Economic Development

# Policy Brief | 2

## Start Up Palestine Credit Line: Outreach, Impact and Way Forward


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Launched in early 2014, "Start Up Palestine" is a three-year bilateral initiative implemented jointly by the Ministry of Finance & Planning, the Palestinian Fund for Employment and Social Protection (PFESP) and the Italian Agency for Development Cooperation – Jerusalem Office, aiming to support entrepreneurship among socio-economically marginalized groups as women, young graduates and small-scale farmers.

Within this perspective, the initiative mainly focuses on promoting access to credit for micro, small & medium enterprises (MSMEs), through a EUR 14M credit line activated in February 2016. Given the local legal framework, which requires that institutions operating in the lending market are licensed by the Palestine Monetary Authority [1], the credit line is currently offered by five out of the six microfinance institutions (MFIs) [2] legally entitled to grant loans in Palestine.

The first EUR 7M installment of the credit line was allocated among the MFIs according to a set of criteria defined ex-ante, including the portfolio size and other outreach indicators – such as the number of branches, the share of women clients, etc. In turn, each MFI committed to managing the allocated amount as a revolving fund for a period of seven years and, through the credit line funds, to support individuals and local MSMEs with limited or no access to finance, by giving priority to the "Start Up Palestine" target groups. The final allocation of the credit line is shown in table 1 [3].

| MFIs | Amount Allocated in February 2016 (USD) | Amount Disbursed as of June 2016 (USD) | Percentage of Disbursement (%) |
|---|---|---|---|
| **ACAD** | 1,050,000 | 1,079,917 | 102.8 |
| **ASALA** | 1,575,000 | 1,755,688 | 111.5 |
| **FATEN** | 3,150,000 | 3,216,365 | 102.1 |
| **VITAS** | 1,050,000 | 1,030,500 | 98.1 |
| **AL-IBDAA** | 525,000 | 350,539 | 66.8 |
| **TOTAL** | 7,350,000 | 7,433,009 | 101.1 |

**TABLE 1 – Allocation and disbursement of the credit line, as of June 30, 2016.** Source: Authors' calculations

According to the second quarterly report submitted to the PFESP at the end of June 2016 [4], the five MFIs disbursed almost one thousand loans in less than five months for a total amount exceeding the funds allocated – meaning that some MFIs, after disbursing all the allocated amount, had already started revolving the credit line to other clients.

In light of the above, is the "Start Up Palestine" credit line an effective tool to promote access to credit for MSMEs? Is the credit line giving priority to those excluded by the financial market – such as women, young graduates and small-scale farmers? How can the socio-economic impact of the credit line be improved while ensuring, at the same time, the social and economic sustainability of both MSMEs and MFIs?

This policy brief is organized in three sections. The first one presents the key outreach indicators and compares the credit line portfolio with the MFIs total outstanding portfolio. The second section focuses on the impact of the credit line, both on the whole microfinance market in Palestine, and on some selected MSMEs benefiting from the credit line. Finally, the third section discusses the way forward, by presenting some conclusions and policy recommendations.

# 1. OUTREACH

## 1.a. Key Indicators

Table 2 shows the main financial conditions and outreach indicators of the 969 loans disbursed out of the credit line between February and June 2016. The average loan size amounts to about USD 7,600, which is more than twice the average loan disbursed by MFIs (USD 2,770, see table 3), suggesting a potential "mission drift": MFIs tend to serve better-off clients, rather than poorer groups. However, within the sample, the loan size greatly varies, ranging from less than USD 1,000 to more than USD 30,000 – even though for seven loans only. Given that about half of the loans are less than USD 5,000, one-third of the loans are between USD 3,500 and 5,000 (suggesting that loans are for small-scale investments in fixed or working capital, rather than personal use), while only less than one loan out of five is above USD 10,000 (most likely indicating a medium-scale, relatively better-off business), we can assume that the credit line targets mostly MSMEs, with a prevalence of micro businesses, to finance small-scale investments in assets and/or running capital.

In terms of financial additionality – i.e. reaching out to clients who were previously out of the financial market, one of the main goals of "Start Up Palestine," as well as of the Italian credit lines in general, the results of the credit line are encouraging. Data show that one-fourth of the credit line was granted to "newcomers," in particular by MFIs with a strong focus on the most marginalized areas of Palestine, such as the Gaza Strip (Vitas, almost half of the loans) and East Jerusalem (Al-Ibdaa, one-third of the loans). However, from a gender perspective, two-thirds of the "newcomers" were men, while the remaining one-third "women newcomers" accounted for only one-fourth of the amount lent to clients who had never taken out a loan. Therefore, even though generally speaking the credit line achievement in terms of women's outreach was satisfactory (almost half of the loans), there is still need to close existing gender gaps in access to finance.

