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POLICY ISSUES IN THE ESCWA REGION

INCLUSIVE FINANCING FOR SMALL AND MEDIUM-SIZED ENTERPRISES AND CREATING JOB OPPORTUNITIES

Summary

This background paper on inclusive finance discusses the status of financial inclusion in the region of the Economic and Social Commission for Western Asia (ESCWA) and the way forward. It provides an assessment of individual and small and medium-sized enterprise (SME) access to finance, examines the financial infrastructure in the region and proposes a set of policy recommendations to advance financial inclusion.

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I. BACKGROUND

1. Functional, productive financial systems allocate resources efficiently to spur economic development, improve income distribution, and equalize opportunities. Deficiencies in the financial sector result in missed growth opportunities, worsening poverty and widening inequality. Thus, finance matters not only for growth but also for inclusive growth. The Consultative Group to Assist the Poor and the World Bank estimate that around 2.7 billion adults around the world lack access to financial services.[1] According to the United Nations Advisors Group on Inclusive Financial Sectors, financial institutions are reluctant to provide a sustainable broad range of financial services to people and small and medium enterprises (SMEs).[2] Inclusive finance is “a means to an end – to help reduce poverty and meet other social and economic development objectives”,[3] thereby contributing to achieving the Millennium Development Goals of reducing poverty and inequality, fostering education and empowering women. The role of financial systems in promoting economic development is well documented, but much less work has been done on inclusive finance that fosters the equitable distribution of income and opportunities among economic agents.

2. Inclusive finance is an essential development issue comprising individual and enterprise finance that allows households and businesses to manage cash flows, build assets and guard against risk. Recently, there has been rising interest in financial inclusion across the globe. In June 2010, the Group of Twenty Finance Ministers and Central Bank Governors (G20) developed and endorsed the “Principles for Innovative Financial Inclusion”,[4] committed to improving access to financial services for the poor. Fundamentally, greater access to finance is not about increasing the number of people with bank accounts, but about removing price and non-price barriers to financial services. All economic agents, whether individual or institutional, need access to credit, savings, payments settlements, insurance, pension plans and remittance facilities.

3. In the Economic and Social Commission for Western Asia (ESCWA) region, financial systems lag behind other regions, thereby limiting positive spillover that would result from greater finance availability to the real economy. Capital markets are incomplete and are not deep enough to encourage capital formation. The main providers of credit (banking institutions) are generally reluctant to expand credit to individuals and businesses because deficiencies in financial infrastructure and regulatory frameworks make expanding access to finance costly and risky for banks. Other serious barriers to financial depth include: the lack of competition in the delivery of financial services; weak credit information systems and enforcement of creditor rights; inefficient judicial systems; and existing collateral regimes that are unreliable and not readily enforceable.[5]

4. This background paper on inclusive finance discusses the status of financial inclusion in the ESCWA region and the way forward. Section II provides an assessment of individual access to finance and section III examines SME access to finance. Section IV examines the financial infrastructure in the region and section V proposes a set of policy recommendations to advance financial inclusion.

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1 Consultative Group to Assist the Poor and the World Bank Group, *Financial Access 2010: The State of Financial Inclusion Through the Crisis* (Washington D.C., World Bank, 2010).

2 United Nations Advisors Group on Inclusive Financial Sectors, *Microcredit, Microfinance, Inclusive Finance: Building on Past Success* (New York, United Nations, 2008).

3 United Nations Secretary-General’s Special Advocate for Inclusive Finance for Development, *Annual Report to the Secretary-General 2010* (New York, United Nations, 2010).

4 http://www.g20.utoronto.ca/2010/to-principles.html.

5 Douglas Pearce, *Policy Research Working Paper, Financial Inclusion in the Middle East and North Africa: Analysis and Roadmap Recommendations* (Washington D.C., World Bank, 2011).

II. INDIVIDUAL ACCESS TO FINANCE

5. Inclusive financial systems benefit the poor by reducing income inequality and poverty in society. The challenge of financial inclusion is not simply about increasing the number of people who are banked, but more broadly about ensuring a wider quality and reach of financial services. Broadly defined, financial inclusion aims to improve the availability of financial services to all at a fair price. To better understand the status of financial inclusion for individuals in ESCWA member countries, this section reviews key indicators of financial access, obstacles to financial access, and non-bank financial outreach.

6. Ideally, the status of financial inclusion can be assessed based on data that show the use of financial services, such as the number of deposit and loan accounts, the number of depositors and borrowers, and the number of physical access points (such as branches, agents, and ATMs). Although countries in the ESCWA region record the total volume of deposits and loans, few of them collect other indicators of financial access. Even when other indicators of financial access are collected, it is difficult to avoid double counting when individuals have deposit and loan accounts across different institutions. Financial access indicators in selected ESCWA member countries are detailed in table 1.

TABLE 1. FINANCIAL ACCESS INDICATORS, INDIVIDUAL DEPOSIT AND LOAN ACCOUNTS

	Deposits						Loans					
	Accounts per 1,000 adults		Value (*percentage of GDP*)		Average account value (*percentage of income per capita*)		Accounts per 1,000 adults		Value (*percentage of GDP*)		Average account value (*percentage of income per capita*)	
	2009	2010	2009	2010	2009	2010	2009	2010[a/]	2009	2010	2009	2010[b/]
Egypt	-	439	-	-	-	-	-	85	-	-	-	-
Jordan	814	899	-	143	-	245	161	201	-	93	-	713
Kuwait	-	-	64	52	-	-	-	-	69	52	-	-
Lebanon	1 310	1 372	328	338	347	333	-	520	99	93	-	242
Oman	-	1 043	61	44	-	-	-	413	66	47	-	-
Saudi Arabia	-	-	-	-	-	-	-	47	-	-	-	8
Syrian Arab Republic	157	191	-	44	-	354	23	73	-	30	-	632
United Arab Emirates	-	1 751	-	-	-	-	-	-	-	-	-	-
West Bank-Gaza	-	-	-	-	-	-	-	50	-	-	-	8
Yemen	106	104	-	25	-	431	6	8	-	8	-	1 658
Average	597	828	151	108	347	341	63	175	78	54	-	544
World average	1 140	1 213	68	63	257	164	307	328	65	57	1 219	827
World median	744	804	49	44	94	72	247	272	53	41	275	270

Sources: Consultative Group to Assist the Poor and the World Bank Group, *Financial Access 2009: Measuring Access to Financial Services around the World* (Washington D.C., World Bank, 2009) pp. 54-56 and *Financial Access 2010: The State of Financial Inclusion Through the Crisis* (Washington D.C., World Bank, 2010) pp. 56-60.

Notes: A dash (-) indicates that the value is nil.

a/ Number of loans per 1,000 people for Saudi Arabia and West Bank-Gaza.
b/ Average loan size/GDP per capita for Saudi Arabia and West Bank-Gaza.

