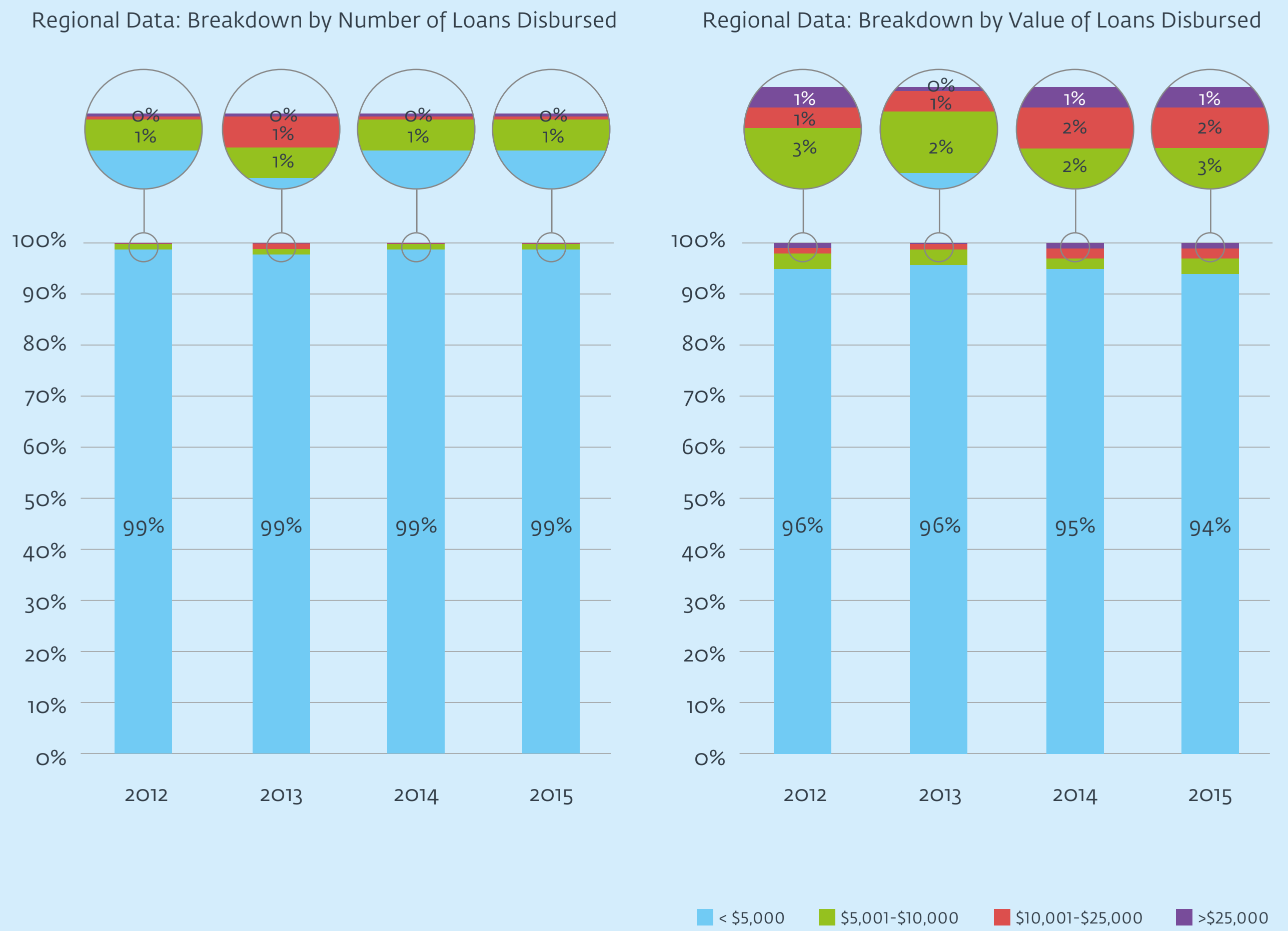
Looking at the data of all 25 MFIs that reported serving VSE/SEs combined in the last three and a half years, as shown in figure 9, we find that about three of every four loans are for less than $1,000. Meanwhile, about a quarter of loans disbursed fall between $1,001 and $3,000 and very few (3-4 percent) are worth more. When we look at the value of loans disbursed, we find a slightly different picture because larger loans typically account for a higher percentage of MFI portfolios. Approximately 35 percent of the total value of loans disbursed by responding MFIs are for less than $1,000, half are between $1,001 and $3,000 and about 10 percent are greater than $3,000.

Figure 9: Regional Data on Number and Value of Loans Disbursed



Based on the assumption that the definition of a VSE loan is a loan that is roughly greater than $5,000, the respondent data shows that only about one percent of loans disbursed and five percent of value of loans disbursed can actually be considered VSE loans. This is clarified in Figure 10 below. These findings suggest that perhaps there is a weak understanding of this market segment in the sector given the initial survey finding that 78 percent of MFIs say they serve VSEs. This is because while many MFIs provide larger loans to serve this segment, the number that can indeed be classified as VSE loans as per the suggested definition represents only a small percentage of the overall disbursement.

Figure 10: Regional Data Based on Proposed Definition



There are Some Exceptions: While this is the overall regional picture, some countries in the region are actually further ahead than others when it comes to VSE lending, such as Palestine and - to a lesser degree - Jordan. Figures 11 and 12 show that in these countries, average loan size has increased gradually over the past three and a half years. Today, some MFIs in these countries are disbursing loans worth more than $25,000. In the case of Palestine, in 2015, 14 percent of the loans disbursed and 45 percent of portfolio value were from loans above $5,000. This is not surprising as Palestine has the highest average loan balance/ GNI per capita (54 percent), suggesting that in Palestine, MFIs have begun moving past the bottom of the pyramid to target larger enterprises. In Jordan, although in terms of number, only one percent of the loans disbursed were worth more than $5,000, they represent 15 percent in terms of value of loans disbursed.

