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THE LEBANESE MICRO FINANCE INDUSTRY STATUS AND CHALLENGES[1]

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[1] This technical note was written by ***Judith Brandsma***, senior financial sector development specialist and ***Maha Keramane***, research assistant at the World Bank. The note was prepared as part of the ongoing joint effort of the Government of Lebanon and the World Bank to prepare an action-oriented strategy for poverty Reduction. Bassam Ramadan of the World Bank's representative office in Beirut is the Bank's coordinator for this joint effort.

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SUMMARY

The micro enterprise sector in Lebanon is not like the typical micro enterprise sector in developing countries. The Lebanese micro enterprise sector can be segmented in two categories: (i) people running micro economic *activities*; and (ii) people running micro or very small *enterprises*.

Micro Economic Activities are run by the poor and poorest, often women. They complement the household income but the main source of household income is usually wage income from (male) members of the household. However, more than anecdotal evidence suggests that–given the depressed economy resulting in layoffs-the income from the micro activity is becoming the main source of income for more and more households. There are an estimated 200,000 households in Lebanon that have micro economic activities.

People who manage this type of micro activity are the typical clients of micro finance programs as we know them from around the world. They usually need very short-term working capital loans and are able and willing to pay relatively high interest rates that are needed to cover the costs of the providers of micro finance. Although many in Lebanon argue that the typical micro credit loan sizes of US$200 or US$500 are not appropriate for Lebanon, the success and growth of the programs offering these loans, proofs that there is a sizable (and growing) demand for this type of loans.

The provision of micro finance services to this target group will not solve Lebanon's economic or unemployment problems. Rather, the provision of micro finance services to this target group should be seen as contributing to a social safety net. The income of the micro economic activity can be considered as a buffer that the poor use against unexpected shocks i.e., as a means to reduce vulnerability. While the provision of micro finance services does not necessarily result in a sustained increase in household income, it contributes to a decrease in the household's vulnerability to shocks and it helps build assets. *To say it simply: it may not help the poor getting out of poverty, but it will help the poor from becoming poorer.*

Micro and Very Small Enterprises are usually the only source of income of the household of the entrepreneur. The majority of these businesses either employs no peoples (self-employed such as plumbers, electricians or repairmen) or employs one or two people. The majority of them does not grow. The sector is highly turbulent with individual businesses starting and disappearing. The sector as a whole however offers relatively stable employment and income opportunities. The sector appears to be growing because of the many new entrants: laid-off, often low skilled, workers who are starting their own business. Many of these new entrants however may not be good entrepreneurs and would be better off working for somebody else. There are an estimated 300,000 micro and very small businesses in Lebanon, with the majority being self-employed.

The "typical" micro loans as described above are not attractive for these enterprises. Rather they need medium term investment capital, albeit also in low size ranges (US$1,000- US$5,000). Only those in trade and services also demand working capital loans. *Providing these financial services to these businesses will result in job retention rather than job creation.*

The 19 Lebanese micro finance programs mirror the segmentation of the micro enterprise sector as described above, and can be split in two categories: (i) the "Poverty Lenders; and (ii) the Very Small Business Lenders. These two categories together had year end 1999 over 10,000 active clients and a total loan portfolio outstanding of over US$10 million. Fifty-two percent of the clients was female,

and 56 percent of all borrowers lived in rural areas. The micro finance industry in Lebanon has only grown with 17 percent since year end 1997 while other countries in the region saw growth rates of up to 400 percent. Quoted reasons for the limited growth of the industry were: (i) the general economic depression; (ii) the lack of institutional capacity of many programs (especially among the very small business programs) to effectively and efficiently increase their outreach; (iii) the lack of "bankable" enterprises, especially among the very small enterprises; and in only a few cases (iv) lack of funds for on-lending.

The Poverty Lenders are very similar to the "typical" micro finance programs, providing very small working capital loans of up to US$500 to the poor. Lebanon has five Poverty Lending programs. Together they had year end 1999 about 4,500 active clients and an outstanding portfolio of about US$2 million. Not surprisingly, 95 percent of their clients were female: women around the world are among the poorest. The majority of clients lives in urban areas.

The future of the Poverty Programs appears quite promising. Three of the five programs -together serving over 90 percent of all active clients in this segment- are capable organizations that implement best practices and that have a clear vision for the future. The five providers together are expected to reach over 18,000 active clients five years from now.

What makes the micro finance industry in Lebanon different from the industry in many other countries, is the large presence of many "non-traditional" micro finance lenders: the Very Small Business lenders. The majority of them provide medium term loans (2 to 3 years maturity) to very small businesses or self-employed. They also combine the provision of loans with the provision of business development services (BDS) such as training and technical assistance. These programs offer loan sizes that are a bit larger than the traditional micro loans but surprisingly not that much larger. While the average outstanding balance of the clients of the Poverty programs was US$454, the average outstanding loan balance of the clients of the very small business programs was only US$1,358! There are today in Lebanon over 12 providers of very small business loans. Together they had year end 1999 6,330 active clients and an outstanding loan portfolio of about US$8.6 million. The majority of clients was male and lived in rural areas.

The future of the Very Small Business Programs appears however rather bleak. Many of these programs are not well organized, and do not have appropriate systems for loan screening, monitoring and follow up. Many charge subsidized interest rates compared to market rates. Even more worrisome is that the providers of Very Small Business loans have no clear vision for the future. If we exclude one provider, the only one among the 12 that offers working capital loans but targeted to the entrepreneurial poor through the formal banking system, the number of active clients in this segment may actually go down because of bad loan portfolio quality, loan write-offs and depletion of capital. With the exception of two programs, the main constraint to the growth of these programs is not the lack of funds for on-lending but the lack of capacity to deliver micro finance to a high number of clients.

To summarize, the provision of micro finance to people running micro economic *activities*, provides the household with a social safety net, creating a buffer against falling into deeper poverty. The provision of micro finance services to micro and very small *enterprises*, mainly contributes to job retention rather than job creation. The provision of micro finance services to both groups is important but will not help solve Lebanon's unemployment and economic problems. Addressing the issues faced by the Lebanese SME sector (small and medium enterprises with between 5 to 100 employees) would contribute to job creation and economic growth.

The Government of Lebanon is advised *not* to regulate the micro finance sector. Regulation is only needed when the micro finance providers would take deposits and savings i.e., other people's money. None of the current NGO programs is likely to do so. However, for those programs that are expected to grow in the coming years, the legal form NGO will become an impediment to accessing commercial funds such as borrowing from banks for on-lending to the micro enterprises. The Government may wish to create a non-bank, non-deposit taking legal form for micro finance intermediaries.

Micro finance programs in Lebanon could benefit from better coordination and cooperation with each other. This cooperation could include the exchange of information on "bad borrowers", the setting of minimum industry performance standards, and over time, the establishment of a credit-rating agency set up as a private sector venture but owned by all the programs. The micro finance industry is advised to take the lead in sharing of information and cooperation and not wait for the Government to do so.

An improved legal environment for the collection of bad loans will not only help the micro finance industry but the financial sector as a whole. To quote a participant in the workshop: "whoever you are, to whomever you owe, whether US$500 or US$500,000, you have to repay!"

While the Poverty Lenders face a relatively rosy future, the need for capacity development of the Very Small Business Lenders is urgent. In this context, it is worrisome that the planned for EU Social Economic Development Fund has ample funds available for on-lending but very limited funds for capacity development. The Government is advised to re-allocate some of the EU funds for on-lending to not only capacity building of the programs offering finance to very small businesses but also to develop the capacity of the very small businesses themselves. Best Practices show that it is best to separate the provision of so-called small business development services from the provision of credit. Also, the most effective manner to develop the capacity of the small businesses is not do so directly (one-on-one) but through the development of the capacity of Business Development Services (BDS) providers such as accountants, chambers of commerce, and sub-sector business associations.

I. The Micro Enterprise Sector in Lebanon

The micro enterprise sector in Lebanon is not like the typical micro enterprise sector in developing countries. In these countries, there is a large informal sector consisting of very small enterprises, which transform local inputs into simple goods and services for local niche markets. Also, these countries often have a financial system, including the actors located at points along the marketing chains that is rather inefficient. In Lebanon by contrast:

- There are well organized marketing chains, and within these chains supplier credit is widely available and apparently cheap[2];

[2] The agricultural input sector, which is dominated by a few large wholesalers, may be the exception. Anecdotal evidence suggests that supplier credit in this area is expensive (as high as 100 percent annually).

- The population in urban centers is accustomed to using imported high quality products (80 percent of the Lebanese consumption basket is imported) which are becoming expensive compared to the declining purchasing power of the population;

- The majority of the country's micro businesses operate in the retail sector, and the profitability of these businesses is sensitive to variations in the performance of the overall Lebanese economy (which has been declining in the last few years[3]);

- For many years the micro and small enterprise sector has been segmented along religious and ethnic lines (areas of settlement, neighborhoods, specialization in certain sub-sectors etc.) with supplier chains and clienteles basically mirroring this segmentation. Within this context, (cheap) supplier credit and sales on credit are widespread. Purchasing habits appear to follow a similar segmented pattern. The segmentation along religious and other cultural lines however limits the scope of the enterprises to grow, even within the immediate vicinity of their business premises[4]; and

- Competition among market participants seems to be strong, except for certain sub-sectors. Business margins earned by certain types of businesses, e.g. mini-markets or tailors, are very standardized and permit only moderate profits to be earned, i.e., just enough to support the family of the entrepreneur. Decreasing margins and low demand (due to the low economy) suggest that a good percentage of micro and small businesses, which have been in the business for a long time but have not achieved any appreciable growth over the years.

A. Two Broad Categories of Micro Enterprises in Lebanon

Despite the differences mentioned above, we can group the Lebanese micro enterprise sector in two broad categories: (i) micro economic *activities*; and (ii) micro and very small *enterprises*.

1. Micro Economic Activities

Micro economic (or income-generating activities) are run by the poor and the poorest. The micro economic activity is often home-based, or run in the vicinity of the household. The activity is undertaken a couple of hours per day and the main reason for running the activity is to supplement the household income. Many of the micro economic activities are run by women. This type of micro business does not grow and does not create jobs. They are very small and will always remain very small.