7. In the ESCWA region, the average number of individual deposit accounts per thousand adults stands below the corresponding world average and median figures. However, the average value of deposits both as a per cent of gross domestic product (GDP) and GDP per capita exceeds the corresponding world figures. Although deposit penetration in the ESCWA region lags behind world figures in terms of the number of

accounts, sources of funds are relatively more abundant. Lebanon scores highest on financial access indicators and Yemen scores lowest on access to financial services.

8. The average number of individual loan accounts in the region is below the corresponding world average and median, pointing to relatively low access to credit for individuals and firms. In contrast, the average value of loan accounts as a percentage of GDP is in line with world figures, despite a lower mean value for loan accounts relative to GDP per capita. Due to weak credit information and protection systems, banks are generally reluctant to extend credit, but when they do average loan account values are in line with international norms.

9. Non-geographic barriers can seriously hamper access to a range of basic financial services such as savings, credit, insurance, payments, and remittances. The delivery of financial services is associated with significant costs in the form of minimum deposit and loan balances, maintenance and payment fees, documentation requirements, and lengthy processing times. According to the World Bank, barriers to deposit services in the region are on the higher end of the spectrum compared to other countries.[6] Costs associated with individual access to consumer and mortgage loans also include the amount of credit extended, related fees and the amount of time required to process a loan application.

10. Other barriers to financial access include the relatively high cost to transfer funds internationally. When the cost to transfer funds internationally is high, individuals have a great incentive to use non-official channels to transfer money abroad. It is important for countries in the region to rethink their fee structure for transferring funds internationally if they are to achieve broader financial inclusion.

11. Financial access need not be confined to such traditional delivery channels as branch outlets and ATMs, which are costly to operate and maintain.[7] With the evolution of new technologies, other delivery channels have emerged, including bank agreements with non-financial institutions, mobile branches, phone and electronic finance. In other parts of the world, the challenge of increasing outreach in the delivery of banking services has been met through recent technology-enabled innovations, including the agent banking model in Brazil and the mobile banking model in Kenya. In the ESCWA region, mobile networks are generally well-developed and encompass a large segment of the population. Mobile and agent-based financial services have the potential to transform access to finance. Recent cooperation in Yemen between MTN Mobile Money and Cooperative Agricultural Credit, one of the largest state-owned banks in the country, is one of the few emerging mobile phone banking services in the region. The Mobile Money product is a mobile electronic wallet, where customer funds are kept in Cooperative Agricultural Credit's large network of branches, ATMs, and POS systems. In Iraq, a strategic partnership between banks and AsiaCell is intended to provide money transfer services through mobile phones.[8] Egypt has a very low rate of financial access, but mobile phone banking services could improve access to financial services because 65 per cent of the Egyptian population has a mobile phone .[9]

12. Finally, financial outreach extends beyond banking institutions. Microcredit presents an alternative model of financial inclusion and plays a central role in improving access to financial services and employment for low-income households and microbusinesses. Microcredit helps to incorporate inactive

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[6] Aslı Demirgüç-Kunt, Thorsten Beck, and Patrick Honohan, *Finance for All?: Policies and Pitfalls in Expanding Access* (Washington D.C., World Bank, 2008).

[7] Examples of traditional delivery channels include Egypt Post, which serves over 17 million microentrepreneurs and lower income clients through 3,700 outlets nationwide, providing savings, payments and domestic transfer services. Similarly, Yemen Post Office has more branches than commercial banks and it serves 403,000 clients providing domestic transfers, government salary disbursements, retiree pensions, and social welfare payments.

[8] Douglas Pearce, *Financial Inclusion in the Middle East and North Africa*, p. 18.

[9] Ibid., p. 17.

members of the labour force (especially women) into production activities, improving household welfare and promoting human dignity.

13. In the ESCWA region, microfinance institutions that provide a broad range of financial services to low-income people and microenterprises have increased in importance over the past few years.[10] From 2008 to 2009, the number of microfinance borrowers increased across most of the ESCWA region (table 2).

TABLE 2. ACTIVE BORROWERS IN THE MICROCREDIT SECTOR

Country	2006	2007	2008	2009
Bahrain	2 175	2 175	2 175	2 175
Egypt	751 529	1 093 539	990 145	1 130 746
Iraq	15 234	24 597	38 084	55 266
Jordan	77 778	110 202	139 715	161 154
Lebanon	16 109	21 284	27 759	38 036
Saudi Arabia	7 000	7 012	7 064	7 064
Syrian Arab Republic	50 611	54 620	22 660	26 118
Yemen	33 934	34 062	34 982	41 268
Total	954 370	1 347 491	1 262 548	1 461 827

Source: Microfinance Information Exchange (MIX), Sanabel, and Consultative Group to Assist the Poor, *2009 Arab Microfinance Analysis & Benchmarking Report* (Washington D.C., MIX, 2010) pp. 2-5.

Notes: A dash (-) indicates that the value is nil.

14. However, microcredit outreach is generally limited in scale, with active borrowers as low as 0.16 per cent of the working age population in Iraq to 3.7 per cent in Jordan. Egypt has the largest number of microfinance institutions (MFIs) whereas Yemen and Jordan have the highest per cent of women borrowers. Outreach to the poor in Jordan is highest at 65.6 per cent and is lowest in Yemen at 0.2 per cent. Nonetheless, the total volume of microcredit as a proportion of domestic private credit is below 1 per cent in selected ESCWA member countries (table 3).

TABLE 3. MICROCREDIT OUTREACH IN SELECTED ESCWA MEMBER COUNTRIES

Country	Microfinance providers	Percentage of women borrowers	Percentage active borrowers/population of working age	Percentage clients/population in poverty	GLP[a/]/Total credit[b/]
Egypt	14	55.7	1.69	5.8	0.24
Iraq	4	14.7	0.16	-	0.45
Jordan	7	84.1	3.7	65.6	0.68
Lebanon	3	32.8	0.84	-	0.1
Palestine	8	43.2	1.68	-	-
Syrian Arab Republic	2	31.4	0.18	7.2	0.04
Yemen	6	95.8	0.2	0.2	0.16

Source: Adapted from Douglas Pearce, *Financial Inclusion in the Middle East and North Africa: Analysis and Roadmap Recommendations, Policy Research Working Paper 5610* (Washington D.C., World Bank, 2011) p. 9.

Notes: A dash (-) indicates that the value is nil.

a/ Gross (microcredit) Loan Portfolio.
b/ Domestic private credit to the real sector by banks.