Figure 11: VSEs Lending Breakdown in Palestine

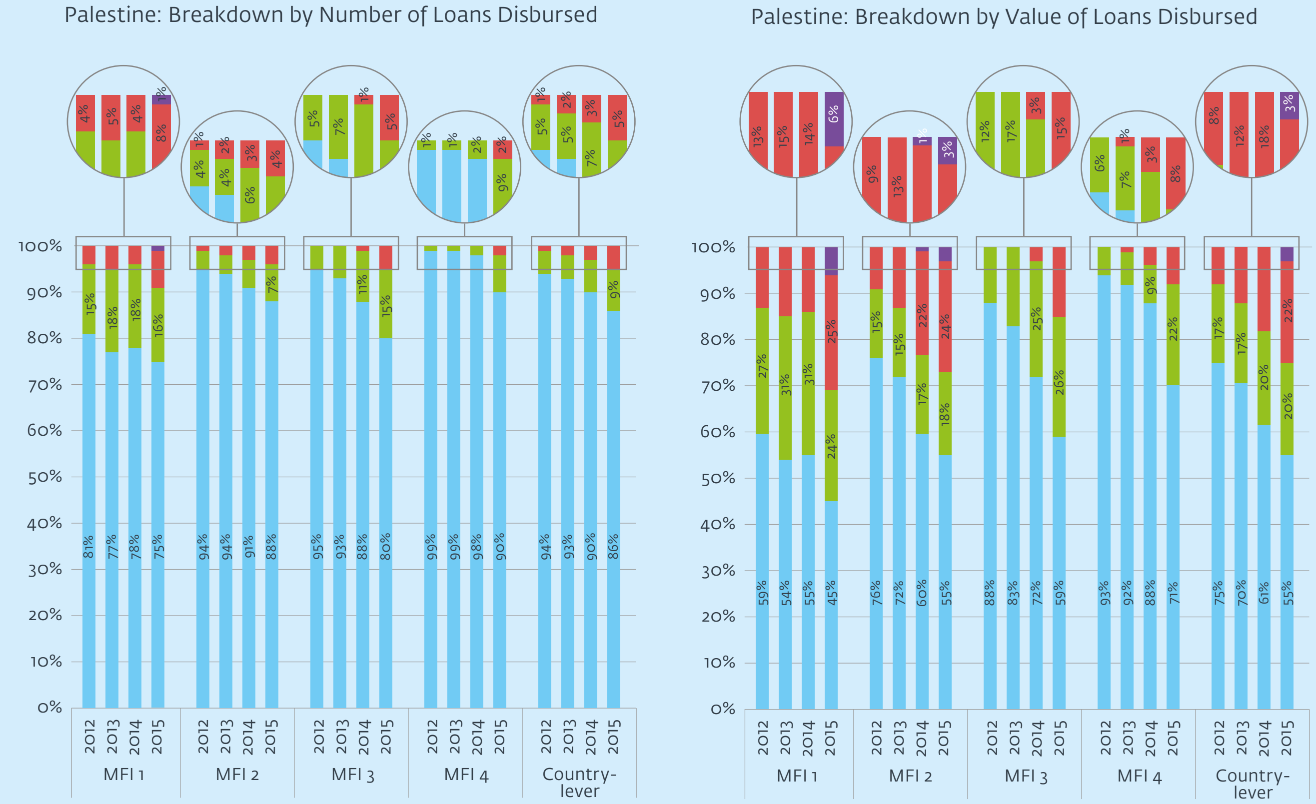
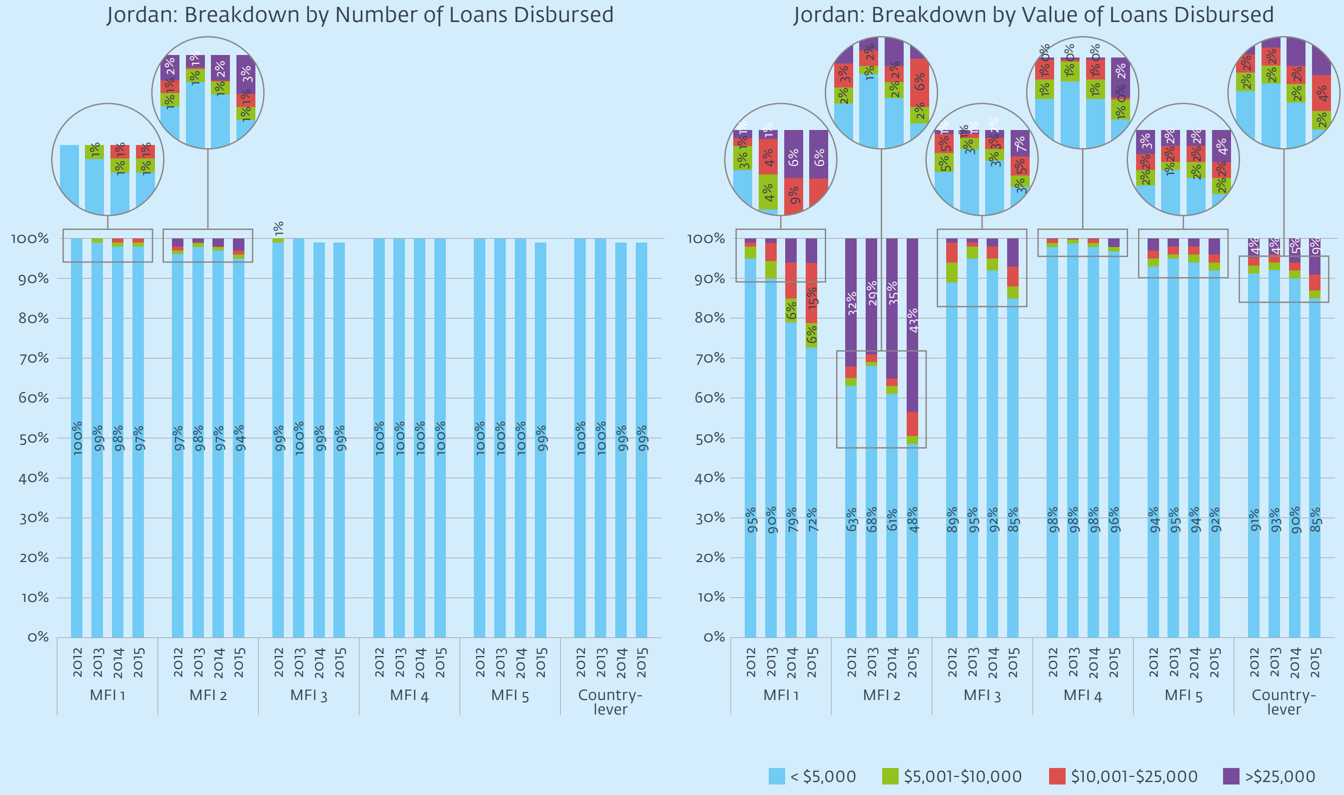


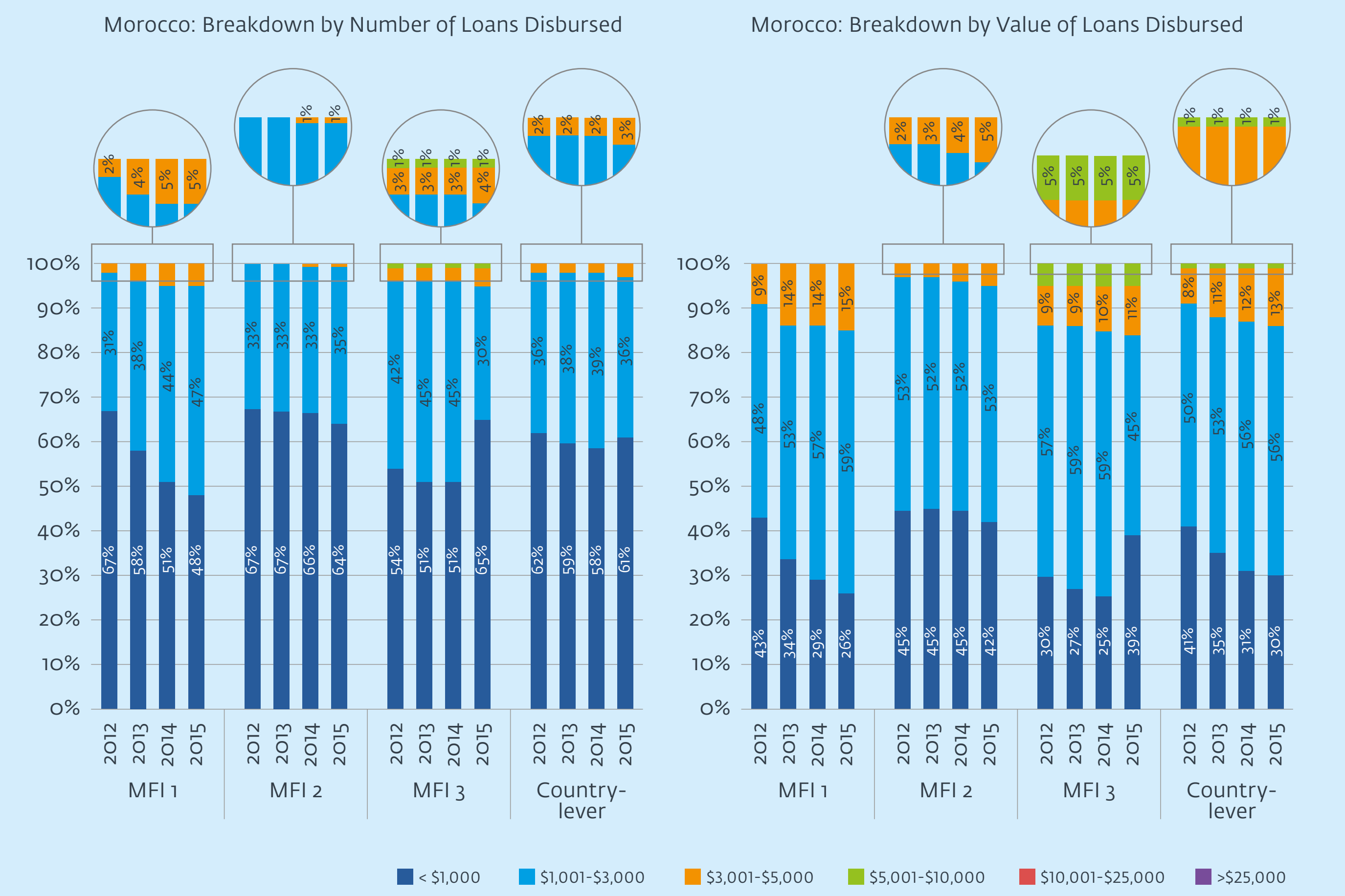
Figure 12: VSEs Lending Breakdown in Jordan



Caps on Loan Size are not the Only Reason: Of course it is important to recognize that in the countries where the local regulations enforce a cap on loan size, MFIs are simply unable to disburse larger VSE loans. One example is Morocco, where the cap is approximately $6,000[18]. Looking back at the breakdown of the loans disbursed in Morocco, Figure 13 reveals that most loans are for less than $1,000 and the next largest bracket is $1,001-$3,000. In terms of value of loans disbursed, the same two brackets are the most common.

