

ENHANCEMENT OF THE BUSINESS SOUTHERN S ENVIRONMENT IN THE MEDITERRANEAN





Innovation: Financing schemes and instruments

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Introduction





Background



- MSMEs are considered the backbone of any developing economy, MSMEs play a key role in:

Creating healthy job opportunities

Alleviating poverty

Improving the competitiveness, innovation and efficiency of the private sector

Promoting economic growth

- *MSMEs are a vital means to develop markets and to create healthy employment opportunities.*

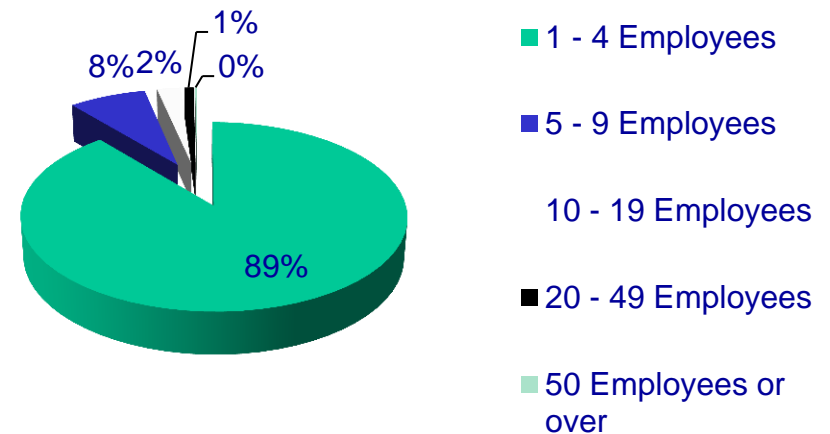


MSME in Palestine



- MSMEs constitute 99% of the Palestinian private sector by number of enterprises.
- MSMEs employ >80% of the workforce.
- MSMEs are the basis for employment and productive activity.
 - In all productive sectors.
 - In all regions of the country.
- MSMEs are key providers of inputs and services to larger industries.

% distribution of operating establishments by Employment size groups (PCBS 2012)



Definition of Small and Medium Enterprises (SMEs) in PA (Small Business Act)

Enterprise classification	Number of employees	Annual Turnover (USD)	Registered capital (USD)
Micro	1-4	Up to 20,000	Up to 5,000
Small	5-9	From 20,001 to 200,000	From 5,001 to 50,000
Medium	10-19	200,001 to 500,000	From 50,001 to 100,000

Source: Financing Palestinians SME, MAS

Out of the nearly 145,000 economic establishments operating in Palestine in 2012 (131,000 were private sector companies) almost 90% employed less than five workers and nearly 8% had 5-9 employees (Portland Trust)



Challenges to SME Innovation Financing





Challenges



- **The main impediment to growth of SMEs Innovation has been the political and economic situation.**
 - Continuous closures and restrictions on the free movement of goods and people increases the production cost and access to market, thus threatening the survival of the SMEs sector.
 - The above has resulted in a decrease SMEs profitability and in difficulties in debt collection.
- **Moreover, SMEs Innovation are faced with other challenges which have hindered their ability to grow and develop including:**
 - Lack of export orientation and capacity
 - Limited use of modern managerial, marketing and financial concepts
 - Lack of government support and a national strategy to develop this sector
- **Insufficient financial resources at start up and for growth at later stages, coupled with a difficulty in accessing the needed financing have proved to be significant obstacles for Palestinian SMEs**

Source: Financing Palestinians SME, MAS



Challenges



- **Access to Capital is a Major Obstacle for Palestinian SMEs and Impedes their Ability to Grow and Improve**
- **Most SMEs are in dire need for financing; key drivers for demand for financing by MSMEs include:**
 - The need to expand business and economic activity, to increase output or to invest in a new project;
 - Financing assets and working capital
- **However, most SMEs Innovation lack access to capital and financing from local finance institutions**
 - Estimates of unmet SME credit demand exceed \$400 million.
 - Most SMEs are generally unable to satisfy lender collateral requirements, resulting in no credit access or insufficient loan sizes that do not meet the capital needs of borrowers.
 - SMEs are generally obliged to struggle with inadequate and poorly structured credit.