Finally, as for the outreach among marginalized groups, two loans out of five were disbursed to less than 30-year-old people, while almost one out of six was disbursed to refugees [5]. As per the geographical distribution, almost one loan out of five was disbursed in the Gaza Strip or East Jerusalem, i.e. the most deprived areas in Palestine, therefore, with a higher potential risk of default. Unfortunately, the data available do not allow to check the share of MSMEs clients based in Area C. However, as almost two businesses out of three are located in rural areas, we can assume that a high share of them are indeed located in the most disadvantaged areas.

| | ACAD | ASALA | FATEN | VITAS | AL-IBDAA | ALL FIVE MFIs |
|---|---|---|---|---|---|---|
| **Number of loans** | 148 | 252 | 448 | 53 | 68 | 969 |
| **Total disbursed amount (USD)** | 1,079,917 | 1,755,688 | 3,216,362 | 1,030,500 | 350,539 | 7,433,006 |
| **Average loan size (USD)** | 7,297 | 6,967 | 7,179 | 19,443 | 5,155 | 7,671 |
| **Average grace period (months)** | 1.7 | 2.3 | 2.1 | 0.0 | 2.7 | 2.0 |
| **Average maturity (months)** | 38.8 | 34.8 | 35.5 | 72.8 | 24.3 | 37.0 |
| **Loans to women** | | | | | | |
| *Percentage of loans* | 49.3 | 81.7 | 33.7 | 17.0 | 20.6 | 46.7 |
| *Percentage of portfolio* | 44.9 | 82.1 | 32.0 | 15.6 | 12.6 | 42.5 |
| **Loans to new businesses** | | | | | | |
| *Percentage of loans* | 45.3 | 7.1 | 7.8 | 0.0 | 4.4 | 12.7 |
| *Percentage of portfolio* | 43.0 | 9.8 | 7.5 | 0.0 | 5.2 | 12.1 |
| **Loans to new women-led businesses** | | | | | | |
| *Percentage of loans to new businesses* | 34.3 | 77.8 | 37.1 | 0.0 | 0.0 | 40.7 |
| *Percentage of portfolio to new businesses* | 31.0 | 63.9 | 33.1 | 0.0 | 0.0 | 37.3 |
| **Loans to clients who had never received a loan** | | | | | | |
| *Percentage of loans* | n.a. | 13.1 | 8.0 | 100.0 | 55.9 | 19.5 |
| *Percentage of portfolio* | n.a. | 11.8 | 7.4 | 100.0 | 46.6 | 25.8 |
| **Loans to women who had never received a loan** | | | | | | |
| *Percentage of loans to clients who had never received a loan* | n.a. | 57.6 | 36.1 | 17.0 | 34.2 | 33.8 |
| *Percentage of portfolio to clients who had never received a loan* | n.a. | 63.6 | 33.4 | 15.6 | 23.5 | 25.0 |
| **Areas (% of loans)** | | | | | | |
| *Rural* | 56.8 | 67.3 | 65.0 | 30.2 | 51.5 | 61.5 |
| *Urban* | 33.8 | 13.9 | 29.0 | 69.8 | 13.2 | 27.0 |
| *Refugee camp* | 9.5 | 18.7 | 6.0 | 0.0 | 35.3 | 11.6 |
| **Age groups (% of loans)** | | | | | | |
| *Less than 20* | 0.0 | 2.0 | 1.1 | 0.0 | 0.0 | 1.0 |
| *20-30* | 41.2 | 42.9 | 37.5 | 39.6 | 41.2 | 39.8 |
| *31-40* | 30.4 | 31.7 | 32.6 | 34.0 | 29.4 | 31.9 |
| *41-50* | 15.5 | 22.2 | 19.2 | 18.9 | 26.5 | 19.9 |
| *More than 50* | 12.8 | 1.2 | 9.6 | 7.5 | 2.9 | 7.3 |
| **Governorate (% of loans)** | | | | | | |
| *Gaza Strip* | 6.1 | 24.6 | 23.0 | 43.4 | 0.0 | 20.3 |
| *East Jerusalem* | 0.0 | 0.0 | 0.0 | 0.0 | 29.4 | 2.1 |
| *Bethlehem* | 10.8 | 5.2 | 8.7 | 0.0 | 0.0 | 7.0 |
| *Hebron* | 11.5 | 7.5 | 13.2 | 7.6 | 0.0 | 10.2 |
| *Jenin* | 14.9 | 18.7 | 17.6 | 5.7 | 0.0 | 15.6 |
| *Nablus* | 18.2 | 14.3 | 23.4 | 22.6 | 41.2 | 21.5 |
| *Ramallah* | 13.5 | 13.9 | 2.8 | 9.4 | 29.4 | 10.9 |
| *Others (Qalqilya, Salfeet, Tubas, Tulkarem)* | 25.0 | 15.9 | 8.3 | 11.3 | 0.0 | 12.5 |