This suggests that the ceiling is not necessarily the only reason MFIs in Morocco are not disbursing larger loans, as very few disbursed loans are even close to the ceiling ($3,000-$6,000). This is likely due to self-restraint by MFIs related to issues of capacity and/or the perceptions identified in the survey and discussed further in the next section. Until regulations evolve, MFIs in Morocco should at least be able to disburse larger loans to qualifying clients within the current ceiling.

Figure 13: VSEs Lending Breakdown in Morocco

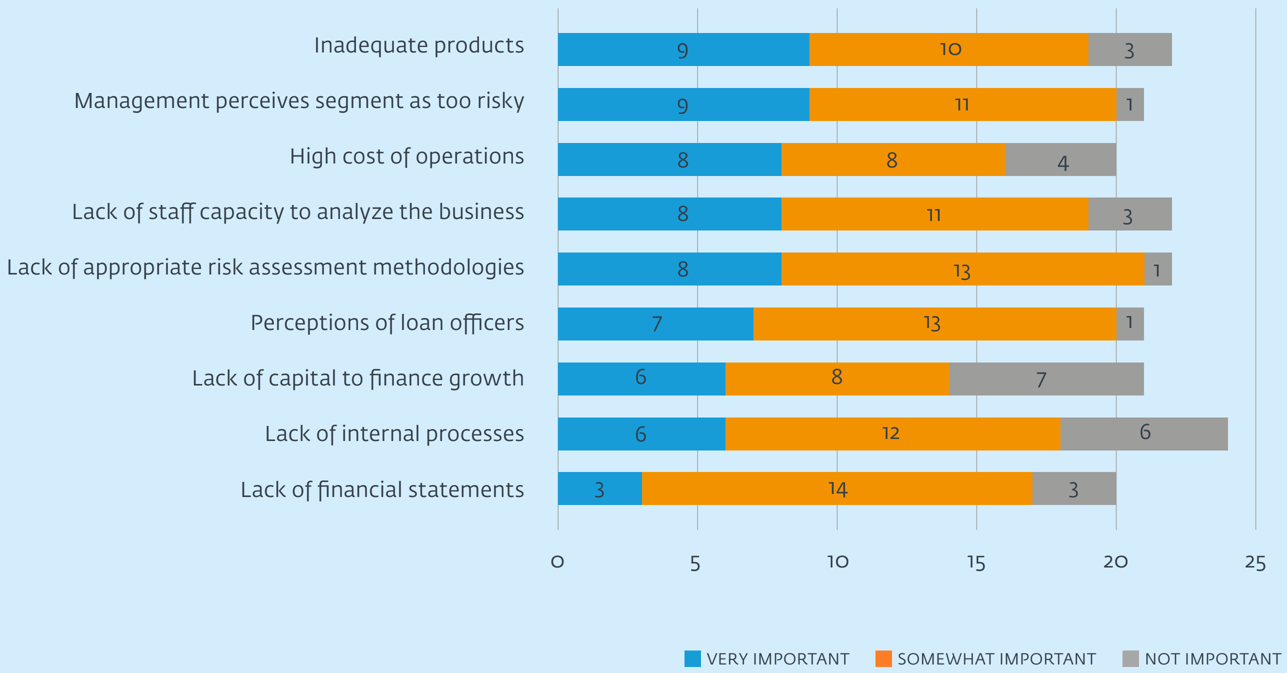


MFIs Recognize that Serving VSEs Comes with Challenges: As shown in Figure 14, MFIs that have started to venture into the VSE space have indeed recognized that targeting this segment comes with its challenges. When asked about the most critical internal challenges they face, the most pressing issue listed was an inability to develop adequate VSE products. This is likely linked to the absence of thorough product development processes within MFIs; the common practice tends to focus on modifying existing products rather than undertaking a full product development process that includes designing, piloting, evaluating and modifying a new product prior to rolling it out. Lack of staff capacity to analyze and process VSE loans also emerged as a key challenge and this in

[18] Morocco is used here as an example as it has one of the lowest caps on loan size. Similar patterns are indeed observed in other countries across the region.

particular has proven to be an issue in the region given that most MFIs' staff have grown up with the group lending methodology and often lack the skill set needed for sufficient analysis of larger loans. However, many MFIs find it difficult to recruit externally for this line of business and prefer to use the introduction of such products as a means to promote their current staff despite limited capacity. This of course increases the risks associated with lending to this segment, and perhaps these MFIs are indeed doing the right thing by not rushing into the VSE segment given that they often do not have adequate capacity. But shying away from the VSE segment for these reasons is a lost opportunity, as discussed in section 3, particularly now that the sector has accumulated the necessary experience to serve this segment and MFIs in the Arab World can safely profit from this experience[19].

Figure 14: Internal Challenges Facing MFIs

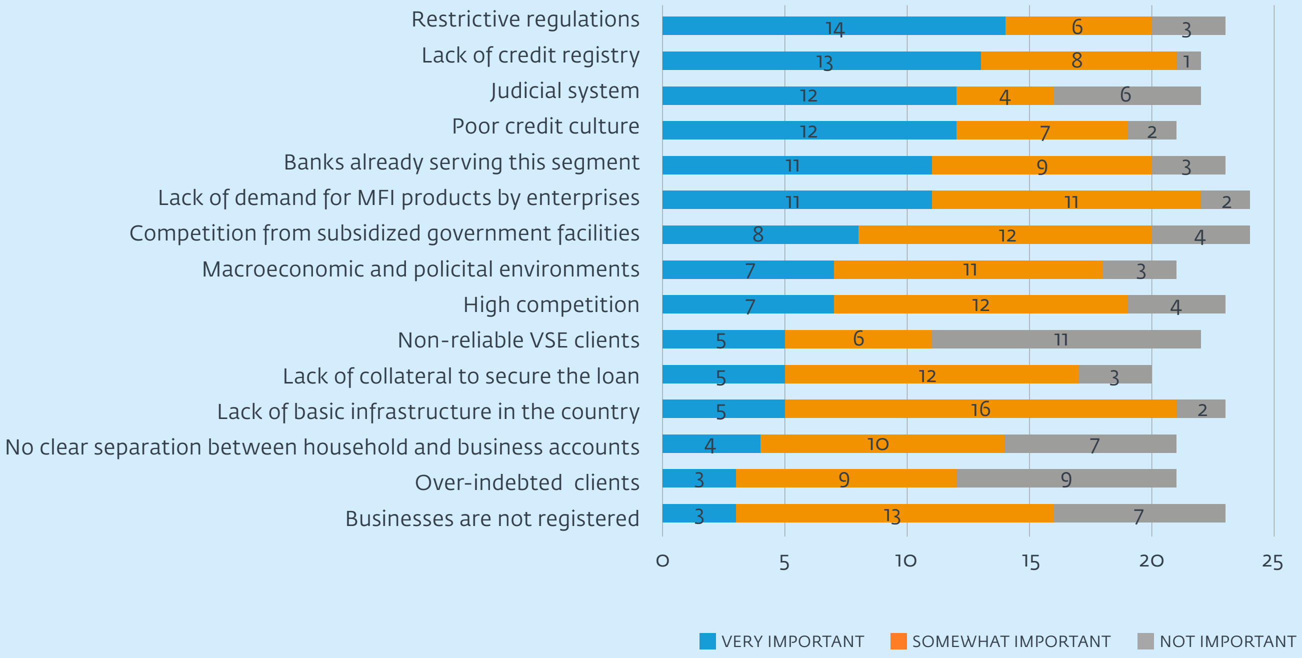


In terms of the external challenges MFIs face when lending to VSEs, it appears that the most critical are related to the enabling environment. As shown in Figure 15, at the top of the list are restrictive regulations, the lack of credit bureaus and movable assets registries, and a judicial system that does not ensure MFIs will get repaid should their clients become delinquent. These are serious concerns, but they can be addressed by central banks and relevant regulatory bodies, with the support of international donors. Interestingly enough, there appears to be little concern regarding the clients themselves. Despite the perception that serving the VSE segment is risky given the larger loan size, non-reliable VSE clients ranked quite low on the list of external challenges and over-indebted clients ranked even lower[20]. Perhaps this is a result of the fact that MFIs have not necessarily been targeting VSEs, as has been argued in the previous section, but rather serving their clients who have outgrown their previously available product range.