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[10] The Arab Gulf Programme for Development has set up microfinance institutions in Bahrain, Egypt, Jordan, the Syrian Arab Republic and Yemen, and the Aga Khan Agency has also committed to establishing such specialized financial institutions, one of which is the Social Financial Banking Institution in the Syrian Arab Republic. From Douglas Pearce, *Financial Inclusion in the Middle East and North Africa.*

III. SME ACCESS TO FINANCE

15. Financial inclusion in the private sector is also needed. In the ESCWA region, SMEs make up the vast majority of the private sector, and they have an important role to play in building a competitive private sector that drives employment activity. Relative to larger firms, SMEs are at a disadvantage with fewer internal resources and less capacity to compete in international markets. In addition, SMEs are significantly financially constrained, which limits their capacity to increase employment and produce sustainable growth.[11] According to the International Finance Corporation, small firms find it difficult to secure long-term bank financing because they lack collateral. They may have difficulty in proving credit-worthiness due to inadequate credit history and they may be required to pay high risk premiums and transaction costs because of insufficient cash flow.[12]

16. Results from the World Bank Business Survey indicate that firms in the Middle East and North Africa (MENA) region report that access to finance is a severe obstacle to growth, with only one in five SMEs having a loan or a line of credit and with as little as 10 per cent of SME expenditures financed by a bank loan. Similarly, a study by EU-GCC Chamber Forum lists access to finance among the top obstacles hindering the development of SMEs in the GCC region along with bureaucracy impediments and limited talented human resources.[13]

17. The majority of firms in the ESCWA region are small family-owned businesses that originated with the initial owners' equity and relied on internally generated capital in subsequent years. As firms grow, their ability to invest and expand becomes critically dependent on the availability of external finance provided by financial intermediaries because of inefficient or inactive capital markets. Heterogeneous access to financing widens inequalities in the production capacity of firms and creates a vicious cycle that limits the growth prospects of lower-capital sectors and production units. Thus, unequal financing availability and conditions undermine the growth and prospects of businesses and perpetuate social inequality. Improved SME access to financing generates more employment and helps close the gap with large companies. To that end, countries in the region have adopted targeted SME financing policies (box 1).

Examples of SME financing policy and programme initiatives in selected ESCWA member countries

Egypt

- The National Microfinance Strategy was launched in 2006.
- Microfinance Law was drafted to regulate activities of MFIs and NGOs delivering microfinance.
- Amendments to the leasing law in 2006 reduced the time required to register a leasing company.
- In 2007, the Prime Minister approved a governmental Fund of Funds (US$100 million) for promising SMEs and high-growth potential start-ups. The Ministry of Finance and the Ministry of Investment are examining legal issues and guidelines.
- The Credit Bureau (I-Score) was launched in 2007 (founded and owned by 25 banks and the Social Fund for Development) to provide borrower credit history to lenders. The aim is to facilitate SME access to financing.
- SME Unit was established in the Egyptian Banking Institute in 2007 to provide technical assistance and training to banks on lending to SMEs and to SMEs on approaching banks for financing.
- SME Exchange (NILEX) was launched on Cairo and Alexander Stock Exchange in 2007, with the target to have 100 SME listings by 2015.

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[11] Lois Stevenson, *Private Sector and Enterprise Development: Fostering Growth in the Middle East and North Africa* (Ottawa, International Development Research Centre, 2010).

[12] International Finance Corporation (IFC), *The SME Banking Knowledge Guide* (Washington D.C., IFC, 2009).

[13] Steffan Hertog, *Benchmarking SME policies in the GCC: a survey of challenges and opportunities* (Brussels, Eurochambres, 2010).

Jordan

- The Microfinance Committee was established in 2005 to prepare a five-year National Strategy for Microfinance Development which was launched in 2008. It provides a supervisory and regulatory framework for expansion of MFI activity. The Microfinance Network was established to provide technical assistance and capacity-building to MFIs and commercial banks.
- In 2008, Jordan Enterprise created two venture capital funds – an Early Stage Fund (€5 million) and a Capital-for-Growth Fund (€20 million).
- Regulations for the licensing of credit bureaus are expected to be issued by the Central Bank of Jordan.

The Syrian Arab Republic

- The General Microfinance Decree was issued in 2007 to permit the licensing of Social Financial Banking institutions to provide microlending, deposit-taking and microinsurance to the poor.
- The Central Bank of Syria, in cooperation with Ministry of Finance and private and public banks (assisted by KfW) began preparations for a credit guarantee scheme and leasing law in 2008.
- The Government recently licensed a number of holding companies to mobilize equity funds from private investors.
- The Capital Markets Authority was established in 2006; the Syria Stock Exchange became operational in 2009.

Source: Adapted from Lois Stevenson, *SMEs in the Arab Region: Challenges and Opportunities: A Focus on Seven MENA Countries* presented at ESCWA conference 'Innovative Sources to Finance SMEs', Dubai, 16-17 February 2010.

18. The Financial Access database represents a first attempt to collect global comparable statistics on SMEs from central banks and financial regulators.[14] Out of 142 regulators, very few were from the ESCWA region. Though SMEs are commonly defined as registered businesses with less than 250 employees for other parts of the world,[15] the definition in the ESCWA region varies by country and by bank.[16] The Sudan defines SMEs as businesses with a maximum of 10 employees as opposed to Oman's definition of 99 employees. Kuwait defines SMEs by the maximum loan size of US$868,703 whereas the corresponding figure for the Syrian Arab Republic is US$107,048. Lebanon and Oman have disclosed definitions for SMEs in terms of maximum sales volume (US$5 million and US$5,201,561, respectively). Only Jordan and the Syrian Arab Republic reported that they regularly monitor SME lending and Jordan is the only country in the region to actually provide the total outstanding SME loan volume. Lebanese banks have recently begun disclosing SME lending activity.

19. A recent joint survey by the Union of Arab Banks and the World Bank, examined the supply side of credit or the perception of banks in relation to financing SMEs found that banks in the region regard the SME segment as potentially profitable, offering the possibility to diversify portfolio risks.[17] Large banks are not necessarily engaged in more SME financing compared to banks which maintain a wide network of branches, stressing the importance of relationship banking in this region where weak financial infrastructures prevail. Further, State banks seem to play a more significant role in financing SMEs in the region, while

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[14] Consultative Group to Assist the Poor and the World Bank Group, *Financial Access 2010.*

[15] IFC, *The SME Banking Knowledge Guide.*

[16] Other SME definitions use sales volume or total assets. See Hertog, *Benchmarking SME policies in the GCC* for different SME definitions.

[17] Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, *The Status of Bank Lending to SMEs in the Middle East and North Africa Region, Policy Research Working Paper 5607* (Washington D.C., World Bank, 2011).

other special programmes provide incentives for SME lending such as reserve requirements exemption, credit subsidies, and partial credit guarantee schemes. Probably the most alarming finding of the survey is that the share of SME lending is only 6.29 per cent (table 4 and figure 1), although significant variations prevail across the region.

Figure I. Percentage of SME loans/Total loans

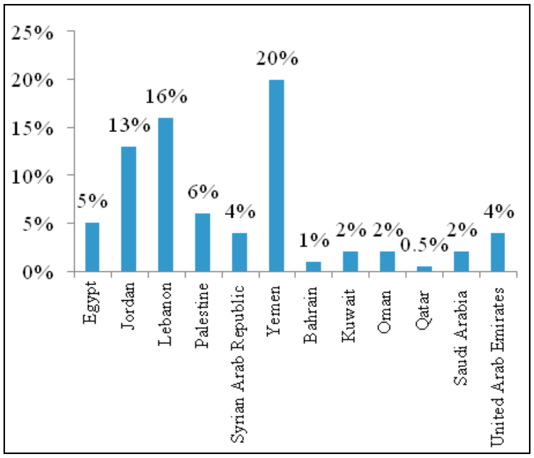

TABLE 4. PERCENTAGE OF SME LENDING IN TOTAL LOANS IN SELECTED ESCWA MEMBER COUNTRIES

Egypt	5
Jordan	13
Lebanon	16
Palestine	6
Syrian Arab Republic	4
Yemen	20
MDEs average	*10.67*
Bahrain	1
Kuwait	2
Oman	2
Qatar	0.5
Saudi Arabia	2
United Arab Emirates	4
GCC average	*1.92*
Combined average	*6.29*

Source: Figure and table adapted from Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, *The Status of Bank Lending to SMEs in the Middle East and North Africa Region, Policy Research Working Paper 5607* (Washington D.C., World Bank, 2011) p. 20.