The micro economic activity is usually not the only source of income of the household. The main source of the household income is often low wage or contract income from one or more other household members. However, more than anecdotal evidence in Lebanon suggests that because of the downturn of the economy, resulting in layoffs or business closures, for more and more households the micro economic activity becomes the sole source of income.

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[3] Real economic growth was at its peak in 1994 with 8 percent and has steadily declined since to 2 percent in 1998 and 1 percent in 1999.

[4] Market fragmentation can be observed at a very local micro level: enterprises in one street will do good business, while a similar operation one block further down the road, experiences a low volume of business.

There are no reliable estimates on how many micro economic activities exist in Lebanon. Given the fact that they are often home-based, they were not captured in the 1996 Establishment Census or the Industrial Census. As we will see in the following section, a reasonable estimate could be about 200,000.

This type of micro businesses are the typical micro finance clients. They usually need very short-term working capital loans and are able and willing to pay relatively high interest rates that are needed to cover the costs of the provider of micro finance[5]. Although many in Lebanon argue that the typical micro credit loan sizes of US$200 or US$500 are not appropriate for Lebanon, the success of those programs[6] offering loans in this size range, proofs that there is a demand for this type of loans. Moreover, when asked, many of the clients of these programs say not to want larger loans.

The provision of micro finance services to this target group will not solve Lebanon's economic or unemployment problems. Rather, the provision of micro finance services to this target group should be seen as contributing to a social safety net. The income of the micro economic activity can be considered as a buffer that the poor use against unexpected shocks, or as a means to reduce vulnerability. While the provision of micro finance services does not necessarily result in a sustained increase in household income, it contributes to a decrease in the household's vulnerability to shocks and it helps build assets. To say it simply: it may not help the poor getting out of poverty, but it will help the poor from becoming poorer.

Note that *micro-credit for micro-enterprise is just one of the many financial services that the poor may need.* The poor often need access to lump-sums of money for a variety of purposes such as financing periodic predictable expenses such as school fees or books, financing life-time events such as weddings, coping with unexpected expenses such as financing a funeral, or grasping an economic opportunity such as starting a micro business. The poor gain access to varying lump sums of money for these purposes through savings (putting aside small varying sums of money at varying time-intervals), or through loans (using lump sums now in return for future savings in the form of repayments).

The majority of micro and small business finance programs in Lebanon only offer *credit for micro economic activity or enterprise* while there may be a demand for credit for non enterprise purposes such as consumption credit or credit to pay school fees or hospital bills[7]. Moreover, currently none of the programs currently offers voluntary savings –or deposit services[8].

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[5] The poor are bankable and are willing to pay a premium for access to financial services (whether savings or credit). Using best practices, micro finance services can be provided in a sustainable manner. Best practices include: (i) charging interest rates and fees that are high enough to cover the program's operational costs as well as its imputed costs of funds; (ii) in the case of credit, rapid access to follow-up loans, allowing the micro entrepreneur to build the business and encouraging repayment; (iii) strong delinquency management ; and (iv) achieving high volumes and significant outreach by designing loan and savings products that the poor want.

[6] Examples are Al Majmoua and the CRS Village Bank program.

[7] There are two known exceptions: the Monetary Housing Institution offers so-called "Hassan" loan or "Good loans. This is a loan without interest (but an administration fee) for emergencies such as roof-repair, payment of school fees or hospital bills. The maximum loan size is US$1000. Currently the Institution has about 2,250 active clients of this type of loan. The other exception is AFED, the Armenian Foundation for Enterprise Development, which although not its core activity, does offer loans for school fees and other household matters.

[8] The CRS Village Banking program offers savings services. However, these are not true voluntary savings services but more a means to accumulate cash collateral for the loans.

2. *Micro and Very Small Businesses*

Lebanon has thousands of micro and very small businesses. They are run full time and often the only source of income of the household of the entrepreneur. The majority of these businesses either employ no people (self-employed such as plumbers, electricians or repairmen) or employ one or two people. The majority of them does not grow but offers relatively stable employment and income[9]. Their number appears to be growing because there are many new entrants: people – often low skilled workers-who have been laid off because of the economic down turn, starting their own business[10]. Many of these new entrants however may not be good entrepreneurs and would be better off working for somebody else.

The IFC commissioned in 1998 a study on the demand for micro credit. This study is still the best source of information[11]. The study used the "Recensement des Immeubles et des Etablissements" (1996) from the Statistical office as basis. This census provided a complete coverage of all physical enterprise structures in Lebanon. Any activity found in buildings (structures) was considered an establishment. This census found 673,000 employees working in almost 200,000 operating units. Over 88 percent of the operating units had less than 5 employees.

The study found a high degree of concentration of micro businesses in certain sectors of the economy. In effect, as is shown in the table on the next page, over 90 percent of all micro businesses was concentrated in 14 of the 33 economic sectors.

The Lebanese micro and small business sector can be segmented in two categories: (i) older and traditional small enterprises, some of them having well-established but stagnant market shares and others which are loosing ground because of their inability to offer higher quality products and services; and (b) more modern and dynamic enterprises. There is a correlation between these two categories of enterprises and the age of the entrepreneur. Younger entrepreneurs with businesses, which were established less than 5 years ago, seem to be doing better than the older entrepreneurs. They run more modern types of businesses (automotive, electronics, photo processing, sale of school books or music tapes) and tend to have a more dynamic operation (expansion) with above-average margins.

Economic Areas *(in brackets sectors of concentration)*	*< 5 employees*	*5-10 employees*
Agriculture (agriculture and mining/fishing)	14,000 units	400 units
Manufacturing (food processing/textile and leather/wood and paper/metal products/furniture)	20,000 units	2,600 units
Vehicles (trade and maintenance of vehicles)	22,000 units	1,000 units
Trade (wholesale trade/retail trade)	78,000 units	2,300 units
Tourism (hotel and restaurants)	9,000 units	700 units
Services (Services for firms/private services/health)	17,000 units	1,100 units
Subtotal (14 selected areas of concentration)	160,000 units	8,000 units

[9] The micro and small enterprise sector is highly turbulent: many businesses fail and start again. Hence, at the level of the individual enterprise, employment is not stable. However, at the level of the sector as a whole, employment is rather stable.
[10] The Program manager of Al Majmoua quoted several cases where the women who have been clients of his program for years bring their husband or brother needing loans to start a business. They often need much larger loans than the US$ 250 average that Al Majmoua offers.
[11] "Study on the Informal Financial Markets in Lebanon", by Alexander Melzer and Philippe Chetelat from Tulum Ltd. Switzerland (October 1998).

Total (all 33 sectors)	175,000 units	11,000 units

A rigorous consolidation process appears to be taking place with older enterprises established in the pre-war period being pushed out of the market by enterprises which succeed either in serving narrow niches in international markets (jewelry, wine, sweets) or by offering higher quality products and services on the Lebanese domestic market. Those that are not able to find niches, or upgrade quality and innovate are the most likely candidates to be shaken-out. At the same time there are new entrants: new business start-ups.

The number of new *enterprises* appears to be decreasing. For instance, according to the Ministry of Industry, the number of manufacturing entrants in the first two months of this year decreased by 24 percent compared to the same period in 1999. In the first two months of 2000, 63 companies were established, employing 446 workers. In terms of employment this is a decrease of 41 percent compared to the same period in 1999. The total capital of the 63 new firms was US$5.6 million, which is a decrease of 52 percent compared to the same period in 1999[12].

The same study also included an assessment of possible demand. Note that the study focused on "*eligible*" demand i.e. demand by those businesses that are able to take a loan and repay a loan. These are often businesses with either growth prospects and/or good margins. Given the consolidation and shake-out process[13] of the Lebanese micro and very small enterprise sector, the eligible demand is quite low as is shown in the following table:

Sector	*Total population micro businesses*	*# in need of investment credit*	*# in need of seasonal credit*	*# in need of working capital*
Agriculture	14,000		3,000	
Manufacturing	20,000	4,000		
Trade	78,000			7,000
Vehicles	22,000	5,000		
Other services	17,000	3,000		
Tourism	9,000	3,000		
Total	**160,000**	**15,000**	**3,000**	**7,000**

The Lebanese micro and very small enterprise credit market is also characterized by a network of financing relationships involving the provision of credit by suppliers to businesses and by the businesses to their consumers, which indicates that liquidity constraints are of less importance than in other countries. What makes the Lebanese market for micro enterprise credit different from the market in many other countries, is that many of the Lebanese businesses *do not need working capital loans but investment capital loans* i.e. medium term loans for fixed assets in the range of US$1,000 to 25,000. Note that the needs of the majority – the self-employed-, range between US$1,000 and US$10,000. Only in trade and services there is a demand for working capital loans. The "typical" micro loans (e.g. below US$1,000) are not attractive for these enterprises.

The provision of "non-typical" micro finance services to this target group will not necessarily create jobs and economic growth. Rather, the main benefit of micro finance will be that jobs are maintained

[12] Note that these numbers are not comprehensive for total investment in manufacturing because only exporters and those seeking to apply for bank loans are obliged to register with the Ministry.
[13] The authors argued that less than 25 percent of the micro businesses would survive in the long term due to a shake-out and consolidation of the economy.

rather than created. This is very important because it will avoid that people will fall in the poverty trap.

3. *Caveat*

The establishment census on which the IFC based its estimates of demand, probably has underestimated the number of micro and very small enterprises. The authors themselves mention that –given the fact that the census focused on economic activities based in buildings–certain sectors such as agriculture could be under-represented. A study undertaken by the UN Integrated Rural development project and FAO, estimated that already in the Baalbek region alone, there were 25,000 agricultural units with less than five employees.

Moreover, the establishment census has under-estimated the number of self-employed. Many self-employed do not have premises and do not need premises. For instance, a plumber or an electrician can have his/her tool set at home. The 1997 Household Living Conditions survey found that of the over 1,200,000 labor force, 26 percent (about 312,000) worked as "independent" and 7.7 percent (about 90,000) worked as "employer".