[19] Based on its global experience, IFC has developed solutions that address these issues and is working with some first-tier MFIs in the MENA region to implement them.

[20] Some hold the view that serving the VSE segment is less risky than serving informal, and in many cases, more vulnerable micro clients, as VSEs do have some documentation and some collateral to provide.

Figure 15: External Challenges Facing MFIs



Box 3: Credit Bureaus and Moveable Asset Registries

Credit bureaus play an important role in helping small and very small businesses access financing. Reliable credit information on individuals and small businesses helps lenders reduce the uncertainty typically associated with lending, as reliable credit information allows financial institutions to reduce risks, loan processing times, costs, and most importantly default rates. In addition, detailed credit information also benefits small businesses as it often leads to lower interest rates, making loans more available and more affordable. Credit bureaus also support responsible lending practices and help borrowers avoid over-indebtedness.

Collateral provides the basis for free-flowing credit markets, reducing the potential losses lenders face from non-payment. While land and buildings are widely accepted as collateral for loans, the use of movable collateral is also important as it allows businesses to leverage their assets into capital for investment and growth, making it easier for smaller businesses to access finance.

While these mechanisms are important for MFIs seeking to serve the VSE segment, their presence depends on having effective regulations in place to support them. Unfortunately, in the MENA region, many countries still do not have such regulations in place. But in the absence of such mechanisms, some national microfinance networks have been working to establish information exchange platforms for their members. Although this may not be an ideal solution, it is a positive step in offsetting the obstacles posed by the lack of credit bureaus.

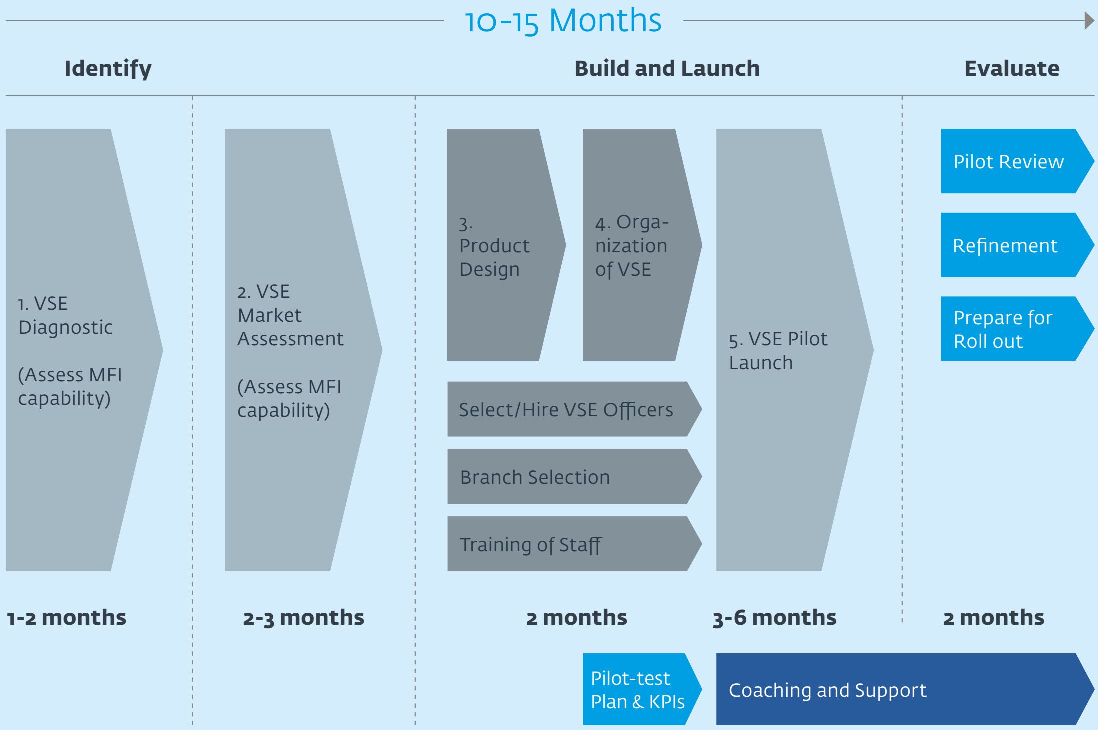
Various IFC Sources

MFIs Need Support to Scale-Up VSE Lending: To be able to scale up their VSE portfolios more successfully, MFIs in the Arab World have, in the survey, pointed to the need for various forms of external support. In terms of external financing, as shown in Figure 16, most responding MFIs are interested in long-term senior debt (76percent). Indeed, as MFIs begin providing larger loans to clients, their own institutional funding profile (liabilities) needs to evolve to match their portfolio (assets). Equity (where possible) and partial credit guarantees (to mitigate the risk) will also be needed. In terms of technical assistance, the majority of respondents (64percent) expressed an interest in advisory services (see Box 4) and exposure visits to MFIs who have successfully upscaled (52percent). MFIs who have not yet ventured into the VSE space but have expressed interest in doing so in the next 3-5 years require similar forms of external support (Annex 4 presents more details on the MFIs that are not yet serving VSEs/SEs).

Figure 16: Support Needed to Boost VSE Portfolio

Box 4: IFC's Proposed VSE Product Development Life Cycle

This box presents a typical VSE product development life cycle[21]. This process is general and in practice is often tailored to the needs of the client and its level of maturity.



6. Some Lessons Learnt from MFIs' Experiences with the VSE Segment

The following section presents a brief review of the lessons drawn from the experiences of MFIs serving VSEs in other regions and the very early experiences of the few MFIs in the MENA region that have begun to serve this segment.

This information should be taken into consideration by any MFI seeking to target this segment. It is important to remember though that the approach an MFI takes to serve VSEs largely depends on the market and regulatory context as well as the given institution's strategy and goals (IFC, 2014). Therefore, this section is not prescriptive but simply outlines the array of issues that MFIs should consider when upscaling to serve VSEs.

1) In order for MFIs in the region to scale up their VSE lending operations, it is important that first and foremost, they recognize that VSE lending is different from micro-lending and that a VSE loan is not just a bigger loan that can be processed in the same way as a micro loan and by the same staff without significant additional training. As discussed earlier, micro loans are often cycle-based loans in which the MFI begins by lending a very

[21] IFC's experience in the MENA region has shown the VSE product development life cycle may take more than 15 months.

small amount to the borrower, and upon timely repayment, the borrower becomes eligible for a larger loan (thus, the cycle). Furthermore, micro enterprises are typically one of several income sources for the household and not necessarily even the prime household income source. Thus if the business deteriorates, the client can usually repay from other household income sources (perhaps over a longer period of time). Hence, micro lending can be client-character focused. In the case of VSEs, however, the VSE business is typically already the prime and dominant household income source and the main focus of the household. If the business deteriorates, the loan is unlikely to be repaid from other income sources. Thus, while the client's character is still vital, analysis of the actual business and repayment capacity becomes even more crucial in VSE lending.