20. Where the average ratio of SME loans to total loans stands at 10.67 per cent for more diversified economies (MDEs), it is less than 2 per cent in GCC countries, notwithstanding significantly higher bank targets for SME lending. These figures contrast sharply with the average share of SME lending of 22 per cent in developed countries and 16 per cent in developing countries.[18]

21. Although data on SME access to finance is not readily available, an estimation of loans to SMEs in the region and their share in domestic credit to the private sector can be made based on information drawn from a variety of sources (table 5). There is great disparity in SME financing across the ESCWA region.

22. Estimates for SME lending are as low as US$32 million in Palestine and US$91 million in Yemen, and as high as US$7.1 trillion in the United Arab Emirates, US$4.1 trillion in Saudi Arabia and US$3.6 trillion in Jordan. The estimated total volume of SME lending stands at US$9.1 trillion for MDEs and US$13.6 trillion for GCC countries. The share of SME loans in domestic credit to the private sector is nearly 20 per cent in Jordan, followed by 10.36 per cent in Lebanon. However, all corresponding figures for other countries in the ESCWA region are below 5 per cent, falling as low as 0.53 per cent in Qatar. The average share of SME lending in domestic private credit is 8.44 per cent in MDEs, whereas it stands at less than 2 per cent in GCC economies. The average share of SME lending in the GCC region is low because it mirrors the less-diversified structure of oil-based economies dominated by large corporations that are likely to seek financing from non-bank sources, particularly through capital market funding. These figures suggest that MDEs can foster private sector development by achieving greater financial inclusion for SMEs.

[18] Thorsten Beck, Asli Demirgüç-Kunt, and Maria Soledad Martinez Peria, *Bank Financing for SMEs around the World: Drivers, Obstacles, Business Models, and Lending Practices, Policy Research Working Paper 4785* (Washington D.C., World Bank, 2008).

TABLE 5. ESTIMATES OF SME LOANS, 2009

Country	Industry loans[1] (thousands of US$)	Banking sector market share[2] (%)	Industry loan representation[a/] (thousands of US$)	SME loans/ Total loans[2] (%)	SME loans[b/] (thousands of US$)	Domestic credit to private sector[3] (thousands of US$)	SME loans/Domestic credit to private sector[c/]
Egypt	77 400 000	60	46 440 000	5	2 322 000	68 446 684	3.39
Jordan	30 400 000	91	27 664 000	13	3 596 320	17 991 113	19.99
Lebanon	36 300 000	46	16 698 000	16	2 671 680	25 796 435	10.36
Palestine	570 500	95	541 975	6	32 519	..	..
Syrian Arab Republic	11 500 000	90	10 350 000	4	414 000	10 954 928	3.78
Yemen	1 381 363	33	455 850	20	91 170	1 943 943	4.69
MDEs total	*157 551 863*	*69.17*†	*102 149 825*	*10.67*†	*9 127 688*	*125 133 103*	*8.44*†
Bahrain	63 700 000	67	42 679 000	1	426 790	16 386 610	2.60
Kuwait	114 000 000	60	68 400 000	2	1 368 000	94 196 600	1.45
Oman	26 100 000	71	18 531 000	2	370 620	22 595 850	1.64
Qatar	69 900 000	77	53 823 000	0.5	269 115	50 596 082	0.53
Saudi Arabia	209 000 000	98	204 820 000	2	4 096 400	195 796 504	2.09
United Arab Emirates	258 000 000	69	178 020 000	4	7 120 800	214 173 185	3.32
GCC total	*740 700 000*	*73.67*†	*566 273 000*	*1.92*†	*13 651 725*	*499 548 232*	*1.94*†
Combined total	*898 251 863*	*71.42*†	*668 422 825*	*6.29*†	*22 779 413*	*624 681 335*	*4.90*†

Sources: 1 Bankscope, available at http://www.bvdep.com/kr/BANKSCOPE.html.

2 Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, *Policy Research Working Paper, The Status of Bank Lending to SMEs in the Middle East and North Africa Region* (Washington D.C., World Bank, 2011) p. 31.

3 World Development Indicators, available at http://data.worldbank.org/data-catalog/world-development-indicators.

Notes: Two dots (..) indicate that data are not available.

a/ Total industry loans x banks' market share.
b/ Industry loan representation x SME loans/Total loans.
c/ SME loans/Domestic credit to private sector.

† Average figures.

23. In the light of scarce funding for SMEs in the region, specialized credit entities and guarantee mechanisms have been set up to facilitate access to financing that the market did not spontaneously provide. Table 6 contains data on selected partial credit guarantee schemes in the region. Equity size and ownership vary among funds, with the smallest being the Loan Guarantee Institution of the Syrian Arab Republic.

24. The largest credit guarantee schemes are in Saudi Arabia, followed by Egypt and Lebanon. Generally, Governments in the region are significant participants in credit guarantee schemes, though Egypt and Iraq have privately owned funds. An assessment of the effectiveness of credit guarantee schemes in the MENA region found that though they are few in number their average value is large (table 7). Credit guarantee schemes target a limited segment of firms and do not yet reach a significant number of small firms.

TABLE 6. PARTIAL CREDIT GUARANTEE SCHEMES

Country	Name	Starting date	Equity (millions of US$)	Shareholders (percentage) Government	Banks	Other
Egypt	Credit Guarantee Company	1991	52	-	90	10
Iraq	Iraqi Company for Bank Guarantees	2007	12	-	100	-
Jordan	Jordanian Loan Guarantee Corp.	1994	..	60	14	26
Lebanon	Kafalat	1999	50	37.5	62.5	-
Palestine	European-Palestinian Credit Guarantee	2005	40	100	-	-
Saudi Arabia	Saudi Industrial Development Fund	2005	57	50	50	-
Syrian Arab Republic	Loan Guarantee Institution of Syria	2010	10	94	-	6
United Arab Emirates	Khalifaa Fund	2010	..	90	10	-

Source: Youssef Saadani, Zsofia Arvai, and Roberto Rocha, *Policy Research Working Paper, A Review of Credit Guarantee Schemes in the Middle East and North Africa Region* (Washington D.C., World Bank, 2011) p. 7.

Notes: A dash (-) indicates that the value is nil.

Two dots (..) indicate that data are not available.