An attempt can be made to reconcile the labor force statistics with the establishment census statistics. It is realistic to assume that all 90,000 employers have an establishment. Hence, in 90,000 of the counted 200,000 establishments, more people than the owner/manager are employed. That leaves us with 110,000 establishment with an owner/manager but no salaried employees, to so-called one-person shops. These could well be those self-employed with an establishment. This leaves us then about 200,000 self-employed without an establishment. Many in this group could well run micro-economic activities as described in the first section.

II. The Micro Finance Industry in Lebanon

Currently Lebanon has 19 micro finance programs, together serving almost 11,000 active borrowers and less than 1000 active savers. Year end 1999, the total loan portfolio outstanding was about US$10.7 million. Year end1997, there were 16 micro finance programs, together serving over 9,000 active clients with an outstanding loan portfolio of about US$ 7.4 million. The average loan amount outstanding per client was about US$800 and slightly increased to almost US$1000 year end 1999. While other countries in the MENA region have experienced dramatic growth in the micro finance industry since 1997[14], this has not been the case in Lebanon, where the industry (measured in terms of active clients) grew with less than 17 percent. The main contributors to this growth two new programs[15].

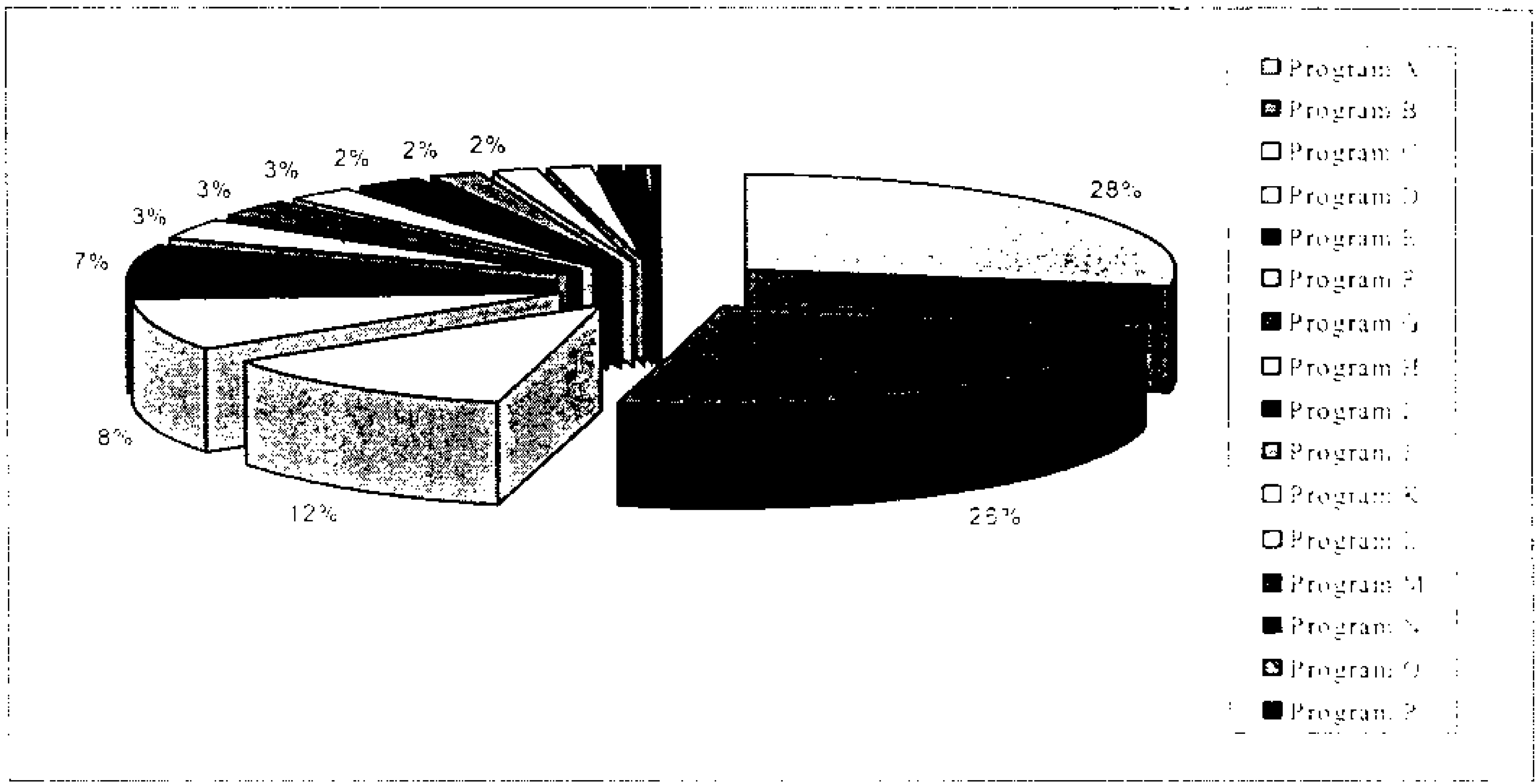
The majority of programs is small (defined in number of active clients) and have been small since their inception. Today, three programs in Lebanon (CRS individual lending program, the UNDP Baalbek Program and Al Majmoua) together serve over 66 percent of all the active clients (see graph below). Only one of these three, Al Majmoua, implements best practices. AFED, the Armenian

[14] For instance the micro finance industry in Morocco grew with over 500 percent from over 7,000 active clients to over 40,000 active clients. Even countries with moderate growth, such as West Bank Gaza, grew at higher rates than Lebanon (80 percent from about 10,000 active clients to almost 18,000 active clients).

[15] The data on the status of the micro finance industry are derived from the study "Making Micro finance Work in the Middle East and North Africa Region", based on a region wide survey among all micro finance programs in MENA in 1997. The 1997 data were updated and combined with the data from the same survey repeated in the year 2000. These results will be published in a forthcoming study.

Foundation for Enterprise Development, which is a project, and the CRS Village Bank Program share the fourth place. The same three programs that currently dominate the market, dominated the market year end 1997 with a 77 percent market share. However, as noted above, the position of the top 3 programs may not be stable given some dynamic new players in the field.

Distribution of Active Microfinance Clients in Lebanony/e 1999



The percentage of female borrowers is high and has remained stable at 51 percent in 1997 and 52 percent in 1999. The high percentage is due to the fact that some of the large programs (Al Majmoua and CRS Village Bank) focus almost exclusively on women. Given the high urbanization in Lebanon, the percentage of borrowers living in rural areas be considered very high: with 56 percent. In 1997 this was 62 percent.

A. Segmentation of the Market

A segmentation of the Lebanese micro finance industry along the lines of the Lebanese micro enterprise sector, provides interesting results. The providers of micro finance are grouped in two categories: (i) those lending for micro economic *activities*, and (ii) those lending for micro and very small *enterprises*. Given the fact that the micro finance providers in the first group are most similar to the *traditional* micro finance as we know it around the world, we label their programs and loans *"Poverty Lending Programs."* The loans provided by providers of credit to micro and very small enterprises, are labeled "*Very Small Business Lending Programs.*" Annex 2 provides an overview of the Programs in the two categories.

The main criteria for segmentation used were:

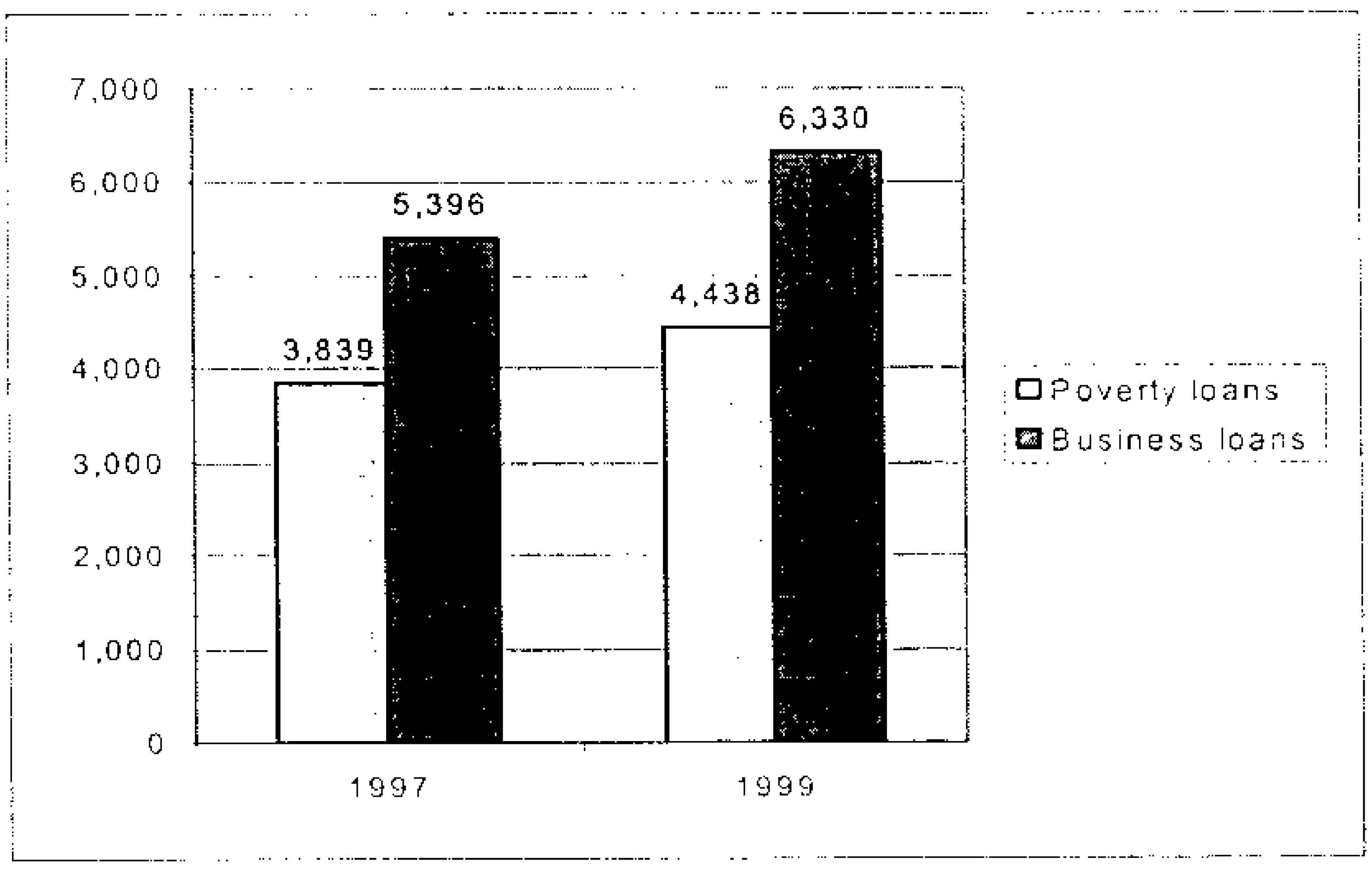
- **Target group** as stated by the Programs. The stated target groups of the Poverty Lenders are often explicitly the poor and the poorest, often women. The target groups of the Very Small Business Lenders are often youth, or unemployed, and reference to poverty is made implicitly.