2) There is no hard rule when it comes to **organizing VSE lending** within an MFI. MFIs may choose to have a separate VSE unit or have their VSE lending integrated into their existing credit department as a separate product. This is largely dependent on the structure of the MFI's current business and the extent and concentration of the market opportunity. While a separate VSE unit with separate targets may increase the number and volume of VSE loans, it may also discourage 'graduation' of micro clients as micro loan officers may be reluctant to give up their best clients. Either way, whether VSE lending is organized within a separate unit or as part of the existing credit department, VSE loans should only be processed by appropriately skilled and trained staff. For risk management purposes, it is also important that MFIs are able to report separately about the VSE business at all the levels of the institution, regardless of whether it is set up as an independent unit or integrated within the existing credit department. In the Arab World today, among the MFIs that have started to serve VSEs, some 72 percent have a dedicated VSE unit or department, 80 percent have dedicated VSE staff and 88 percent have training programs specifically designed for VSE loan officers[22].

3) Understanding that VSEs have minimal records, it is crucial that loan officers conduct a **thorough financial analysis** by developing financial statements from whatever information is available (account records, bank statements, invoices, etc.). While these records and statements do not need to be extremely accurate, they should be accurate enough to assist MFIs in answering three core questions:

   a. Is the owner risking their own equity in the business? This can be answered through a simple balance sheet that shows how much capital the owner has invested in the VSE. In other words, how much will he/she lose if this business fails?[23]
   b. Is the business profitable? This can be answered though a simple income statement.
   c. Is the business generating sufficient cash to cover repayment? And are there certain revenue cycles or seasonality to consider? This can be answered through a simple cash flow statement that shows an MFI the capacity of the VSE to pay loan repayment amounts on schedule.

   So even though VSE loans can be seen as simply larger loans, they should not be processed in the same manner as micro-loans, given that a sound financial analysis is required to ensure that they will be repaid.

4) While conducting a thorough financial analysis on VSE clients is crucial, VSE loan officers should also conduct a **character and risk analysis** on the business as well as its owner. This may vary from one context to another but could include visiting the VSE's suppliers, understanding the history of the business and the management experience, assessing its market potential and understanding the competitive environment in which the business operates. Taking all of these factors into account will allow for a more informed loan decision given the better understanding of the business at hand and the risks associated with it.

5) Even though micro- loans are designed to support a micro-business, in practice, little emphasis is placed on whether the client uses her/his loan in the business or not, as long as s/he has a business.[24] Lending to a VSE does not only require having a business, but before a VSE loan is approved, it is crucial to ensure that the **VSE loan will contribute to the growth of the business activity and income. If this is not done, risk increases considerably**[25]. Ensuring this requires

[22] While it is not essential for VSE loan officers to focus exclusively on VSE loans, it is essential that they be appropriately trained to undertake VSE lending.

[23] This is usually not the case with a micro business where the borrower has very little capital. Whatever capital is available is typically working capital.

[24] Indeed, many institutions no longer insist on clients having a business as a condition for a loan and in some MFIs/Markets, it is estimated that more than 50% of the microloans disbursed are used for consumption purposes.

[25] Theoretically, this should be the case in a micro-loan, but in reality, a good percentage of those loans do not rely on the capacity of the business to generate enough profit and cash to pay back the loan. This is because most households have multiple income sources and are capable of repaying the loan even if their micro business is weak. This is why in most of the cases we find that the amount of the micro- loan exceeds the amount of the assets of the micro- business and while officially the loan is taken for the business, in many cases, some or part of the loan is used for consumption.

that the loan officer checks the VSE's business outlook. The loan may even be incorporated into a forward-looking cash flow projection, as mentioned above. Post-disbursal visits to the enterprise to ensure the money has been used for the intended purpose are crucial. Moreover, frequent visits to clients, including those who are paying on time[26], not only serve to build strong relationships and allow for cross-sales of products and services but are also useful as an early warning system in case a given VSE is facing financial difficulties. Frequent visits also allow for the provision of timely advice to help the client resolve these difficulties and avoid becoming delinquent.

6) In VSE lending, with larger exposures, MFIs typically want to have firmer **collateral**[27] than the group guarantee, the client's credit history, and other forms of collateral typically required for micro- loans. MFIs developing such a product need to identify alternative sources of repayment if the client's business does not generate the anticipated income. These sources could include sale of assets, household goods, and guarantors, among other things. The challenge an MFI is likely to face is coming up with a list of possible pieces of collateral that guarantee the repayment of the loan, fit under the client protection principles, and are permitted by local regulations, yet can be made available by the VSE owners.

If an MFI complicates its collateral requirements so much that they are similar to those of banks, many VSE owners will not be able to provide them. It is important to bear in mind that the existence of collateral does not necessarily reduce the probability of default; it may only reduce the losses resulting from such default[28]. An MFI may gain a competitive advantage and speed up its processes if it establishes robust and transparent collateral registration procedures and offers them as a service to clients. In general, collateral should be kept in a place that is safe and accessible for evaluation.

Box 5: Collateral

Collateral is something pledged as security for repayment of a loan, to be forfeited in the event of a default Collateral is more important in VSE lending than in micro lending because:

- Higher repayment amounts are more difficult to collect from VSEs than in micro lending, even if the client is willing to pay
- Business may not be able to rebound quickly when they are in distress
- Given that in micro lending individual loans are smaller and interest margins tend to be higher, it is possible to write-off a larger number of micro loans and remain profitable. In the case of VSE lending, where not only are loans larger, but margins are typically smaller, writing off individual loans will have a greater impact on profitability.

When analyzing collateral, the following points need to be taken into account:

- Collateral coverage: This covers the capital, interests and recovery costs (120-150 percent of the loan). If a large proportion of this is not easily liquidated, it is better to have lower coverage with higher liquidation value. Trusted repeat customers can get lower coverage requirements.
- Choice of collateral: which depends on i) what is permitted as collateral under the local legislation and ii) ▶

[26] In micro- loans, MFIs tend to focus follow up on delinquent loans only.

[27] Based on the results of the survey, MFIs are requiring additional and firmer forms of collateral from their VSE clients. These include physical assets, letters of guarantee, real estate guarantees, and deposits/cash.

[28] This means that risk and financial analysis are even more important for VSE/SEs than in microfinance.

- the probability that the collateral can be sold when needed. The choice of collateral of VSE clients is wider than that of micro- enterprises, but not always abundant. In VSE lending, we usually find the following categories: business assets; vehicles; guarantors; mortgages; deposits; household assets (excluding vehicles); bonds and post-dated cheques. Given the advantages and disadvantages of the different collaterals, it is good to **envision a mix**, where it is possible. It is also possible to collateralize goods that are part of the investment purpose of the loan, if appropriate control and monitoring mechanisms are in place.
- Collateral evaluation: Though it is possible to use external evaluators (very costly for the customers) to conduct a collateral evaluation, for most VSEs, the collateral amounts are too small to make external evaluators worthwhile. At the same time, loan officers are biased and may also over-value collateral, and in many cases they may not have the expertise to assess the right value. While this bias and lack of expertise may do only marginal damage in microfinance, in VSE finance, the damage can be major due to the amounts at stake and the reputation of the MFI.

Some ways to overcome the dilemma are:

- Have some internal personnel trained to do the evaluation
- Have the loan officer's evaluation validated by an independent internal evaluator, although this can be challenging in a large branch network
- Train the loan officers and supervisors and conduct peer evaluations with respective portfolio responsibility
- Have reference list for ranges of collateral value for common collaterals

Before considering an item as collateral that the institution is not familiar with, it is important to know:

- The legislation and the procedural requirements
  - There are different formalization and registration procedures for different types of collateral. These include how and where the collateral is to be registered, how much time is needed for registration, how much registration costs and who pays the registration fee.
  - There will also be specific requirements for specific types of collateral. For example, does the person signing a mortgage contract need a power of attorney from the Board of Directors
- The evaluation process requirements
  - An internal evaluation process is required that conforms to local standards and legislation
- Staff are appropriately trained and have current information
  - Staff need to know how to analyze collateral and any changes in legislation that may affect this
  - Staff need to keep customers informed so as to avoid surprises, particularly in terms of cost or timing
- Respect all legal requirements
  - Whilst legal requirements exist in micro lending, but the power asymmetry in VSEs may lead towards VSE clients having more difficult attitudes regarding their obligation towards financial institutions
  - All MFIs are required to observe legal requirements. However, when lending to VSEs, reputational and legal risks become more significant

