



ESAF & the Microfinance Sector



Photos by CARE, Save the Children, and ShoreBank International

CARE provides finance and credit training to small farmers in Rafah, Gaza, left; a Gazan microentrepreneur rebuilds his business after receiving a small grant, middle; and an advisor from SBI counsels the Faten Human Resources Manager on HR best practices, right.

Palestine’s microfinance sector has made substantive strides in recent years toward enabling and facilitating the flow of credit to micro- and small enterprises and low-income households, yet it remains relatively weak. At the institutional level, some MFIs have not fully embraced the concept of sustainability and continue to look for donor funds to cover operating losses, while others have weak governance structures that do not provide adequate oversight to their operations. Further, industry outreach to the poor is extremely limited: only 12% of microfinance clients fall below the national poverty line, according to ESAF research. At the regulatory level, the Palestinian Monetary Authority (PMA) has made progress on internal reform and is preparing for its future role as principal regulator of the microfinance sector, but regulatory reform is pending the passage of a draft banking law, now stalled due to the broader legislative impasse in Palestine. To strengthen the microfinance sector and enable its sustainability, ESAF is providing assistance at every level of the industry, specifically microentrepreneurs, microfinance institutions (MFIs), industry associations, the PMA, and donors.

Households and Enterprises

In Gaza, Operation Cast Lead and the blockade imposed since 2007 have not only stifled the ability of residents to access assets and livelihoods, but have posed tremendous challenges for small enterprises. As a coping mechanism, many MFI clients, including those with solid track records of loan repayment, have decapitalized their businesses to the point of being unable to repay their loans. This, in turn, led to a downturn for the microfinance industry in Gaza. ESAF is seeking to ease the burden of small businesses as they rebuild, while encouraging them to repay defaulted loans, consequently improving their credit standings and future access to credit. ESAF, with partner Save the Children, is providing small grants (approximately US\$750, paid in two stages and conditional upon performance) to almost 500 microentrepreneurs with good credit history with their institutions. To date, 90% of beneficiaries have increased their business assets, and over 60% of those eligible have qualified to receive the full grant amount. In addition, beneficiaries have made an average of US\$114 each in loan repayments during the first four months alone.

At-a-Glance: Poverty Assessment

ESAF studied poverty levels among microfinance clients in the West Bank using a Poverty Assessment Tool (PAT) developed on the basis of region-specific household data and finalized in late 2009. In total, over 2,300 clients of seven MFIs were surveyed, providing a large enough sample to be representative of the microfinance client population as a whole and each MFI. Initial findings show that levels of poverty outreach are generally quite low, with only 11.5% of all surveyed clients falling below the national poverty line. Beyond that, only 4.5% are considered “very poor” according to USAID standards, meaning they are in the bottom 50% of all people below the national poverty line. Even the MFI with the greatest level of outreach had only 19% poor clients. Notably, MFIs pursuing commercialization approaches achieved poverty outreach levels equal to or greater than those of the industry as a whole.

Also in Gaza, ESAF, through partner CARE, is supporting 670 farmers through provision of in-kind grants and training, including financial education tailored to their circumstances and referrals to financial institutions in Gaza when appropriate.

Financial Institutions Strengthening

Six major MFIs are engaged in the West Bank and Gaza’s relatively small microfinance market. Political crises, a culture of donor dependency, and the absence of more sophisticated product development and risk management approaches mean that less than a quarter of the potential microfinance market is being served. In addition, only half of the main players are currently operationally sustainable. This is due to the difficulty of the environment, but also and perhaps more importantly, to MFIs’ lack of focus on profitability. Regulatory pressure, as well as yet unrealized market competition from commercial banks exploring entry into micro and small markets, started the trend towards commercialization. ESAF is focusing on increasing the professionalism and commercial orientation of select MFIs through technical assistance (TA) and training.

Reef has set out to become the primary microfinance service provider in the agriculture sector, but needs significant TA and capital mobilization. ESAF technical service provider SBI is providing TA to build Reef's internal operating capacity to adequately support its current operations and prepare it for the rapid growth projected through 2011. TA includes developing a marketing strategy and practices, refining human resource policies and procedures, increasing loan officer effectiveness, and mentoring management staff. ESAF's help in developing Reef's stakeholders' vision for commercializing operations was a vital step to attract the loan capital needed to reach the MFI's projected portfolio growth.