- **Characteristics of the loans** provided and the loan size. Micro finance providers in the "Poverty group" all offer very small loans (varying from US$100 to US$500), with a maturity of less than one year. Providers of credit in the "Very Small Business Group" offer larger loans, varying from US$500- up to US$10,000, often for capital investment, with medium or long term maturities.

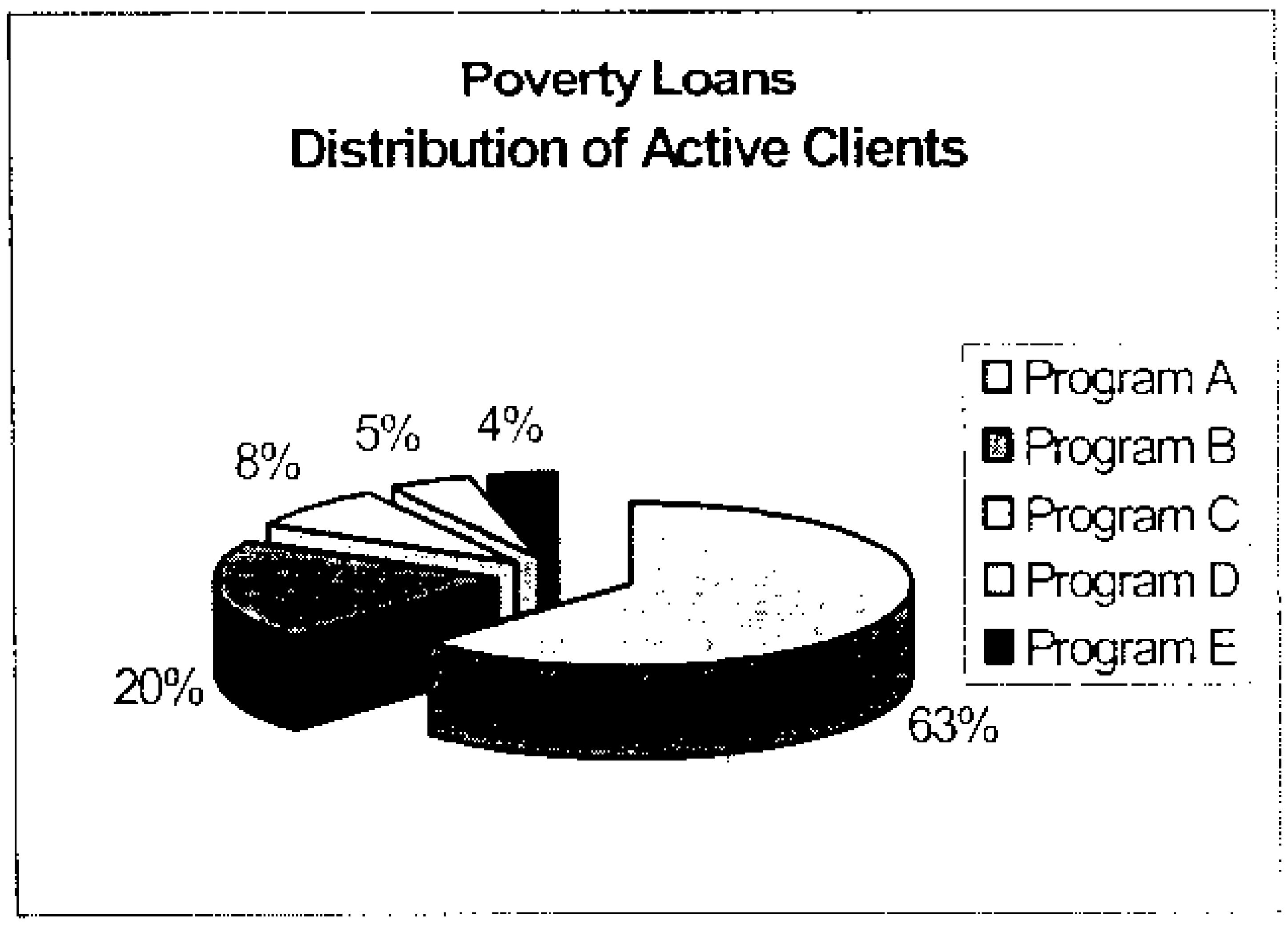
- **Other non-financial services** provided. Most of the programs in the Poverty Group are focused and offer only financial services, while the providers of very small business loans usually also provide also non-financial services such as training or intensive technical assistance to the borrowers. In some cases, the training is obligatory.

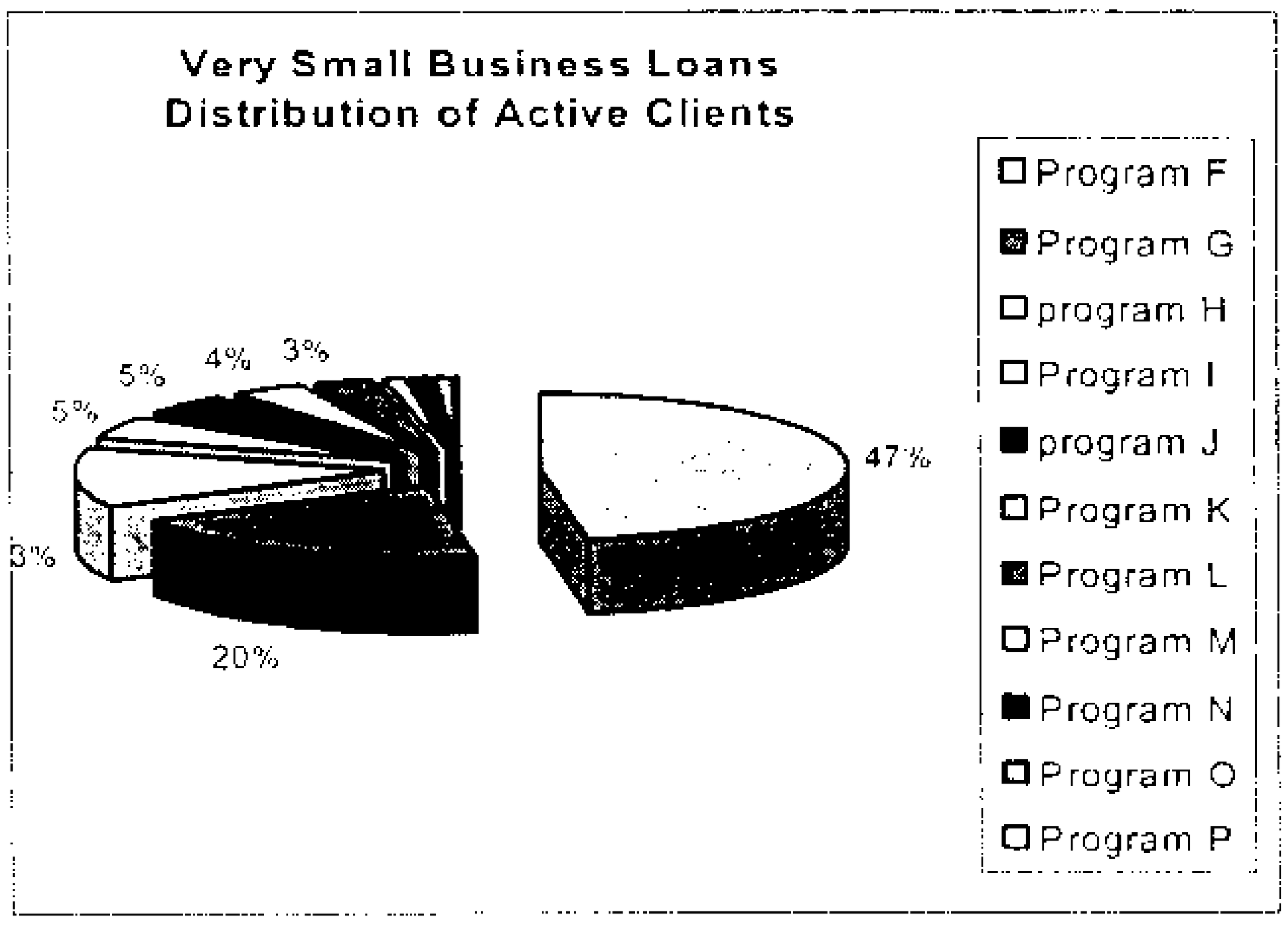
The graph on the next page shows that year end 1997 there were 3,839 active poverty loans and year end 1999, 4,438. The number of both type of active loans grew very moderately and the share of each type of loan in the total market remained the same: 41 percent for poverty loans and 59 percent for the very small business loans.