**TABLE 2 – Key outreach indicators of the credit line, as of June 30, 2016.** Source: Authors' calculations

### 1.b. Comparing the credit line portfolio with MFIs total portfolio

Table 3 compares some outreach indicators on the credit line portfolio with the MFIs total portfolio. Interestingly enough, as for women outreach, data show that in gender allocation, the whole credit line achievement is higher than the MFIs total portfolio in gender allocation (46.7 versus 39.8% as for the number of clients, 42.5 versus 37.5% as for the portfolio value), while the opposite is true when MFIs are considered alone. Two observations explain this result: (a) the MFI Asala, whose clients are almost exclusively women, was allocated about one-fourth of the credit line. Therefore, Asala's substantial contribution in women's outreach raises the average of the whole credit line; and (b) given that gender inequalities widely persist in the Palestinian socio-economic life, there are relatively few women-led MSME able to take out a loan for investment purposes, averaging USD 7,000. Therefore, it could be easier (and also less risky) for MFIs to find potential clients of medium-sized loans among men-led businesses.

| | ACAD | | | ASALA | | | FATEN | | | VITAS | | | AL-IBDAA | | | ALL FIVE MFIs | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | TOT | CL | | TOT | CL | | TOT | CL | | TOT | CL | | TOT | CL | | TOT | CL | |
| **Outstanding portfolio (M USD)** | 11.21 | 1.10 | | 9.82 | 1.75 | | 97.17 | 3.22 | | 29.73 | 1.03 | | 10.07 | 0.35 | | 158.00 | 7.45 | |
| **Average loan size (K USD)** | 2.61 | 7.30 | | 2.70 | 6.97 | | 2.85 | 7.18 | | 4.07 | 19.44 | | 1.32 | 5.15 | | 2.77 | 7.67 | |
| **Women clients** | | | | | | | | | | | | | | | | | | |
| *% clients* | 54.0 | 49.3 | | 98.2 | 81.7 | | 34.0 | 33.7 | | 22.3 | 17.0 | | 47.1 | 20.6 | | 39.8 | 46.7 | |
| *% outstanding portfolio* | 50.1 | 44.9 | | 96.7 | 82.1 | | 34.5 | 32.0 | | 22.2 | 15.6 | | 39.6 | 12.6 | | 37.5 | 42.5 | |
| **Economic sector % clients** | | | | | | | | | | | | | | | | | | |
| *Agriculture* | 27.8 | 43.2 | | 30.6 | 32.5 | | 9.2 | 25.9 | | 2.2 | 3.8 | | 8.6 | 8.8 | | 11.0 | 27.9 | |
| *Trade* | 43.5 | 43.9 | | 30.6 | 35.7 | | 21.1 | 45.8 | | 15.3 | 37.7 | | 16.7 | 30.9 | | 22.1 | 41.4 | |
| *Services* | 1.5 | 1.3 | | 10.0 | 17.9 | | 9.9 | 19.2 | | 12.2 | 49.1 | | 18.4 | 32.3 | | 10.7 | 18.8 | |
| *Light industry* | 9.4 | 11.5 | | 9.9 | 13.9 | | 3.5 | 8.9 | | 4.5 | 9.4 | | 11.4 | 27.9 | | 11.0 | 12.0 | |
| **Economic sector % outstanding port-folio** | | | | | | | | | | | | | | | | | | |
| *Agriculture* | 30.5 | 40.1 | | 28.1 | 29.4 | | 10.9 | 21.8 | | 2.0 | 4.4 | | 3.7 | 10.2 | | 11.2 | 23.3 | |
| *Trade* | 47.1 | 46.1 | | 31.7 | 40.3 | | 24.0 | 44.2 | | 14.4 | 36.5 | | 7.0 | 31.3 | | 23.2 | 41.9 | |
| *Services* | 1.6 | 1.9 | | 12.0 | 19.1 | | 17.6 | 22.8 | | 11.9 | 50.1 | | 3.4 | 25.0 | | 14.1 | 22.8 | |
| *Light industry* | 10.4 | 11.9 | | 8.3 | 11.1 | | 5.2 | 11.2 | | 3.3 | 9.1 | | 5.7 | 33.5 | | 5.4 | 12.1 | |
| **Gaza Strip** | | | | | | | | | | | | | | | | | | |
| *% clients* | 8.0 | 6.1 | | 27.0 | 24.6 | | 33.8 | 23.0 | | 37.4 | 43.4 | | 0.0 | 0.0 | | 17.8 | 20.3 | |
| *% outstanding portfolio* | 7.9 | 4.6 | | 20.4 | 23.5 | | 29.9 | 18.8 | | 38.3 | 51.9 | | 0.0 | 0.0 | | 27.4 | 21.6 | |

Credit line outreach higher   Credit line outreach lower

**TABLE 3 – Comparison of the outreach of the credit line portfolio (CL) with the MFIs total portfolio (TOT), as of June 30, 2016.** Source: Authors' calculations and Sharakeh Network, 2nd Quarterly Outreach Report, June 2016

Moreover, the credit line seems to be an effective tool in promoting the growth of labor-intensive and productive sectors which are currently only marginally served by MFIs and make a limited contribution to the Palestinian economy as a whole. For instance, while agriculture accounts for only 13.4% of the GDP [6], almost one-third of the credit line clients are MSMEs in the agri-business sector. A similar trend can be also observed in the trade sector: the credit line outreach (two-fifths) is twice as much as this sector's total contribution to the Palestinian economy (17.7%, or less than one-fifth). As for the light industry, a sector which represents 10.5% of the GDP, the credit line achieved relatively good results (12% of the loans), especially in light of the fact that MSMEs working in this sector tend to approach banks, rather MFIs, to fulfill their financing needs. Finally, in the sector of services, the credit line (18.8% in terms of number of loans and 22.8% in terms of outstanding portfolio) shows an outreach level similar to the overall contribution of this sector to the GDP (19.9%).