Source: Financing Palestinians SME, MAS

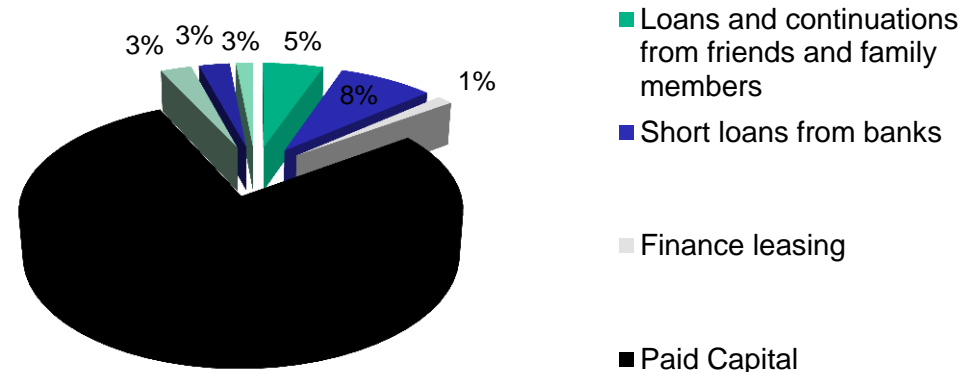


Relevant studies for MSMEs Innovation Financing

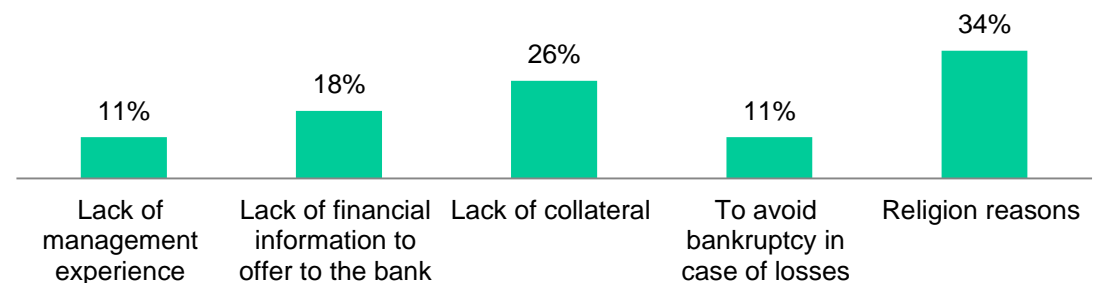


- 62% of the MSMEs answered that they did need extra finance to develop and to improve their business.
- Majority of MSMEs do not seek credit from banks or Microfinance institutions, but rather rely on:
 - Paid Capital represents the main source of business financing in MSMEs with a share of 78% of respondents.
 - This is followed by short term loans, loans from their families and friends, commercial credit and retained earnings respectively.

Sources of Finance for Palestinian MSMEs



Reasons of not getting loans (% of respondent)



Source: MSMEs in Palestine; Challenges and Potential, MAS 2010



Financing schemes and instruments

Strength and weakness of the system





Key Venture Capital/ Private Equity Programs



- 3 private equity/venture capital funds, mainly focusing on SMEs and start-ups:
 - Sadara Ventures, first technology-focused VC fund to target early stage investments invested in promising Palestinian start-ups such as Yamsafer.me, Souktel and Anoud Games.
 - Abraaj Capital, through Palestine Growth Capital Fund, US\$ 650 million SME investment platform to target investments in 13-15 businesses, which are expected to achieve tremendous growth and have the potential to expand into new regional and international markets.
 - Siraj Palestine Fund, a \$90 Million fund, private equity fund comprised of direct equity investments in viable start-up, distressed, SME and relatively large enterprises in Palestine across various economic sectors.



Incubation and Acceleration Financing Programs



- **Palestine ICT Incubator (PICTI)**
- **Arabreneur**
- **Leaders and FastForward**

Works with the entrepreneur to create customized financing opportunities through:

1. Access to VC Funds and Investors
2. Seed Capital Funds
3. Access to International Donors
4. Financial Planning



Challenges to Finance Innovation through VCs and Incubators



- Inability to secure initial funding for early-stage ventures due to the high risk and immature business idea (strong bias for finance for expansion).
- Absence of national plan/ lack of a policy framework for SMEs innovation to fund the SMEs innovation initiatives and programs.
- Most Incubation and accelerators depends on the donor funding to sustain their activities (limited impact and return on investment).
- *Capital for innovation**:
 - ✓ Palestine financial support system of innovative entrepreneurial ventures is still underdeveloped [due to current legislation]. While seed capital generally exists, grants for capital intensive entrepreneurial ventures are very small.
 - ✓ The Palestinian firms are facing difficulties in acquiring capital. Family businesses, most of the times, prefer to stay small and prefer not to bring in any external partner to their firms.
 - ✓ There is no centralized database on innovation support providers.

The participants ranked the financial support system of innovation as "poor" showing that grants and loans supporting innovative entrepreneurial ventures are very small. *

Source: Small Business Act

Source: * How Innovative is Palestine?, GSBD, 2014



Banks and key figures



- 17 banks (local and foreign) are operational in Palestine.
- Since 1994 banking activities has increased in total value, with public deposits reaching nearly \$8.3 billion (Palestine Banking Association, 2013).
- The ratio of loans to private sectors deposits is low in West Bank and Gaza in comparison with neighboring countries. The growth in public deposits in 2013 was accompanied by a clear growth in lending. The percentage of Net direct credit facilities / Customers' deposits has slightly increased from 29.4% in 2012 to 32.8% at the end of 2013.
- Financial market development in PA is limited, as domestic credit to the private sector remains relatively low, at only 24% of GDP in 2011 (Palestinian Economic Policy Research Institute, MAS).
- Regarding SME financing, the share of bank credit to SMEs was only 6% of total bank loans (Farazi *et al.*, 2011), while the average for the MENA region (excluding GCC countries) was more than 13% (Beck *et al.*, 2011).
- Personal contributions generally constituted the primary source of financing for around 80% of SMEs while bank credit accounted only for 8.2%. This low rate of bank lending prevails despite the fact that 60% of enterprises surveyed stated that they need external sources of financing (MAS survey, 2011).
- Source: Palestine Banks Association and Small Business Act