TABLE 7. OUTREACH OF SELECTED CREDIT GUARANTEE SCHEMES IN THE REGION, 2009

Country	Number of guarantees issued	Per million people	Outstanding guarantees Amount (millions of US$)	Percentage of GDP[a/]	Percentage total loans to SMEs	Average value of guarantees issued Amount in US$	Scaled by GDP per capita[a/]
Egypt[b/]	3 595	45	162	0.07	9	37 830	22
Iraq	964	33	8	0.01	..	10 000	5
Jordan	245	41	16	0.07	1.4	37 700	10
Lebanon	1 169	292	292	0.90	10	117 000	14.6
Palestine	539	128	18	0.30	33	18 000	11.4
Saudi Arabia	504	18	69	0.03	3.2	95 000	13
Average	*1 169*	*93*	*94*	*0.23*	*11*	*52 588*	*13*

Source: Adapted from Youssef Saadani, Zsofia Arvai, and Roberto Rocha, *Policy Research Working Paper, A Review of Credit Guarantee Schemes in the Middle East and North Africa Region* (Washington D.C., World Bank, 2011) p. 26.

Notes: Two dots (..) indicate that data are not available.

a/ Excluding oil.
b/ Excluding microloans.

25. This could be due to weak financial infrastructure and weak lending technologies. However, in view of their financial soundness, credit guarantee schemes have the potential to grow and play a greater role in financing SMEs.[19]

[19] Youssef Saadani, Zsofia Arvai, and Roberto Rocha, *Policy Research Working Paper, A Review of Credit Guarantee Schemes in the Middle East and North Africa Region* (Washington D.C., World Bank, 2011).

IV. SME USE OF FINANCE AND JOB CREATION: EMPIRICAL ANALYSIS

26. To shed more light on the impact of SME finance on job creation, a unique sample of 1,330 private and public firms has been built using data from various sources over the period 2007-2010.[20] Descriptive statistics on the funding and portfolio compositions, liquidity and profitability conditions of the industrial sector in the ESCWA region are contained in table 8 and reveal interesting insights.

TABLE 8. CHARACTERISTICS OF SMES VS. LARGE FIRMS

Panel A: SMEs	MDEs					GCC				
Variable	Firms*	Mean	StdDev	Min	Max	Firms*	Mean	StdDev	Min	Max
Asset composition										
Current assets/Total assets	252	50.9	27.4	1.1	100.0	200	41.2	26.9	2.2	99.7
Fixed assets/Total assets	252	41.4	28.8	-	98.9	199	44.8	31.6	-	97.5
Funding structure										
Current liabilities/Total assets	194	23.4	18.0	0.6	95.5	167	22.8	16.2	0.6	66.8
Total debt/Total assets	174	22.7	19.3	0.1	91.2	159	28.6	23.0	1.5	99.1
Equity/Total assets	173	70.9	21.2	8.8	99.6	158	67.5	23.8	0.9	98.5
Turnover/Liquidity										
Asset turnover*	194	0.7	1.0	-	7.8	149	0.9	1.7	-	15.0
Current ratio*	197	4.8	6.3	-	41.0	172	3.4	4.7	0.1	40.6
Profitability										
Pretax profit margin	154	9.0	25.2	-97.3	76.1	122	5.9	30.6	-98.6	82.8
Pretax return on assets	200	5.9	14.1	-32.7	69.3	164	3.1	10.0	-24.1	54.2
Pretax return on equity	160	5.7	13.6	-51.1	54.9	138	4.5	16.8	-85.3	51.3
Panel B: Large firms	MDEs					GCC				
Variable	Firms*	Mean	StdDev	Min	Max	Firms*	Mean	StdDev	Min	Max
Asset composition										
Current assets/Total assets	569	53.3	23.9	3.0	99.7	309	42.2	22.8	0.4	96.2
Fixed assets/Total assets	569	44.4	24.0	0.3	97.0	309	52.6	24.8	0.3	99.6
Funding structure										
Current liabilities/Total assets	450	32.2	17.9	1.7	153.4	293	26.2	15.3	2.1	84.9
Total debt/Total assets	282	34.4	23.0	0.1	98.3	281	33.7	19.6	0.1	84.9
Equity/Total assets	280	56.7	22.8	3.4	99.7	281	62.3	20.8	12.8	99.9
Turnover/Liquidity										
Asset turnover*	426	0.8	0.9	-	9.4	276	0.6	0.5	-	2.9
Current ratio*	452	2.5	3.1	0.2	48.3	294	2.3	2.5	-	22.7
Profitability										
Pretax profit margin	378	12.8	26.8	-87.1	268.2	257	13.8	19.4	-65.4	76.6
Pretax return on assets	499	11.1	16.8	-53.8	78.1	289	7.8	8.7	-14.2	70.2
Pretax return on equity	269	16.0	23.2	-79.3	109.2	261	11.1	14.0	-40.7	52.0

Source: data are drawn from various sources as described in the text.

Notes: A dash (-) indicates that the value is nil.

* All figures are percentages, except for the number of firms, asset turnover, and the current ratio.

27. The structure of asset composition in MDE and GCC countries indicates that SMEs invest less in fixed assets relative to large firms. The lower capital expenditures of SMEs eventually decrease prospects for profitability and growth. This finding is consistent with the lower overall profitability of SMEs compared to

[20] Data are drawn from the Orbis Database http://www.bvdinfo.com/Products/Company-Information/International/ORBIS.aspx and Zawya http://www.zawya.com/.

larger corporations using various measures of profitability (pretax profit margin, pretax return on assets and pretax return on equity).

28. More importantly, the analysis of capital structure points to greater reliance on current liabilities for large firms than for SMEs. Large businesses are likely to have access to more bank credit in the form of funding lines from commercial banks compared to SMEs that usually have little or no credit history. More importantly, SMEs in the ESCWA region rely considerably less on debt financing and more on equity sources of funds relative to large businesses in order to finance their investments. While lower reliance on debt financing reduces the likelihood of bankruptcy, it nonetheless points to a deficiency in the ability of SMEs to borrow funds when compared to larger firms. Thus, descriptive statistics indicate that SMEs are more financially constrained relative to large firms, whether the company operates in a MDE or the GCC.

29. Further, the current ratio of assets to liabilities is consistently higher for SMEs than for large firms. Higher current ratios indicate that SMEs maintain better liquidity positions compared to their peers to be able to meet short-term obligations, probably because of lower access to alternative liquidity lines relative to large firms. In summary, descriptive statistics shows that financing and operating conditions differ for SMEs and for large firms.

30. Using a multivariate regression framework, a unique database on corporate firms can be used to investigate: (a) the degree to which SMEs operating in the MENA region are financially constrained (table 9); and (b) what the implications of corporate financing on job creation may be (table 10).