Source: IFC VSE Training Course developed by Elza Hermann

7) An MFI seeking to serve the VSE segment should ensure that its staff, particularly loan officers working on VSE loans, receive the necessary **training on financial analysis** using a mix of classroom and on the job/field training and guidance. In addition, loan officers should be trained to think critically when making a recommendation on a VSE loan. As most VSEs will have incomplete or informal financial records – and some will have none at all – loan officers need to be able to assess the outlook for the business, the intensity of the competition, whether a client is the owner of the business, and skilled enough to succeed, whether the client is inflating their assets, sales, or revenues, whether the business has any hidden debt. For MFI's operating 'Model 1.0" ('loan-cycle' based lending), this is typically the biggest challenge as it requires the transformation of loan officers from loan processers to loan analysts. MFIs seeking to serve VSEs need to identify those loans officers with analytical skills and provide them with the necessary training to become VSE loan officers. This can also become a means of promoting competent loan officers[29]. If MFIs fail to find the right profile for VSE officers among their existing staff, they should resort to external recruitment –which brings its own set of challenges (particularly if recruiting from banks, where there may not be a strong cultural fit with an MFI). In any case, it is important that MFIs exploring the VSE business dedicate full-time staff to work on this during the pilot phase. Later, these staff can become supervisors, trainers, and coaches for new loan officers assigned to VSE lending.

Box 6: Loan Approval Processes

For microloans, speed of service is key. As such, loan approval is generally decentralized. For very small micro loans, senior loan officers or credit committees comprised of several loan officers may even have approval authority. For larger micro loans, loan approval often requires branch manager signoff. However, for VSEs, full autonomy for loan approval should generally not rest at the branch level, despite potential reductions in the agility of loan disbursement. If they do not already exist, an MFI should establish different levels of loan approval based on loan size and segment served. It is best that for larger loans such as VSE/SE loans, loan decisions are made through the presentation of comprehensive loan files to credit committees that include senior management as well as branch staff, whose incentives are not linked to approval amounts. (IFC, 2014)

Source: "Experiences of Microfinance Institutions Serving Very Small to Small Enterprises in Latin America", IFC

8) It is crucial that during this process, MFIs strike the **right balance between head office involvement and branch manager involvement.** In some cases, when MFIs introduce a new VSE product, they tend to bypass branch managers in the VSE loan approval process, based on the assumptions that they do not have sufficient time or knowledge to process VSE loans. This approach typically creates internal conflicts and in some cases bottlenecks in the processing as head office management tend to be too busy to review every VSE loan, especially beyond the pilot phase. It is important that MFIs moving into the VSE segment invest in training their branch managers so that they can support VSE officers and have ownership of the VSE portfolio in their branches.

9) It is also crucial that MFIs seeking to serve VSEs have **strong controls and risk management structures** in place. By definition, VSE loans are larger loans and as such, they carry both higher default and fraud risk, be it by the client or MFI staff. Furthermore, many VSEs in the region today have minimal records and credit history, which makes it more difficult to assess the risks associated with their borrowing. Analysis of risk becomes dependent on verbally collected information and the loan officers' ability to

[29] This can also contribute to partially solving the issue of limited career paths for loans officers who have been with a given MFI for a while and who cannot become branch managers either because of their own capacity or because there is a limited number of branches.

critically evaluate this information. In practice, clients have an incentive to be optimistic about the prospects of their business in order to receive a loan and loan officers have an incentive to believe the client in order to disburse the loan. Sound controls thus become essential. An MFI seeking to serve VSEs should clearly define its risk appetite, including the client segment/profile to be served, risk thresholds, and product limits (exposure limits, maturity, and grace periods)[30]. The MFI should also make sure to conduct constant, random, and systematic checks prior to and after disbursal. These should be conducted by different levels within the organization including team leaders, branch managers, and business managers, who should visit both the clients' businesses and homes. In the head office, the risk department should develop risk management reports and engage in data mining to check on concentrations in certain business activities or pinpoint where portfolio quality is affected and advise on corrective actions. Finally, the MFI's internal audit team needs to systematically and critically test controls to ensure their effectiveness.

10) Related to data mining, MFIs moving into the VSE space can also **utilize credit scoring** to help them in the credit analysis decision. Credit scoring for MFIs entails mapping out existing client records in terms of contracts, product socio-economic context, business activities, lifestyle preference, credit history and reputation among other factors. Based on this information, MFIs may develop a statistical scoring model, which includes a combination of statistically validated variables and some expert judgement on the risk factors prevalent in the market. Credit scoring is best suited for institutions already familiar with the concept and that have rich databases from which to develop a statistical credit scoring model. Developing such a model requires specific expertise though, which many MFIs may not have on staff. In addition, the MFI needs to have a sophisticated MIS and a team able to track and analyze the efficacy of the model. An ill-designed model can quickly increase an MFI's credit risk exposure. Even a well-designed model needs to be fine-tuned on a regular basis to provide the MFI with useful outputs.

While VSE loans are larger loans that require a more prudent approach in general, portfolio quality combined with efficiency are still the keys to profitability in the segment and it is important that MFIs moving into this space strike **the right balance between prudence and efficiency.** VSE loans are still 'small' loans; despite requiring more analysis and documentation and consequently a longer processing time, it is equally important not to overly complicate the process. MFIs seeking to increase their efficiency can resort to various forms of technology to do so. Some examples include the aforementioned credit scoring systems, reviewing information from credit bureaus, providing tablets for loan officers so that data can be entered in the field, the use of mobile wallets for disbursements and repayments and automated client communication systems via SMS. Also, more advanced analytics in the form of MIS-generated reports can provide ample benefits to management to enable quick diagnoses and decisions.

11) Before MFIs begin serving VSEs, which represents both an important new business opportunity and also a differing risk profile than micro-, they should take the time needed to **undertake a qualitative market research.** Such an exercise can help MFIs not only to better understand the types of activities most common within the local VSE market, but also to identify distinct sub-segments operating within the VSE space (often considerably less uniform than micro-) which can often vary widely in their cash flow, and hence better determine their financial needs and risk characteristics. By segmenting the market effectively at the outset of the product design process, MFIs can begin to identify the most promising or risky target segments, and design their products and strategy accordingly.

12) Sound practice dictates that before launching a new product, particularly one with a methodology that differs significantly from typical micro-lending and has much greater exposures, MFIs should carefully **pilot-test it first in a few branches.** Typically, it makes sense that these are close to the headquarter (for oversight) and for MFIs to start slowly and gradually before scaling up (so that losses are minimized). Modest initial targets also allow loan officers the time to learn and absorb the new analysis method. Likewise, it is useful to involve as many relevant staff as is feasible in the training, preparation and pilot-test, including branch managers who will need to understand (and control) this product, other loan officers who may grow into or replace new VSE loan officers, and senior management who should have some exposure in order to fully grasp this new aspect of their business. Finally, before scaling up, it's important to review what has worked and not worked in the pilot, and have a very clear plan for scale up, carefully rolling out in new branches by leveraging experienced VSE loan officers who can play a significant role in training/coaching.

[30] These include: debt to equity ratio, repayment capacity ratios etc.

7. Concluding Remarks

Based on the results of the survey, it appears that MFIs in the Arab World are interested in upscaling to serve the very small enterprise segment. Several reasons have been cited for this interest, including job creation, supporting growing micro clients, and business growth opportunities for the MFIs. Despite the high level of interest, however, efforts to target VSEs have remained minimal in the Arab region.

This is mainly due to limited know-how as the most critical internal challenge that emerged from the survey was a lack of capacity to develop adequate products for VSEs. However, MFIs in the Arab World can benefit from the experiences of MFIs in other regions who have already upscaled to serve this segment and have accumulated enough experience in VSE lending. The most critical point to remember is that a VSE loan is not simply a larger loan. In lending to VSEs, analysis of the actual business in terms of financial analysis and risk analysis becomes even more critical than the client's character. For this reason, loan officers working in VSE lending should have the capacity to analyze, not simply process a loan and be trained to effectively do so. Given that VSE loans carry higher risk due to their larger size, it is also essential that before approving any loan, MFIs are certain that the VSE loan will indeed contribute to the growth of the business activity and income and that the loan is backed up by sufficient collateral. MFIs seeking to serve the VSE segment should have strong controls and risk management structures in place, and where possible should leverage technology to strike the right balance between prudence and efficiency. Finally, MFIs seeking to serve the VSE segment should carefully pilot test any products they have designed for VSEs before rolling them out to ensure that staff have the capacity and that there are strong policies, procedures, and controls in place before rolling them out.