Concerning the outreach in the Gaza Strip, in terms of number of clients, the credit line achieved a better result than the MFIs total portfolio, while in terms of allocation, only 21.6% of the credit line funds went to the Gaza Strip, as compared to 27.4% of the MFIs total portfolio. However, figures in table 3 show that this is not true for all MFIs – such as Asala and Vitas. While for Acad, the difference in the outreach of the credit line compared to the total portfolio is small, ranging between 2 and 3%.

# 2. IMPACT

It is still early to assess the impact of the credit line, especially on the MSMEs which took out loans. However, by comparing the credit line loan dataset (provided by the five MFIs to the PFESP) with the overall quarterly market performance figures (prepared by the Sharakeh Network), it is possible to assess how the credit line contributed in expanding the microfinance market during the second quarter of 2016 (April-June). Additionally, in this section we present seven MSMEs which accessed the credit line. The case studies analysis provides some preliminary evidence on the positive impact of the credit line on the businesses themselves, as well as on the socio-economic well-being of the clients' families.

## 2.a. Contribution to the microfinance market growth

The USD 7.35M credit line has a limited weight in the Palestinian MFI market, as it accounts for 3.9% of the total outstanding portfolio (in June 2016, USD 189M) and serves 1.3% of all the active clients (in June 2016, 77,000 clients). However, for relatively small MFIs, the credit line is a primarily funding source: for Acad it accounts for 9.6% of the total outstanding portfolio, serving 3.4% of the active clients, while for ASALA it accounts for 17.9% of the outstanding portfolio (20.7% in the Gaza Strip and 17.2% in the West Bank), serving almost 7% of all its active clients. [7]

Moreover, between April and June 2016, the credit line played a crucial role in boosting the microfinance market growth in Palestine. According to the Sharakeh Network data, in the second quarter of 2016, the total outstanding portfolio grew by 10.7% (12.2% for the five MFIs offering the credit line) and the number of active clients increased by 6.2% (8.0% for the five MFIs offering the credit line), as compared to the first quarter. Calculations in table 4 show that in the same period the credit line produced almost one-fifth of the total outstanding portfolio growth – meaning that without the credit line, the microfinance market growth in Palestine would have been 2.1% lower than the 10.7% achieved. Moreover, for relatively small MFIs such as Acad and Asala, the credit line accounted for up to three-fourth of their total portfolio growth in the second quarter of 2016. [8]