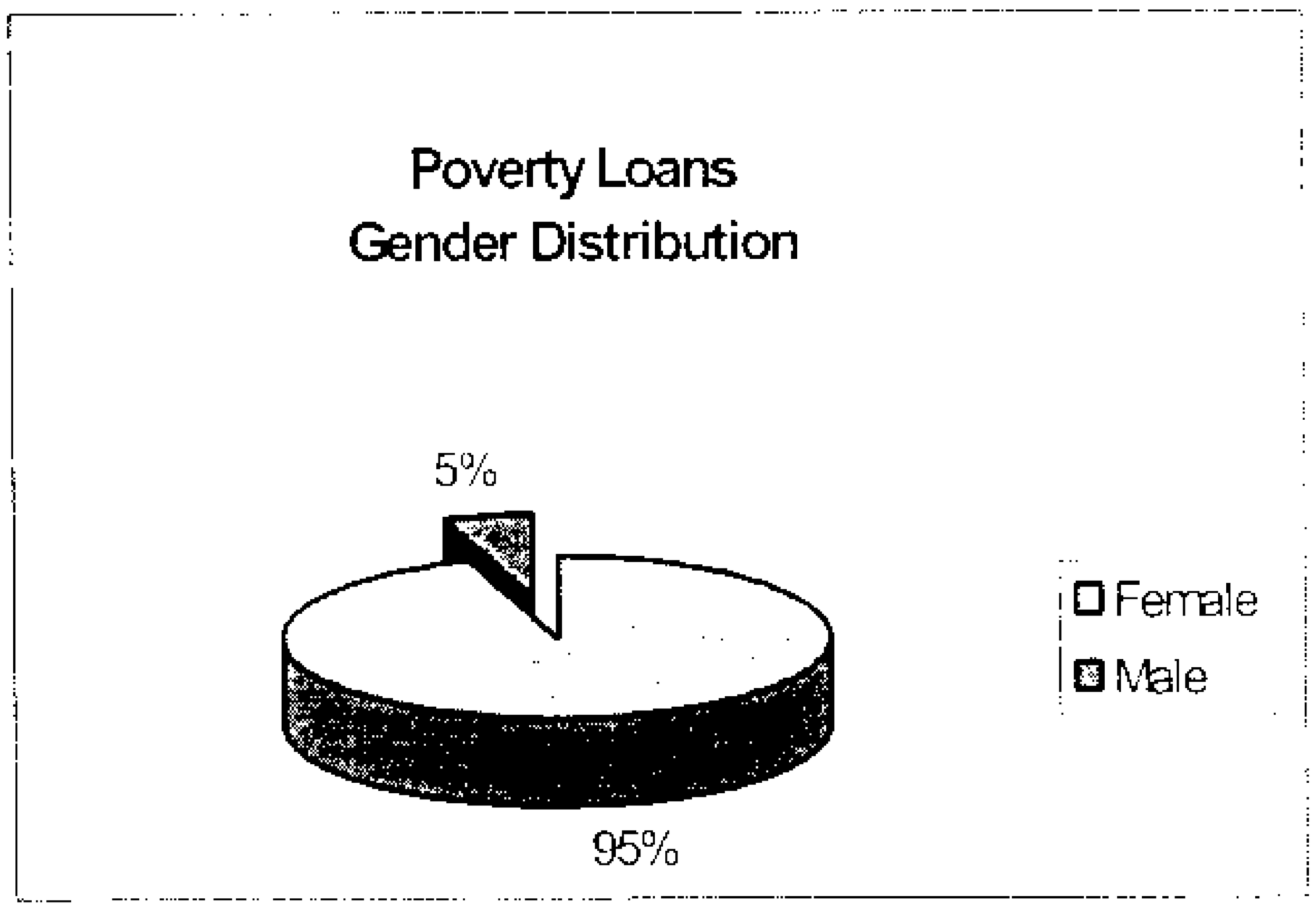
Distribution of Active Poverty Loans and Very Small Business Loans
Year end 1997 and year end 1999

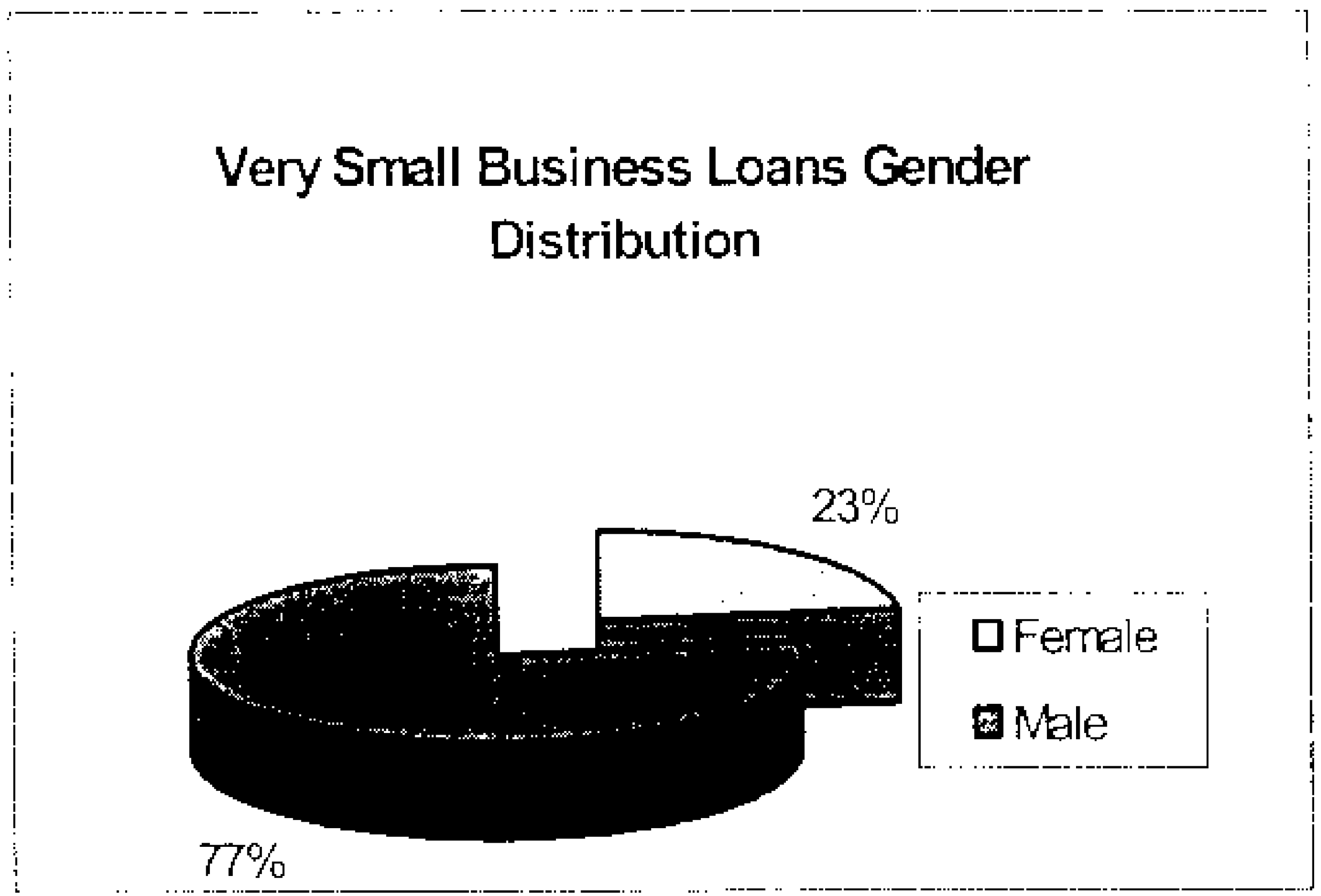


While there are 5 players in the "Poverty Market", there are over 12 players in the "Very Small Business market". The graphs below show that both the market for Poverty Loans as well as the market for Very Small Business Loans are dominated by one or two large players. In the Poverty Lending market the market leader has a 63 percent market share (measured in terms of active clients) while the runner-up in this market has a 20 percent market share. Both these programs implement best practices. The share of the market leader in the market for very small business loans is 47 percent, and that of the runner up is also 20 percent. Both these programs *do not* implement best practices.