Annex 1: Methodology and Respondents

SURVEY METHODOLOGY

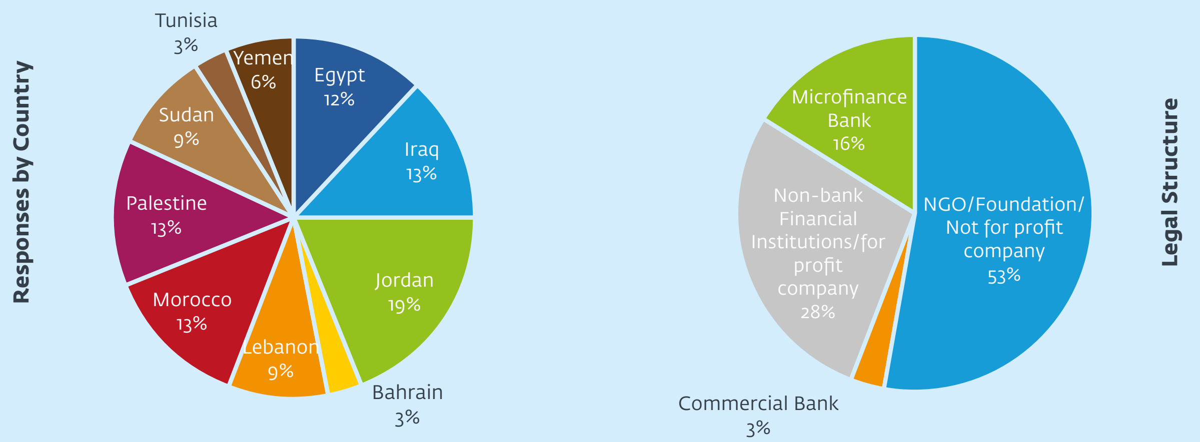
The findings of this report are based on a survey conducted in May and June of 2015 designed to better understand how MFIs in Arab countries have targeted the VSE/SE segments and what efforts have been made in this space thus far. The survey was sent to a select number of MFIs via email and was broken down into three main sections. The first section was designed to collect background information on the responding institutions. This included information on whether or not there exists a definition of VSE/SE in the countries in which they operate and whether or not they are serving the VSE/SE segment. The second section was designed only for the institutions who serve VSEs/SEs, with the objective of understanding MFIs' reasons for serving VSEs/SEs, the differences they perceive between the microfinance segment and the VSE/SE segment, the size of their VSE/SE portfolios, and the challenges and opportunities that they face. The final section was designed for the institutions not currently serving the VSE/SE segment to better understand their willingness to move into this space.

In addition to the survey, the authors have benefited from: multiple conversations with the leaders of many of the responding MFIs to better understand their involvement in the VSE/SE space; discussions during Sanabel's 11th conference and the workshop IFC conducted on the subject prior to the conference; IFC's study on the same subject, "Experiences of Microfinance Institutions Serving Very Small Enterprises in Latin America;" several VSE institutional assessments and/or product development support provided by IFC to five leading MFIs in the MENA region (in addition to IFC's work on the topic globally); and finally CGAP's focus note "Financing Small Enterprises: What Role for Microfinance Institutions", written by Glisovic and Martinez in 2012.

PROFILE OF RESPONDENTS

The survey was sent to a select group of MFIs, who are either the leading/largest MFIs in their countries and/or who are known to have begun exploring the VSE/SE segment. Responses were received from 32 different institutions operating in ten different Arab countries,[31] and are somewhat evenly distributed by country, with a slight preponderance in Jordan and a bit less response from Yemen, Tunisia, and Bahrain, where there are fewer MFIs operating in this space (breakdown shown below in Figure 17). In terms of the legal structure of the responding MFIs, just over half of them (53 percent) are NGOs while about 28 percent are non-bank financial institutions or for-profit companies. Meanwhile, 16 percent of the MFIs in the survey are microfinance banks (MFBs), but these are limited to certain countries where regulations allow for such a legal structure - namely Bahrain, Yemen, and Sudan. Of the 32 MFIs who completed the survey, 25 (78 percent) indicated that they do serve VSEs.

Figure 17: Breakdown of Survey Responses



[31] While this may not seem like a large number of responses, these 32 MFIs combined serve more than 75% of the region's active borrowers, so we can consider this sample to be representative.

Table 3: Responding MFIs

Country	Microfinance Institution
Egypt	Al Tadamun Microfinance Foundation
	Dakahlya Businessmen's Association
	ABA
	Commercial International Bank CIB
IRAQ	Al-Bashaer Microfinance Organization
	Al-Tadhamun Economic Development Center (TDMN)
	VITAS Iraq
	Relief International
Jordan	National Microfinance Bank (Watani)
	Tamweelcom
	VITAS Jordan
	FINCA Jordan
	Ahli MicroFinance Company
	Microfund For Women
Kingdom of Bahrain	Family Bank
Lebanon	Emkan Finance
	Al Majmoua
	VITAS S.A.L
Morocco	Attadamoune Micro Finance
	Al Amana Microfinance
	Attawfiq Micro-Finance
	ALBARAKA (EX. FONDEP)
Palestine	VITAS Palestine
	FATEN - Palestine for credit & development
	The Arab Centre for Agricultural Development (ACAD)
	ASALA for Credit and Development
Sudan*	PASED
	Ebdaa Bank for Microfinance-Sudan
	Family Bank-Sudan
Tunisia	Enda inter-arabe
Yemen*	Al-Amal Microfinance Bank
	Alkuraimi Islamic Microfinance Bank (KIMB)

Note: Sudan, Syria and Yemen are the only countries where regulations allow MFIs to collect deposits.

Annex 2: An Attempt to Define the VSE Segment

According to the Microfinance Information Exchange (MIX), microfinance loans are loans whose average outstanding balance does not exceed 250 percent of the average income per person (GNI/capita). As the average loan size is approximately equal to 1.67 times the average loan balance[32], one can calculate the ceiling on microfinance loans based on this definition, as shown in table 4 below. Comparing this ceiling to the one that exists based on the current regulations, we find that the ceiling for the size of loans disbursed by MFIs should be three to five times higher than the existing loan amount ceilings (in countries where there are specific regulations) and, in the case of Bahrain, it should be almost ten times higher.

Table 4: Calculation of Loan Ceiling (USD – approximate figures based on FX rates at time of writing)

Country	Sudan	Morocco	Tunisia	Egypt	Bahrain	Yemen	Jordan	Lebanon	Iraq	Palestine
GNI/ capita	3,920	7,100	10,600	10,260	37,650	3,650	11,910	17,910	14,440	5,080
Cap on loan size for MFIs (based on regulation)	3,500	6,000	10,000	13,000	18,000	1% of total shareholder equity				
Ceiling based on MIX definition	16,366	29,643	44,255	42,836	157,189	15,239	49,724	74,774	60,287	21,209
Ceiling based on MIX definition/ cap on loan size	5X	5X	4X	3X	9X					

Notes:
- Number and value of outstanding loans are extracted from IFC's database on MFIs in the Arab World which uses a combination of data from the MIX, data reported to IFC and the respective MFIs' websites as of end of 2014.
- Ceiling based on MIX definition = 250% x 1.67 x GNI per capita to demonstrate maximum loan size.

When we calculate the current average loan balances as a percentage of GNI (table 5), we see that the average loan balance over GNI/capita is still quite low –approximately equal to or less than 10 percent of GNI in all countries, except Palestine and Sudan[33].

[32] Based on the assumption that the average loan balance lies somewhere between 55%-65% of the average loan size.

[33] Based on the data that was presented in section 5, MFIs in Palestine are some of the few in the region that have actually started serving VSEs with any significance, and this is why their average loan balance and accordingly average loan size is relatively higher. In the case of Sudan, the authors believe that the data is not representative as data is only available for two MFIs when there are several others in the market.