TABLE 9. SMEs AND DEBT FINANCING, RANDOM EFFECTS MODELS

	Model (1)	Model (2)	Model (3)
SME[a/]	-9.84	-9.935	-9.21
	(1.564)***	(1.557)***	(1.558)***
Firm age[b/]	-0.055	-0.051	-0.082
	(0.043)	(0.043)	(0.043)*
Credit bureau[c/]	-	4.05	4.704
	-	(1.879)**	(1.946)**
Public registry[c/]	-	4.764	5.554
	-	(1.837)***	(2.056)***
Industry loans/Assets ratio	-	-	0.167
	-	-	(0.077)**
Asset concentration[d/]	-	-	0.055
	-	-	(0.068)
Foreign assets[e/]	-	-	0.13
	-	-	(0.072)*
Telephone lines/100 people	-0.582	-0.796	-0.873
	(0.152)***	(0.188)***	(0.196)***
Real GDP growth rate	-0.18	-0.187	-0.167
	(0.099)*	(0.100)*	(0.102)
GDP per capita	3.544	5.11	5.922
	(1.032)***	(1.196)***	(1.520)***
Constant	12.927	-2.644	-19.242
	(7.784)*	(9.789)	(11.645)*
Number of observations	1 403	1 403	1 403

Notes: A dash (-) indicates that the value is nil.
Robust standard errors clustered by country are in parentheses. * $p<.1$, ** $p<.05$, *** $p<.01$.
The dependent variable is the ratio of debt to assets.

a/ Dummy variable set to 1 if the number of employees is below 250.
b/ The number of years that the firm is in existence at the end of 2010.
c/ Dummy variables that designate the presence of a private credit bureau and public credit registry.
d/ Total asset concentration of the largest three banks.
e/ Foreign banks' share in the industry's total assets.

TABLE 10. DEBT FINANCING AND EMPLOYMENT, BETWEEN EFFECTS MODELS

	Panel A: full sample			Panel B: SMEs			Panel C: large firms		
	Model (1)	Model (2)	Model (3)	Model (1)	Model (2)	Model (3)	Model (1)	Model (2)	Model (3)
Debt to assets[a/]	0.013	0.013	0.013	0.01	0.009	0.008	0.006	0.006	0.006
	(0.003)***	(0.003)***	(0.003)***	(0.003)***	(0.003)***	(0.003)***	(0.002)***	(0.002)**	(0.002)**
Firm size[b/]	0.47	0.496	0.468	0.012	0.039	0.031	0.365	0.366	0.365
	(0.032)***	(0.034)***	(0.034)***	(0.048)	(0.049)	(0.049)	(0.027)***	(0.028)***	(0.028)***
Firm age[c/]	0.022	0.021	0.02	0.013	0.013	0.01	0.007	0.007	0.008
	(0.003)***	(0.003)***	(0.003)***	(0.005)***	(0.005)***	(0.005)**	(0.002)***	(0.002)***	(0.002)***
Credit bureau[d/]	-	0.137	0.237	-	0.044	0.112	-	0.264	0.183
	-	(0.166)	(0.178)	-	(0.238)	(0.254)	-	(0.125)**	(0.138)
Public registry[d/]	-	0.207	0.319	-	0.567	0.893	-	0.199	0.072
	-	(0.172)	(0.216)	-	(0.247)**	(0.356)**	-	(0.132)	(0.162)
Loans/Assets[e/]	-	-	0.041	-	-	-0.008	-	-	0.006
	-	-	(0.009)***	-	-	(0.013)	-	-	(0.007)
Asset concentration[f/]	-	-	-0.022	-	-	-0.025	-	-	-0.009
	-	-	(0.007)***	-	-	(0.011)**	-	-	(0.006)
Foreign assets[g/]	-	-	0.012	-	-	-0.003	-	-	0.006
	-	-	(0.008)	-	-	(0.010)	-	-	(0.006)
Telephone Lines/100 people	0.014	0.029	0.045	0.013	0.019	0.013	0.018	0.002	0.007
	(0.009)	(0.015)*	(0.016)***	(0.016)	(0.021)	(0.023)	(0.009)**	(0.012)	(0.013)
Real GDP growth	0.029	0.004	0.02	-0.039	-0.042	-0.048	0.024	0.021	0.027
	(0.012)**	(0.014)	(0.015)	(0.017)**	(0.017)**	(0.019)**	(0.011)**	(0.011)*	(0.012)**
GDP per capita	-	-0.22	-0.567	-0.079	0.031	0.196	-0.09	0.001	-0.061
	-	(0.099)**	(0.152)***	(0.105)	(0.117)	(0.234)	(0.065)	(0.082)	(0.122)
Constant	-0.862	0.355	1.578	3.913	2.195	1.094	2.505	1.711	1.958
	(0.332)***	(0.879)	(1.161)	(0.774)***	(1.044)**	(1.660)	(0.545)***	(0.738)**	(0.965)**
Number of observations	1 379	1 379	1 379	573	573	573	806	806	806

Notes: A dash (-) indicates that the value is nil.

Robust standard errors clustered by country are in parentheses. * p<.1, ** p<.05, *** p<.01.
The dependent variable is firm employment considered as the natural logarithm of the number of employees for each firm.

a/ The ratio of the firm's debt to assets.
b/ The natural logarithm of the firm's total assets.
c/ The number of years that the firm is in existence at the end of 2010.
d/ Dummy variables that designate the presence of a private credit bureau and public credit registry.
e/ Industry loans to assets ratio.
f/ Total asset concentration of the largest three banks.
g/ Foreign banks' share in the industry's total assets.

31. Five main findings emerged from the data analysis. First, only 10 per cent of SMEs report their financials. The absence of past performance records discourages banks from extending credit to them. Greater disclosure of information may be achieved by increasing the financial literacy of SME owners.

32. Second, SMEs benefit from well-developed financial infrastructure and greater competition in the provision of financial services. The supply of credit is currently constrained by weak financial infrastructure and very high bank concentration. Those barriers could be overcome if countries promote the development of new financial products tailored to the needs of SMEs (factoring, leasing, Islamic finance), in parallel with the establishment of collateral registries to ensure better protection of creditor rights.

33. Third, older firms have greater employment capabilities than younger firms. Thus, ensuring SME survival is crucial for private sector development and this can be achieved by improving the business environment and investment climate for firms.

34. Fourth, compared to large firms, SMEs rely significantly less on debt financing and more on equity sources of funds. Greater reliance on equity is associated with a higher cost of capital and impairs firm competitiveness. The reliance of SMEs on equity could be changed through strategies at the national level to increase SME access to financing.

35. Fifth, reliance on debt financing relative to equity significantly fosters job creation within SMEs. Two scenarios for SME financing and job creation have been developed based on wide and narrow definitions of SMEs. If SME are defined widely as firms with fewer than 250 employees, a 1 per cent increase in the debt to assets ratio can be expected to increase employment by 1.01 per cent. Under those assumptions, the average new job costs US$4,833 in credit. It is estimated that region needs 50-75 million new jobs over the next decade to ensure social and political stability and the model predicts that those jobs could be created with US$241.65 billion to US$362.48 billion in new SME financing. These financing needs can be met with current excess liquidity in the banking sector.[21] If SMEs are defined narrowly as those firms that generate less than US$5 million in annual sales, a 1 per cent increase in the debt to assets ratio raises employment by 1.018 per cent. Under those assumptions, the average new job costs US$161,109 in credit. To create 50 million new jobs over the next decade would require an estimated US$8.05 trillion in new financing for SMEs. Assuming a 10 per cent increase in loans and deposits, cumulative excess liquidity over 10 years amounts to US$3.8 trillion. To fill the remaining gap, large firms could be encouraged to raise funds through debt markets thereby freeing bank resources for SMEs.