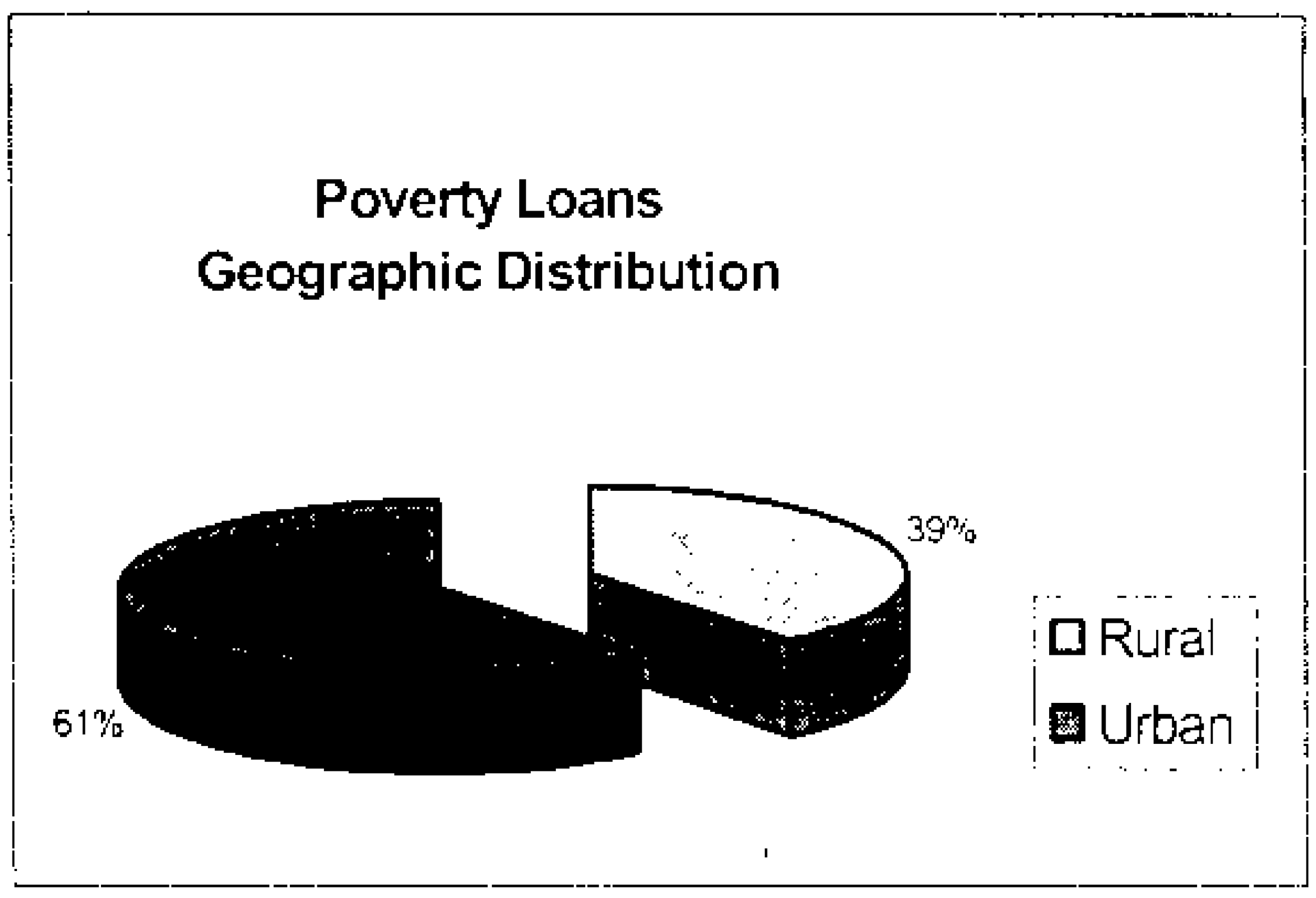


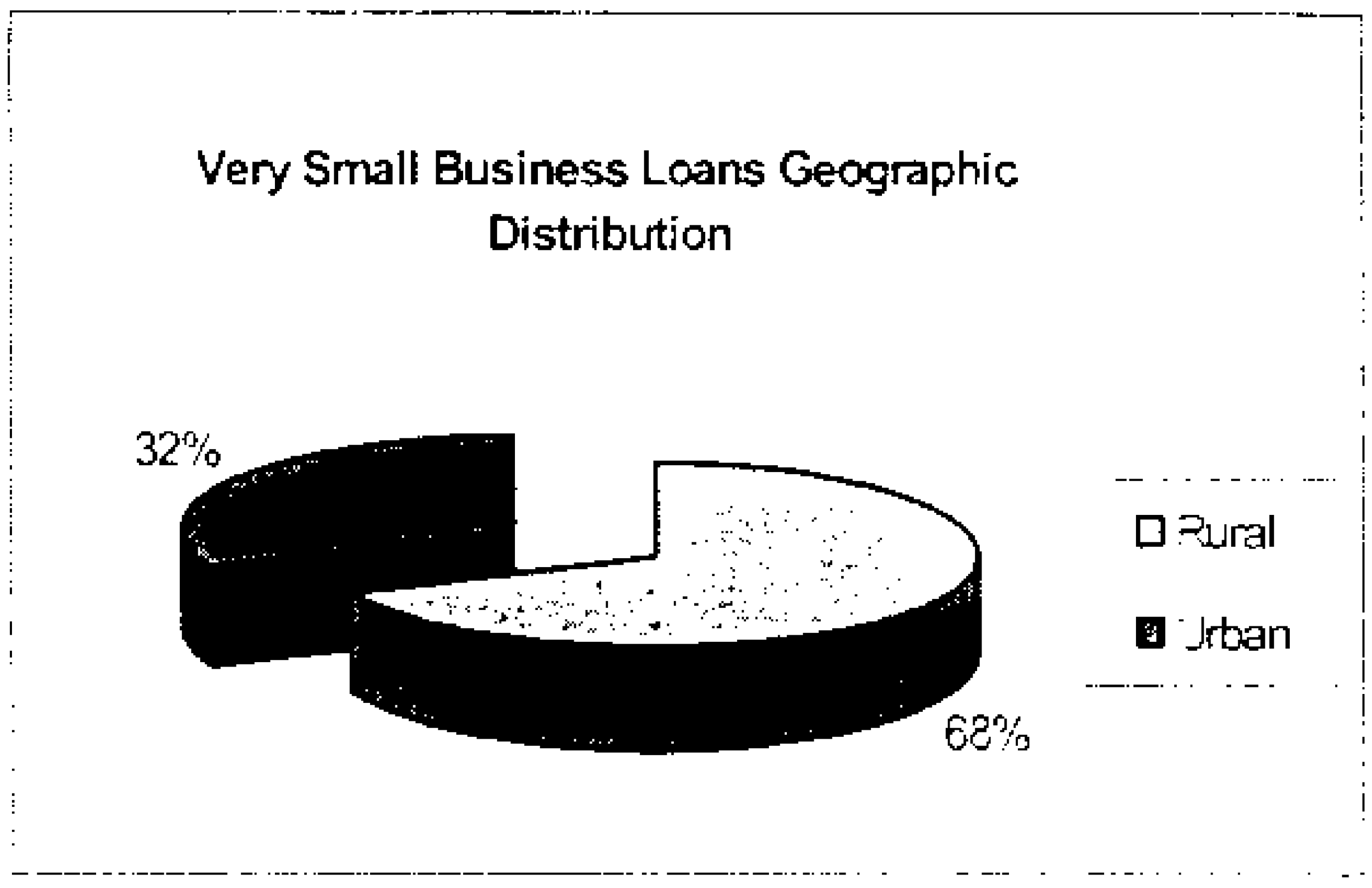






It is not surprising that the majority of clients of the Poverty Programs is female. Women around the world are among the poorest. In contrast, the majority of borrowers of the Very Small Business loan programs is male. The differences between the geographic location (urban versus rural) of the clients of the two types of programs is pronounced as is shown below. The majority of the clients of poverty loans lives in urban areas (61 percent) while the majority of the clients that have very small business loans lives in rural areas. This is not surprising. For a Poverty Lending program to become sustainable, it needs to reach thousands of poor clients. Although relatively, poverty in Lebanon is higher in rural areas, in absolute number, more poor people live in urban areas. Also, a Poverty Lending program has given its very small loan sizes per definition relatively high transaction costs such as the costs of processing a loan application. These transaction costs may become prohibitive in rural areas.





B. The Sustainability of the Programs

Sustainability is a minimum prerequisite not only for a micro finance institution to *continue* to deliver financial services to the poor, but more important for its growth and the ability to serve *more poor*. In addition, sustainability enables a micro finance institution to be(come) independent of (often unreliable) donor or Government funds.

Financial sustainability is the ability of a micro finance program to cover its operating and financial costs from its interest and fee income. The determinants and underlying premises of financial sustainability are: (i) high, demand driven outreach, resulting in a high number of active clients, enabling a program to spread its overhead costs and to benefit from economics of scale;[16] (ii) efficiency in operations such as a lean and mean organization structure, resulting in as low operations (and transactions) costs as possible; and (iii) fees and interest rates that are high enough to cover the costs.

The other part of the sustainability equation is the *institutional sustainability*, i.e., has the program the leadership, skills, systems and organizational arrangements in place to manage and grow the program. What is the institutional set up? Is it optimal? Will the program have the continued support from its clients and other stakeholders? Who will "own" the program? These questions are much more difficult to answer.

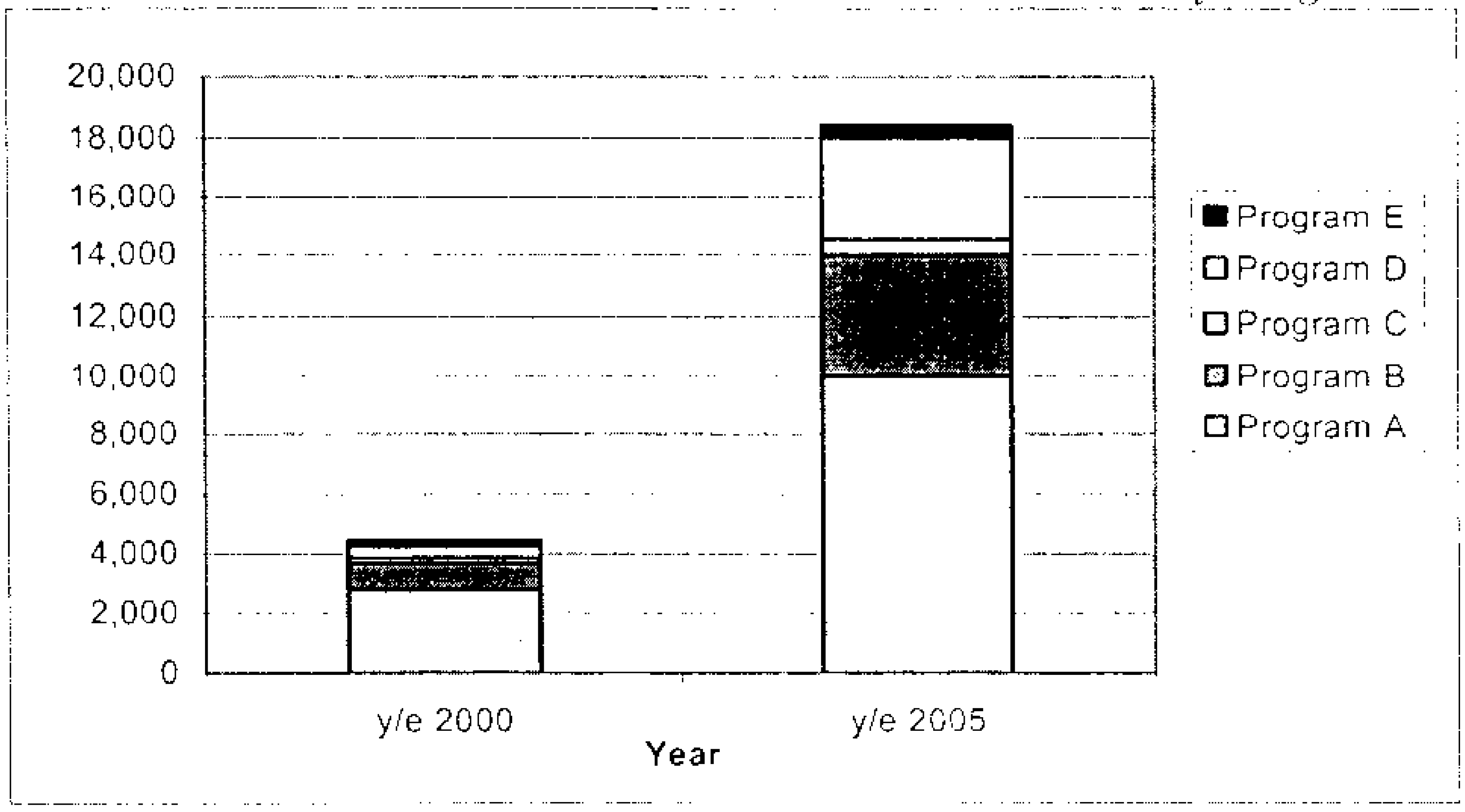
1. Sustainability of the Poverty Programs