Challenges to Finance Innovation through Banks



Banks Operating in Palestine are Highly Liquid

- Despite great liquidity at banks, the role of banks in providing financing for MSMEs has been limited.
- The challenge is to facilitate the flow of available capital into the productive credit market.

Banks have Very Conservative Lending Policies

- Due to the unstable political climate, banks are very conservative and demand excessive collateral (often up to 130% - 200%).

**Difficulty in Accessing Capital Jeopardizes the Growth and Expansion
of this Vital Sector**



Key Microfinance Programs:



PMA is responsible for licensing MFIs and is in charge of their supervision and monitoring.

Microfinance sector in PA is still dominated by NGOs, funded by grants and donations, with only a few commercial banks providing microfinance services.

- *No. of Microfinance Institutions and Programs Under Sharakeh (11)*
- *Total Outstanding Portfolio \$74,698,065.91*
- *No. Of Active clients 43,131*
- *No. of Women Borrowers 23,294 = 54%*
- *Average Loan size \$1,732*

Source: Sharakeh, 2011

Key Microfinance Programs:

- Non for profit company (2)
 - **FATEN-REEF**
- Programs under International Organizations (4)
 - **CHF-YMCA-Islamic Relief-Relief International**
- Local NGO's (2)
 - **Asala - ACAD**
- Programs under financial institutions (1)
 - **PDF**
- **UNRWA**
- Programs under governmental institutions (1)
 - **Women Fund**

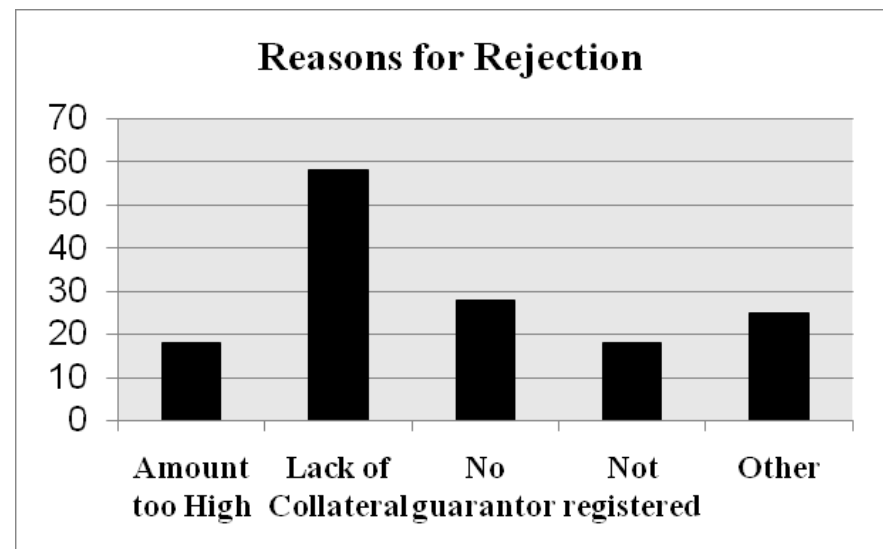


Challenges to Finance Innovation through MFIs



- Access to suitable finance is heavily constrained for young people in Palestine, unable to provide guarantees or not employed.
- The size of micro-finance loans is unsuitable with the cost of starting a business and self-financing is rarely an option.
 - Recent survey by Sharek indicated “*Almost 72% would like to own a business in the future.*”
- Young people need to be able to take risks in order to start their business
- Majority of micro-enterprises do not seek credit from banks or Micro Finance Institutions, but rather rely on family and suppliers. 37% of those who formally applied for a credit were rejected.”

Source: IFC and PNSMF
Microfinance Market Survey 2007





Key SME Credit Guarantee Fund Programs



- **European Palestinian Credit Guarantee Fund (EPCGF)/ KfW to support SME project**
 - Working in co-operation with 9 partner banks
 - 3,000 loan guarantees for a cumulative amount of USD 104 million (EUR 77 million)
- **PIF, OPIC and the Aspen Institute through MEI's Loan Guarantee Facility**
 - Partnerships with nine banks (2013)
 - 446 loan guarantees for approximately USD 85 million (EUR 63 million) to SMEs (2012).

Overall, both schemes guarantee between 60% and 70% of the value of the loans, and the most important qualifying criteria is meeting the definition of an SME and generating sufficient cash flow for the repayment of the loan.

Source: Small Business Act



Thank you for your attention

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