V. FINANCIAL INFRASTRUCTURE DEVELOPMENT

36. Since the majority of companies are small, SME financing is receiving a lot of attention from policymakers. Early policies focused on direct government intervention, subsidizing SMEs lines of credit, and providing public guarantee funds, but recently there has been a move away from size-oriented policies and towards levelling the playing field across all firms. Particular attention is given to improving financial infrastructure and fostering a business environment that is conducive to private commercial transactions.

37. Financial infrastructure is an enabling factor for industrial firms to survive and thrive. All businesses are affected by the efficiency in the delivery of financial services, from the provision of credit lines and payment systems to insurance coverage, pension allocations, and long-term loans. Banks in the region are most concerned about the transparency of SMEs and the weak financial infrastructure to ensure protection of the rights of credit providers.[22] Firms in the region are generally single proprietor companies, and the distinction between company and private assets is often blurred. In the light of insufficient disclosure, limited credit history and an absence of official income records, credit institutions incur high fixed costs for information gathering and loan assessment and monitoring. As a result, banks impute a higher risk factor for microenterprises and SMEs, thereby increasing the cost of borrowing.

38. Against this background, the optimal solution to increase SME access to finance would be to reduce borrowing costs by bridging the information gap. Greater availability of information and the use of automated credit appraisal or scoring systems should facilitate transactional lending. Credit registries can provide valuable assessments of borrower risk, allowing creditors to allocate funds efficiently. The improvement of collateral and credit information systems and the strengthening of the judicial framework will make it possible for firms to leverage their assets. More loans can then be extended at a lower cost, thereby increasing access to credit. With greater access to finance, industrial firms can create high-quality, sustainable jobs and close the labour productivity gap which will have a positive impact on social inclusion and help to bring about greater social equality.

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[21] Data from Bankscope reveal that excess liquidity stood at US$457 billion in 2010, or the difference between US$1.478 trillion in deposits and US$1.021 trillion in loans. http://www.bvdep.com/kr/BANKSCOPE.html.

[22] Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, *The Status of Bank Lending to SMEs in the Middle East and North Africa Region.*

39. In the ESCWA region, financial infrastructure remains to be developed to promote greater credit availability. To offer credit to borrowers, banks need to be able to cross-check data on borrowers to reliably identify those who are creditworthy and those who are not. Iraq, Jordan, Lebanon, the Sudan and Yemen do not have credit bureaus. All GCC countries except Qatar have established credit bureaus to record the credit worthiness of existing and prospective borrowers and to allow credit information to be shared between various institutions.[23] Egypt set up a credit bureau in 2005, as did the Palestinian Authority. The existence of a credit bureau, however, does not ensure that it functions adequately. In the United Arab Emirates, for example, the EMCREDIT information service was established in 2006, but it has limited data based on voluntary disclosure and does not receive sufficient support from the central bank.

40. In addition to credit information systems, collateral frameworks help to reduce moral hazard and creditor risk, and are conducive to a robust access to credit. However, most firms in the region, whether microenterprises or SMEs, usually do not have adequate collateral to seek credit from financial institutions. In the event where collateral does exist, prevailing structures are not sufficient to ensure bank financing because fixed collateral regimes in the region are generally weak. They are even weaker for movable collateral, especially with respect to registration, enforcement, and final sale of the seized collateral.[24]

41. Furthermore, public and collateral registries need to be complemented with efficient judicial processes and commercial courts because SME access to external finance rests on the institutional environment that supports collateral liquidity and enforceability. With strong rule of law that protects property rights and ensures the enforceability of contracts, sizeable financial flows can be released to SMEs. A wide range of appropriate financial products can be developed to assist businesses in meeting their working capital and long term investment needs. One such product is asset-based lending that includes factoring, fixed-asset lending and leasing. Emerging markets usually lack those products, and the ESCWA region is no exception.

42. The Legal Rights Index computes the average strength of legal rights protection in each country. This ranking is lower for MDEs and GCC countries than other regions. The weakness of financial infrastructure in the ESCWA region is exacerbated weak protection of legal rights which increases the fear of expropriation by creditors and discourages banks from extending credit. As a result, the supply of finance to businesses is reduced and value-enhancing projects are forgone, thus inhibiting development, growth and much-needed job creation. The Credit Information Index mirrors the depth of credit information and shows that the ESCWA average score is better than that of Eastern Europe but it lags behind East Asia and Latin America. The coverage of private credit bureaus reveals a wide gap between GCC countries and MDEs. The GCC private credit bureau coverage ranks second highest following Latin America, but MDEs lie at the bottom of the spectrum behind South Asia. Similarly, the coverage of public credit registries is highest in the GCC region, whereas the figures for MDEs are smaller than any other region (table 11).

43. The foregoing analysis has revealed that all countries in the ESCWA region need to ensure better enforcement of legal rights as a condition to foster financial inclusion. MDEs lag behind other regions in terms of information disclosure and credit coverage through private and public registries. As a result of weak financial infrastructure, financial service providers require high spreads and large volumes for transactions to be viable. Credit remains based on relationship lending, characterized by personal interactions between creditors and borrowers, which causes a significant reductions in SME access to finance because banks face high costs to overcome information asymmetries. Limited access to finance imposes serious constraints on the ability of economies to deal with the challenge of youth employment, poverty reduction, and sustainable economic growth. Economies in the ESCWA region need a more vibrant private sector and more robust SMEs to drive private sector growth.

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[23] The Qatar Central Bank is currently at an advanced stage of establishing a credit bureau.

[24] Roberto Rocha, Subika Farazi, Rania Khouri, and Douglas Pearce, *The Status of Bank Lending to SMEs in the Middle East and North Africa Region.*

TABLE 11. MEASURES OF FINANCIAL INFRASTRUCTURE

Country	Legal rights index (0=weak to 10=strong)	Credit information index (0=low to 6=high)	Private credit bureau coverage (% of adults)	Public credit registry coverage (% of adults)
Bahrain	4	4	35.9	-
Kuwait	4	4	29.6	-
Oman	4	2	-	19.6
Qatar	3	2	-	0.1
Saudi Arabia	5	6	18	-
United Arab Emirates	4	5	17.7	8.4
GCC average	4	3.83	16.87	4.68
Iraq	3	0	-	-
Jordan	4	2	-	1.5
Lebanon	3	5	-	8.7
Egypt	3	6	10.3	2.9
Palestine	0	3	-	5.6
The Sudan	5	0	-	-
Syrian Arab Republic	1	2	-	2.2
Yemen	2	2	-	0.3
MDE average	2.63	2.50	1.29	2.65
ESCWA average	3.21	3.07	7.96	3.52
East Asia	5.3	8.9	14.6	3.7
Eastern Europe	6.8	2.4	14.1	3.5
Latin America	4.4	10.6	36.2	4.6
South Asia	5.7	0.5	2	2.9
Sub-Saharan Africa	5.2	1	6.9	1.5

Source: http://databank.worldbank.org.