Those micro finance programs that use best practices are the most likely to become sustainable. A key indicator whether a program implements best practices is the interest rate and/or fee charged for the financial service. Of the five programs that are offering "Poverty Loans" which are most similar to micro credit as we know it around the world, three use best practices and charge interest rates and fees that are high enough to cover the costs. Charging high interest rates on working capital loans for high

[16] World Bank research in the MENA region indicated that in smaller MENA countries, a minimum number of active clients should be around 5,000. In some of the countries the market for micro finance is relatively small and a micro finance program may not be able to reach this number of clients with one "loan product" only. This is a common phenomena with a simple solution: diversification – the introduction of new loan products to the same target group or the same loan product to new target groups.

turnover economic activities is not a problem for the borrowers as is shown by the very high retention rates of the programs charging these high rates.[17] These three programs together have over 75 percent of the market. Hence we can conclude that-provided these programs can achieve a high outreach-the providers of micro finance in this market segment are likely to become financially sustainable. Two of these three programs also have good management. appropriate systems and well defined and worked out strategies for the future including targets for outreach. However, for both these two programs, their current legal form (NGO and Foundation) will become an impediment for sustainability. The graph on the next page shows the estimated number of active clients of the Poverty Lending programs five years from now. These estimates are based on projections of the Programs themselves. As we can see, the five programs together expect to reach over 18,000 active clients year end 2005.

Current versus Estimated Number of Active Clients Poverty Programs



2. Sustainability of the Very Small Business Loan Programs

All but two of the Very Small Business Loan Programs offer medium term loans. The exception are CHF/Ameen which offers short term loans, and the UNDP Baalbek program which offers mainly long term loans[18]. The average maturity of all other programs is 2 to 3 years. A Very Small Business Lending Program offering medium term loans does not need to charge the high rates that a Poverty Lending Program has to charge for the following reasons: (i) the loan sizes of a very small business lending program are larger than those of a Poverty Lending program, and hence more income is generated with a similar amount of work; and (ii) the maturity of the loan is longer, hence income is made on the loan for a longer period of time.

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[17] The retention rate measures the ability of a Program to keep its customers. It measures the percentage of borrowers that comes back for another loan after repayment of a previous loan. The opposite of retention rate is the drop-out rate, the percentage of borrowers that leaves the program after one loan.

[18] The CHF/Ameen program is included among the Very Small Business Loan providers because of its loan size (initial US$1500), its target group (the Entrepreneurial Poor) and the fact that the program is managed through a bank, requiring from the borrowers certain formalities that the Poverty Borrowers may not be able to meet. The UNDP Baalbek program also offers seasonal loans but its main loan product is long term loans.

Still, a very small business lending program also has to cover its operational and financial costs. If it does not it will deplete its capital. It is best practice to charge market rates. The table below shows the interest rates and fees charged by a leading Lebanese bank on personal loans and small business loans. These rates can be considered a proxy for market rates.[19]

Type of Loan	*Amount (US$)*	*Maturity*	*Interest Rate*	*Fees*
Personal Loan	2,000 -15,000	Up to 3 years	10-16% on US$ 16-18% on LBP	US$75; Stamp fees of 1.5 per 1000; commission of 2 per 1000 paid quarterly
Small Business Loan	5,000-50,000	Up to 3 years	14,75 to 16.75% on US$ 16-18 percent on LBP	US$100-150, 2 % quarterly commission

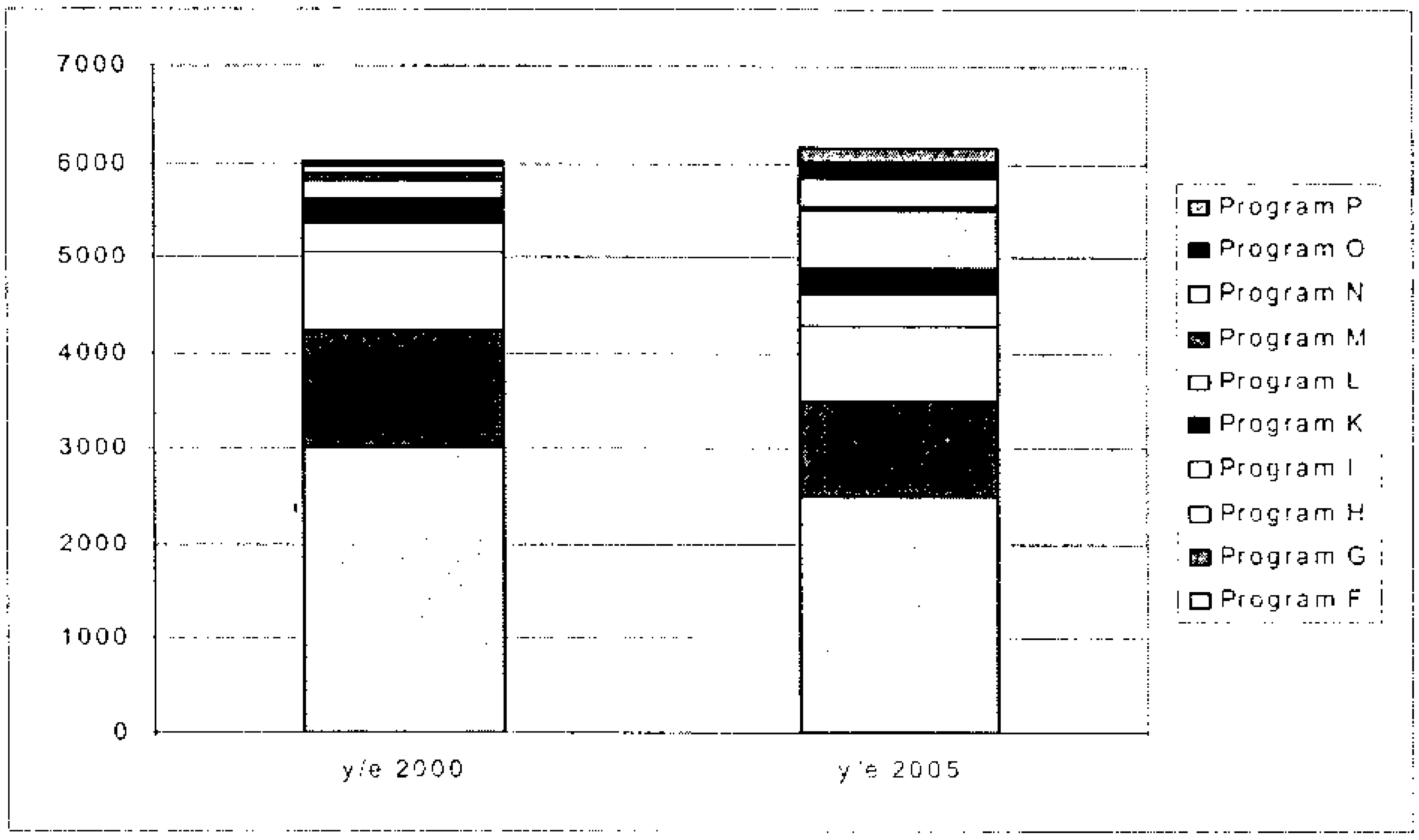
Of the 11 Very Small Business programs, two charge rates that are in the range of the medium term loans market rates (AFED and the Rural Skills Development Foundation), and one charges rates that are in line with best practices for micro working capital loans (CHF/Ameen). These three programs together serve about 18 percent of the current number of active clients. The largest program in this market (CRS Individual Loan Program with 3,000 active clients) charges subsidized rates. One program charges rates that are negative in real terms.

All but one program also offer business development services (BDS) such as training services or technical assistance services. In several cases, the training is obligatory. The programs either charge nothing for these services or nominal fees. Obviously this is not in line with best practices. Charging fees not only helps a program screen its clients as only the serious candidates will apply, but also helps a program to cover its costs. Moreover, best practices suggest that a program should focus on the delivery of one type of service only, either financial services or business development services. Combining these two types of services had proven to be very difficult, especially if the same staff offer both services: a good trainer is not necessarily a good loan officer and vice versa. Also, experience around the world shows that there is little overlap between clients needing both financial services as well as business services. In effect, several studies have shown that the overlap may be less than 20 percent. Hence, many people getting training, do not need loans, or vice versa, many people getting loans, do not need training.

The future of the programs appears rather bleak. Only the program that offers the short term working capital loans has a clear vision and strategy for the future and a business plan that outlines its objectives and targets. The largest provider of medium term loans has no strategy or business plan. Its operational systems appear very weak, and given the fact that it charges subsidized interest rates, one can expect that it will deplete its capital and hence will experience a negative growth. If we exclude, the one provider of working capital loans, the market segment of very small business loans is not expected to grow in the next five years, as is shown in the graph below. The supply of loans in this segment may even go down given the bad loan portfolio quality of some of the programs, resulting in loan losses and depletion of capital.

[19] Note however that the collateral requirements of this bank are quite stringent. In theory, this bank would charge a potential client who cannot meet the collateral requirements, a higher rate, reflecting the higher required risk premium.