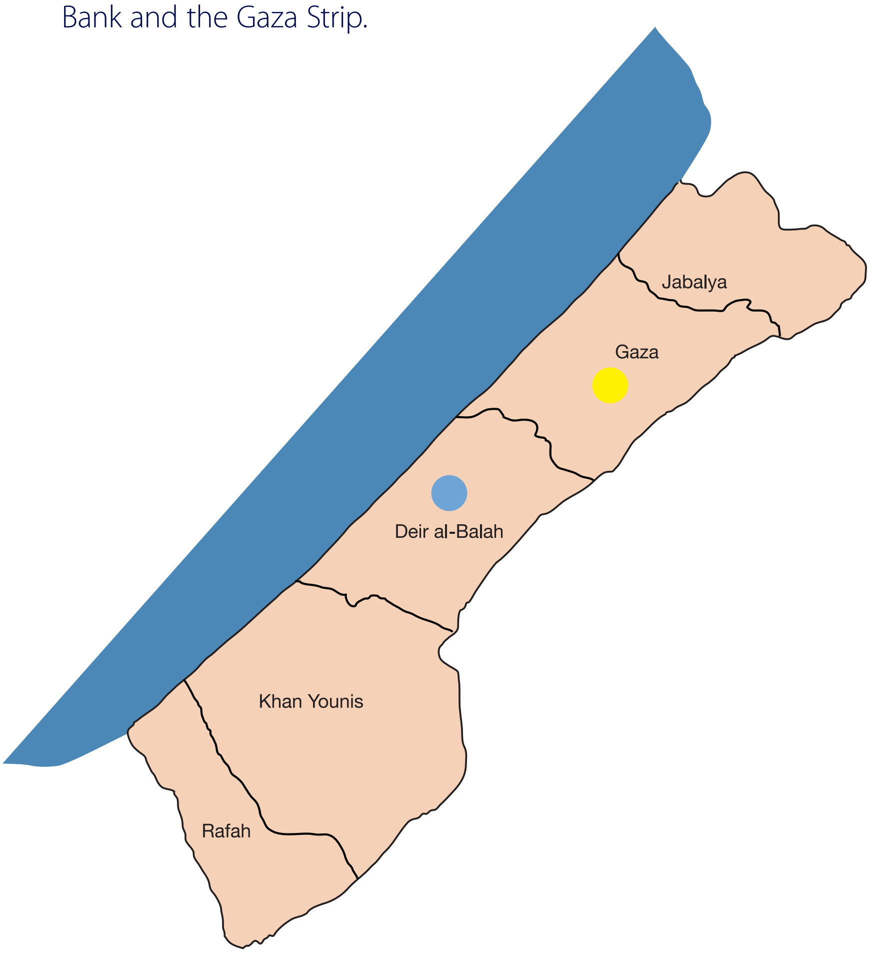
| | OUTSTANDING PORTFOLIO (USD) | | | | | | |
|---|---|---|---|---|---|---|---|
| | TOTAL | | | CREDIT LINE | | | % over differences |
| | March 2016 | June 2016 | Difference | March 2016 | June 2016 | Difference | |
| **ACAD** | | | | | | | |
| *All clients* | 10,270,540 | 11,212,507 | **941,967** | 341,000 | 1,079,917 | **738,917** | **78.4** |
| *Women clients* | 5,193,589 | 5,614,150 | **420,561** | 219,000 | 484,400 | **265,400** | **63.1** |
| **ASALA** | | | | | | | |
| *All clients* | 8,187,441 | 9,818,633 | **1,631,192** | 690,000 | 1,755,688 | **1,065,688** | **65.3** |
| *Women clients* | 8,147,441 | 9,498,024 | **1,350,583** | 477,000 | 1,441,176 | **964,176** | **71.4** |
| **FATEN** | | | | | | | |
| *All clients* | 88,352,015 | 97,174,135 | **8,822,120** | 1,989,457 | 3,216,362 | **1,226,905** | **13.9** |
| *Women clients* | 31,424,555 | 33,564,436 | **2,139,881** | 560,748 | 1,029,965 | **469,218** | **21.9** |
| **VITAS** | | | | | | | |
| *All clients* | 25,855,355 | 29,731,173 | **3,875,818** | 1,000,500 | 1,030,500 | **30,000** | **0.8** |
| *Women clients* | 5,962,171 | 6,610,647 | **648,476** | 160,500 | 160,500 | **0** | **0.0** |
| **AL-IBDAA** | | | | | | | |
| *All clients* | 8,117,971 | 10,072,993 | **1,955,022** | 57,126 | 350,539 | **293,413** | **15.0** |
| *Women clients* | 3,232,395 | 3,992,106 | **759,711** | 21,866 | 44,360 | **22,494** | **3.0** |
| **ALL FIVE MFIs** | | | | | | | |
| ***All clients*** | **140,783,322** | **158,009,441** | **17,226,119** | **4,078,083** | **7,433,006** | **3,354,923** | **19.5** |
| ***Women clients*** | **53,960,151** | **59,279,363** | **5,319,212** | **1,439,114** | **3,160,401** | **1,721,287** | **32.4** |
| **ALL SHARAKEH MEMBERS** | | | | | | | |
| *All clients* | 170,881,981 | 189,178,834 | **18,296,853** | 4,078,083 | 7,433,006 | **3,354,923** | **18.3** |
| *Women clients* | 59,800,766 | 65,530,129 | **5,729,363** | 1,439,114 | 3,160,401 | **1,721,287** | **30.0** |

**TABLE 4 – Contribution of the credit line to the total microfinance market growth in Q2 2016 (April-June 2016), as compared to Q1 2016 (January-March 2016).** Source: Authors' calculations and Sharakeh Network, 2nd Quarterly Outreach Report, June 2016

Finally, it is particularly interesting to analyze the credit line contribution to the market growth between April and June 2016, by looking at the data disaggregated by gender. In the second quarter of 2016, the total outstanding portfolio to women clients grew by 9.6% (6.0% for the number of women clients). Figures in table 4 show that the credit line represented one-third of the growth of the total outstanding portfolio to women clients – meaning that without the credit line, the growth of MFI loans granted to women would have reached approximately 6.6%, compared to the achieved 9.6%. Concerning the increase in the total number of women clients, the credit line produced only one-sixth of the 6.0% growth rate achieved (calculations omitted) – the reason being that the credit line average loan size is more than twice as big as the total MFIs portfolio average loan size.

## 2.b. Case studies: MSMEs benefiting from the credit line

In October 2016, field visits were conducted all over Palestine to meet the credit line clients. Thirteen semi-structured interviews were carried out to assess key business performance indicators, as well as the loans general impact on the client's family well-being. Figure 1 presents some of the MSMEs interviewed, both from the West Bank and the Gaza Strip.




### Case study 6

**Solar panels & energy efficiency shop in the Gaza Strip**

**Client:** male, 44, high school degree, married with six children.

**Location:** Gaza City.

**Amount and objective of the loan:** USD 15,000, to diversify his business: purchase of running capital (solar panels and energy efficiency equipment to be sold). He started his business in computer selling and maintenance twenty years ago and took out his first loan three years ago.