Faten is the second-largest MFI in Palestine by clients, but first by portfolio size. Through SBI, ESAF has been providing TA to help Faten commercialize its operations and support an aggressive growth plan. With assistance from ESAF, in spring of 2010, Faten became the first Palestinian MFI to receive a commercial loan. While Faten has flourished under ESAF's TA thus far, its commercialization process is not yet complete, and ESAF is continuing to assist Faten in this capacity.

While **Asala** represents only a small portion of the microfinance market, its undiluted focus on poor female entrepreneurs—clients other financial institutions would not often serve—makes it an important institution. ESAF is assisting Asala to strengthen and to identify strategies for commercializing its operations. As these strategies are fully implemented, ESAF will assist Asala's management to prepare for the entity's transformation into a registered MFI that is ready to attract the capital investment needed to fund further outreach. In the Spring of 2010, Asala became the second MFI to receive a commercial loan.

Ryada is a microfinance program of **CHF**, a US-based NGO, whose natural trajectory is to evolve into a local institution. With TA, Ryada is taking critical steps to effectively make this transformation into a for-profit institution, a first for Palestine.

At-a-Glance: Portfolio Gains

Technical assistance (TA) from ESAF has contributed to significant portfolio increases for partner MFIs. Since ESAF began in September 2008, the following gains were made. The first figure is for Fiscal Year 2007 (except Reef, which is Fiscal Year 2008); the second is as of June 2010:

- **Al Rafah Microfinance Bank:** US\$23.27 million to US\$47.31 million (203%)
- **Asala:** US\$0.972 million to US\$3.19 million (328%)
- **CHF Ryada:** US\$5.13 million to US\$11.80 million (230%)
- **Faten:** US\$4.68 million to US\$19.72 million (421%)
- **Reef Finance Company:** US\$0.948 million to US\$3.25 million (343%)

ESAF also facilitated the first commercial loans to Faten and Asala through SBI's TA to the MFIs and CHF Loan Guarantee Fund's TA to the banks.

Ryada is being prepared to be a professionally-run, independent, and incorporated MFI that is able to comply with PMA regulations and access commercial and quasi-commercial sources of funds. ESAF, with Making Cents International, is also supporting CHF Ryada to design, market, pilot, and roll out a microfinance product specifically for **youth** who endeavor to be self employed.

To complement its individualized TA, ESAF, through SBI and in collaboration with the Palestinian Network for Small and Microfinance (**Sharakeh**) and the Association of CPAs, is providing microfinance sector-specific workshops to disseminate general lessons learned and to a broader audience. Topics include how to prepare documents and financial information when requesting debt financing from a commercial source and the process of auditing an MFI.

Enabling Environment

Sharakeh is the principal microfinance industry association in Palestine. As with other Palestinian financial associations, it has the potential to serve as a strong advocacy vehicle for and service provider to its members, but has been hindered by capacity and leadership weaknesses. ESAF conducted an institutional assessment of Sharakeh and, through small grants, is working with the association to implement assessment recommendations and conduct needed activities. Among those activities is supporting Sharakeh to deliver a series of financial analysis tool trainings for its members.

Regulatory Environment

Though one of the strongest institutions within the Palestinian National Authority, the PMA still needs support. The PMA is working on a draft banking law that, when passed, will place the regulation of MFIs and other non-banking financial institutions (NBFIs) under the PMA. To prepare, the PMA reactivated its NBF Unit, which will supervise and regulate NBFIs and support microfinance sector development. AED, with partner IRIS Center, is working closely with the PMA to help build the Unit's capacity and encourage sector growth. AED is encouraging a "light" style of regulation that is appropriate to the MFIs' structure and type of lending. ESAF also provides TA and training to the PMA on consumer education and financial literacy.

Donor Coordination

Significant resources continue to be invested in Palestine's financial sector. Coordinating assistance to ensure that best practices are upheld and donor funds strengthen the sector rather than perpetuate a cycle of dependency is essential. ESAF actively participates on donor taskforces for microfinance and other financial sector issues to forge consensus around key issues. ESAF also supports the creation, dissemination, and implementation of an appropriate microfinance policy that has been approved by USAID, the PMA, and the donor community.

The Expanded and Sustained Access to Financial Services (ESAF) program is a three-year US\$36 million program, funded by USAID, and designed to build a more inclusive financial sector in the West Bank and Gaza, for Palestinian households and enterprises. The program is implemented by AED in partnership with The William Davidson Institute at the University of Michigan, ShoreBank International, CHF International, CARE and Save the Children. ESAF is an Associate Award under USAID's FIELD-Support Leader with Associates cooperative agreement, which is managed by AED. www.microlinks.org/field



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