Current versus Estimated Number of Active Clients Very Small Business Loans



In general, the main constraint to growth of these programs is not the lack of funds for onlending but the capacity and ability to make loans. Even if these programs would have funds abundantly available, they would not have the systems and organization in place to disburse these funds.

Moreover, another constraint faced by the Very Small Business lending programs, is the small businesses themselves i.e., the lack of "bankable" business plans. Programs that would offer so-called Business Development Services (BDS) on the sub-sector level would be beneficial but should be offered separately from financial services.

It is worrisome, that the only source of donors funds that appears to become available in the near future -the EU Social and Economic Development Fund -has mainly funds for onlending available but very limited funds for capacity building of the providers of micro finance as well as of the providers of Business Development Services (BDS) such as accountants, chambers of commerce or sub-sector business associations.

C. The Monetary Housing Institution

Excluded from the previous analysis were the data of the Monetary Housing Institution, an organization that provides loans based on Islamic financial principles. The main reason for the exclusion was the lack of reliability of the data. However, despite this fact, they are a serious player in the market for micro and very small business finance.

Half of the institutions current portfolio of about 4,500 borrowers comprises of so-called "Hassan" loans, loans without interest for emergencies such as payment of school-fees, weddings, funerals or roof-repair. The loans have a 6 months maturity.

The other half of the portfolio is for working capital loans of up to US$10,000 for very small businesses. Clearly, the Monetary Housing Institution provides a services that is needed. In contrast to the majority of Very Small Business lenders, it would be able to lend more if it had more funds because it appears a well organized institution. Hence, the bottleneck for this organization is not its capacity to disburse but the lack of funds for onlending. The main source of funds for onlending currently is deposits and savings of people. The organization puts these funds in an non-interest bearing bank account.

D. Legal Impediments to Growth and Regulatory Issues

Most of Lebanon's micro finance programs are registered as Non Governmental Organizations (NGOs) or voluntary or charitable associations.[20] The exceptions are the programs based in the UN organizations (UNICEF, UNRWA and UNDP), and one program that has no legal form. Though these legal forms may be appropriate in the early stages of a micro finance program, they will likely block a program" development as a financial intermediary. To decrease its dependence on donors, achieve growth, and become fully sustainable, a micro finance program has–over time-to gain access to commercial sources of funds, that is, by borrowing from banks for onlending or by taking deposits.

The legal forms NGO and charitable or voluntary association impede a micro finance program's move towards sustainability. NGOs and charitable associations do not have identifiable owners who can be held personally on institutionally liable (even to a limited extend) for achieving the organization's statutory objectives. As a result, these types of organizations often have no proper governance structure, and can lack accountability and transparency. Thus commercial providers of funds are unwilling to invest in such entities.

Thus an NGO micro finance provider eventually will have to change its legal form to ensure an appropriate ownership structure and related accountability. In other parts of the world, NGO micro finance providers that made a legal transition, chose legal forms such as non-profit company, for-profit company, finance company, and even deposit-taking bank (licensed by the banking authorities). In some countries, regulators have created special legal forms for micro finance intermediaries.

Finally, an improved legal environment for the collection of bad loans will not only help the micro finance industry but the financial sector as a whole. To quote a participant in the workshop: "who-ever you are, to whom-ever you owe, whether US$500 or US$500,000, you have to repay!"

Regulatory Issues

Some Government officials in Lebanon have mentioned the need to regulate the micro finance industry in Lebanon. Regulation would only be needed if micro finance providers start taking other poor people's money, i.e., deposits or voluntary savings. Micro finance programs can take deposits or savings for two main reasons: (i) as a source of funds; or (ii) as a service.

Experience around the world shows that taking deposits and savings as a source of funds is quite an expensive activity for a program. Moreover the level of savings and deposits is often quite unstable and as a result not a reliable source of funds. Many programs are better off to borrow from a bank

[20] To process of registering a NGO in Lebanon used to be quite easy. Anecdotal evidence suggests that this is not the case anymore. Moreover, Programs complained about uncalled for Government interference with the threat of being shut down any moment.

sources of funds for onlending. We do not expect that any of the active programs in Lebanon is interested (and capable) to take deposits and savings as a source of funds.

The CRS Village Banking system is the only program in Lebanon that takes savings. Women save with the "Village Banks" and once they have accumulated a certain amount, they are eligible for loans. The Program puts the savings of the women in the bank, in the name of the women. Hence, no supervision is needed.

One can argue that this savings-service provided is not a true savings service. In effect, it is a method for the program to collect cash collateral for the loans. A true savings services offers the poor the opportunity to save (irregular) amount of money whenever they want, with the option to withdraw whenever they need. There may be a market for such a service in Lebanon.

III. Conclusions and Recommendations

The provision of micro finance to people running micro economic *activities*, provides the household with a social safety net, creating a buffer against falling into deeper poverty. The provision of micro finance services to micro and very small *enterprises*, mainly contributes to job retention rather than job creation. The provision of micro finance services to both groups is important but will not help solve Lebanon's unemployment and economic problems. Addressing the issues faced by the Lebanese SME sector (small and medium enterprises with between 5 to 100 employees) would contribute to job creation and economic growth.

The Government of Lebanon is advised *not* to regulate the micro finance sector. However, the Government may, in order to promote a healthy growth of the industry, wish to create a non-bank, non-deposit taking legal form for micro finance intermediaries.

Micro finance programs in Lebanon could benefit from better coordination and cooperation with each other. This cooperation could include the exchange of information on "bad borrowers", the setting of minimum industry performance standards, and over time, the establishment of a credit-rating agency set up as a private sector venture but owned by all the programs. The micro finance industry is advised to take the lead in sharing of information and cooperation and not wait for the Government to do so.

While the Poverty Lenders face a relatively rosy future, the need for capacity development of the Very Small Business Lenders is urgent. In this context, it is worrisome that the planned for EU Social Economic Development Fund has ample funds available for onlending but very limited funds for capacity development of both the providers of very small business loans as well as of the providers of Business Development Services (BDS) for these very small businesses.

ANNEX I

List of Participants in the Micro finance Workshop (Beirut, May 16, World Bank Office)

1. Hari Prasad	World Bank
2. Judith Brandsma	World Bank
3. Bassam Ramadan	World Bank
4. Taline Urnechlian	Ministry of Economy
5. Fadi Esta	Economic Office of the Prime Minister
6. Nada Mufarrej	CDR
7. Samia De Clercq	CDR
8. Amal Karaki	CDR
9. Patricia Steenhuis	UNV
10. Dann Naseemullah	UNDP
11. Randa Abul Hosn	UNDP
12. Christian De Clercq	UNDP
13. Antoine Mansour	ESCWA
14. Umayma Yamut Nasser	ESCWA
15. Sana Saliba	USAID
16. Youssef Fawaz	Al Majmoua
17. Reda Mamari	Al Majmoua
18. Mayada Baydas	CHF/Ameen
19. Anwar Jammal	Jammal Trust Bank
20. Rania Al Darwish	CRI
21. Mona Khalaf	Institute for Women Studies/AUB
22. Layla Mubayed	YMCA
23. Rabi Saba	Pontifical Mission
24. Fadi Yarak	Rene Mouwad Foundation
25. Silvia Cornacchia	SIDI
26. Josiane Fahed-Sreih	Institute of Family Entrepreneurial Business, LAU
27. Diane Abchi	LAU
28. Dalia Ouaidat	Makhzoumi Foundation
29. Imad Hamze	Micro finance consultant

ANNEX II

Key characteristics of trends in the Lebanese Micro finance Industry

Characteristics	*Situation as of year end 1997*	*Situation as of year end 1999*
Number of programs	16	18
Number of new programs since y/e 1997		3
Number of stopped programs since y/e 1997		1
Number of programs with < 200 active clients	8	7
Number of active savers in industry	568	<1000
Number of active borrowers in industry	9,235	10,768
Growth in industry 1999/1997		17%
Programs that contributed most to growth		One existing program and two new programs
Percent market share (in terms of active clients) of top 3 programs	77	66
Loan Portfolio Outstanding US$	7,400,000	10,700,000
Average Outstanding Loan Balance	801	993
Percent Female borrowers	51	52
Percent Borrowers living in rural areas	62	56

Key characteristics of the Providers of Poverty Loans[21]

Characteristics	*Situation as of year end 1997*	*Situation as of year end 1999*
Number of Programs	4	5
Number of new programs since y/e 1997		1
Number of stopped programs since y/e 1997	0	
Number of programs with < 200 active clients	2	2
Number of active savers in industry	568	<1000
Number of active borrowers in industry	3,839	4,438
Growth in industry 1999/1997		15.6%
Programs that contributed most to growth		One new program
Percent market share (in terms of active clients) of the largest program	75	63
Loan Portfolio Outstanding US$	1,200,000	2,000,000
Average Outstanding Loan Balance	308	454
Percent Female borrowers		95
Percent Borrowers living in rural areas		39

[21] Included are: Al Majmoua; CRS Village Banks; Association Najdeh; Mahkzoumi Foundation and the UNICEF program.

Key characteristics of the Providers of Very Small Business Loans[22]

Characteristics	*Situation as of year end 1997*	*Situation as of year end 1999*
Number of Programs	12	13
Number of new programs since y/e 1997		2
Number of stopped programs since y/e 1997	1	
Number of programs with < 200 active clients	5	6
Number of active savers in industry	0	0
Number of active borrowers in industry	5,396	6,330
Growth in industry 1999/1997		17%
Programs that contributed most to growth		One new program and two existing programs
Percent market share (in terms of active clients) of the largest program	46	47
Loan Portfolio Outstanding US$	6,200,000	8,600,000
Average Outstanding Loan Balance	1,148	1,358
Percent Female borrowers		16
Percent Borrowers living in rural areas		68

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مركز مشاريع ودراسات القطاع العام

[22] Included are: AEP; CRS/Caritas Individual Loan Program; Displaced; UNRWA; Mouvement Social; Council of Churches; CHF/Ameen; Rural Skills Development Foundation; AFED; CLD; CD (stopped); UNDP Baalbek. Although included in the number of Programs, all other data of the program of the Pontifical Mission are excluded. However, this is a very small program and hence the exclusion of the data of this program has negligible impact.