**Impact of the loan:** through the diversification of his activity, he gained new skills and his business income increased. He could purchase new assets for his house.

**Challenges:** the renewable energy & energy efficiency market in the Gaza Strip is still at its beginnings.

### Case study 7

**Family farm in the Gaza Strip**

**Client:** female, 35, high school degree, married with two children.

**Location:** Deir al Balah village, Gaza Strip.

**Amount and objective of the loan:** USD 4,000, to purchase two water pumps. To irrigate the cultivated land (2.5 dunum owned and 20 dunum rented), the farm used to buy water from other farmers: given the high price of water, the production was expensive and therefore, less competitive.

**Impact of the loan:** this is her fifth loan. Over the last ten years, access to finance enabled her to rent more land, purchase inputs and build greenhouses. Through the MFI, she was also offered training and coaching services in business management, accounting, marketing and gender-related issues. After she purchased two water pumps, the quality and quantity of the production increased – and so did productivity. Moreover, improved access to water enabled her to diversify the production (olives, eggplants, tomatoes, cauliflowers, cabbages, wheat, etc.). As the family income increased, she could afford to send her children to a private school, enlarge the family house, and buy new assets – such as a computer.

**Challenges:** buyers currently come to the farm to pick up the products by themselves. The family is planning to take up a new loan to purchase a vehicle.

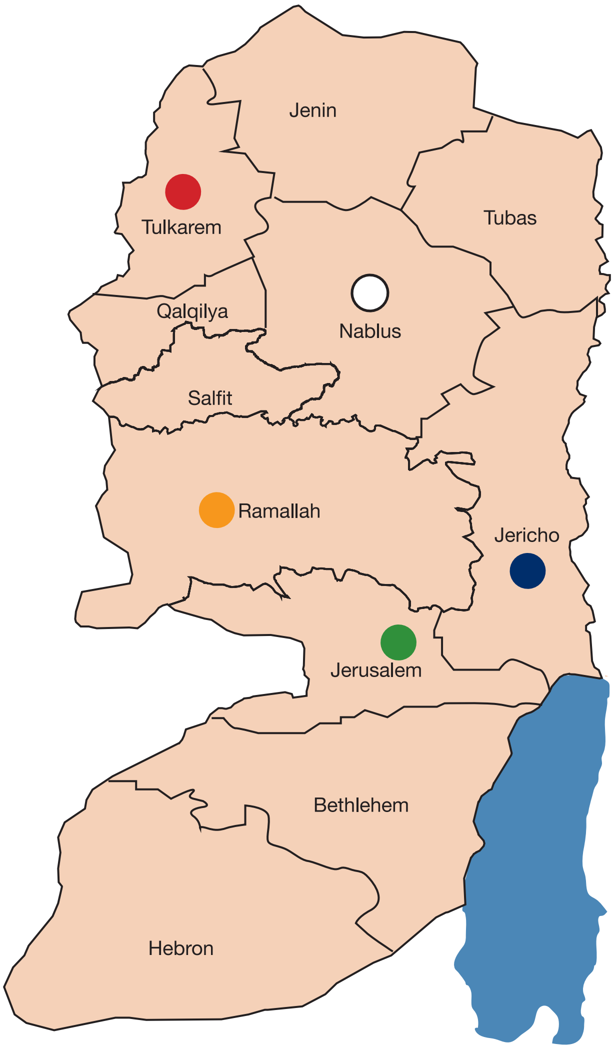



**FIGURE 1 – Impact of the credit line on MSMEs: case studies.** Source: Authors' semi-structured interviews

## Case study 1

**Carpentry in a refugee camp**

**Client:** male, 54, vocational training in carpentry, married with six children.
**Location:** Ein As-Sultan refugee camp, Jericho (Area A).
**Amount and objective of the loan:** USD 25,000, to improve the business: purchase of new machinery and running capital.
**Impact of the loan:** this is his eighth loan and currently his outstanding credit amounts to NIS 450,000 (more than USD 110,000). Access to credit enabled his business to grow: he currently owns two workshops and one shop. He is in the process of building a new house for his family.
**Challenges:** difficult to find five guarantors.

## Case study 2

**Pharmacy in a refugee camp**

**Client:** male, 40, BA in Pharmacy, married with three children.
**Location:** Al-Jalazoon refugee camp, Ramallah (Area B).
**Amount and objective of the loan:** USD 12,000, to improve his business, which employs two persons: purchase of running capital.
**Impact of the loan:** this is his second loan. Access to credit enabled his business to grow and currently he is trying to rent a new commercial space. UNRWA is among his clients.
**Challenges:** difficult to find two guarantors and need of accessing bigger loans.

## Case study 3

**Sewing shop in a refugee camp**

**Client:** male, 43, married with two children.
**Location:** Shuafat refugee camp, East Jerusalem (Area C).
**Amount and objective of the loan:** USD 2,600, to establish a family business, employing his wife too: purchase of machinery (three sewing machines) and running capital.
**Impact of the loan:** this is his first loan, the daily income of the business ranges between USD 100 and 200 and it is growing further. The business income enabled him to purchase a new family car and repay old debts.
**Challenges:** perception of jealousy from the community.