Note: A dash (-) indicates that the value is nil.

VI. POLICY RECOMMENDATIONS

44. Financial services alone cannot bring people out of poverty, but inclusive finance can significantly contribute to meeting social and development objectives.[25] The ESCWA region has an advantageous liquidity position despite the global financial crisis. However, there are challenges for household and business finance. This section offers a set of specific policy recommendations to expand financial access and support the real economy, thereby safeguarding systemic stability and ensuring more inclusive economic growth. Governments have critical roles to play in creating helpful policy environments that extend financial inclusion to a broader range of economic agents.

1. *Committing to a national strategy on inclusive finance*

45. The importance of access to financial services is generally recognized across ESCWA member countries, and the interest of Governments in financial inclusion is increasing; yet no country in the region has formally enacted a financial inclusion mandate. It is critical that Governments commit to inclusive finance as an integral part of their financial sector development programme. A strategy for financial inclusion may call for public policy interventions to increase competition in the provision of financial services and develop relevant institutional and financial infrastructures to make financial services more affordable to a larger part of the population.

[25] United Nations Secretary-General's Special Advocate for Inclusive Finance, *Annual Report 2010*.

2. *Expanding financial infrastructure development*

46. The ESCWA region lags behind other regions in terms of financial infrastructure development, broadly defined as the underlying foundations of financial systems that are vital to facilitating greater access to finance. Governments need to monitor effective credit sharing across all institutions and ensure that credit information services are reliable. Each credit institution must agree to share customer information, while complying with regulations on private data protection. Most ESCWA member countries have established credit bureaus (albeit with low coverage), but more work is needed to develop frameworks for fixed and movable collateral. Legislation can be enacted to allow for modern financing technologies such as leasing and factoring. Additional priorities include strengthening the protection of creditor rights, the judicial enforcement of debt contracts, and the reform of bankruptcy codes.

3. *Advancing financial literacy and safeguarding consumer protection*

47. The beneficiaries of inclusive finance are low-income households and SMEs. Governments need to commit to the fair treatment and protection of the interest of those stakeholders. Poor clients, microenterprises and SMEs are often put at a disadvantage by asymmetries in financial knowledge. Policies are needed for financial institutions to embrace transparency, offer a wide range of financial services and promote financial literacy. Consumers must be protected from abusive financial practices, however very few countries have legislation in place for the protection of consumers of financial services. Bahrain, Egypt, Kuwait, Lebanon, Oman, Qatar, and the Syrian Arab Republic have enacted a general consumer protection law, but Saudi Arabia has not. Only Kuwait and the Syrian Arab Republic include an explicit reference to financial services in their consumer protection law. In Jordan, the protection of consumers of financial services lies within the framework of financial sector legislation. Official consumer protection legislation is insufficient by itself and must be complemented by an effective third-party dispute resolution mechanism.

4. *Increasing competition in the provision of financial services*

48. Capital markets in the ESCWA region are at an early stage of development and do not play an active role in financing the economy. Financial systems in the ESCWA region remain bank-based, and banks lead the process of financial intermediation. The historical high concentration in banking, however, can be detrimental to efficient competition in the provision of financial services.[26] Financial regulators should focus not only on promoting access to deposit, credit and payments services, but also on increasing the openness, contestability and competitiveness of banking markets to ensure the delivery of better quality financial services at a lower cost. In this respect, Governments need to ensure that financial institutions are embracing new technologies and delivery channels for financial services, such as electronic and mobile finance. In addition, recent developments of Islamic banking provide an opportunity to expand sharia-compliant financial services outreach to a broader segment of the population.[27] Related regulatory constraints need to be relaxed to meet that objective.

5. *Designing public policies for the development of microfinance*

49. Microfinance has received much attention over the past few years, and several microfinance schemes are providing basic financial services to underprivileged segments of society. However, the cost of microfinance services remains high and outreach has yet to expand. Appropriate public policies can improve the capacity of microfinance institutions in channelling resources and developing new products. Also, Governments need to tackle regulatory challenges to facilitate risk monitoring and to develop a framework for the assessment of the impact of microfinance.

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[26] Rima Turk Ariss, “Competitive Behavior in Middle East and North Africa Banking Systems”. *Quarterly Review of Economics and Finance*, May 2009.

[27] Rima Turk Ariss, “Competitive Conditions in Islamic and Conventional Banking: A Global Perspective”. *Review of Financial Economics*, August 2010.

6. *Setting industry targets for SME financing and ensuring sustainability in their access to finance*

50. The private sector is severely underdeveloped in ESCWA member countries and the region has the highest youth unemployment rate in the world. With the majority of the population under the age of 24, 100 million jobs need to be created over the next 20 years.[28] SMEs embody the overwhelming majority of enterprises in the region and they represent the engine for inclusive growth. However, financial constraints on SMEs hamper their ability to meet their operational and investment needs and impede their prospects for inclusive growth and much needed job creation. Policymakers need to set industry targets for SME financing that will increase over time. SME financial access can also be deepened by a clear policy commitment to strengthen development banks that operates with a longer horizon relative to private banks. Islamic finance exemplifies that kind of banking. Typically, SMEs require access to stable and sustainable sources of finance to enhance their resilience to emergencies, invest in education and training and modernize production activities, thereby increasing their survival rates and narrowing social gaps. Isolating SME credit from countercyclical effects of the business cycle would encourage innovation and foster long-term productivity growth.

7. *Ensuring regular collection of data on SME financing*

51. It is critical to measure SME access to finance on a regular basis. When SMEs submit loan applications to banks, credit officers usually request information on the firm size, turnover, and number of employees among other financial disclosure requirements. Ideally, such data will be stored and communicated to financial regulators to assess SME access to finance over time. Governments are in a position to ensure adequate and much-needed data collection on SME financial access and usage. Greater transparency in SME financing data would also serve as a starting point to develop alternative and emerging sources of SME finance such as the provision of equity finance and Islamic finance.

8. *Deepening financial markets*

52. Capital market activity is currently concentrated in the financial services industry but financial markets have the potential to play a greater role in meeting the funding requirements of large corporations. A key challenge for increasing the role of capital markets in financing the economy is to develop secondary trading platforms for corporate bonds and *Sukuk*. Currently, trading in corporate bonds is characterized by low liquidity that deters investors from entering into that market. The development of a bond market is essential for investors to transition from the volatile quick profits of equity markets into more stable fixed-income instruments.[29] More importantly, as large corporations rely less on traditional bank financing, more bank resources will be available to finance microenterprises and SMEs that are in dire need of funding, and banks will play a greater role in financing the real economy.

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[28] Lois Stevenson, *Private Sector and Enterprise Development.*

[29] "Middle East Bond Issuance to hit US$30 billion by End of 2010". *Middle East Economic Digest*, 5 November 2010.