Table 5: Average Loan Balance as Percentage of GNI/Capita

Country	Sudan	Morocco	Tunisia	Egypt	Bahrain	Yemen	Jordan	Lebanon	Iraq	Palestine
Outstanding Portfolio (USD)	65,132,702	607,023,463	125,803,526	293,334,240		47,707,666	264,994,050	91,592,160	139,867,131	182,054,865
Number of Active Borrowers	66,384	838,906	253,245	1,135,430		111,247	321,695	88,002	93,795	66,593
Average Loan Balance	981	724	497	258	0	429	824	1,041	1,491	2,734
GNI per capita	3,920	7,100	10,600	10,260	37,650	3,650	11,910	17,910	14,440	5,080
Average Loan Balance/ GNI Capita	25%	10%	5%	3%	0%	12%	7%	6%	10%	54%

Given the low average loan balance/GNI per capita ratios prevalent in most countries (≈10%), which suggest that MFIs are only targeting the very poor clients, we propose here that a VSE loan is a loan with an average loan balance/GNI per capita between 25 percent and 250 percent[34]. Based on this definition, the ranges for the respective countries are presented in table 6 below.

Table6: Suggested VSE Loan Size by Country

Country	Sudan	Morocco	Tunisia	Egypt	Bahrain	Yemen	Jordan	Lebanon	Iraq	Palestine
VSE Range (lower bound)	1,500	3,000	4,500	4,500	15,000	1,500	5,000	7,500	6,000	2,000
VSE Range (upper bound)	16,000	30,000	45,000	40,000	150,000	15,000	50,000	75,000	60,000	20,000

[34] One can argue why we are using the 250% figure from the MIX, which represents micro, and not taking something mid-way between micro- and something we might have on small or SME (e.g. 100%-500% for example). However, the fact that the average loan balance in the region as a percentage of GNI/capita is too low (≈10%) indicates that the ceiling the MIX had put for the micro definition is too high.

Annex 3: Some Official Definitions for Small Enterprises in the Arab World

Table 7: Official Definitions for Small Enterprises in the Arab World

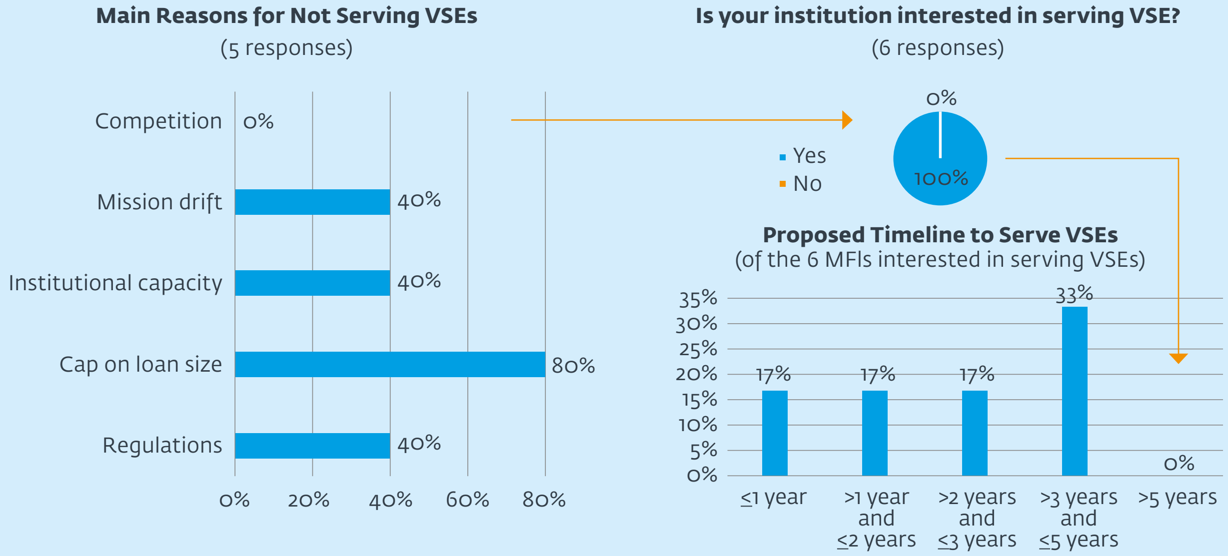
Country	Entity	Definition		
		Number of Employees	Paid-In Capital/ Initial Investment (USD)	Annual Turnover (USD)
Egypt	Egyptian Small Enterprise Law No. 141 of 2004 (EFSA, n.d.)	<50	$6,000-$125,000	
	Ministry of Trade and Industry[35] (MTI)	<200		$ 1.2- 2.5 million
	Central Bank of Egypt (VSE)			$ 130,000 – 1.2 million
	Central Bank of Egypt (SME)			$ 1.2-2.5 million
Jordan	Ministry of Industry and Trade (JEDCO)	10-49	$42,000	
	Department of Statistics (DOS) (Young Entrepreneurs Association)	5-19		
Lebanon	Banque Du Liban (Ministry of Economy and Trade, 2014)			< $ 9 million
	Kafalat (Ministry of Economy and Trade, 2014)	<40		
Yemen	Ministry of Industry and Trade (Abdullah)	4-9		
	Central Statistical Organization (2004) (IFC)	<5		
Tunisia	FONAPRAM (Di Tommaso, Lanzoni, & Rubini)			< $25,000

[35] The Ministry of Industry and Trade also has a definition for the VSE segment, which is enterprises with less than 200 employees and annual turnover of $ 130,000 – 1,200,000.

Annex 4: Survey Findings on MFIs that currently do not Serve VSEs

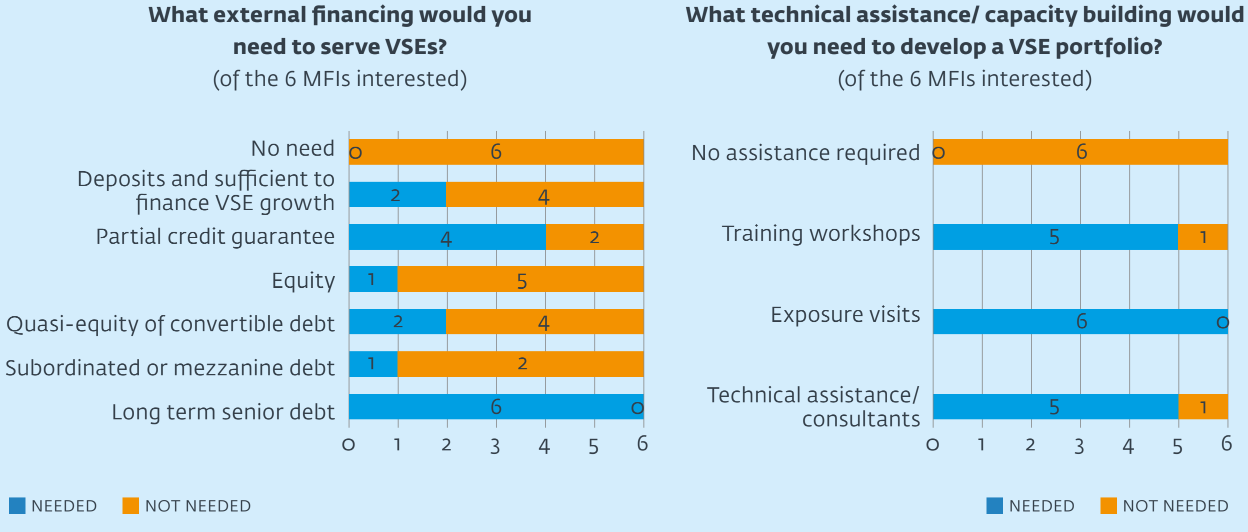
Among the MFIs that do not offer VSE loans, there appears to be clear interest, with the majority saying that they are interested. These MFIs expect to move into the VSE space in the next 3-5 years.

Figure 18: Survey Results for MFIs that are not Serving VSEs



In terms of the external assistance they require, the majority are interested in long-term senior debt and technical assistance in the form of advisory services, exposure visits and training workshops.

Figure 19: Assistance Required by MFIs Currently not Serving VSEs



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Notes

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