## Case study 4

**Livestock in Area C**

**Client:** female, 34, high school degree, married with four children.
**Location:** Talluza village, Nablus (Area C).
**Amount and objective of the loan:** USD 6,000, to improve her family business in the livestock sector, which she started six years ago, with five cows and half a dunum (500 sqm) of land.
**Impact of the loan:** the family currently owns eight cows and six calves. Her husband takes care of the livestock and she produces dairy products – such as lebaneh, milk and yoghurt. The products are sold in the village.
**Challenges:** the business needs more space (at least one dunum, 1,000 sqm) to grow, the family is now involved in land rehabilitation works to gain additional space.

## Case study 5

**Woodcarving workshop in Tulkarem**

**Client:** male, 25, BA in IT from the Arab American University of Jenin, single.
**Location:** Tulkarem (Area A).
**Amount and objective of the loan:** USD 9,000 to improve his business established three years ago: purchase of machinery and running capital.
**Impact of the loan:** the income of his business increased, he is currently building a showroom in his workshop. He started investing in marketing also using his skills in IT. He is also building a house for him.
**Challenges:** difficult to find three guarantors, needs of coaching for marketing and developing new products.

# 3. THE WAY FORWARD: CONCLUSIONS AND RECOMMENDATIONS

Only five months since its activation, the credit line achieved significant results in terms of outreach and impact – and proved that local MFIs can be an important partner for the PFESP and, more generally, public institutions to support MSMEs growth and development in Palestine. However, it is still early to assess the overall impact of the credit line on the Palestinian economy, as well as its strengths and weaknesses. In any case, based on the findings of the policy brief, some lessons and policy recommendations can be drawn to guide the way forward and ensure the achievement of the "Start Up Palestine" programme objectives:

- There is indeed a great demand for microfinance services, but with the financial resources currently available, MFIs can only partially satisfy the loan requests. The microfinance market is currently growing at a 10% rate per quarter: donors, but also investors, shall look at microfinance in Palestine as a dynamic, fast-changing industry in need of affordable financing opportunities and technical assistance.
- In doing so, an emphasis should be put on supporting small and medium MFIs, in order to stimulate competition, with long-term positive effects on the clients themselves. Moreover, Palestinian small and medium MFIs seem to have a stronger focus and commitment to reach marginalized groups (mainly women, young people, small-scale farmers) and geographical areas (East Jerusalem, Area C and the Gaza Strip).
- So far, the results of the credit line in terms of financial additionality are encouraging. However, specific gaps still need to be addressed, in particular to increase financial inclusion among women (especially "newcomers" in the market) and start-ups. For this aim, at least in the short term, injections of liquidity in the microfinance market do not seem to be a solution: innovative risk-sharing and partial risk-coverage mechanisms, targeting specific segments of the population, economic sectors or geographical areas, shall be developed in partnership with players both on the supply and the demand side of the financial market.
- At the sectoral level, the credit line proved to be an effective tool in reaching small- and medium-scale farmers and MSMEs in the trade sector. However, there is still room to improve the credit line outreach in labor-intensive, productive and transforming sectors, by providing specific technical assistance initiatives stimulating the demand for loans and decreasing the transaction costs for MFIs.
- Public institutions and donors should be aware that increasing the outreach among marginalized groups or geographical areas comes at a cost – which ultimately, impacts on the interest rate. As pointed out in the AICS Economic Development Policy Brief n.1 [1], interest rate caps are not an effective policy option.
- For loans disbursed in the West Bank, MFIs should track whether the client is located in Area A, B or C. This would greatly help in identifying and addressing specific market gaps and contribute to better assess the social impact on the most vulnerable groups. From a broader perspective, to ensure an effective targeting and prevent a potential "mission drift," it is of the utmost importance that the local industry adopts a set of indicators to measure the social impact of microfinance in Palestine.
- During the field visits, it emerged that most clients think that it is difficult to satisfy the loan requirement of presenting two or more guarantors. To facilitate access to finance, and at the same time decrease the cost of funds – one of the main determinants of interest rates, the possibility for MFIs to mobilize clients' savings should be brought to the attention of policymakers. However, if this opportunity was limited to relatively big MFIs, this might create potential asymmetries in the market and ultimately, harm the clients.
- Interviews with clients also highlighted that only very few of them received non-financial services. In this perspective, MFIs and the PFESP have a great role to play in getting MSMEs ready to borrow, coaching the credit line clients once the loan is disbursed, and ensuring a constant follow-up with the beneficiaries. Moreover, the PFESP, being the fund manager of the credit line, shall define a set of performance indicators ex-ante and shall constantly monitor the socio-economic impact of the "Start Up Palestine" program on MSMEs.

# … AND THE INTEREST RATE?

In the dataset of all the loans granted by MFIs through the credit line, the interest rate is indicated using the "flat" calculation methodology. As it was extensively discussed in the AICS Economic Development Policy Brief n. 1 [1], this does not allow to make comparisons between loans having different financial conditions. Moreover, one of the MFIs offering the credit line adopts the Islamic finance principles, thus making it even more challenging to come up with accurate figures on the interest rate. However, the average unweighted "flat" interest rate applied to the loans is 8.9% per annum and ranges between 7.4 and 11.2% depending on the MFI.

Multivariate regressions were run on the dataset to assess the determinants of the interest rate for four out of the five MFIs offering the credit line [9]. Four main findings can be drawn from the results of the regressions (available upon request):

**a)** The loan amount and maturity are significant determinants of the interest rate: a 25% increase in the average loan amount results in a 0.4-0.5% decrease in the interest rate, while a 25% increase in the average maturity results in a 0.2-0.3 % decrease. An increase or decrease of the grace period does not have any statistically significant impact on the interest rate.

**b)** MFIs do not determine the interest rate on the basis of the characteristic of each loan – e.g. gender, age and location, new business or already-existing business, economic sector. The pricing is based on standardized financial products offered by MFIs, therefore their flexibility is scarce.

**c)** MFIs greatly differ as for their pricing levels. This difference can be mainly explained by the size (i.e. economies of scale) and composition (i.e. levels of risk and transaction costs) of each MFI's gross loan portfolio (GLP). For instance, a 25% increase in the average GLP share in the Gaza Strip [10], which most likely implies a higher risk of portfolio default, results in a 1% increase in the interest rate applied to each loan. Similarly, a 25% increase in the average GLP share to women clients, which probably drives higher transaction costs [11], raises the interest rate by 1.2%. And finally, a 25% increase in the average total GLP decreases the interest rate by 0.1 to 0.6% – suggesting the possibility to create economies of scale, although the magnitude seems to be limited.

**d)** As mentioned above, an increase in the average GLP share in the Gaza Strip results in an increase of the interest rate applied to each loan. In absolute terms, its magnitude seems to be significant: an increase from 30% (i.e. the average GLP share in the Gaza Strip for the four MFIs) to 37.5% drives a 1% increase in the interest rate applied to loans. However, it is interesting to note that the increase mostly affects loans granted in the West Bank, rather than in the Gaza Strip. On average, a loan granted to a West Bank client has a 0.3% higher interest rate compared with the same loan granted to a client living in the Gaza Strip. This difference probably derives from the economic and political environment in the Gaza Strip, inasmuch as very competitive financial conditions need to be offered to "convince" clients to take out a loan. Alternatively, given the limited size of the Gaza Strip and its high population density, mutual trust networks might be relatively more developed than in the West Bank, thus affecting the interest rate.

# 4. FOOTNOTES AND REFERENCES

**[1]** Azzalini M., Pujia V. E. and K. Raguzzoni. 2016. "Microfinance in Palestine: Are loans too expensive and should interest rates be capped?". Economic Development Policy Brief n.1. Italian Agency for Development Cooperation – Jerusalem Office.

**[2]** All the MFIs licensed by the PMA were invited to join the credit line, and only five of them decided to submit an application to access the credit line.

**[3]** Similarly to other countries, MFIs operating in Palestine generally manage their lending activities in dollars. Therefore, part of the credit line funds disbursed by the Italian Government (EUR 6.75M out of the EUR 7M) were converted into dollars (USD 7.35M) to be allocated among the MFIs. A residual amount of about EUR 250,000 was kept in the PFESP dedicated bank account, to be distributed among the MFIs once the second and last installment of the credit line is transferred.

**[4]** A first quarterly report was submitted on March 31, 2016, about six weeks after the credit line was activated and the related funds were transferred to the MFIs. Back then, 55% out of the total allocated funds (USD 7.35) were disbursed.

**[5]** It must be noted that UNRWA, the United Nations Agency in charge of providing refugees with services and protection, has its own MFI – whose total portfolio in Palestine reaches USD 15.5M (Sharakeh Network. 2016. "2nd Quarterly Outreach Report – June 2016").

**[6]** Palestinian Central Bureau of Statistics. 2015. "Percentage contribution to GDP by economic activity for the quarters of the years 2000-2015 at constant prices".

**[7]** Calculations are based on the outreach indicators provided by Sharakeh Network in the "2nd Quarterly Outreach Report – June 2016".

**[8]** As for the growth of the total number of clients, the credit line contributed to a lesser extent (one-tenth, calculations omitted) – the reason being that the credit line average loan size is more than twice as much as the total MFIs portfolio average loan size.

**[9]** Al-Ibdaa, an MFI adopting Islamic finance principles, was excluded from the sample.

**[10]** For instance, for the four MFIs included in the sample, the average GLP share in the Gaza Strip is almost 30%. A 25% increase in this share means, in absolute terms, a 7.5% increase (30 times 0.25 equals 7.5), and therefore, an increase from 30% to 37.5% of the GLP in the Gaza Strip.

**[11]** Campion, A., Kiran Ekka, R. and Wenner, M. (2010). "Interest Rates and Implications for Microfinance in Latin America and the Carribean". Inter-American Development Bank Working Paper Series n. 177.

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